

## Market Braces for Seasonal Glut of Supply

BY BRIAN CHAPPATTA

The \$3.7 trillion municipal-bond market is heading for its worst monthly performance since June. If the past decade is any guide, October may be even worse.

Munis on average have lost 0.41 percent in October since 2001, the biggest decline for any month, Bank of America Merrill Lynch indexes show. This month, local-government bonds have gained about 0.21 percent, the least since they lost 0.07 percent in June.

With muni mutual funds adding the fewest assets since April and localities issuing the most debt in three months, that trend is poised to continue, said **John Dillon**, chief municipal-bond strategist at Morgan Stanley Smith Barney.

States and cities that end their fiscal

years June 30 tend to wait a few months before coming to market, which may account for the sales surge, he said.

"We are on the tail end of robust demand, and we are at the front end of a step-up in supply," said Dillon, whose company oversees more than \$150 billion in local debt. "There's this supply-demand imbalance that's opposite what you had in June, July and August. It's a seasonal trend reversal."

The tax-exempt market has returned 6.2 percent this year as investors sought a haven from Europe's debt crisis. The gain is more than triple that of Treasuries, which have returned 2 percent, Bank of America data show. That's the biggest differential for the period since 2009.

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## Cities Try Fracking for Dollars

BY MARK NIQUETTE

Youngstown, Ohio, needs money to demolish vacant buildings, so it's turning to fracking. The City Council is debating a proposal to combat blight by leasing the rights for oil and gas drilling under public land.

The city has enough money to raze only 260 homes, with more than 5,000 other structures vacant or ready for demolition, Mayor **Charles P. Sammarone** said.

Opponents of hydraulic fracturing say the money isn't worth the risk of polluting drinking water and the environment. Sammarone said demolition is a priority because dilapidated homes are causing people to leave or avoid the city, and raising taxes isn't an option. Surrounding cities and private landowners are already leasing mineral rights.

"We're not inventing anything here," Sam-

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## BLOOMBERG BAROMETER

### BENCHMARK STATES 5-YEAR CDS

| STATE        | THIS WEEK | LAST WEEK | CHANGE(BPS) |
|--------------|-----------|-----------|-------------|
| California   | 196       | 190       | +6          |
| Florida      | 96        | 89        | +7          |
| Illinois     | 206       | 200       | +6          |
| New York     | 99        | 93        | +6          |
| Pennsylvania | 118       | 112       | +6          |
| Texas        | 70        | 63        | +7          |
| Wisconsin    | 90        | 86        | +4          |

Source: CMA

### IN THE PIPELINE

| MUNICIPALITY          | AMOUNT            |
|-----------------------|-------------------|
| North Texas Tollway   | \$170 million Rev |
| New York Dorms        | \$430 million Rev |
| New York City         | \$880 million GO  |
| University of Alabama | \$269 million Rev |
| Maine Bond Bank       | \$29 million Rev  |
| Rockland County NY    | \$36 million GO   |

### BLOOMBERG VALUATION AAA BENCHMARK YIELDS

| DESCRIPTION | CURRENT | PREVIOUS | NET CHANGE |
|-------------|---------|----------|------------|
| BVAL 1Y     | 0.20    | 0.20     | 0          |
| BVAL 2Y     | 0.29    | 0.29     | 0          |
| BVAL 3Y     | 0.37    | 0.37     | 0          |
| BVAL 4Y     | 0.54    | 0.52     | +0.01      |
| BVAL 5Y     | 0.63    | 0.71     | -0.08      |
| BVAL 6Y     | 0.92    | 0.95     | -0.03      |
| BVAL 7Y     | 1.16    | 1.18     | -0.02      |
| BVAL 8Y     | 1.38    | 1.40     | -0.02      |
| BVAL 9Y     | 1.58    | 1.59     | -0.01      |
| BVAL 10Y    | 1.76    | 1.77     | -0.01      |
| BVAL 20Y    | 2.54    | 2.54     | -0.01      |
| BVAL 30Y    | 2.88    | 2.89     | -0.01      |

### VOLUME

| NEW SUPPLY              | SOLD YTD                   | TRADED     | OFFERINGS        |
|-------------------------|----------------------------|------------|------------------|
| 30-DAY                  | \$200.8 Bln (Neg Fixed LT) | \$13.4 Bln | \$11.6 Bln       |
| \$8.1 Bln LT (Fixed LT) | \$56.6 Bln (Comp Fixed LT) | (MSRB)     | (Bloomberg Pick) |
| \$2.2 Bln ST (Fixed ST) | \$49.5 Bln (Fixed ST)      | 58.3%      | 1.2%             |

### VARIABLE RATE (VRDOs)

|                        |                  |
|------------------------|------------------|
| WEEKLY AAA RATE        | 0.169%           |
| WEEKLY AA RATE         | 0.183%           |
| DAILY RESET INVENTORY  | \$1.2 Bln  15.5% |
| WEEKLY RESET INVENTORY | \$6.0 Bln  1.6%  |

Available VRDO/TOB inventory offered by remarketing agents for cash settlement

**FRACKING...**

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marone said. "We need money for demo, and if we don't get it, then there's no demo."

Municipalities and school districts in states including Texas, Pennsylvania and Colorado have been approving oil and gas leases to pay for services as horizontal drilling with fracking opens land for development, said **John Krohn**, a spokesman for Energy in Depth, a Washington-based group that represents drillers.

"Given our national energy needs will increase significantly, it's reasonable to assume these arrangements will continue to increase," Krohn said in an e-mail.

Municipal finance officers anticipate that revenue will fall 3.9 percent this year when adjusted for inflation, the sixth decline in a row, according to the National League of Cities.

Youngstown faces a deficit of as much as \$5 million next year as it weeds out unneeded housing after its population declined to about 66,500 from 168,330 in 1950.

Sammarone estimated there are about 180 acres that could be leased and, if the council approves, wants a study to determine how much municipal property might be eligible.

Campbell, a city of 8,179 in fiscal emergency that abuts Youngstown, leased mineral rights on 167 acres to Houston-based Hilcorp Energy Co. in June for \$5,000 an acre plus 20 percent in royalties from gas production, Administrator **Jack Dill** said. The land includes two parks, and Dill said he was surprised there wasn't more resident opposition.

In Barnsville, about 120 miles southwest of Youngstown, there also was no major protest, Mayor **Ron Bischof** said. The village of 4,178 signed a contract Sept. 10 with Denver-based Antero Resources to lease more than 1,000 acres for \$5,700 an acre plus 20 percent in royalties, he said.

Besides the municipalities, Ohio is exploring leasing parks, forests and other state land for drilling after the Legislature approved a bill in June 2011 to allow it.

**SUPPLY...**

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In the three months beginning July 1, the muni market has returned about 2 percent. That's the seventh-straight quarter of gains, the longest stretch since 2001.

The rally is poised to pause in October, the month with the most local-government sales for the past three years, data compiled by Bloomberg show. The New York State Dormitory Authority and Kansas State Department of Transportation are among issuers planning deals next month.

The jump in supply caused yields on top-rated general-obligation bonds to rise in eight of the past 10 Octobers, Bloomberg data show.

Such predictable patterns cause buyers to wait to invest, said **Peter Hayes**, head of muni bonds at New York-based BlackRock Inc., the world's biggest money manager.

"If you look historically at price performance in October, you can see the market exhibits some seasonal weakness," said Hayes, whose company oversees about \$106 billion of munis. "If you have cash and bonds coming due, you just sit on it a little bit longer and wait for the market to adjust."

That mindset may be behind the slowing of cash flowing into municipal-bond mutual funds. They added about \$256 million in assets during the week ended Sept. 19, the fewest since April, Lipper US Fund Flows data show. Inflows this year total \$23 billion, the most since 2009.

The drop in demand comes as issuers are selling \$9.3 billion this week, the most in three months, Bloomberg data show. In the week ended Sept. 21, municipalities issued \$9.1 billion of debt.

Municipalities have sold about \$257.5 billion in debt this year, close to the \$258 billion issued in all of 2011.

About 51 percent has been to retire previously issued debt, which has helped create "net negative" supply, or when cash to investors from redemptions and refunding exceeds sales.

That phenomenon will reverse in September and October, when new debt may exceed maturing securities and bond calls by about \$27 billion, the most for a two-month period since December 2010, according to Citigroup Inc. data.

The U.S. presidential election and potential changes to the municipal-bond tax exemption may heighten the trend of localities issuing debt next month, Dillon

said. In October 2010, three months before the expiration of the Build America Bonds program, states and cities sold \$54 billion, the most since at least 2003 and more than any month since.

Muni yields heading into October are hovering near record lows. The interest rate on 10-year benchmark AAA munis was 1.76 percent yesterday. It fell to 1.63 percent on July 27, the lowest since at least January 2009, Bloomberg data show.

The yield on that debt rose 0.28 percentage point in October 2011. That was the biggest jump since October 2009, when interest rates rose 0.49 percentage point.

Last year, the interest rate plunged 0.62 percentage point in November and December, sending rates near the lowest since **Lyndon Johnson** was president.

"Yields have fallen awfully far and awfully fast," Hayes said. "Any time they rise, it does create a better opportunity, and that's what we're looking forward to."

**Bloomberg Brief Municipal Market**

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