# Municipal Market Insight

July 2018

Portfolio Advisory Group – U.S. Fixed Income Strategies

## What's inside



# Trading places on the muni curve

Concerns over the potential impact of escalating trade tensions have put financial markets on edge and, as a result, high-quality assets such as munis are in high demand. Federal Reserve Chair Jerome Powell and a chorus of global central bankers recently suggested that trade uncertainty could ultimately weigh on their economies and impact their plans to right-size monetary policy. For the Fed, this means we may be closer to the end of the current rate hike cycle than many expect, and we agree with market expectations that foresee just three more rate increases in 2018. For investors, we believe this suggests interest rates may be near peak levels; we see the 10-year Treasury yield topping out at approximately 3.25%–3.50%.

A very noisy issue for investors at the moment is the shape of the U.S. Treasury yield curve and the narrowing yield differential between short- and longer-dated issues. Investors often view this narrowing as a reason to purchase only short maturities, but while the Treasury curve has been flattening, the municipal curve has actually been steepening. Moving from the short end of the muni curve to the long end nets investors an incremental yield gain of 1.50%, the highest since March. As such, we believe investors should extend on the yield curve to pick up additional yield.

### U.S. Treasury rate forecasts (% as of June 30, 2018)

| | 2018 | | | | 2019 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1E | Q2E | Q3E | Q4E | Q1E | Q2E | Q3E | Q4E |
| FF | 1.75 | 2.00 | 2.25 | 2.50 | 2.75 | 3.00 | 3.25 | 3.50 |
| 2-yr | 2.10 | 2.35 | 2.55 | 2.75 | 3.00 | 3.25 | 3.40 | 3.55 |
| 5-yr | 2.50 | 2.70 | 2.90 | 3.05 | 3.25 | 3.45 | 3.55 | 3.65 |
| 10-yr | 2.80 | 3.00 | 3.15 | 3.30 | 3.45 | 3.60 | 3.70 | 3.75 |
| 30-yr | 3.20 | 3.35 | 3.50 | 3.60 | 3.70 | 3.75 | 3.80 | 3.85 |

Source - RBC Economics

### Treasuries vs. municipals

| | 5-yr TSY | 5-yr Muni | 10-yr TSY | 10-yr AAA Muni | 30-yr TSY | 30-yr AAA Muni |
|---|---|---|---|---|---|---|
| Beginning of month (6/1/18) | 2.75% | 1.99% | 2.90% | 2.44% | 3.05% | 2.92% |
| Midmonth (6/15/18) | 2.80% | 2.00% | 2.92% | 2.48% | 3.05% | 2.99% |
| End of month (6/30/18) | 2.74% | 1.99% | 2.86% | 2.46% | 2.99% | 2.94% |

Source - Bloomberg (Treasury), Thomson Reuters TM3 (Municipals)

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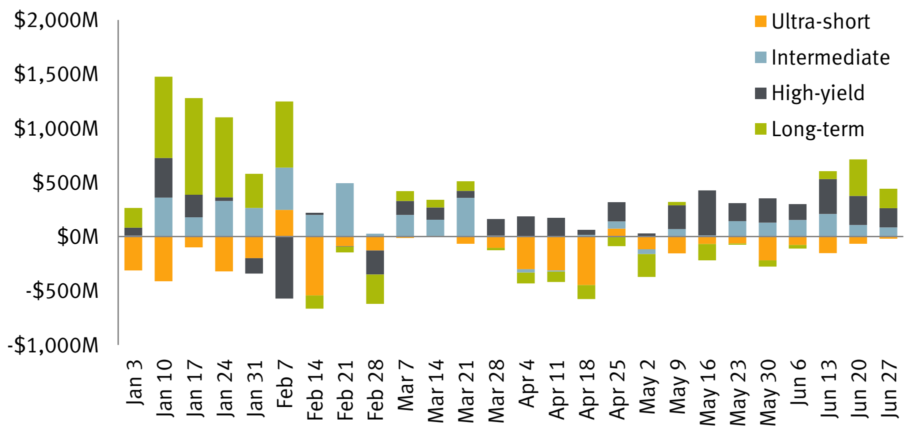
RBC Wealth Management

## Market investment strategy & market commentary

### Munis post positive returns, barely

June provided another month of uncertainty for investors amid the disruption between the U.S. and its allies, including talk of tariffs on imports as well as a possible trade war and the disruption it may cause to the global economy. Further stoking the flames of market volatility are rising crude oil prices as sales of Iranian crude oil decline in response to U.S. pressure on its trading partners following the U.S. exit from the Iran nuclear deal.

2018 muni fund flow




Source - RBC Wealth Management, Lipper U.S. Fund Flows; data through 6/27/18

Although their performance was erratic through the first half of the year, we believe munis remain attractive and are well-positioned to post strong returns ahead of what could be a long summer of investor frustration over dwindling supply and limited opportunities.

Although their performance was erratic through the first half of the year, we believe munis remain attractive and are well-positioned to post strong returns ahead of what could be a long summer of investor frustration over dwindling supply and limited opportunities. We also think muni/Treasury ratios beyond 15 years remain attractive, currently offering investor returns that are between 94% and 99% of Treasuries.

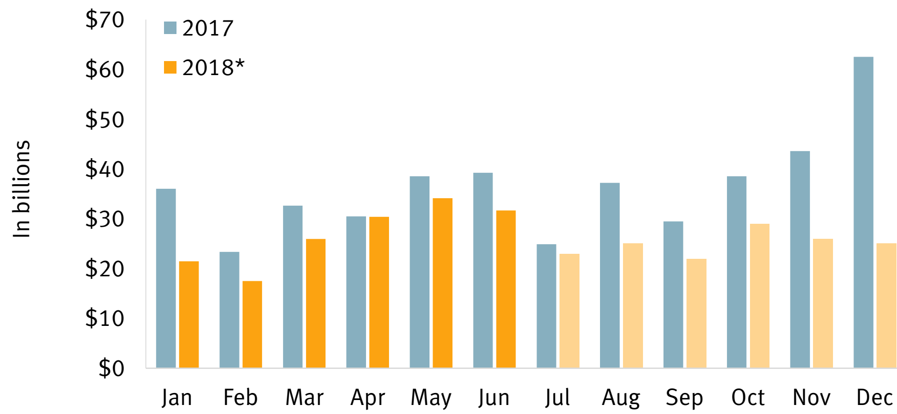
Despite June's challenging environment, munis were able to eke out a positive return for the second consecutive month and for the third time this year. Demand by muni bond funds has helped fill the void created by banks that have reduced their muni holdings following passage of tax-reform legislation. Muni funds experienced eight consecutive weeks of inflows through the end of June. During that period, investors added $2.4B and have added approxiamtely $5.7B year to date (YTD).

Munis returned 0.09% in June according to the Bloomberg Barclays Municipal Bond Index, outperforming both Treasuries (0.02%) and corporates (-0.58%). Munis' year-to-date performance (-0.25% YTD) has also exceeded both Treasuries (-1.08% YTD) and corporates (-3.27% YTD).

Looking ahead, July is shaping up to be a challenging month for investors with our expectations of issuance to drop to $23B while investors are set to receive approximately $45B in maturities and called debt. In addition to the $45B due, investors are scheduled to receive an additional $15.3B of interest payments for total receipts of $60.3B, generating a potential demand/supply imbalance of $37.3B in July and leaving investors with fewer opportunities to reinvest in the muni market.

Despite our short-term enthusiasm, we remain guarded about Illinois' future given the state's entrenched political rancor and, more importantly, its unfunded pension challenges.

2018 issuance vs. 2017 issuance




* Dark orange represents actual year-to-date issuance per *The Bond Buyer*. Light orange bars represent RBC Captital Market projections through December 2018
Source - RBC Capital Markets, *The Bond Buyer*; data as of 6/30/18

Although we expect limited opportunities this summer, we believe investors should stay the course and continue seizing opportunities in intermediate- and longer-dated, higher-quality munis while avoiding lower-grade, lower-quality bonds whose yields have contracted signficantly and which are overvalued, in our estimation.

## Illinois passes a budget, albeit an imperfect budget

Illinois lawmakers recently passed a budget on time for the first time in four years, and with bipartisan compromise. Unfortunately, the budget relies on non-recurring revenues and aggressive assumptions to achieve "balance." Also, the budget does not address the state's outstanding accounts payable totaling $7B or improve the state's pension dilemma.

Governor Bruce Rauner acknowledged the budget wasn't perfect, but was a necessary compromise. He also recognized a need for further pension reform to address the state's $129B unfunded pension liability, and pay down the outstanding accounts payable. Regrettably, the governor provided no detail on how or when the state would confront those challenges. Rauner is up for re-election this fall, while 89% of the state's legislative seats are also up for grabs.

Illinois officials' ability to compromise was essential—without the compromises, the state likely would have been downgraded to below investment-grade. Earlier in the year, several rating agencies telegraphed negative rating action if the state budget was late or if additional financial irregularities were employed. While the FY2019 budget employs some financial sleight-of-hand, we believe it is not enough to warrant a rating below investment-grade, especially since crossing this threshold would be historic for a state in modern times.

Yet despite our short-term enthusiasm, we remain guarded about Illinois' future given the state's entrenched political rancor and, more importantly, its unfunded pension challenges.

Illinois has the economic backbone to address its financial challenges, but only if officials start making fundamentally different decisions in the near future instead of politically expedient ones. We believe future decisions must more closely align with Illinois' fiscal reality if administrators expect to overcome the state's financial challenges, especially its outsized unfunded-pension obligation.

If a new Democratic governor is elected in the fall, the political discord may abate; however, politicians will still face extremely unpopular choices (such as raising taxes and reducing public services) to address the escalating pensions and structural imbalance. Otherwise, politicians risk ratings below investment-grade if they continue to dawdle in the face of those pressing issues.

*Parting thoughts*

The state's ability to pass a budget on time is commendable, but at the same time it is disheartening that surmounting such a low bar merits praise. Time is of the essence. Politicians must take tangible actions to address the state's pension challenge and structural imbalance or risk receiving ratings below investment-grade. Thankfully, we believe the state has a strong enough economic backbone to support the necessary changes. The bigger question is, do officials have the political backbone to make those fiscally responsible decisions?

## U.S. Supreme Court overturns e-commerce sales tax collection ban

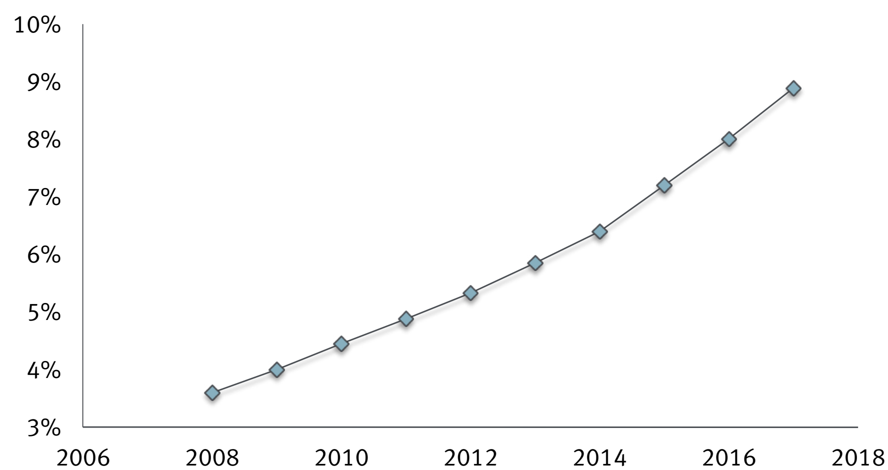
The U.S. Supreme Court last month overturned its 1992 *Quill Corp. v. North Dakota* decision that previously required retailers to have a physical presence in the state in order for the state to collect sales taxes from the retailer.

In the 5–4 ruling, the majority opined that "Each year, the physical presence rule becomes further removed from economic reality and results in significant revenues losses to the states. These critiques underscore that the rule … is an incorrect interpretation of the Commerce Clause."

The GAO estimated that state and local governments could have collected a combined $8B–$13B in additional sales tax revenues in 2017 if they had collected from all e-commerce sellers.

In aggregate, internet sales represented a still-modest 9% of total retail sales in 2017 according to the Federal Reserve Bank of St. Louis, but accounted for 49% of total growth. E-commerce grew 16% in 2017, eclipsing all recent years except 2011 when growth was 17.5%. Unsurprisingly, the bulk of the internet sales growth was driven by Amazon.com, which accounted for 70% of the $63B in online retail growth in 2017 according to Digital Commerce.

### E-commerce sales as a percentage of total sales




Source - Federal Reserve Bank of St. Louis

The U.S. Government Accountability Office (GAO) estimated that state and local governments could have collected a combined $8B–$13B in additional sales tax revenues in 2017 if they had collected from all e-commerce sellers, an amount equal to roughly 3% of all state and local government sales tax revenues. Other groups have produced much higher estimates; the National Conference of State Legislatures, for example, has estimated $26B in additional revenues.

Guam's bond offering is expected to save the Port Authority $20M in interest payments through the life of the bonds.

Overall, states receive about one-third of their total tax collections from general sales taxes. GAO estimates of potential revenue gains from e-commerce sales tax collections range from more than $1B for California and Texas to roughly $20M for Vermont and Wyoming, with the average gain being around $200M However, in aggregate, the additional revenues still account for a small portion of total sales tax revenues, and by extension, a smaller portion of a state's budget. Alaska, Delaware, Montana, New Hampshire, and Oregon will not benefit from the recent court ruling, unfortunately, because they do not levy a sales tax.

While the potential influx of sales tax revenues is a positive development, we do not anticipate any immediate rating changes because online sales still account for a relatively small percentage of total sales. Nonetheless, the projected growth of e-commerce is notable; therefore, this new revenue stream is likely to grow in significance as more shoppers transition online.

## Territorial Update

### Guam – Successfully tests the capital markets

The Port Authority of Guam sold $72.6M of revenue bonds to fund capital improvements to the port and to retire outstanding loans from the U.S. Department of Agriculture, Bank of Guam, and Australia and New Zealand Banking Group. The bonds were split into three series: tax-exempt; private activity; and taxable. The offering came to market rated Baa2 by Moody's and A by S&P. The offering cost the U.S. territory 4.48% all-in (lower than originally projected) and is expected to save the Port Authority $20M in interest payments through the life of the bonds, according to the Port General Manager Joanne Brown.

### Puerto Rico – Aqueduct and Sewer Authority (PRASA)

The water authority tapped reserves to make a $121M debt service payment due July 2. PRASA reported a fund balance of $522M as of May 31 and estimates it may have a $1B shortfall to cover principal and interest due between 2018 and 2023, which could drop to $806M after including federal funds. PRASA has continued paying creditors and has avoided bankruptcy thus far while it continues independently negotiating a workout with creditors outside the purview of the PROMESA board.

### Puerto Rico – PREPA to be partially privatized

Governor Ricardo Rosselló signed a bill that sells the utility's generation units and makes a concession of its transmission and distribution system. The concession could be similar to the concession completed for the commonwealth's airport. While buyers of the generation units would not take on PREPA's debt burden, PREPA could use proceeds of the sale of its power plants to pay off a portion of its $8.9B of debt outstanding. The plan previously approved by the PROMESA board on April 19 assumed PREPA would go through a privatization.

### Puerto Rico – Oversight board certifies revised budget

Easy come, easy go! What was once seen as a $34B surplus over the next 30 years was quickly reduced to $14B by the eight-member federal oversight board. The surplus reduction was included in the board's recently revised and certified FY2019 budget. Board member Ana Matosantos said the board believes the commonwealth will begin running deficits once federal aid from Hurricanes Irma and Maria runs out, prompting the board to reduce its surplus projections from $34B to $14B over the next 30 years.

A deep reduction of the corporate income tax to 21% from 35% has made munis less attractive to banks and other buyers of muni debt.

## State news

### General Commentary

*States bump spending amid modest revenue improvements*

The National Association of State Budget Officers (NASBO) recently released a report noting that states are experiencing modest revenue growth. As a result, many governors are proposing spending increases averaging 3.2% for FY2019. In a sign of improving revenue trends, 39 states reported meeting or exceeding their FY2018 revenue projections, compared with only 17 meeting projections in FY2017. The NASBO survey estimates state revenue will grow 4.9% on average in FY2018. Only nine states reported making midyear budget reductions totaling $830M in FY2018, compared with 22 states that cut $3.5B in FY2017.

*Banks reduce their holdings in municipal debt*

Following passage of tax reform legislation last December, banks reduced their muni holdings 2.8% during Q1 2018—the first decline in almost 10 years, and the largest decline in thirty years. Banks reduced their holdings to $555.7B in Q1 2018, down from $571.5B during the Q4 2017. A deep reduction of the corporate income tax to 21% from 35% has made munis less attractive to banks and other buyers of muni debt.

### Holders of municipal debt ($B)

| | 2015 | 2016 | 2017 | Q2 2017 | Q3 2017 | Q4 2017 | Q1 2018 | Q/Q change |
|---|---|---|---|---|---|---|---|---|
| Muni Bond Market Outstanding Debt | 3,811 | 3,853 | 3,864 | 3,846 | 3,822 | 3,864 | 3,844 | (20) |
| *Held By:* | | | | | | | | |
| Households | 1,655 | 1,712 | 1,641 | 1,668 | 1,632 | 1,641 | 1,640 | (1) |
| Mutual funds | 604 | 632 | 688 | 667 | 680 | 688 | 688 | 0 |
| Money market funds | 268 | 162 | 142 | 142 | 135 | 142 | 141 | (1) |
| Closed-end funds | 90 | 87 | 89 | 89 | 89 | 89 | 87 | (2) |
| Exchange traded funds | 19 | 25 | 30 | 27 | 29 | 30 | 31 | 1 |
| Non-financial corporate businesses | 22 | 20 | 30 | 27 | 29 | 30 | 28 | (2) |
| Non-financial non-corporate businesses | 4 | 5 | 5 | 5 | 5 | 5 | 5 | 0 |
| Gov't-sponsored enterprises | 8 | 6 | 5 | 5 | 5 | 5 | 4 | (1) |
| State & local gov't general funds | 14 | 15 | 15 | 15 | 15 | 15 | 16 | 1 |
| Rest of the world | 87 | 94 | 102 | 99 | 100 | 102 | 101 | (1) |
| U.S. depository institutions | 499 | 549 | 570 | 557 | 561 | 570 | 554 | (16) |
| Property & casualty insurance companies | 346 | 339 | 327 | 329 | 327 | 327 | 327 | 0 |
| Life insurance companies | 171 | 179 | 193 | 186 | 190 | 193 | 194 | 1 |
| State & local gov't retirement funds | 3 | 2 | 3 | 3 | 2 | 3 | 3 | 0 |
| Brokers & dealers | 14 | 21 | 17 | 21 | 17 | 17 | 19 | 2 |

Source - Federal Reserve Financial Accounts of the United States, Q1 2018

The Supreme Court's decision affects the 23 states and two territories that allowed public unions to collect agency dues.

*U.S. Supreme Court overturns 1977 ruling*

On June 27, the high court overturned its 1977 *Abood v. Detroit Board of Ed.* decision that previously required all public employees who were represented by unions to pay a portion of union dues— known as "agency" or "fair share" dues. The decision affects the 23 states and two territories that allowed public unions to collect agency dues.

The court opined that forcing non-union public workers to pay the agency dues is unconstitutional because it violates the non-union members' free speech rights by forcing them to subsidize the union's private speech. In the 5–4 ruling, the majority wrote that "Exclusive representation of all the employees in a unit and the exaction of agency fees are not inextricably linked. To the contrary, in the Federal Government and the 27 States with laws prohibiting agency fees, millions of public employees are represented by unions that effectively serve as the exclusive representatives of all the employees."

## State/territory credit ratings

On June 18, Moody's downgraded New Mexico's GO rating to 'Aa2' from 'Aa1'. Moody's revised the state's outlook to stable from negative. The downgrade was primarily triggered by the state's large pension liabilities. On June 21, Moody's upgraded Florida's GO rating to 'Aaa' with a stable outlook because of the state's economic and employment growth, which has outplaced U.S. averages for several years.

| State/Territory | Fitch | Moody's | Standard & Poor's |
|---|---|---|---|
| Alabama | AA+ | Aa1 | AA |
| Alaska | AA | Aa3 | AA |
| Arizona | ----- | Aa2 | AA |
| Arkansas | ----- | Aa1 | AA |
| California | AA- | Aa3 | AA- |
| Colorado | ----- | Aa1 | AA |
| Connecticut | A+ | A1 | A |
| Delaware | AAA | Aaa | AAA |
| Florida | AAA | Aaa | AAA |
| Georgia | AAA | Aaa | AAA |
| Hawaii | AA | Aa1 | AA+ |
| Idaho | AA+ | Aa1 | AA+ |
| Illinois | BBB | Baa3 | BBB- |
| Indiana | AAA | Aaa | AAA |
| Iowa | AAA | Aaa | AAA |
| Kansas | ----- | Aa2 | AA- |
| Kentucky | AA- | Aa3 | A |
| Louisiana | AA- | Aa3 | AA- |
| Maine | AA | Aa2 | AA |
| Maryland | AAA | Aaa | AAA |
| Massachusetts | AA+ | Aa1 | AA |
| Michigan | AA | Aa1 | AA- |
| Minnesota | AAA | Aa1 | AA+ |
| Mississippi | AA | Aa2 | AA |
| Missouri | AAA | Aaa | AAA |
| Montana | AA+ | Aa1 | AA |
| Nebraska | ----- | ----- | AAA |

| State/Territory | Fitch | Moody's | Standard & Poor's |
|---|---|---|---|
| Nevada | AA+ | Aa2 | AA |
| New Hampshire | AA+ | Aa1 | AA |
| New Jersey | A | A3 | A- |
| New Mexico | ----- | Aa2 | AA |
| New York | AA+ | Aa1 | AA+ |
| North Carolina | AAA | Aaa | AAA |
| North Dakota | ----- | Aa1 | AA+ |
| Ohio | AA+ | Aa1 | AA+ |
| Oklahoma | AA | Aa2 | AA |
| Oregon | AA+ | Aa1 | AA+ |
| Pennsylvania | AA- | Aa3 | A+ |
| Rhode Island | AA | Aa2 | AA |
| South Carolina | AAA | Aaa | AA+ |
| South Dakota | AAA | Aaa | AAA |
| Tennessee | AAA | Aaa | AAA |
| Texas | AAA | Aaa | AAA |
| Utah | AAA | Aaa | AAA |
| Vermont | AAA | Aaa | AA+ |
| Virginia | AAA | Aaa | AAA |
| Washington | AA+ | Aa1 | AA+ |
| West Virginia | AA | Aa2 | AA- |
| Wisconsin | AA+ | Aa1 | AA |
| Wyoming | ----- | ----- | AAA |
| District of Columbia | AA | Aa1 | AA |
| Guam | ----- | ----- | BB- |
| Puerto Rico | ----- | Ca | D |
| Virgin Islands | ----- | ----- | ----- |

Blue text indicates ICR (Issuer Credit Rating); all other ratings are GO
Source - Fitch Ratings, Moody's Investors Service, Standard & Poor's

California's FY2019 budget will divert approximately half of the state's $8.9B surplus to savings accounts in the event the state experiences an economic slowdown.

### Alaska – Budget draws on reserves

On June 13, Alaska Governor Bill Walker signed the state's FY2019 budget bills. The four bills include $6.7B of general fund spending and an additional $1.3B is set aside for capital spending. Included in one of the budget bills is a 5.25% draw on the Permanent Fund Earnings Reserve Fund, marking the first time the state will draw on the fund to meet operating expenses. Included in the budget law, the fund would pay state residents a $1,600 dividend. Tapping the fund to cover operating expenses will help the state reduce its budget deficit to $700M from $2.4B.

Shortly after the state passed its FY2019 budget, Standard & Poor's rewarded Alaska with a rating outlook boost by revising the state's outlook to stable from negative. The revision to stable reflects the state's recent fiscal reforms and the state's recognition of the Permanent Fund Earnings Reserve Account as unrestricted general fund revenue.

### California – Gas tax repeal effort underway

Senate Bill 1, which increased the state's gas tax, was approved by the majority Democratic legislature last year and is expected to raise $5.4B annually for the next 10 years, enabling the state to fast-track numerous infrastructure projects. With a recent USC Dornsife/Los Angeles Times poll suggesting that 51% of Californians favor repealing the tax, the Office of the Governor has indicated that repeal would jeopardize many of infrastructure projects that have already been fast-tracked. On June 5, Democratic state Senator Josh Newman was recalled by Orange County voters in protest of his support for Senate Bill 1.

### Governor Brown – Leaves the state's coffers plentiful in his last year

Governor Jerry Brown's budget for FY2019, which began July 1, 2018, steers more funds to the state's reserves than required by law. The governor's final budget, approved by legislators, will divert approximately half of the state's $8.9B surplus to savings accounts in the event the state experiences an economic slowdown. The state stands to end the year with reserve funds totaling over $13.8B. The outlook revision follows the state's enactment of pension reform during the 2018 legislative session. S&P noted that recently enacted pension reform "should be sufficient to prevent further decline of the funded ratios in the current outlook period."

### Colorado – Pension reform law provides a boost

On June 7, S&P returned the state's outlook to stable from negative, affecting the state's AA- rated leased-back debt and its A+ rated certificates of participation. The state does not issue general obligation debt. The outlook change was triggered by the recent passage of pension reform legislation, which S&P expects will stabilize the funded ratio of the system and prevent further deterioration.

### Florida – Scores third triple-A rating

On June 21, Moody's upgraded Florida's general obligation rating to Aaa from Aa1 with a stable outlook, as the state's economic and employment growth has outpaced U.S. averages for several years. While the state remains an attractive location for retirees, job seekers have been relocating to the state in light of the strong economy.

### Louisiana – Budget signed with a shortfall

Governor John Bel Edwards signed a 2019 spending plan totaling $34B in expenditures including federal funds. After signing the budget, the governor immediately called for a third special legislative session to address an expected budget shortfall of $500M that may necessitate additional spending cuts. Edwards is asking legislators to take action on a temporary 1% sales tax, which is set to expire June 30. The governor wants legislation that will require keeping 0.5% of the 1% sales tax on the books to help close the projected $500M budget gap.

Michigan (for the first time in 18 years) no longer has any school districts or municipalities under state supervision.

### Michigan – A milestone

Following the release of the Highland Park School District from state receivership, the state (for the first time in 18 years) no longer has any school districts or municipalities under state supervision, according to State Treasurer Nick Khouri. The Highland Park School District was placed under state supervision in 2012.

### New Jersey – Legislators and governor reach a last-minute agreement

Governor Phil Murphy signed a $37.4B spending plan after negotiating a last-minute deal with the House and Senate, both of which are controlled by Democrats. The compromise budget was reached after Gov. Murphy threatened to veto the budget submitted by legislators because it did not include tax increases on millionaires and corporations. A last-minute compromise between the governor and legislators calls for tax increases on corporations and on individuals earning more than $5M.

## Regional updates and other market news

### Allen Park, Michigan – Back to investment-grade

Allen Park, rated CCC just over one year ago, was upgraded twice in the past year by S&P. On June 14, S&P upgraded Allen Park to BBB+ from BB. The city's rating had fallen into junk territory after it experienced financial deterioration and struggled to pay bonds for a failed movie studio deal that landed the city under state oversight in 2012.

### Atlanta – Passes a balanced budget

The city adopted a $2.1B FY2019 operating budget, which is 3% or $61.6M higher than the previous year. Approximately $667.3M of the operating budget is general fund spending, an increase of $18.7M from FY 2018. A majority of the increased general fund spending is pegged to investments in parks, information technology network infrastructure, economic development, and employee compensation. Atlanta was subjected to a ransomware attack earlier this year and is taking steps to improve its technology infrastructure to avoid future cyberattacks.

### Build America Mutual (BAM) – Bond insurer rating affirmed

Citing strong market acceptance and the likelihood that market demand for muni bond insurance could increase in an environment of rising interest rates and widening spreads, S&P affirmed BAM's AA rating with a stable outlook.

### Flint, Michigan – Contentious budget battle

The City Council's first budget after exiting state oversight, which included amendments that increased salaries and benefits, was vetoed by Mayor Karen Weaver. The City Council was unsuccessful in its attempt to override the mayor's veto. As a result, Mayor Weaver's original $56M budget will now move forward to the city council for a full vote.

Harrisburg, Penn. Mayor Eric Papenfuse said he will declare a state of fiscal distress in an effort to avoid being forced to implement austerity measures to help close a projected $12M deficit.

### Harrisburg, Pennsylvania – Fiscal challenges on the horizon

The state's $32.7B budget, passed on June 22, failed to include a provision allowing the capital city to exit state supervision under the Act 47 program for distressed cities. In addition, the state budget did not extend the city's ability to keep its special taxing authority. As a result, Harrisburg Mayor Eric Papenfuse said he will declare a state of fiscal distress in an effort to avoid being forced to implement austerity measures to help close a projected $12M deficit. City officials asked state legislators to approve the city's exit from distressed city status while expanding special taxing status to help the city address its budget deficit. The state-appointed recovery coordinator has recommended a three-year exit plan.

A decade after filing for Chapter 9 bankruptcy protection, Vallejo, California continues to make strides in its recovery.

### Hempstead, New York – Surpluses garner rating upgrade

On June 14, S&P raised the township's rating to AA- from A+ following three consecutive years of multi-million-dollar surpluses. The township, located in Nassau County, ended FY2017 with $23.5M of reserves, or 14.7% of expenditures, which compares favorably to the deficit of $13.7M, (8% of expenditures), in FY2014.

### Jefferson County, Alabama – Receives a rating boost

Fitch Ratings rewarded the once-bankrupt county with a two-notch upgrade to AA- from A with a stable outlook. Fitch said the upgrade reflects the county's fully funded pension liability and new general fund revenue collections as a result of a sales tax warrant refunding last year. Further supporting the upgrade is a rapidly amortizing debt schedule.

### New York City – Mayor and City Council reach budget accord

Mayor Bill de Blasio and City Council members agreed to an $89.2B FY2019 budget that calls for increased reserves and funds a Fair Fares program aimed at providing discounted subway fares to low-income residents. The budget also provides Fair Student Funding for city schools. Spending has increased 20% since de Blasio took office in 2015. The FY2019 spending plan calls for a $1.125B general reserve (a $125M increase) and directs $4.35B into the retiree health benefits trust fund, an increase of $100M. The budget maintains the city's capital stabilization reserve fund at $250M.

### Seattle – City Council buckles to pressure

After approving a $275 "head tax" on the city's largest employers, the City Council buckled to pressure from Amazon and other large employers and repealed the head tax. Revenues from the tax aimed at companies earning more than $20M annually had been slated to help alleviate the city's growing homelessness problem. The City Council projected the tax, which had been set to expire in 2023, would raise over $47M annually starting in January 2019. The agreed-upon budget is slightly larger than the budget previously introduced by the mayor and is 4.7% higher than the city's $85.2B spending plan for FY2018.

### Stockton University, New Jersey – Rating lowered on increased debt

On June 19, Fitch dropped Stockton's rating to A- from A ahead of the university's planned opening of a satellite Atlantic City campus in September. Fitch cited weaker-than-expected operating performance in FY2017. The downgrade affects $277.8M of revenue and GO lease bonds. Fitch also noted that Stockton has to significantly improve operating cash flow to cover escalating debt service by 2021.

### Vallejo, California – 10 years after bankruptcy

A decade after filing for Chapter 9 bankruptcy protection, the city continues to make strides in its recovery. Driving the city's recovery is a rapidly growing real estate market where the median house sells for $1M. Located 30 miles north of San Francisco, Vallejo is the fourth-most-populous city in the Bay Area, with a population of 118,280 in 2017. The city has had trouble shaking off a reputation for high unemployment and crime, both of which were associated with the bankruptcy. Despite all its achievements, a dark cloud of pension liabilities could once again be looming over Vallejo as well as other California cities with growing economies.

### Wayne County, Michigan – Three is a charm

June proved to be a good month for the county, as both Moody's and S&P upgraded its rating to investment-grade. The county, home to Detroit, is now rated investment-grade by the three major rating agencies. On June 1, S&P raised the county's rating two notches to BBB+ from BBB-, while maintaining a positive outlook on the county's rating. S&P cited "the county's continued maintenance of structurally balanced operations, and that it is well positioned to be able to maintain structural balance even as operating and fixed costs are set to grow in the near term."

On June 14, Moody's raised the county's rating two notches to Baa2 from Ba1 and revised the county's outlook to stable, noting that "The county's improved financial position means it can absorb the added costs of servicing debt the county plans to issue to finance a new criminal justice center."

## RBC Wealth Management retail trading (6/1/18 – 6/30/18)

Top 10 CUSIPs selling volume to retail customers

| CUSIP | Description | Maturity | Coupon | Volume |
|---|---|---|---|---|
| 718814U38 | PHOENIX-REF | 07/01/2019 | 5.00 | 8,289 |
| 7962532R2 | SAN ANTONIO ELEC/GAS | 02/01/2048 | 5.00 | 5,256 |
| 59259Y5J4 | MET TRAN AUTH-B | 11/15/2055 | 5.25 | 2,674 |
| 63968MKM0 | NEBRASKA ST INVESTMEN | 09/01/2030 | 3.45 | 2,337 |
| 90634PND7 | UNION CO-A-B | 03/01/2030 | 3.00 | 2,244 |
| 70914PN32 | PENNSYLVANIA ST-1ST | 03/01/2039 | 3.75 | 2,212 |
| 70920PBF0 | PA SCH BLDG-CMNTY CLG | 06/15/2028 | 6.00 | 2,047 |
| 372640JU7 | GEORGETOWN CNTY-BANS | 06/20/2019 | 3.00 | 2,028 |
| 200588MN8 | COMMERCE CITY-SLS TAX | 08/01/2040 | 4.25 | 1,703 |
| 65819GKX5 | NORTH CAROLINA ST CAP | 10/01/2055 | 5.00 | 1,698 |

Top 10 CUSIPs buying volume from retail customers

| CUSIP | Description | Maturity | Coupon | Volume |
|---|---|---|---|---|
| 70870ECC1 | PA ECON DEV-B | 07/01/2053 | 6.00 | 1,482 |
| 674736AP8 | OCEAN CNTY-GEM IMP | 12/01/2029 | 3.00 | 1,354 |
| 511115AQ0 | LAKE VIEW MGMT DEV | 02/15/2046 | 4.00 | 1,276 |
| 64972GRE6 | NYC MUNI WTR-CC-PRERF | 06/15/2047 | 5.00 | 1,143 |
| 64577HQZ7 | NJ ECON | 07/01/2048 | 5.00 | 1,060 |
| 769584DL4 | RIVIERA BEACH-TXBL | 04/01/2035 | 5.12 | 986 |
| 57419PA58 | MD DEV-NON AMT NON AC | 07/01/2045 | 4.60 | 760 |
| 59259Y5J4 | MET TRAN AUTH-B | 11/15/2055 | 5.25 | 753 |
| 68608JQD6 | OR FACS AUTH-CHF | 07/01/2044 | 5.00 | 650 |
| 45385LLT8 | INDEP CITIES FIN AUTH | 12/15/2037 | 3.25 | 638 |

Source - RBC Wealth Management

## RBC Capital Markets institutional trading (6/1/18 – 6/30/18)

Top 10 CUSIPs selling volume to retail customers

| CUSIP | Description | Maturity | Coupon | Volume |
|---|---|---|---|---|
| 718814U38 | PHOENIX-REF | 07/01/2019 | 5.00 | 8,289 |
| 7962532R2 | SAN ANTONIO ELEC/GAS | 02/01/2048 | 5.00 | 5,256 |
| 59259Y5J4 | MET TRAN AUTH-B | 11/15/2055 | 5.25 | 2,674 |
| 63968MKM0 | NEBRASKA ST INVESTMEN | 09/01/2030 | 3.45 | 2,337 |
| 90634PND7 | UNION CO-A-B | 03/01/2030 | 3.00 | 2,244 |
| 70914PN32 | PENNSYLVANIA ST-1ST | 03/01/2039 | 3.75 | 2,212 |
| 70920PBF0 | PA SCH BLDG-CMNTY CLG | 06/15/2028 | 6.00 | 2,047 |
| 372640JU7 | GEORGETOWN CNTY-BANS | 06/20/2019 | 3.00 | 2,028 |
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Top 10 CUSIPs buying volume from retail customers

| CUSIP | Description | Maturity | Coupon | Volume |
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| 70870ECC1 | PA ECON DEV-B | 07/01/2053 | 6.00 | 1,482 |
| 674736AP8 | OCEAN CNTY-GEM IMP | 12/01/2029 | 3.00 | 1,354 |
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| 68608JQD6 | OR FACS AUTH-CHF | 07/01/2044 | 5.00 | 650 |
| 45385LLT8 | INDEP CITIES FIN AUTH | 12/15/2037 | 3.25 | 638 |

Source - RBC Capital Markets

## *Bond Buyer* indexes

| Weekly | Current 6/28/18 | Previous 6/21/18 | 2018 high | Date | 2018 low | Date |
|---|---|---|---|---|---|---|
| Bond Buyer Revenue Bond Index | 4.36% | 4.36% | 4.46% | (4/26) | 3.92% | (1/04) |
| Bond Buyer 20-Bond Index | 3.87% | 3.87% | 3.97% | (4/26) | 3.44% | (1/04) |
| Bond Buyer 11-Bond Index | 3.35% | 3.35% | 3.45% | (4/26) | 2.94% | (1/04) |

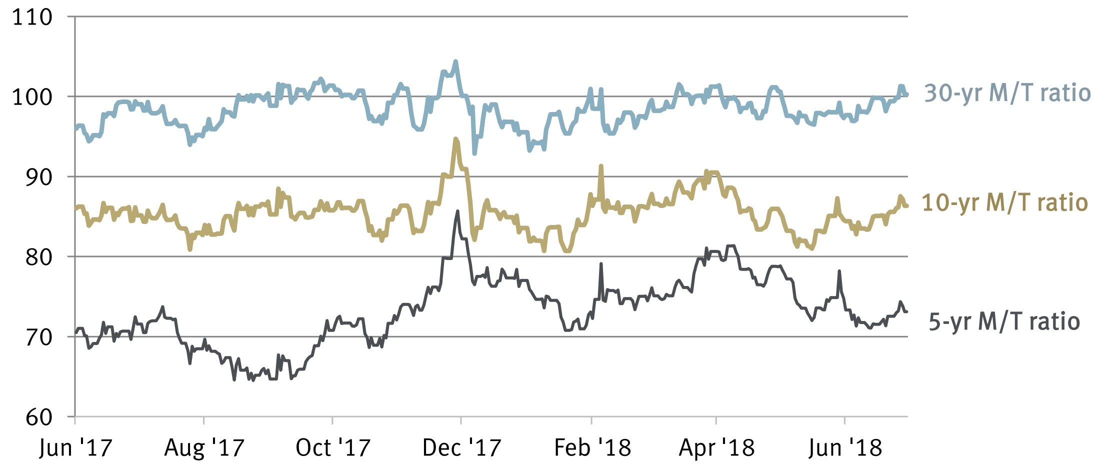
Source - *The Bond Buyer*

## Barclays Municipal Index returns

| | INDEX | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1 Month | 5 Year (4-6) | 10 Year (8-12) | 15 Year (12-17) | Long Bond (22+) | AAA | AA | A | BAA |
| Month-to-date total return | 0.09% | 0.27% | 0.07% | -0.02% | -0.13% | 0.09% | 0.06% | 0.10% | 0.16% |
| Year-to-date total return | -0.25% | 0.30% | -0.72% | -0.57% | -0.66% | -0.48% | -0.32% | -0.18% | 0.40% |

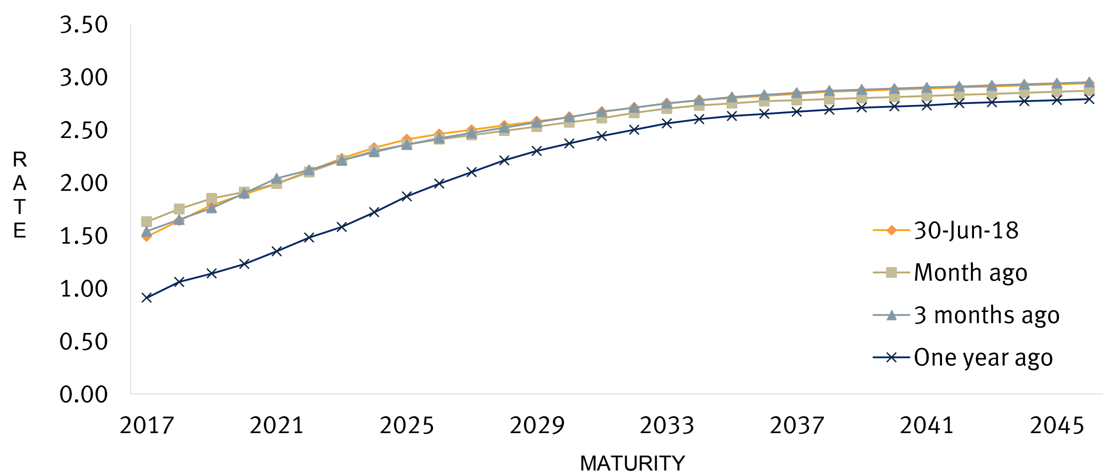
Source - Barclays; data as of 6/30/18

## Muni/Treasury ratio comparison




Source - RBC Wealth Management, Bloomberg; data through 6/30/18

## Muni market data AAA yield curve




Source - RBC Wealth Management, Thomson Reuters TM3

## Municipal bond insurers

| Insurer | Moody's | Standard & Poor's | Kroll Ratings |
|---|---|---|---|
| ACA | Not rated | Not rated | Not rated |
| AMBAC | Not rated | Not Rated | Not rated |
| Assured Guaranty (AGC) | A3 (stable outlook) | AA (stable outlook) | AA (stable outlook) |
| Assured Guaranty Municipal Corp. (AGM) | A2 (stable outlook) | AA (stable outlook) | AA+ (stable outlook) |
| Berkshire Hathaway (BHAC) | Aa1 (stable outlook) | AA+ (stable outlook) | Not rated |
| Build America Mutual (BAM) | Not rated | AA (stable outlook) | Not rated |
| FGIC | Not rated | Not rated | Not rated |
| Municipal Assurance Corporation | Not rated | AA (stable outlook) | AA+ (stable outlook) |
| National Public Finance (MBIA) | Baa2 (stable outlook) | Not Rated | Not Rated |
| Syncora | Not rated | Not Rated | Not rated |

Source - RBC Wealth Management; data through 6/30/18

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# Third-party disclaimer

References herein to “LIBOR”, “LIBO Rate”, “L” or other LIBOR abbreviations means the London interbank offered rate as administered by ICE Benchmark Administration (or any other person that takes over the administration of such rate).

# Disclaimer