



# Ehlers Market Commentary

December 20, 2011

## Some Pre-Year-End Thoughts

The municipal bond calendar for 2011 has essentially drawn to a close, with virtually all new issues having been sold and now waiting for the securities to be delivered in exchange for cash. Although the year-end statistics are a couple of weeks away, we can look back at 2011 and make some tentative observations about the bond market in general:

- Interest rates across most fixed-income sectors in the United States have moved downward in a saw tooth fashion to near historic lows. Recent 10-year benchmarks for the U.S. Treasury and AAA municipal bonds (as reported by Thomson Reuters) were both around 1.90%, compared with 3.30% at the beginning of this year.
- “Flight to quality or safety” drove investors to U.S. Treasury securities, despite the fact the U.S. government’s bond rating had been downgraded and/or given a negative outlook by major rating agencies. The instability in the world’s largest collective economy, Europe, has been given the credit (or blame) for this phenomenon. However, lack of confidence in the U.S. private economy continues, as well.
- The drop in Treasury rates has occurred in spite of an increasing supply of U.S. government debt, seemingly overpowering the laws of supply and demand.
- The Federal Reserve Board’s Federal Open Market Committee has kept the target rate for overnight lending between the Federal Reserve System Banks within its target range of 0.00% and 0.25% in an effort to keep borrowing costs low and stimulate private lending (and economic activity). This has served to keep rates for short-term, fixed-income investments at historically low levels.

Looking beyond the headlines and benchmark numbers, there have been other factors affecting municipal debt of which we can make note:

- Higher “Muni to Treasury” ratios. The highest-rated tax-exempt municipal bonds have typically carried a lower interest rate than U.S. Treasury debt of a similar maturity, with that ratio being in the range of 85% to 95%. However, during most of 2011 the ratio of 10-year, AAA-rated municipal yields to the 10-year U.S. Treasury note has hovered between 100% and 110%. Basically, the general “flight to safety” that has served to drive U.S. Treasuries lower (in yield) has not been fully reflected in yields for the highest-rated tax-exempt municipal bonds.



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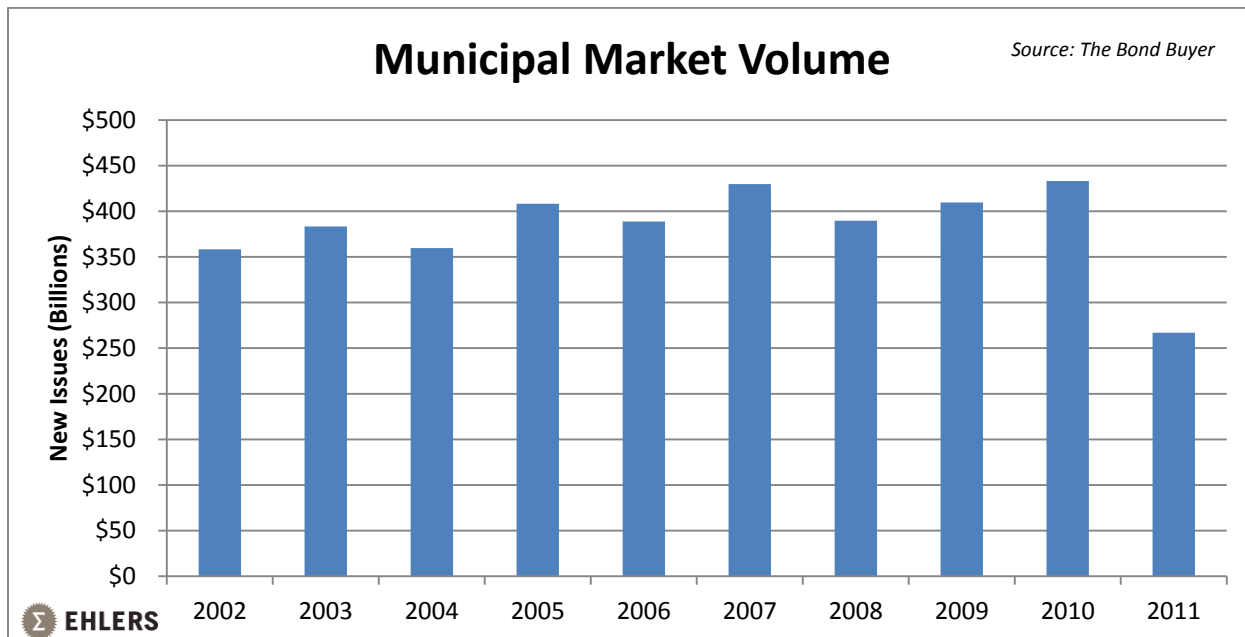
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- The “steepness” of the yield curve, or the relative difference between returns of longer versus shorter maturities, has flattened through 10 years as rates have fallen in general during 2011. For example, the difference in yields for 2 and 10 year maturity AAA-rated municipal bonds (as reported by Bloomberg.com) showed a difference of 2.69% in January, compared with 1.68% last week. However, the difference for 10 and 20 year maturity bonds rose from 1.12% to 1.42%, reflecting the fact that yields on longer maturities did not fall as much as yields on intermediate maturities (i.e. 10 years).
- Buyers of municipal bonds are becoming more careful when it comes to credit ratings, terms and security. Bonds of exactly the same rating and maturity can vary as much as 0.75%, depending upon location, local economy, call dates, coverage ratios and disclosure history.
- Municipal bond volume fell about 33% to less than \$300 billion for the year to date, as compared to 2010. However, municipal bond volume in 2009 and 2010 had increased with several federal stimulus borrowing programs that are no longer available (Build America Bonds, for instance). In the five years prior to 2009 new issue volume ranged from \$358 Billion to \$409 Billion, so current levels are 20% to 30% less than what the market absorbed in those years and as shown in the following graph, will be the lowest in the past ten years.





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Current municipal borrowing rates are attractive when the various indices are viewed from a historical perspective. Current bond sales in the Midwest reflect that, as well (see attached). So, if we are to look forward, can we expect these low rates to continue, rise or fall even further? Looking at the municipal bond market alone, there are factors that could drive rates even lower, such as (a) a return to more normal “Muni to Treasury” ratios and (b) continued moderate supply of municipal bonds. Also, rated municipal bonds may become perceived as relatively safer investments when compared to the falling credit ratings of other fixed income investments, such as commercial banks and non-U.S. sovereign debt instruments.

However, on the larger interest rate front, there are factors that could push rates higher. At this point we can only pose questions and “wait and see”:

- Will Europe avoid defaults in the sovereign debt of its weaker governments? If so, will it be through a lasting solution, or through a series of stop-gap measures?
- Will the lagging recovery of the U.S. economy show real improvement? If so, will the Federal Reserve begin to take actions to attempt to increase short-term interest rates?
- Will the U.S. government reign in its deficits and thereby slow the increasing supply of its debt? If not, will global investors begin to decide to put their money elsewhere?





## Competitive Sale Results December 5 - 16, 2011

Sale Date	Issuer	St	Par Amt (in millions)	Issue	Underlying Rating	Credit Enhanced Rating	BQ	TIC / NIC	Maturities	# of Bidders	Winning Bidder
12/05/11	Brainerd	MN	1.00	GO Improvement Bonds	AA-		Y	1.83%	2013 - 22	3	BOSC
12/05/11	Campbell-Tintah ISD#852	MN	3.57	GO Alternative Facilities Bonds	Non-rated	Aa2	Y	3.03%	2013 - 32	2	BOSC
12/05/11	Chaska	MN	3.06	Electric Utility Revenue Bonds	A1		Y	3.06%	2012 - 31	2	Northland Securities
12/05/11	Des Plaines	IL	3.54	GO Refunding Bonds	Aa2		Y	2.08%	2012 - 21	4	Robert W. Baird - Lead
12/05/11	Hallock	MN	1.68	GO Refunding Bonds	A-		Y	2.67%	2013 - 24	2	Northland Securities
12/05/11	Moorhead	MN	4.20	GO Flood Mitigation Bonds	Aa3		Y	2.89%	2014 - 33	4	United Bankers' Bank
12/05/11	Waunakee Village	WI	3.85	Waterworks & Electric System Mortgage Revenue Bonds	A1		Y	2.56%	2013 - 26	4	Bankers' Banks
12/05/11	West Bend	WI	3.53	GO Refunding Bonds (Taxable)	Aa2		N	2.96%	2012 - 31	6	Robert W. Baird - Lead
12/05/11	West Bend	WI	1.84	GO Refunding Bonds	Aa2		Y	2.08%	2012 - 27	5	Bankers' Bank
12/06/11	Burnsville	MN	2.45	GO Improvement Crossover Refunding Bonds	Aaa		Y	1.33%	2013 - 20	6	FTN Financial Cap Markets
12/06/11	Columbus	WI	2.95	GO Promissory Notes	A1		Y	1.66%	2013 - 20	5	Bankers' Bank
12/06/11	Eau Claire County	WI	4.00	GO Promissory Notes	Aa1		N	1.09%	2012 - 15	4	Fifth Third Securities
12/06/11	Eau Claire County	WI	18.00	GO Building Bonds	Aa1		N	3.40%	2016 - 31	5	Bank of America Merrill Lynch
12/06/11	Farmington ISD#192	MN	19.21	GO School Building Refunding Bonds	A1	Aa2	N	2.25%	2013 - 23	8	Piper Jaffray
12/06/11	Hillsboro	KS	0.35	GO Tax Increment Bonds	A-		Y	2.77%	2012 - 25	2	Central States Cap Markets
12/06/11	Hillsboro	KS	1.60	GO Bonds	A-		Y	2.67%	2016 - 26	4	UMB Bank
12/06/11	White Bear Lake ISD#624	MN	8.75	GO School Building Refunding Bonds	AA	AA+	Y	0.80%	2013 - 17	8	Piper Jaffray
12/06/11	Wisconsin	WI	138.26	GO Bonds	Aa2/AA/AA		N	3.78%	2023 - 32	14	JP Morgan
12/07/11	Chisago County HRA-EDA	MN	1.29	GO Housing Development Refunding Bonds	Aa2		Y	3.26%	2016 - 33	3	Northland Securities
12/07/11	Merrill Area Common Public SD	WI	3.77	GO Refunding Bonds	A+		Y	1.22%	2012 -17	2	BOSC
12/07/11	New Lenox Village	IL	3.92	GO Refunding Bonds	AA		Y	1.93%	2012 - 21	7	Morgna Keegan
12/08/11	Chaska ISD#112	MN	4.72	GO School Building Refunding Bonds	Aa2	Aa2	Y	0.65%	2013 - 14	8	Citigroup
12/08/11	Deer River ISD#317	MN	2.20	GO Aid Anticipation Certificates of Indebtedness	Non-rated		Y	0.46%	2012	4	Jefferies
12/08/11	Fox Valley Park District	IL	0.91	GO Limited Tax Park Bonds	Non-rated		Y	1.50%	2012 - 13	4	First Trust
12/08/11	Genoa City	WI	0.49	GO Promissory Notes	Non-rated		Y	2.40%	2013 - 21	3	Bankers' Bank
12/08/11	Genoa City	WI	1.37	Water System Revenue Refunding Bonds	Non-rated		Y	2.20%	2012 - 20	4	Bernardi Securities
12/08/11	Salt Creek Rural Park District	IL	0.51	GO Limited Tax Park Bonds	Non-rated		Y	2.98%	2012	1	Bernardi Securities



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12/12/11	Crookston ISD#593	MN	3.06	GO Refunding Bonds	A3	Aa2	Y	0.91%	2013 - 15	4	United Bankers' Bank
12/12/11	DeForest Area School District	WI	4.31	GO Refunding Bonds	AA+		Y	0.96%	2012 - 17	6	Fifth Third Securities
12/12/11	Hartford Joint School District#1	WI	3.77	GO Refunding Bonds	Aa3		Y	1.59%	2012 - 24	2	BOSC
12/12/11	Hartford Joint School District#1	WI	1.54	GO Refunding Bonds (Taxable)	Aa3		N	2.63%	2012 - 23	5	Bankers' Bank
12/12/11	Iola-Scandinavia School District	WI	4.38	GO Refunding Bonds	A+		Y	1.65%	2013 - 20	3	Bankers' Bank
12/12/11	Johnson County USD#232 (De Soto)	KS	22.55	GO Refunding Bonds	Aa3		N	2.25%	2012 - 23	6	Guggenheim Securities
12/12/11	Lake Como Sanitary Dist#1, Geneva Twp	WI	4.84	GO Refunding Bonds	A		Y	2.88%	2012 - 31	3	BOSC
12/12/11	New Hope	MN	2.70	GO Tax Increment Refunding Bonds	AA		Y	1.96%	2015 - 25	4	Robert W. Baird - Lead
12/12/11	New Hope	MN	1.33	GO Tax Increment Refunding Bonds (Taxable)	AA		N	3.91%	2016 - 31	3	Northland Securities
12/12/11	Osakis ISD#213	MN	1.10	GO Aid Anticipation Certificates of Indebtedness	Non-rated		Y	0.62%	2012	2	Jefferies
12/12/11	Ramsey County	MN	37.77	GO Capital Improvement Plan Bonds	Aaa/AA+		N	1.34%	2013 - 22	9	JP Morgan
12/12/11	Roseville	MN	10.00	GO Bonds	Aaa		Y	2.43%	2014 - 28	4	FTN Financial Capital Markets
12/13/11	Dayton	MN	1.08	GO Bonds	AA-		Y	1.08%	2013 - 18	5	UMB Bank
12/13/11	Madison	WI	19.37	Water Utility Revenue Bonds	Aa1		N	3.19%	2013 - 32	8	JP Morgan - Lead
12/13/11	Outgamie County	WI	4.99	GO Promissory Notes	Aaa		Y	1.24%	2012 - 19	7	BMO Capital Markets GKST
12/13/11	Rockford	MN	1.61	GO Water Revenue Refunding Bonds	AA-		Y	1.77%	2013 - 21	2	Robert W. Baird - Lead
12/13/11	Schaumburg Village	IL	9.99	GO Refunding Bonds	Aaa/AA+		Y	2.13%	2012 - 24	5	Raymond James - Lead
12/13/11	St. Anthony	MN	2.21	GO Refunding Bonds	AA		Y	1.51%	2013 - 21	6	United Bankers' Bank
12/13/11	University of Illinois BOT	IL	71.90	Auxiliary Facilities System Refunding Revenue Bonds	Aa2/AA-		N	3.98%	2013 - 32	10	Piper Jaffray
12/13/11	Woodville	WI	1.15	GO Refunding Bonds (Taxable)	Non-rated		N	3.05%	2012 - 26	4	Bankers' Bank
12/14/11	Carver County CDA	MN	1.70	Governmental Development Bonds (Cnty GO)	AAA		Y	4.24%	2017 - 41	1	Cronin
12/14/11	D.C. Everest Area School District	WI	2.78	GO Refunding Bonds	Aa2		Y	1.57%	2012 - 20	4	BOSC
12/14/11	D.C. Everest Area School District	WI	3.54	GO Refunding Bonds (Taxable)	Aa2		N	2.57%	2012 - 23	5	BOSC
12/14/11	Long Prairie-Grey Eagle ISD#2753	MN	5.20	GO School Building Refunding Bonds	A1	Aa2	Y	1.06%	2013 - 17	7	Robert W. Baird - Lead
12/15/11	Big Lake ISD#727	MN	2.00	GO Aid Anticipation Certificates of Indebtedness	Non-rated		Y	0.50%	2012	5	Piper Jaffray
12/15/11	Ridgeland SD#122	IL	3.42	GO Refunding School Bonds	AA-		Y	4.03%	2028 - 30	2	Robert W. Baird - Lead
12/15/11	Three Rivers Park District	MN	4.58	GO Bonds	Aaa/NR/AAA		Y	0.88%	2013 - 17	9	JP Morgan
12/15/11	Three Rivers Park District	MN	6.19	GO Refunding Bonds	Aaa/NR/AAA		Y	1.15%	2013 - 20	8	JP Morgan