



Monthly Municipal Market Update

Market Commentary

“Taxpayer data reveal that municipals are not strictly for the affluent.”

Tax-exemption of municipal bonds has come under fire once again. As government officials explore every possible way to chop back the federal deficit, the tax revenue that might be earned from municipal bond interest is becoming a tempting target.

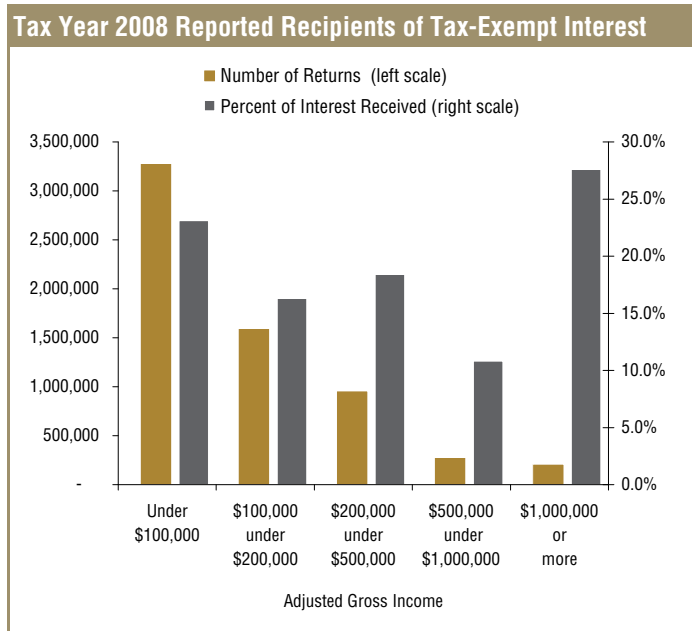
One of the key arguments in the debate over tax-exemption is that the tax benefits from municipal bonds are enjoyed only by the wealthy. The detailed taxpayer data reveal that municipals are not strictly for the affluent (see chart on the left, below). Indeed, in 2008, the last tax year for which the IRS provides information, more than half of the 5.5 million taxable returns reporting receipt of tax-exempt interest were filed by taxpayers with Adjusted Gross Income (AGI) below \$100,000. And this income group’s total share of declared tax-exempt interest reached \$18.4 billion, very close to the cohort of taxpayers with AGI over \$1 million, who reported \$22.0 billion.

With an enormous budget gap to close, legislators and the administration will likely focus on what are known as tax expenditures. The federal government can raise a great deal of revenue by eliminating these loopholes that reduce particular individuals’ tax liabilities. The process is not easy, however: every tax expenditure loophole is attached to a politically-popular cause.

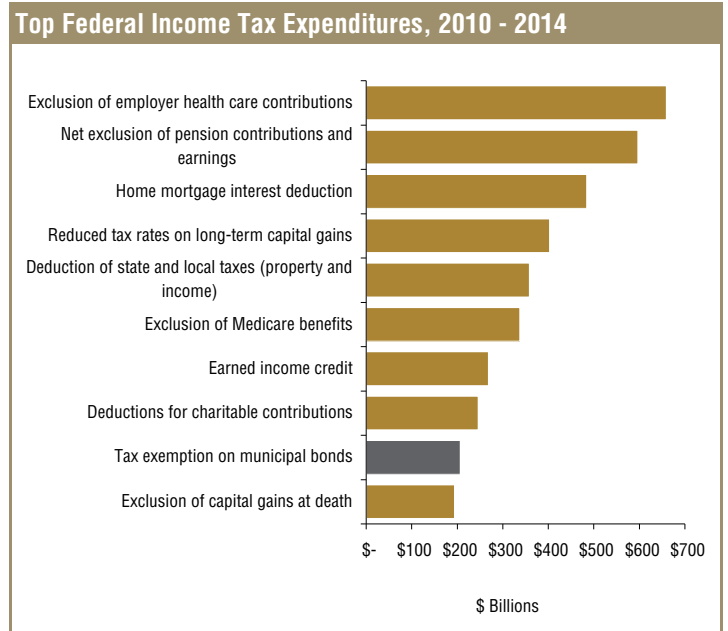
The Joint Committee estimated the ten largest tax expenditures will cost the federal government \$3.75 trillion in foregone revenues over the five years from 2010 through 2014 (chart on the right). Federal exemption of municipal bond interest generates only 5.5% of all projected losses, while the three largest items, which provide preferential treatment for employee-based health insurance, retirement savings and home ownership, together contribute 46.4% of the total figure.

Steven Harvey, Senior Portfolio Manager

Charts of the Month



Source: Statistics of Income Division, Internal Revenue Service



Source: Joint Committee on Taxation, December 15, 2010

Credit Observations

“...the City of Chicago and the airlines have agreed to proceed with approximately \$1.2 billion in airfield improvements, the principal component being the construction of 1 new runway that should help to alleviate congestion at the Airport.”

Credit Under the Spotlight: Chicago O’Hare International Airport**

The City of Chicago issued \$1 billion of tax-exempt debt (Series 2011A-C) in April to finance runway improvements at O’Hare International Airport. Assigned ratings are A1/A-/A- by Moody’s, S&P, and Fitch respectively. The issuance follows a delay earlier in the year caused by a threatened lawsuit from the Airport’s two primary tenants, United Airlines and American Airlines. Under the original financing plan, Bond proceeds were to be used for Phase 2 of the O’Hare Modernization Program, which was to include the construction of 2 new runways, the extension of a 3rd runway, and construction of a new Western Terminal Complex. However, due to recent economic conditions that have resulted in declines in air travel (see chart below), the two carriers argued it was unnecessary to undertake the entire \$5.5 billion Program right away. Under a new agreement, the City of Chicago and the airlines have agreed to proceed with approximately \$1.2 billion in airfield improvements (Phase 2A), the principal component being the construction of 1 new runway that should help to alleviate congestion at the Airport. A decision on remaining airfield improvement (Phase 2B) has been deferred until no later than March 1, 2013 while the new terminal component of the Program has been deferred indefinitely. To defray a portion of the debt service costs to be borne by the airlines, a portion of passenger facility charges and federal grant money (\$280 million) has been pledged to the Series A and B Bonds respectively. Series A, B, and C Bonds are all ultimately secured by the general revenues of the airport, which includes terminal rents, landing fees, concession fees, and parking fees among other sources, justifying their equivalent ratings. However, Standish preferred the Series B Bonds due to the additional pledge of federal grant money, which should be insulated from air travel trends at the Airport. Credit strengths of O’Hare include its location in a large, economically diverse service area, its sizeable cash position equivalent to more than 400 days of operations, and its strategic importance in the nation’s air transportation network, which is evident in its use as a major hub by both United and American and its #2 traffic ranking among North American airports in 2010. Credit concerns include high carrier concentration, with United and American collectively accounting for 85% of total flights (see chart below), a high level of connecting traffic equal to 51% of the total, a high cost structure that will be stressed by the ongoing Modernization Program, and historically thin financial margins.

** Source: Chicago O’Hare Int’l Airport 2011A-C Official Statement

Daniel Barton, CFA, Senior Analyst

Other Credit News:

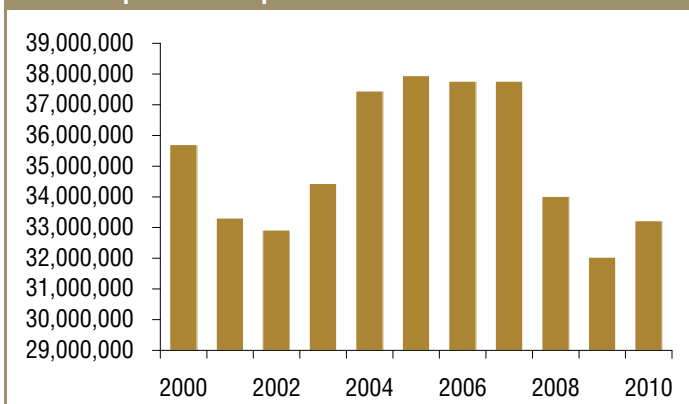
On April 18th Standard and Poor’s revised its outlook on the United State of America’s AAA rating to “negative”. S&P indicated there was at least a one in three chance that U.S. debt would be downgraded in the next 2 years. While S&P indicated that this change will have no impact on the ratings of state and local government debt, S&P did revise to negative the outlooks on its ratings of municipal bonds that are supported directly or indirectly by the U.S. Government. These bonds include escrowed/pre-refunded bonds backed by U.S. Treasury bonds or Federal Agencies; bonds backed by Government related entities such as Fannie Mae and Freddie Mac; bonds secured by Federal lease payments; and two Federal power agencies, Bonneville Power Administration and the Tennessee Valley Authority.*

*Source: “Examining the Relationship Between the U.S. Sovereign Rating and the Ratings on U.S.-Domiciled Entities” published on Standard and Poor’s website 4/29/2011

David Belton, Head of Municipal Bond Research

Credit Charts of the Month

O’Hare Airport Total Enplanements: 2000-2010



Source: Chicago O’Hare Int’l Airport 2011A-C Official Statement

O’Hare Airport Carrier Market Share: 2010

Carrier	Market Share
United / Continental	49.0%
American Airlines	36.0%
U.S. Airways	2.6%
Delta Air Lines	1.7%
Lufthansa	0.8%
Alaska Airlines	0.7%
Other	9.2%

Source: Chicago O’Hare Int’l Airport 2011A-C Official Statement

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