

BABs Outperform Corporates, Treasuries

BY BRENDAN A. MCGRAIL
AND MATT ROBINSON

Build America Bonds, the federally subsidized municipal securities, have outperformed U.S. Treasuries and corporate debt this year even after the taxable program wasn't extended by Congress.

The extra yield investors demand on average to hold Build Americas instead of 30-year U.S. Treasuries fell to 170 basis points, or 1.7 percentage points, on Feb. 9, the lowest since June 11, according to data compiled by Bloomberg. While no more may be issued, the existing securities remain attractive to buyers, said **Clifford Corso**, chief executive officer of Armonk, New York-based Cutwater Asset Management Corp., which oversees \$5 billion in munis.

"It didn't become an orphaned market," said Corso. "They've done very well."

Build Americas lost 1.48 percent since

the program's expirations through Feb. 10, according to a Bank of America Merrill Lynch index, which tracks price changes and interest income. That compares with a 1.54 percent drop in Treasuries, and a 3.89 percent slide in long-term AA rated corporates, Merrill indexes show. Tax-exempts have lost 1.48 percent this year.

The lack of new issuance gives the securities the added value of being harder to find, said **Anthony Greco**, a trader at Boston-based Breckinridge Capital Advisors, which manages \$13.5 billion.

"They're scarce," Greco said. "They're trading better than corporates."

Build Americas, which include a 35 percent interest-cost subsidy, were created under President **Barack Obama's** economic-stimulus legislation in 2009 as a means of driving down borrowing costs

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Bailout Ban Targets Unions

BY CHRISTOPHER PALMERI

Congressional Republicans are using scare tactics to push a bill blocking bailouts of state pensions as a way to undermine government unions, said **John Stanton**, a lawyer for the California State Teachers' Retirement System.

"They are peddling fright about the supposed imminent insolvency of public pension plans," Stanton said at a meeting of the second-largest U.S. public pension fund's board. "It really is an attack on the public-employee unions."

U.S. Representative **Devin Nunes**, a California Republican, has proposed requiring state pension plans to report their liabilities based on more common accounting techniques, such as Treasury rates. That would enlarge estimated unfunded obligations because Treasuries typically provide lower returns than are projected now for pension assets. The bill would strip noncompliant

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BLOOMBERG BAROMETER

BENCHMARK STATES 5-YEAR CDS

STATE	THIS WEEK	LAST WEEK	CHANGE(BPS)
California	226	241	-15
Florida	134	143	-9
Illinois	258	261	-3
New York	170	170	0
Pennsylvania	120	122	-2
Texas	84	85	-1

IN THE PIPELINE

MUNICIPALITY	AMOUNT
Philadelphia H/HEd	\$200 million Rev
Cambridge	\$46 million GO
Bellevue SD WA	\$200 million GO
Saint Paul	\$28 million GO
TEXAS A&M	\$129 million Rev
State of Illinois	\$3.7 bln taxable GO

BVAL AAA BENCHMARK YIELDS

DESCRIPTION	CURRENT PRICE	CURRENT DATE	PREVIOUS PRICE	PREVIOUS DATE	NET CHANGE (BPS)
BVAL 1Y	0.380	02/11	0.387	02/10	-0.007
BVAL 2Y	0.828	02/11	0.830	02/10	-0.002
BVAL 3Y	1.227	02/11	1.230	02/10	-0.003
BVAL 4Y	1.663	02/11	1.669	02/10	-0.006
BVAL 5Y	1.993	02/11	1.989	02/10	+0.004
BVAL 6Y	2.297	02/11	2.307	02/10	-0.010
BVAL 7Y	2.612	02/11	2.603	02/10	+0.009
BVAL 8Y	2.926	02/11	2.915	02/10	+0.011
BVAL 9Y	3.193	02/11	3.205	02/10	-0.012
BVAL 10Y	3.395	02/11	3.402	02/10	-0.007
BVAL 20Y	4.629	02/11	4.633	02/10	-0.004
BVAL 30Y	4.925	02/11	4.924	02/10	+0.001

VOLUME

NEW SUPPLY:	SOLD YTD	TRADED	OFFERINGS
30-DAY \$8.5 Bln	\$10.7 Bln (Negotiated) \$4.6 Bln (Competitive)	\$13.5 Bln (MSRB)	\$12.7 Bln (Bloomberg Pick)
 8.5%		 9.7%	 8.7%

BAILOUT BAN...*continued from page 1*

states of their ability to sell tax-exempt debt.

"The congressman's legislation is intended to protect the interests of government employees and their employers, namely the taxpayers," said **Andrew House**, a Nunes spokesman.

Called the Public Employee Pension Transparency Act, Nunes's bill would prevent the federal government from sending aid to help states cover unfunded pension obligations. Nunes cited estimates that state pension plans are underfunded by as much as \$3 trillion.

A study released in October by Joshua Rauh and Robert Novy-Marx, who teach finance at Northwestern University and the University of Rochester, respectively, said state and local pensions have unfunded liabilities of about \$3.6 trillion, if their returns on assets were projected using Treasury discount rates to adjust for risk. Republicans are using the study as proof that the public funds need bailouts, which is a "red herring," Stanton said.

Representatives of the \$146.4 billion California fund's board should convey to legislators and the public that "states are working on this issue," Stanton said at the meeting in West Sacramento.

"It's not been lost on the Karl Rove crowd that the only group that was able to keep up with them in federal campaign spending was public-employee unions," said Stanton, a partner in the Washington office of Hogan Lovells, referring to the Republican political strategist and former White House adviser.

A Bloomberg analysis of state pensions showed funding levels, as of fiscal 2009, ranged from 51 percent of projected liabilities in Illinois to more than fully funded in New York. The median level was 76 percent.

The California teachers plan reported a funding level of 78 percent in June 2009, according to a statement last month. That's the most recent figure available, said spokesman **Ricardo Duran**. The fund, which covers 852,000 public-school educators and their families, had a 12.7 percent return in 2010.

BUILD AMERICA BONDS...*continued from page 1*

for localities and funneling money to job-creating construction projects. More than \$187 billion of the bonds were sold. The program expired on Dec. 31.

Last week, Democratic Representative **Gerald Connolly**, with backing from Minority Leader **Nancy Pelosi**, introduced a bill to revive Build Americas until 2012, with the federal government subsidy set at 32 percent this year and 31 percent next year. Republicans blocked the measure from going straight to the Republican-led House for a vote, which would send any effort to revive the stalled program through Republican-led committees.

The bill would face a struggle among Republicans who are seeking to cut \$100 billion from the budget and have railed against providing bailouts to cash-strapped states. House Ways and Means Committee Chairman **David Camp** is among critics of the program, and Senate Republicans last year were able to use their power to derail it.

The subsidy was left out of the \$858 billion bill that extended the Bush-era tax cuts. Republican Representative **John Mica** of Florida, chairman of the House Transportation and Infrastructure Committee, said Dec. 17 he planned to introduce a "reincarnation" of the Build America program in 2011.

About \$129 billion in fixed-rated municipal debt was sold in the fourth quarter of 2010, the biggest three-month issuance since at least 2003. Some sales were driven by the end of the Build America Bonds program. In December, projections by **Meredith Whitney**, the banking analyst, about possible municipal defaults began to rattle the \$2.86 trillion municipal-debt market.

Investors last week withdrew \$1.2 billion from U.S. municipal-bond mutual funds, the 13th-straight outflow, Lipper U.S. Fund Flows said Feb. 10. About \$24.8 billion has been redeemed since the week ended Nov. 17, including a record \$4 billion in the week ended Jan. 19, the most since Lipper started compiling data in 1992.

Build America Bonds stabilize the muni market by attracting investors who typically buy taxable debt, according to Greco.

Retail investors make up about two-thirds of the muni market and like to buy debt maturing in fewer than 10 years, Greco said. Build America investors, such as pension funds and international investors, tend to buy longer-term maturities.

There have been other programs to help correct the supply and demand imbalance,

but "this has been the best solution by far," he said. "It just widens the field of demand."

Yields on top-rated tax-exempts maturing in 30 years were 4.92 percent Feb. 10, up 74 basis points since the redemptions began Nov. 10, according to a Bloomberg Valuation index. Thirty-year Treasury rates have risen 53 basis points in the same period.

Meanwhile, the average yield on Build America Bonds has climbed 42 basis points, according to a Wells Fargo index with an average maturing of about 29 years.

A Correction

Illinois this week is selling \$3.7 billion in A+ rated taxable general obligation bonds to help fund its public pension plans. The offering is the state's largest in more than seven years. In 2003, the state sold \$10 billion in taxable pension bonds.

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PEOPLE WATCH

Focus on Chapter 9

■ The House Judiciary Committee will hold a hearing today on “The Role of Public Employee Pensions in Contributing to State Insolvency and the Possibility of a State Bankruptcy Chapter” in room 2141 of the Rayburn House Office Building at 4 p.m. Scheduled witnesses are **Joshua Rauh**, associate professor of finance at the Kellogg School of Management, Northwestern University, co-author of a 2010 study that concluded seven state pension plans would go bust by 2020, **James Spiotto**, a partner at Chapman & Cutler in Chicago and chapter 9 bankruptcy expert, **Matt Fabian** of Municipal Market Advisors and **Keith Brainard**, research director at the National Association of State Retirement Administrators.

BAB Outlook Dim

■ Representative **Gerald Conolly**'s introduction of a bill to revive the Build America Bond program will probably not receive a positive reception in Congress, writes **George Friedlander** of Citigroup in the firm's Municipal Market Comment. “The policy case for reviving BABs is extremely strong, and it could be done at no significant cost to the federal government while reducing funding costs at the state and local level and limiting the upside on borrowing costs during periods of potential saturation in the tax-exempt market,” according to Friedlander. “Perhaps a particularly volatile period in the muni market as new issue supply rebounds could help such a bill garner additional support, but that is likely to take time, if it happens at all in 2011.”

State Ratings ‘Stable’

■ A budget crisis doesn't equal a debt crisis, says Standard & Poor's Corp. in a “Credit FAQ” released Friday. “In fact, as the budget challenges for states have intensified during and since the Great Recession, ratings have been relatively stable.” In the past 12 months S&P downgraded New Jersey, and assigned negative outlooks to Maine and Illinois.

DIARY

States Help with the Bailing

States get involved when local governments run into trouble, and that has “likely contributed” to the low default rate observed in the rated sector of the tax-based municipal market, according to a special comment published by Moody's Investors Service on Thursday.

This being the municipal market, the level of state oversight and assistance varies widely, writes senior analyst **Geordie Thompson**, who then considers how eight states — California, Massachusetts, Michigan, New York, North Carolina, Pennsylvania, Rhode Island and Texas — treat local governments in financial distress.

“Some states have formal programs for distressed local governments, others have stepped in on an ad hoc basis, and there are states that have no history of intervention, often because they have not had actual cases of local governments undergoing severe distress,” writes Thompson, adding “past history may not, however, be predictive of future interventions since states can legislate new authorities on short notice.”

Los Angeles Can't Count on Parking-Lot Lease

Los Angeles, the second most-populous U.S. metropolis, faces a \$54 million deficit for the current fiscal year because it can't count on revenue from leasing parking garages, the city manager said.

The city had hoped to book at least \$53 million this year from the lease of municipal garages. Twelve bidders signaled an interest in the deal, said **Miguel Santana**, the city administrative office. After residents objected and the city changed contract terms, letting it open new garages near some included in the offer, all the bidders dropped out.

“We still recommend moving on the public-private partnership,” Santana said. “It no longer makes sense to include it as a strategy for this year.”

The City Council will have to consider additional furlough days this year that may force some offices to close every Friday, Santana said. He will propose additional cuts of as much as \$200 million in coming weeks to address both the current year deficit and a projected \$350 million hole for the next fiscal year, which begins July 1.

— Christopher Palmeri

How to Reform Retiree Health Care

The real problem facing state and local governments isn't pensions. It's “other post-employment benefits” promised to some of the nation's public employees, writes **Girard Miller** in *Governing* magazine.

“For perspective, the pension deficits accrued to date will cost every man, woman and child in America about \$2,000 over the next 15 years (about \$10 per month per capita), based on current funding ratios,” writes Miller, a public-pension and finance consultant at PFM Group in Los Angeles. “For OPEB, where half the nation's public workers receive a substantial retiree medical benefit and half do not, the \$2 trillion national liability works out to six times that number for the unfortunate 75 million taxpayers who bear the burden of these bills. So a family of four living in a state where the police, firefighters, teachers, road crews and prison guards all get lifetime medical benefits should expect to pay \$50,000 before the parents become grandparents.”

Why doesn't OPEB get more attention? Because it's usually handled on a pay-as-you-go basis, and such benefits aren't uniform nationally. Make no mistake, writes Miller: “Failure to quickly put OPEB plans onto sound, full actuarial footing as the economy gets back on its feet will assure a full-blown crisis before the end of the decade.”

Miller advocates a 3-step solution to fix the problem: ramp up employer contributions, begin to charge employees for as much as half of the normal actuarial costs of their retiree medical benefits, and adopt new policies for the surplus funds that will come in during better times.

CALENDAR — SCHEDULED SALES

SELLING	ISSUE	ST	AMT(MM)	TAX	SR. MGR.	STATUS	TYPE
02/14	Illinois -Txbl	IL	3700.00	T	Morgan Stanley	Thur	Negt
02/14	Chicago O'hare Intl Apt-A	IL	417.04	N	Citigroup Global Mkts Inc	Day/Day	Negt
02/14	Chicago O'hare Intl -Sub	IL	411.17	N	Citigroup Global Mkts Inc	Day/Day	Negt
02/14	Florida St Boe Peco -A	FL	344.68	N	18 Hour Notice		COMP
02/14	Allegheny Cnty Port Auth	PA	263.27	N	Rbc Capital Markets	Wed	Negt
02/14	Phila Hosp Hgr Edu Fac -A	PA	200.00	N	JP Morgan Securities Inc	Day/Day	Negt
02/14	Washington Hlth Care	WA	175.00	N	Citigroup Global Mkts Inc	Thur	Negt
02/14	Univ Of Pennsylvania Hlth	PA	150.00	N	Banc Of America Merrill	Day/Day	Negt
02/14	Grossmont Hlthcare Dist-B	CA	136.86	N	Goldman Sachs & Company	Day/Day	Negt
02/14	New York St Eviron Facs	NY	134.14	N	Citigroup Global Mkts Inc	Tue	Negt
02/14	Chicago O'hare Intl Apt-C	IL	127.07	A	Citigroup Global Mkts Inc	Day/Day	Negt
02/14	Tx Dept Hsg 2009c-1	TX	89.43	N	Morgan Keegan & Co Inc	Day/Day	Negt
02/14	Imperial Irrigation Dist	CA	80.00	N	Goldman Sachs & Company	Tue	Negt
02/14	Lancaster Co Hosp Auth	PA	75.00	N	Banc Of America Merrill	Thur	Negt
02/14	Ca Mun Fin Auth-B -Ref	CA	73.63	N	George K. Baum & Company	Day/Day	Negt
02/14	Birmingham Dev Auth -A	AL	56.54	N	Goldman Sachs & Company	Wed	Negt
02/14	Middlesex Co Imp Auth-Ref	NJ	54.63	N	NW Capital Markets Inc	Day/Day	Negt
02/14	San Bernardino Usd-A-Qscb	CA	53.08	T	Cabrera Capital Markets	Day/Day	Negt
02/14	Indiana Fin Auth -A	IN	44.09	N	Lancaster Pollard & Co	Day/Day	Negt
02/14	Illinois Fin Auth	IL	44.03	N	Banc Of America Merrill	Day/Day	Negt
02/14	Chicago O'hare Intl Apt-B	IL	43.58	N	Citigroup Global Mkts Inc	Day/Day	Negt
02/14	Florida Hsg Fin Corp	FL	40.00	N	RBC Capital Markets	Thur	Negt
02/14	Copperas Cove	TX	39.14	N	Samco Capital Markets	Mon	Negt
02/14	New York Dorm Auth -Ref	NY	33.81	N	M.R. Beal & Company	Day/Day	Negt
02/14	Boise City Arpt Rfdg	ID	33.05	A	Morgan Keegan & Co Inc	Thur	Negt
02/14	Ohio St Higher Ed Fac -A	OH	32.81	N	Morgan Stanley	Wed	Negt
02/14	Romulus Comm Sch	MI	31.16	N	Stifel Nicolaus & Co Inc	Wk/Wk	Negt
02/14	Union Cnty Hosp Auth -Ref	PA	30.34	N	PNC Capital Markets	Tue	Negt
02/14	Opelika Elec Sys	AL	28.52	N	Frazer Lanier Company Inc		NEGT
02/14	Ohio Water Dev Auth -Ref	OH	26.23	N	Siebert Brandford Shank	Day/Day	Negt
02/14	Richmond	IN	26.00	N	Bergen Capital	Day/Day	Negt
02/14	SLO Cnty Fin Auth -A	CA	22.90	N	Wedbush Securities Inc	Day/Day	Negt
02/14	Buffalo-B -Ref	NY	22.85	N	Sterne Agee & Leach Inc	Thur	Negt
02/14	Univ Of Virgin Islands -A	VI	22.00	N	Rice Financial Prod Grp	Wk/Wk	Negt
02/14	Natrona Co Med Center	WY	20.00	N	RBC Capital Markets	Thur	Negt
02/14	Michigan Fin Auth	MI	20.00	N	Stifel Nicolaus & Co Inc	-	NEGT
02/14	Woodland Fin Auth	CA	18.59	N	Southwest Securities Inc	Tue	Negt
02/14	Martin Co Hosp-A	TX	18.08	N	Lancaster Pollard & Co	Mon	Negt
02/14	Sacramento Cnty -Ref	CA	17.50	N	Stone & Youngberg Llc	Thur	Negt
02/14	Antelope Valley Hlth	CA	17.40	N	Lancaster Pollard & Co	Day/Day	Negt
02/14	Indianapolis Redev Di-Cop	IN	17.33	T	Oppenheimer & Company Inc	Day/Day	Negt
02/14	Bethlehem Auth	PA	16.33	N	Wells Fargo Securities	Tue	Negt
02/14	Birmingham Dev Auth-B-Txb	AL	15.48	T	Goldman Sachs & Company	Wed	Negt
02/14	Union County Imp Auth	NJ	15.30	T	NW Capital Markets Inc	Thur	Negt
02/14	Illinois -Txbl	IL	3700.00	T	Morgan Stanley	Thur	Negt
02/14	Chicago O'hare Intl Apt-A	IL	417.04	N	Citigroup Global Mkts Inc	Day/Day	Negt
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