



STANDISH

Tax Sensitive Fixed Income

Monthly Municipal Market Update

Market Commentary

“Federal grants typically cover about 30% of state spending, and are provided for federally-mandated education, health care, infrastructure and welfare initiatives. States are not required to make up any shortfalls if federal pass-through payments are reduced or eliminated.”

Widespread weakening in economic data, the recent debt ceiling debacle, European debt crises and the S & P downgrade of the United State’s triple-A rating have all combined to bring waves of turbulence into the financial markets. Amidst this turbulence, Standish continues to monitor your tax sensitive fixed income portfolios with an eye on two key risks. We discuss these below.

A return to sluggish economic growth: The deep recession of 2008 triggered sharp drops in state tax collections (see chart on the left, below); states responded by cutting spending and, in some cases, by raising their income tax and sales tax rates. Continued spending discipline and modest economic expansion in 2009 and 2010 helped state budgets move back toward balance.

Another stretch of sub-par growth would likely dampen tax collections again, forcing continued austerity upon state and local governments. We carefully monitor tax collection data to get an early warning on any potential slippage in credit quality.

Reduced federal payments to states: Federal grants typically cover about 30% of state spending, and are provided for federally-mandated education, health care, infrastructure and welfare initiatives. States are not required to make up any shortfalls if federal pass-through payments are reduced or eliminated.

Medicaid is the largest recipient of federal grants to states, receiving an estimated 52% of the total in 2009 (see chart on the right, below). This means-tested entitlement program is financed jointly by states and the federal government to provide health care to over 60 million low-income individuals. According to the National Association of State Budget Officers, Medicaid is the single largest line item in state budgets, absorbing an estimated 22% of total state spending in 2010.

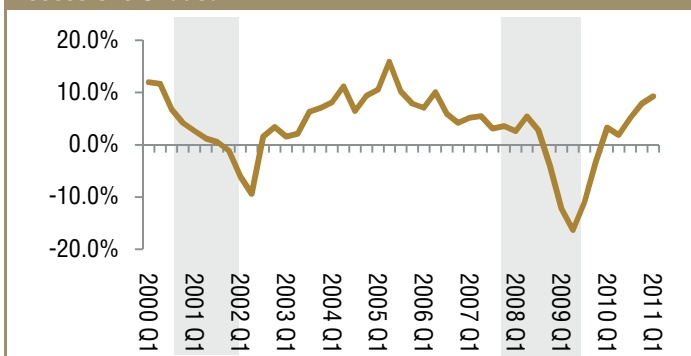
Any budget-driven federal aid cuts would likely put strains on enrollees in Medicaid programs across the country, and on the hospitals and nursing homes serving them as well. Reduced federal payments would presumably lead to curtailed services, but would have less direct impact on state general funds and on overall state creditworthiness.

We expect that congressional efforts to limit growth in entitlements will inevitably lead to less federal spending on health services. If that outcome were to occur, hospitals would probably witness compression in their operating margins; approximately 40 to 45% of total hospital revenues come from federally-funded Medicare and another 10% from Medicaid. Our investments in the hospital sector anticipate lower federal payments by targeting providers with strong competitive positions, high liquidity and manageable debt burdens. These institutions will have more bargaining power to negotiate rates with private insurers and corporations. Management’s capability in dealing with a rapidly changing health care environment is also an important consideration in evaluating hospital credits.

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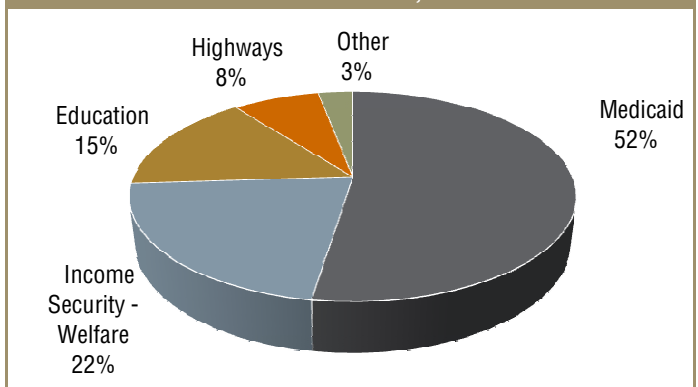
Charts of the Month

Year-over-Year Nominal Change in State Tax Collections
Recessions Shaded



Source: The Nelson A. Rockefeller Institute of Government, National Bureau of Economic Research, July 2011

Federal Grants to State Governments, Federal FY 2009



Source: U.S. Census Bureau, Statistical Abstract 2011

Credit Observations

“Credit strengths include the essential nature of the service the System provides, large and diverse service area, the System’s relatively low current rates and solid financial performance.”

Credit in the Spotlight: Citizens Authority, Indiana, Wastewater System Revenue Bonds*

In August the Indiana Finance Authority issued \$1.08 billion of wastewater revenue bonds to finance the reorganization and recapitalization of the wastewater system serving metropolitan Indianapolis. The bonds were rated A1/AA by Moody’s and S&P respectively. As part of the bond issue, The Citizens Authority will acquire the assets of the Wastewater system from the Indianapolis Sanitary District. The bonds are also financing a portion of the System’s capital improvement program and retiring a portion of outstanding debt. The purpose of the reorganization is to separate the wastewater system from the more political oversight it faced so that rates could be raised as needed to finance the System’s large and required capital program. Credit strengths include the essential nature of the service the System provides, large and diverse service area, the System’s relatively low current rates and solid financial performance. Weaknesses include the large capital program that will likely require continued large rate increases, the need for regulatory approval for rate increases (unusual for a public sector utility) and the use of bond proceeds to establish liquidity. Concern over the magnitude of the capital program and the need for regulatory approval for rate increases is partially mitigated by the Utility Commission’s pre-approval of significant rate increases through 2013. The bonds were issued at yields approximately 90 basis points higher the yields of the Municipal Market Data AAA yield curve, which Standish felt was attractive in view of the high credit quality.

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Other Credit Highlights:

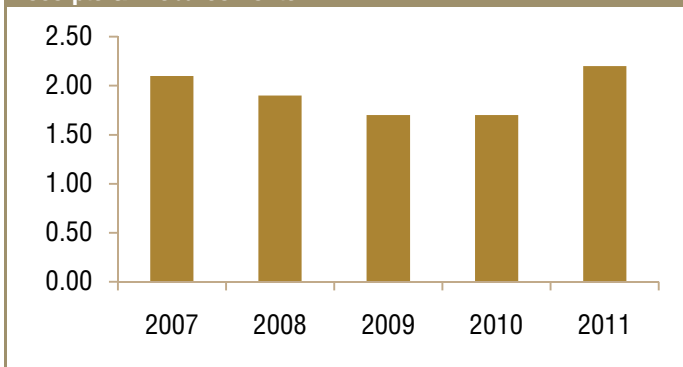
The Commissioners of financially troubled Jefferson County, Alabama have voted to continue negotiations with creditors. As a result, the possibility of the County filing for bankruptcy has been delayed until at least September 16, 2011. The County’s Sewer System has been in default on its revenue bonds and the County’s general operations are greatly strained as a result of a state court ruling that declared invalid the County’s occupational tax, a key revenue source. The County’s largest creditors, chiefly banks, have agreed to a \$1 billion reduction in \$3.1 billion bond principal in exchange for a series of sewer rate increases. The County has been seeking a slightly greater reduction in bond principal and smaller rate increases than sought by creditors. A successfully negotiated settlement would likely preclude the need for the County to file for bankruptcy protection. A key part of settlement would likely be a refinancing of the existing sewer revenue bonds, less the negotiated principal reduction, with sewer revenue bonds backed by a moral obligation pledge of the State of Alabama. The two sides have been in negotiations since 2008.

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* Source: Preliminary Official Statement, Indiana Finance Authority Wastewater Utility Revenue Bonds (CWA Authority Project) dated August 10, 2011.

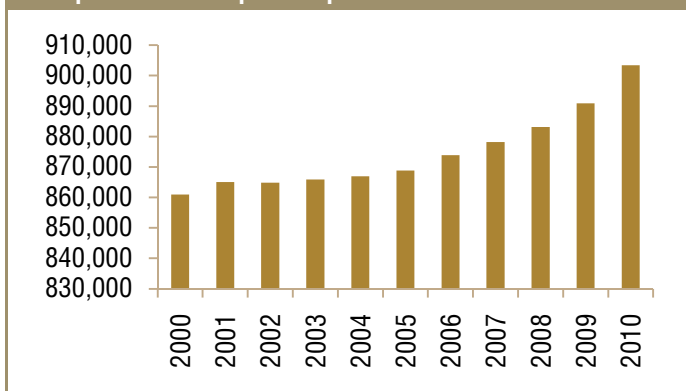
Credit Charts of the Month

Indianapolis, IN Sanitary District: Schedule of Receipts & Disbursements



Source: Preliminary Official Statement, Indiana Finance Authority Wastewater Utility Revenue Bonds (CWA Authority Project) dated August 10, 2011.

Metropolitan Indianapolis Population Trends



Source: US Census Bureau (<http://quickfacts.census.gov/qfd/states>)

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