

Comment on Municipal Market Media Coverage

Over the past several months, the media has been replete with articles and coverage of the municipal bond market and the financial, budgetary, and economic problems of state and local governments. Without the interest of the national media, these issues may not have gained broad attention. For example, The New York Times published an article on Sunday, December 5, 2010 entitled Mounting Debts by States Stoke Fears of Crisis. The article addressed concerns about state budget and unfunded pension liabilities and compared the difficulties that some municipal issuers face to the systemic collapse of the subprime mortgage market. While we recognize there are some municipalities with weaker finances, we believe the vast majority maintain certain inherent strengths, which will prevent a systemic breakdown of the municipal market. It is Samson's mission to identify strong credits and monitor them in our clients' portfolios. We will address the article's points with a straightforward review of the principles that serve as the foundation of public finance in America.

Bondholders lend money to governmental units in good faith expecting to be paid principal and interest as scheduled. The tone of the media headlines has implied that this fundamental premise of public finance will be greatly challenged in the future. Unfortunately, a few doomsayer analysts have monopolized the conversation, leaving little room for the voices of those actually responsible for paying debt service. Some of these officials have communicated their commitment to their obligations to bondholders, while others have begun demonstrating it through their actions. For example, the Controller of California recently reiterated on his website that the state will continue to pay its bonded debt despite facing continued budgetary imbalances.

We are particularly concerned about statements in the New York Times article referenced above like "costs remain hidden" and "much of the debt of states and cities is hidden, since it is off the books, just as the amount of mortgage-related debt turned out to be understated". Precisely what does "off the books" mean here? "Off the balance sheet" would have been a more appropriate term, but even that would only apply to pensions. The bonded debt of states and municipal governments is most certainly included on their balance sheets while unfunded pension liabilities are disclosed in the notes to the financial statements, as are retiree health benefits.

In arriving at some of the numbers that reflect public pension fund's unfunded liabilities, there may be disagreement about whether or not the relevant accounting and interest rate assumptions are appropriate and accurate. At present, several pension plans use 8% actuarial rates while some analysts and economists suggest that a much lower rate and one that is comparable to a 30 year Treasury rate is more appropriate. The latter is now approximately 4.5%, which is sharply higher than its low a few months ago. A higher rate suggests a lower unfunded pension fund liability. A complete picture of a government's financial position can only be obtained by thoroughly reading the financial statements and notes, budgets and other financial disclosures. However, it is imprecise to imply that the liabilities are "hidden" and are thus akin to the off-balance sheet vehicles used by banks and

Highlights

- Concerns about state budgets and pension liabilities have been in the headlines
- Samson's mission is to identify strong issuers and monitor credits in our clients' portfolios
- Officials from issuers have reiterated their commitment to bondholders
- Contrary to claims by media sources, a government's financial position is not hidden, but readily available in financial statements, budgets, and disclosures

other financial firms to obscure structured credit liabilities prior to the mortgage market meltdown.

Much has been said about the problems of the City of Harrisburg, Pennsylvania, and its financial strains have been implied to be typical of the broad condition of the municipal market. We disagree. It has been well known in the municipal marketplace that Harrisburg has had problems for decades and the most recent crisis resulted from a combination of the city's weak socioeconomic profile and a fairly unusual contingent liability guarantee for an incinerator. This is unique and not a systemic problem. We believe that the vast majority of municipal governments are better positioned than Harrisburg to manage their debt issuance. The city has also applied to be a part of the Commonwealth of Pennsylvania's distressed city program, which would ensure a sophisticated level of oversight as city officials consider steps to address its budget challenges.

Comparisons of financial concerns of some municipal issuers to the debacle of the subprime mortgage market are unfounded. The subprime crisis was the result of structured securities created from pools of mortgages and other financial instruments with the modeled supposition that housing prices would only rise. The assumption was that if the homeowner was unable to make mortgage payments the collateral (the home) could be sold to pay off the bonds. Municipal bonds, on the other hand, carry the issuer's pledge to pay interest and principal through either a general obligation or a revenue pledge. The ability to repay the bond is based on actual fundamental factors, such as economic growth, taxable resources, financial flexibility, debt burden, active financial management, and the security covenants. Notably, unlike most mortgage securitizations, municipal bond pledges are generally not limited to a static pool of assets. Both in terms of the systemic dimensions of the crisis and the established intergovernmental relationships, the municipal market does not compare to the collapse of the subprime mortgage market.

Samson Capital Advisors does a thorough analysis of every bond prior to purchase. We believe that a strict credit criteria and review is even more essential in these challenging times. The deep recession has strained the collection of revenues and has forced governments to evaluate their level of expenditures and how they set their priorities. We continue to believe that there are enough strong issuers that the municipal sector should remain part of a conservative investor's asset allocation, sensational headlines aside.

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- Harrisburg has been known to have weak finances
- Its troubles are unique and should not reflect the financial condition of the municipal market as a whole
- Comparing the financial concerns of select municipal issuers to the systemic breakdown of the subprime mortgage crisis is unwarranted