

Municipal Finance – Deleveraging and Future Opportunities

I – REASONS FOR MUNICIPAL COLLAPSE – LEVERAGING AND DELEVERAGING

A – United States Leveraged Up for Past Half Century

1 – Spending – Much Faster than Tax Receipts (State and Local):

2003 - \$979 billion
2007 - \$1.3 Trillion

2 – Net Borrowing (State and Local):

2001 - \$122 billion
2007 - \$215 billion

3 – Outstanding State and Local Debt in U.S.

2003 - \$1.9 trillion
2007 - \$2.7 trillion

4 – Pay and Benefits

Average compensation for full-time employee of New York City

2000 - \$65,000
2008 - \$106,000

Prefunding Retiree Benefits in New York City

2000 - \$2,530
2008 - \$20,333

Full-time employees in New York City

2000 - 24,000
2008 - 31,000

School enrollment fell 4%; Education consumes one-third of city budget.

Nationwide – state and municipal employment

1955 - 4 million
2008 - 20 million

B – United States Now Deleveraging

1 – Investment losses

Municipal plan in Massachusetts – pension contribution going from 4% to 8% of budget

2 – Accounting Irregularities – Revealed when the Tide Goes Out

Money transfers from capital-project accounts to general funds (e.g., Miami, SEC investigation)

3 – Tax Revenue – “Many states are forecasting modest tax increase growth in 2011.” (Rockefeller Institute, State Revenue Report, July 2010)

4 – Operating Expenses – Rule-of-thumb: Annual Maintenance Has Risen 30% from Building Programs

5 – Inflation – Energy, Communications

6 – Access to Municipal Bond Market – New issues and rollover debt

C – Cash Flow – Negative Tendencies

1 - Cash Balance Cushions – State fiscal year-end balances of cash-to-expenditures

6/30/09 - 4.7%

6/30/10 - 2.2% of expenditures (less Texas and Alaska)

(Source: National Association of State Budget Officers)

2 - Principal and Interest – Growing

3 - State Rainy Day Funds (Stabilization funds) – Massachusetts balance in 2008 - \$2.3 Billion. After drawing down \$1 billion past year, \$658 million balance.

4 - Federal government support – This has delayed day of reckoning - \$787 billion federal stimulus ends in January 2011.

5 - Funding Gaps Continue – Budgets Do Not Project Fall in Revenues.

6- Irresponsible Governments – Illinois – 14% pay increase for union workers, additional \$500 million/year

7 - Federal Mandates – Medicare, Homeland Security Act

8 - Recent Federal Legislation Puts Greater Cost Responsibilities on Towns

9 - Rising Pension and Health benefits – out of control

II - UNCERTAINTY AHEAD

A - How will Interests of Bondholders, Municipal Pensions, Taxpayers be Resolved?

Bondholders – Want to be paid in full

Municipal Pensions – “Guaranteed” (This is not true, but widely believed.)

Taxpayers – Want property tax relief

-Ability to Negotiate a Solution – Best if bondholders and municipality negotiate amicably.

-Public Employee Unions Do Not Intend to Negotiate:

Gerry McEntee, president, AFSCME (American Federation of State, County and Municipal Employees) - “We are set to launch a robust field plan across the country during the month of August, including advertising and grassroots events. We intend to highlight the clear choice Americans will make in November...”

B - “Full faith and Credit” of General Obligation bonds – Sometimes

Defaults and Negotiations in Default – different solutions

Tulsa, OK – Pay and Benefit Cuts

Vallejo, CA – Bondholders Take Cut & pay/pension cuts

C - Court interpretations

III – DELAYING THE DAY OF RECKONING –

A - Municipal bond market – Investors Want Yield

B - Obama Administration - “President Barack Obama wrote to congressional leaders over the weekend urging them not to let concerns about the deficit prevent them from supporting measures to lower unemployment and help states deal with budget shortfalls.” 6/14/10

C – The Federal Government Will Forestall Municipal Defaults as Long as it Can Borrow.

IV - BUYING OPPORTUNITIES

A - Currently – Municipal Bond Funds Trading at Highs – Blackrock CA and NJ, Nuveen PA

B – Thin market – retail now (pared back: Commercial banks, Savings banks, Life and Casualty Insurers)

C - Municipal bonds – General sell-off – lack of understanding, as with CDOs

1 - 1933 – All City of Miami bonds, no matter the yield or the maturity, traded at \$26

2 - Mid-1970s – All New York City bonds traded at \$25

D - Selling Assets – Ontario Municipal Employees Retirement Systems – to raise cash, selling Stock in Ontario Lottery and Gaming, and electric generation and distribution companies – (Ontario One and Hydro One)

E - Public-Private Partnerships – “Salvage Investing”

IRR = 13% - 20% (historically)

F – Outsourcing – Education, Trash, Administration Services

The paper “The Coming Collapse of the Municipal Bond Market,” is in the “Articles” section of my website, Aucontrarian.com

Following are some articles about the municipal market in the blog section of my website:

Wednesday, July 7, 2010: [Municipal Pathologies Come to a Head](#)

Tuesday, April 27, 2010: [Possible Misunderstandings about Municipalities and their Bonds](#)

Friday, March 12, 2010: [Municipal Deflation: Consequences of the Greatest Speculation](#)

Friday, February 19, 2010: [Miami’s Municipal Woes \(Again\): Exiting Before the Tide Goes Out](#)

Monday, January 25, 2010: [Municipal Meltdown: Teacher Pensions, Bondholder Coupons, Go to Court](#)