

MUNI MARKET UPDATE

October 11, 2010

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STATE PENSION REFORM

States and local governments have needed to provide for their employees' retirements since 1935, when they were excluded from social security. In the 1950's, states could enter into voluntary, revocable agreements for coverage; however, these agreements became irrevocable in 1983.

In 1991, social security coverage was mandated for all state and local government employees not covered by a public retirement system. States not covered by social security include Alaska, California, Colorado, Connecticut, Georgia, Illinois, Louisi-

ana, Kentucky, Maine, Massachusetts, Missouri, Nevada, Ohio, Rhode Island, and Texas.

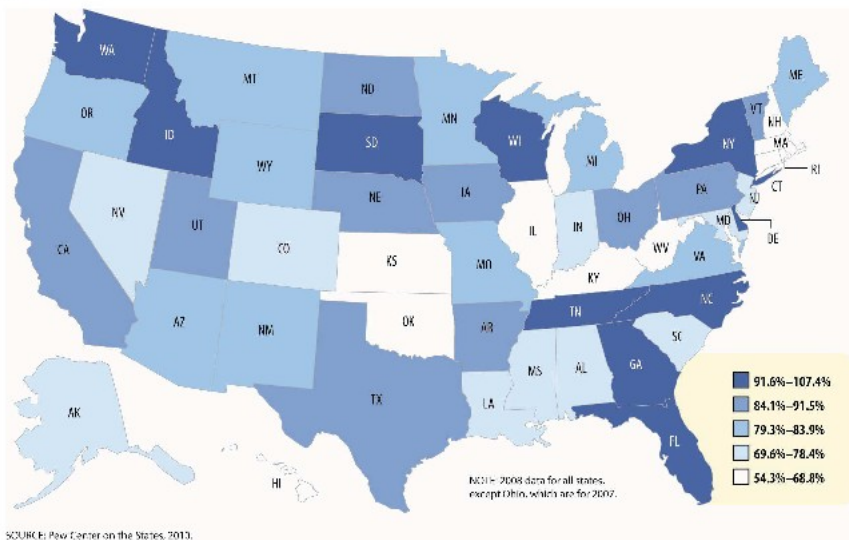
Despite the track record for public pensions — 9.25% per year over the last 25 years, according to the National Institute on Retirement Security — many plans have sustained severe investment losses during the recent recession. Many are underfunded, as shown in the chart below, prepared by [the Pew Center on the States](#).

Additionally, due to ongoing concerns

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Pensions: funding levels



SOURCE: Pew Center on the States, 2010.

Only nine states fully paid the annual required contributions for pensions in each of the past five years.

MARKET UPDATE (CONT'D)

due bills. It faces a possible structural deficit of \$15 billion in FY 2012. In Comptroller Daniel Hynes' [quarterly report](#), it was disclosed that FY 2011 obligations to date total over \$3.5 billion. FY 2010 bills increased to \$6.4 billion, up \$1.7 billion from the prior report. To eliminate FY 2010 debt by 12/31/10 requires:

- ◆ \$1.2 billion tobacco securitization

initiative;

- ◆ \$737 million from inter-fund borrowing; and,
- ◆ Less than \$200 million from tax amnesty program ([see related article on page 4](#)).

Moody's, Standard & Poor's and Fitch Ratings asked a state court

judge in San Francisco for a second time on October 4th to dismiss the \$1 billion lawsuit by Calpers, arguing that defending themselves blocks their free-speech rights. In May, a judge previously refused to dismiss the case. The hearing is scheduled for December 10th. ♣

MUTUAL FUNDS AND MONEY MARKETS

Long-Term Mutual Fund Flows

Total estimated inflows to long-term mutual funds were \$3.26 billion for the week ended Wednesday, September 29, the Investment Company Institute reported.

Municipal bond funds had estimated inflows of \$615 million.

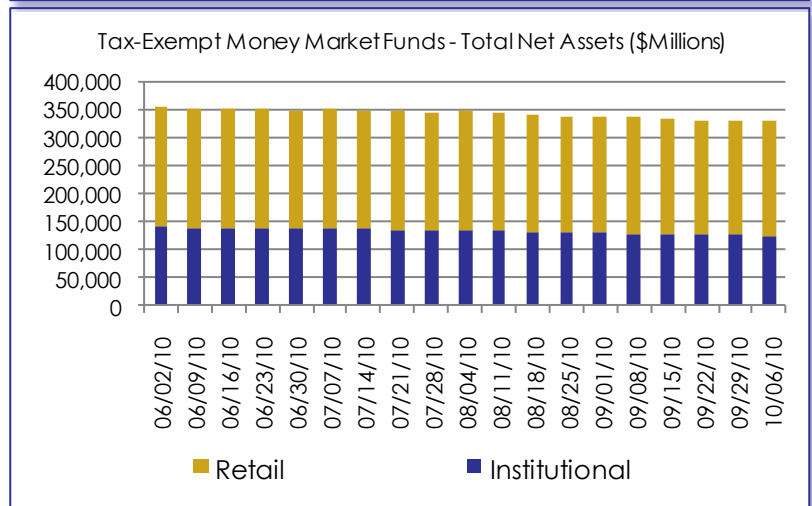
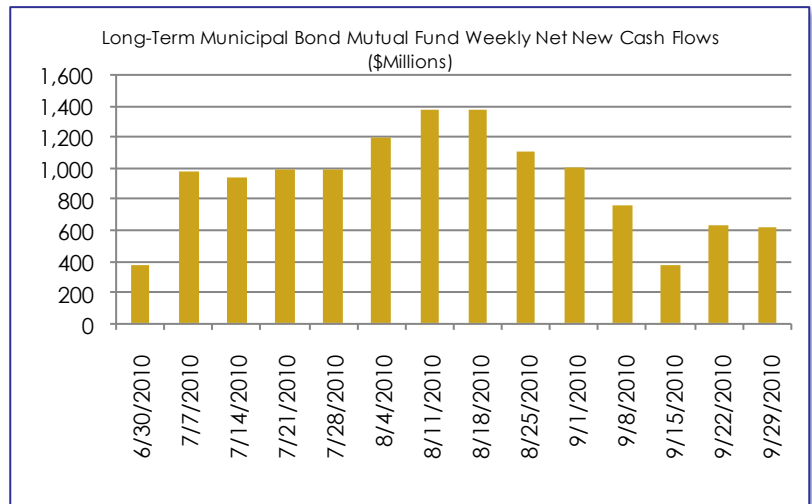
Money Market Mutual Fund Assets

Total money market mutual fund assets decreased by \$500 million to \$2.805 trillion for the week ended Wednesday, October 6, the Investment Company Institute reported.

Tax-exempt funds increased by \$290 million. Assets of retail tax-exempt money market funds increased by \$1.22 billion to \$203.97 billion. Assets of institutional tax-exempt money market funds decreased by \$930 million to \$125.56 billion.

Tax-exempt fund assets have decreased by \$75.4 billion since January 2010 and by \$172.0 billion since January 2009. ♣

Source: Investment Company Institute.



PEW POLL: SPEND LESS, DON'T BORROW

The Pew Center on the States polled residents of Arizona, California, Florida, Illinois, and New York — which comprise one-third of the U.S. population and economic output, and 45% of the states' projected budget gaps for FY 2011 — and recently released its report, "[Facing Facts: Public Attitudes and Fiscal Realities in Five Stressed States.](#)" Key findings include:

- ◆ Government needs improvement — elected leaders are wasting taxpayers' money and could deliver services more efficiently;
- ◆ Core functions include K-12 public education and health and human services and need to be protected from cutbacks, even if that means increased taxes, but funding

for higher education transportation, prisons, and corrections (see our related article, "[The Cost Burden of Incarceration](#)") doesn't warrant increased taxes and/or borrowing;

- ◆ "Tax the Other Guy" — wealthy, corporations, smokers (see our related article, "[Tobacco Bonds: High Yield, High Risk](#)") , drinkers, and gamblers — and don't raise personal income tax or sales tax rates;
- ◆ Spend less and/or raise taxes instead of borrowing, which passes costs down to future generations; and,
- ◆ Immediate fiscal reform is seen as necessary—residents are widely distrustful of state government and believe it can operate more effectively. ♣

ILLINOIS' TAX AMNESTY PROGRAM

From October 1 through November 8, 2010, the Illinois Department of Revenue ("Department") will be conducting a tax amnesty program in which taxpayers may pay income, municipal, sales and use taxes, among others, to the Department without penalty or interest, provided the taxes were owed to or collected by the Department from July 1, 2002 through June 30, 2009.

Taxpayers with eligible tax obligations who fail to participate in the program are subject to a significant penalty — an assessment of double penalties and interest (the 200% sanction).

The Department will run another amnesty program for individuals with liabilities under the Use Tax Act from January 1 through October 15, 2011. ♣

STATE PENSION REFORM (CONT'D)

about the viability of retirement plan benefits, increased life expectancies, and deteriorating fiscal conditions, many states have enacted significant retirement legislation in 2010 to meet their obligations.

States have taken many common steps as well as a few unique concepts to address their unfunded pension liabilities:

- ◆ Increased employee contributions, either only future hires, or also active employees;
- ◆ Increased employer contributions;
- ◆ Reduced benefits;
- ◆ Increased retirement age;
- ◆ Increased (or decreased in one state) vesting periods;
- ◆ Reduced cost of living adjustments, either only future hires, or also active

UPCOMING EVENTS

[National Parking Association's 59th Annual Convention and Exposition](#)
October 11 – 14, 2010
Boston, MA

[2010 Urban Land Institute Fall Meeting and Urban Land Expo](#)
October 12 – 15, 2010
Washington, DC

[MSRB & SIFMA Muni Regulation & Compliance Seminar](#)
October 14, 2010
Chicago, IL

[National Federation of Municipal Analysts: Reassessing and Redefining the Municipal Market and the Approach to Municipal analysis](#)
October 14 – 15, 2010
Chicago, IL

[Municipal Advisory Council of Texas Annual Conference](#)
October 14 – 15, 2010
San Antonio, TX

[International City/County Management Association's 96th Annual Conference](#)
October 17 – 20, 2010
San Jose, CA

[8th Annual New England Public Finance Conference](#)
October 18, 2010
Boston, MA

[More events...](#)

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STATE PENSION REFORM (CONT'D)

- employees;
- ◆ Implemented longer period for calculation of final average compensation;
- ◆ Increased restrictions on return to covered service; and,
- ◆ Reduced benefits for early retirement, either only future hires or also active employees.

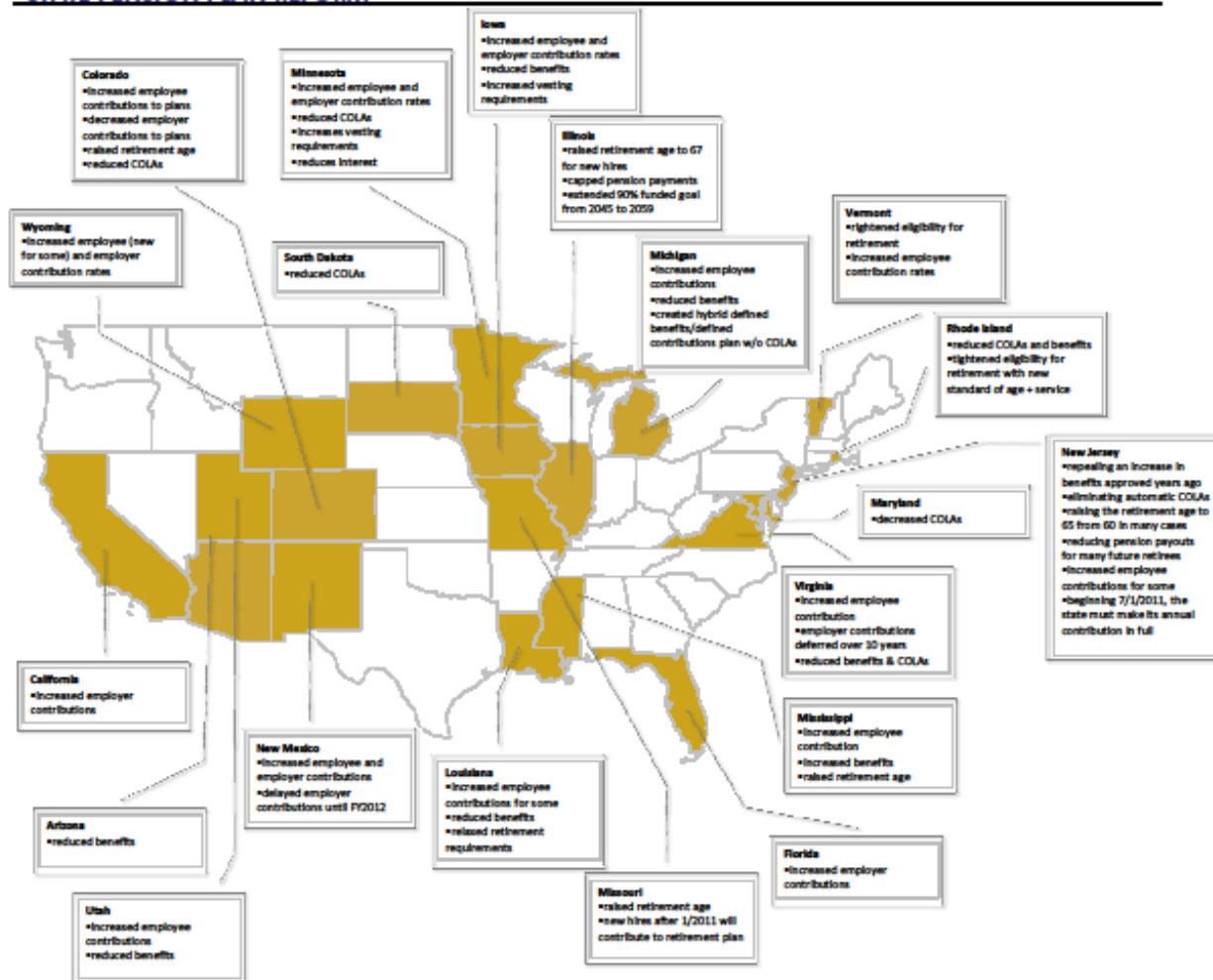
Two states — Michigan and Utah — have made structural changes to their retirement plans. Michigan implemented a hybrid defined benefit/defined contribution plan for its school employees retirement system. Utah also implemented a hybrid plan, and gave employees the choice between the new plan or a defined contribution plan.

Georgia began giving its employees a choice in 2009.

The chart below shows steps various states have taken to address their unfunded pension liabilities.

(Click on the chart for a larger version.) ♣

STATE PENSION PLAN REFORM



Source: National Conference of State Legislatures

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*1. Get email version of
newsletter*

*2. Tell them bonds I'm
interested in seeing*

ROCKFLEET ADDS TO INSTITUTIONAL SALES

Kathryn Lester recently joined Rockfleet in municipal institutional sales, opening the firm's Richmond, Virginia office.

Katie has over 23 years of experience in municipal securities, and joins us from Community Bankers Securities, where she was Head of Fixed Income. Katie began her career at Alex Brown & Sons, Inc. in

municipal trading, later joining Wheat First Securities on the trading desk.

At Davenport & Company, she specialized in the underwriting, marketing and management of municipal bond inventories. As a senior trader at Wachovia Securities, she handled both institutional and retail-sized orders. ♣

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