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JOE MYSAK

ENCYCLOPEDIA OF MUNICIPAL BONDS

A REFERENCE GUIDE TO MARKET EVENTS, STRUCTURES, DYNAMICS, AND INVESTMENT KNOWLEDGE

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A Reference Guide to Market Events, Structures, Dynamics, and Investment Knowledge

Joe Mysak

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Acknowledgments

The *Encyclopedia of Municipal Bonds* is the work of a career rather than of a few months or even years, and I am pleased to acknowledge here the contributions of some of the people who helped make my career.

In December 1980, I interviewed with a soft-voiced gentleman then building the staff of a newspaper that covered the municipal bond market, called *The Daily Bond Buyer*. He didn't find my lack of financial expertise to be a drawback; if anything, he said, that was a plus. He wanted people who could write clear English. When could I start? To John H. Allan I owe my career in this odd little market. I was his first hire at the newspaper, and was soon joined by scores more, many of whom are still in the profession. John was the father of us all.

Editors are fired when their bosses get tired of them. When that happened to me in 1994, Jim Grant, founder of *Grant's Interest Rate Observer*, invited me to come and work for him. I have on my desk five bound volumes of *Grant's Municipal Bond Observer* and two of *Grant's Municipal Bond Issuer*, and consult them to this day. My idea for the publication, I see now, was that the municipal market was, in general, a safe place, and that what investors really needed was a guide to what not to buy. I am pleased to say that almost every nutty, unrated, high-yield deal we wrote about went bust. This perhaps was not a formula for success as measured in terms of circulation, however. Jim was a patient man. So was publisher Jay Diamond. I am fortunate to count them as my friends.

In May 1999, my old boss John McCorry called me while I was on vacation and said there was a big job awaiting me at Bloomberg. When I returned, I sent an e-mail to Matt Winkler, then, as now, famed as the editor of a hard-driving, fast-expanding news service. Over lunch, Matt offered me a job as a columnist. It has been my good fortune to work for him since then, and in a variety of jobs.

Their bylines appear numerous times among the sources for the entries here, but I would be remiss if I did not mention writers past and present on the states and municipalities beat at Bloomberg: Tom Cahill, Darrell Preston, Martin Braun, William Selway, Brendan McGrail, Jerry Hart, Michael McDonald, and Mike Quint, as well as managing editor William Glasgall and executive editor Susan Goldberg. Then there are the colleagues here who ornament the hours and make the days nicer: Reto Gregori, David Wilson, Tom Keene, Caroline Baum, Manuela Hoelterhoff, Laurie Muchnick, Lisa Kassenaar, Lisa Wolfson, Joyce Kehl, and Beth Williams.

In August 2010, Ted Merz spotted me in the office on a Sunday and told me all about his new venture, Bloomberg Briefs, a series of newsletters, and suggested I start one on municipal bonds. And so, the world coming full circle, since February 2011 I have been editor of a daily publication all about the municipal bond market. Thanks to Ted and Brian Rooney, and to all who make up the early-morning world of Bloomberg Briefs: Jennifer Rossa, Rose Constantino, Katie Porter, Ian Maready, Rob Williams, Mike Nol, Deirdre Fretz, Nathaniel Baker, Nicole Allen, Doug Simmons, Mike McDonough, Joe Brusuelas, and Richard Yamarone.

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Bloomberg provides its users with ease of access to information. And so I must mention all those in Data who have helped me gain access to their world: Mike Olander, Joe Helmlinger, Sowjana Sivaloganathan, Bert Louis, and Andy Peszka.

Thanks here to Steve Isaacs of the Bloomberg Press imprint, who asked me whether I wanted to update my 1998 *Handbook for Muni-Bond Issuers*, and at John Wiley & Sons, my thanks to Evan Burton and Meg Freeborn.

The current mania in MuniLand not to comment for the record about anything, ever, is a disturbing one. Journalists are lost without sources. I have been blessed to have many good ones over the years.

James B. G. Hearty was a source, both as an issuer and as a banker, and is a friend. Thanks, pal.

Kit Taylor, executive director of the Municipal Securities Rulemaking Board (MSRB) for three decades, was both an early source and a patient teacher—a guide, if you will, to MuniLand and its history.

He wasn’t alone. Among the analysts who have helped me are Jim Cusser, Richard Ciccarone, Austin Tobin, J. B. Kurish, Natalie Cohen, Tom Doe, Dennis Farrell, Robert Kurtter, Robin Prunty, George Friedlander, John Hallacy, Tom Kozlik, Richard Larkin, Sylvan Feldstein, and Parry Young. Richard Lehmann of the *Distressed Debt Securities* newsletter has been a reliable source on an often inscrutable topic, defaults.

Municipal bond lawyers have played a special part in my education. Since 1994, I have been a speaker at the annual Bond Attorneys Winter Workshop at the invitation of John L. Kraft, whom I have known since at least 1985. That is, the first time I quoted him in a story was in 1985, on the New Jersey Turnpike’s then-record $2 billion bond issue. I suspect we go back even further than that. It has been a privilege to speak before this group, and I am pleased to acknowledge it here. In particular, I’d like to thank Robert Dean Pope, John VanDuys, Bob Jones, Dave Franklin, Fredric Weber, Brad Waterman, Ken Haynie, Rick Weiss, Don Howell, Jerry Turner, Fred Rosenfeld, Margaret Pope, Phil Genetos, Tim Frey, Bill Danhof, Glenn Floyd, Deborah Winter, Gary Walsh, Griff

Pitcher, Tony Stemberger, and Todd Meierhenry. Bankruptcy specialist James Spiotto is not part of this group, but I'd be remiss if I didn't mention his help.

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Only my in-laws, Rob Merett, Bob Loughrey, and Jim Merett, have heard more of those stories, and even their patience pales in comparison with my wife’s. Thanks, Sue!

J.M.

Introduction

Welcome to MuniLand.

If I didn't coin the term, I know I was one of its early adopters, featuring a map of the place in the first issue of a short-lived fortnightly I edited called *Grant's Municipal Bond Observer*, in 1994. The idea behind "MuniLand"—and I refer to the term, not specifically the map—was a simple one: Here was a market that was particular and specific to an almost absurd degree. Calling it MuniLand was the usual attempt to bring order out of chaos. I used the word when attempting to explain the municipal market to those steeped—as most people are—in the culture of equities. I wanted them to, as the poet says, suspend disbelief. They were entering a new world, as strange and idiosyncratic as any uncharted island nation.

There is a 1937 short story by Thomas Wolfe—no, not that one, the other one, who wrote the novel *You Can't Go Home Again* (1940)—called "Only the Dead Know Brooklyn." The story touches on the impossibility of knowing the vast borough east of Manhattan Island, and that is a good way to think about MuniLand. Only the dead know munis. I have been covering this market for more than 30 years; I know I am the only person to have read the first 100 years' worth of *Bond Buyer*s, and I still discover things I didn't know.

Ah, yes, the *Bond Buyer*. The year I began covering the municipal market for the newspaper then known as *The Daily Bond Buyer*, states and municipalities sold $46 billion in bonds, the last time annual issuance was below $50 billion. More than half was sold through negotiation, and revenue bonds far outnumbered general obligation bonds, as they had since 1976. Those are the only characteristics that market had in common with today's.

For the rest of it, the municipal market in 1981 was not so very different from the market of 1961, or even 1941. Bond insurance, whose spectacular blowup in 2008 and 2009 stunned the world, had at that point been in existence for a decade, yet covered less than 1 percent of the year's bonds. Almost all the bonds sold were fixed-rate, and almost all were sold to raise new money, as they say, rather than to refinance existing issues. The market was still a very staid place.

MuniLand was, I also learned, a very mysterious place. For one thing, there was no physical market, like, say, the New York Stock Exchange. It traded, they told me, but there was no way to verify that. You could see the primary market—new issues being priced, and those prices coming over the Munifacts machine—but the secondary market was something of a fiction. I helped perpetrate that fiction when the time came for me to learn how to write "The Column," an adornment of page one of *The Daily Bond Buyer* for decades. As instructed, I called four or five traders and asked them how five or six "dollar bonds," large, recently priced issues, were "trading," and they told me, and I duly figured out where things stood using a Monroe calculator. Things often seemed to be up an eighth when they weren't down an eighth, and more often than not "unch" (unchanged).

There was no actual trading, and there were no prices. Or, as I say, prices were what someone on the other end of a telephone told me they were. It made no difference that I was a reporter. An investor would have been told the same thing. There was a publication called the Blue List, so-called because it was printed on a sort of blue tissue paper, and which one trader advised me was "like a municipal bond novel," if only I would learn how to read it. The Blue List showed dealer inventory in state after state. Sometimes it showed prices; more often, just coupons and yields.

As for other data about “the market,” I found that I was now at the very center of it. Yields, the amount of bonds sold this week, last week, last month, last year, last century, who underwrote the most—those numbers were all gathered by *The Daily Bond Buyer*, and had been since 1891. Having put a couple of publications out of business right out of college, I liked the sound of that.

I also thought I would be at the paper for about six months. What I really wanted to do was write for magazines, like Tom Wolfe (yes, that one). I was there for 13 years.

MuniLand in 1981 was about to be transformed, and I was there to witness it, at New York City headquarters, with very occasional forays out into the bush. These were usually conferences held at various swanky hotels and resorts featuring bankers, bond lawyers, analysts, financial advisers, issuers, and buyers, all the denizens of MuniLand. As a journalist, I fantasized about being assigned to a bureau, preferably in San Francisco, London, or Mustique, but being at headquarters, of whatever publication I actually worked for, gave me a certain advantage. I got to see all parts of the market at once, sort of a bird’s-eye view.

The first thing I learned was that there was no single market at all, but six or seven state markets and perhaps another three or four regional ones. And then there was Washington, DC, which, while a marginal issuer of municipal bonds itself, happened to be very important to what occurred in all those other markets. I took what seemed like years of dictation from reporters on Capitol Hill on the subject of tax reform. As I write these words, it seems that once again tax reform seems likely to be visited upon MuniLand.

I also learned that time in the municipal bond market, with the perhaps singular exception of Orange County, California’s bankruptcy in 1994, which happened in a heartbeat, is marked with a calendar, not a stopwatch. Even the simplest story, like a bond default, almost never seemed to end. It was a rare thing to watch a reporter lay the last clip in a file and put it away, certain that the last bondholder had been paid, or not, and that the case was closed.

Hysteria was the municipal bond market's portion in 2010 and 2011, fed by people who didn't know what they were talking about, talking and writing and, especially, blogging. Yet now that I think about it, it seems that the biggest lesson I've learned is that just as this market resists generalization, so does it fight off periodic calls for Armageddon.

In 1995, for example, one very knowledgeable bond buyer who did know what he was talking about nevertheless said that Orange County, California, then still dithering its way through bankruptcy, might lose access to the capital markets for a generation. In fact, Orange County was back selling bonds within six months of its Chapter 9 filing.

That little story says many things. For example, of course, it says that bond buyers are also that old *Saturday Night Live* character, Mr. Short-Term Memory. For another, though, it says that hyperbole and hysteria are always with us.

The chief reason people get MuniLand wrong is that they think of the municipal market in equity terms. States and localities are not corporations. What's more, there is no reason they should be more like corporations, much to the apparent annoyance of those people who think they should. Again: Welcome to MuniLand. Just because they do things differently here does not mean that what they are doing is wrong.

Take a municipal bond's reaction to bad news: there isn't any. This confounds critics used to the ups and downs of the stock market. Why don't the bonds react? Why don't bonds trade off? The answer is because the typical muni bond doesn't trade at all much beyond the first 30 days after its birth (see the entries for “All bonds go to heaven” and market activity).

Or take bankruptcy. States cannot enter Chapter 9 municipal bankruptcy. This infuriates those who, wrongly, see bankruptcy as a perfectly acceptable tool that incidentally could be used to gut the public labor unions and reduce states’ pension and benefit obligations. They see it, or some heretofore unimagined version of it, as a simple and elegant solution to some states’ seemingly intractable pension burdens. It is neither of those things, neither simple nor elegant, yet that does not stop the proponents of state bankruptcy from insisting that it is a viable solution to states’ budget woes. These people also invariably have an issue with politics and politicians, and with public officials both elected and appointed. I’m not sure who they expect to run the nation’s states and localities, unless they also intend to replace democracy with—what, exactly? Corporate governance?

I seem to have become known, in some circles, as a harsh critic of the municipal bond market. In fact, I consider it one of the wonders of the world, allowing for the ultimate in local independence and control. Reviewing my columns and stories over the years, I see that I have taken a stand against only two things.

The first: I didn’t think the entire market should go negotiated. This has been a consistent position of mine, and I wrote columns back in the 1980s about the subject, predictably angering those on Wall Street who thought that every last municipal bond issue should be sold through negotiation, and not at auction. My own thought on it was: Here you have this old-fashioned, perfectly acceptable way of selling municipal bonds. Why not use it? Competitive, or auction, or, as the old-timers used to call it, advertised sale makes underwriters bid for bonds and divorces the proceedings from favoritism and pay-to-play, which have been prominent features of the modern market.

The other thing I have advocated against on a consistent basis, again angering a certain swath of the professional community, has been the use of swaps. Just too much about them—their pricing, their design, their risks—would prove inaccessible to the citizen financiers in charge of most of the municipal bond market. Because, of course, swaps (like negotiated finance, come to think of it) were one of those things that at first weren't for everybody, but very quickly became so. Wall Street pounds every idea into the ground, as James Grant put it so well, like a tomato stake.

Neither of these positions was designed to ingratiate me with those proposing that every deal, no matter how small and no matter who was the issuer, even the smallest school district, should be sold through negotiation and with a swap. Yet who now can argue against the eminent reasonableness of these positions? Even those municipalities that embrace negotiation should sell an issue at auction from time to time, in order to gauge the acceptance of their securities in the market. As for swaps, it ought to be a while before municipalities engage in their use again. If the $4 billion and counting in termination payments issuers had to make after the financial crisis doesn't dissuade them, perhaps the bid-rigging trials will, or maybe it will be the numerous studies slated to emerge from Washington officialdom in the coming months.

I also wrote stories about the subject of yield burning, after Michael Quint of the *New York Times* broke the story. Yield burning can be described in a shorthand way as overcharging issuers for the various products they use when they have to reinvest their bond proceeds. These stories did not make me popular with those who evidently engaged in this most obscure and yet seemingly ineradicable of all municipal market behaviors. By the time I started to write about the subject, of course, the Securities and Exchange Commission (SEC) was already deeply involved in its investigation into and, ultimately, settlement with the securities firms that thought it was okay to cheat issuers because no one was looking.

For a brief period, I perhaps even kept the story alive, as a legitimate journalistic subject, and even broke news in a publication that came out fortnightly. But how could I not? I was surprised that so few of my brethren elected to sit down and hear out Michael Lissack, the Smith Barney banker who blew the whistle. He had a lot of good stories to tell, supported by a lot of evidence. It broke my heart when my old newspaper carried a front-page story with a headline reading “Refunding Issuers Say Deals Did Not Involve Yield Burning: Survey,” and I almost felt it a sort of personal rebuke. Their readers’ cheer proved short-lived. As I wanted to tell the banker who took an empty chair at a conference lunch and who found to his evident horror that he was sitting next to me: I didn’t invent yield burning.

Yield burning, in both its past and its present manifestations (see the entry on bid rigging), has taken up more than half my career. The industry did not handle it very well the first time around, which may be why there is a second time around. It may be my imagination, but the old industry, I think, would have admitted it had a real problem and then come up with a plan to fix it. The new industry, or the one that existed in 1995, when Lissack spoke first with the FBI and the SEC and then with Mike Quint, denied there was a problem at all and stuck to the somewhat arrogant if novel defense: prices are what we say they are.

The yield-burning business marked, sadly, the last time you could pick up the telephone and talk to bankers, traders, salespeople, analysts, and underwriters. Nowadays few of them will give even the most innocuous quote without a publicity person listening in, if they allow for it at all, which means most municipal market stories are festooned with ridiculous denials, rejections, and refusals to comment—on anything. I don't know what irritates me more: the fact that they don't comment or the rote refusals to comment that so lard up all the stories.

I wasn't the first reporter to write about yield burning. But I was the first to describe flipping in MuniLand, which works in much the same way as it does in the world of initial public offerings. That is, a few big investors get allotments of bonds, and then quickly sell them at a profit. The higher price means a lower yield, which leads this taxpayer to wonder why the issuer didn't get that rate in the first place. It doesn't happen all the time or on every bond issue, but the selection of certain favored investors to act as wholesalers converting municipal bonds into a retail product seems to fly in the face of what the negotiated method of sale was supposed to be all about. That was, award us your business and we will get you the best price on your bonds, because negotiation gives us the time to get your bonds into the hands of final investors. If there is flipping—and until the Municipal Securities Rulemaking Board (MSRB) began listing trades in 1995, there was no way of knowing—then negotiation isn't all it was cracked up to be. And issuers who decide to use it, as so many will, should be smart about it. Please, no more "leave the driving to us" in your dealings with underwriters.

MuniLand is no longer as mysterious as it was, no longer the unknown and unknowable enigma of the capital markets. Those who use the word *murky* to describe it are writing yesterday's story. Anyone who wants to can find details of prices and trades, complete copies of official statements, and all manner of material-event notices, online and for free (see the entries for escrowed to maturity and EMMA). MuniLand is accessible. I was surprised to discover that the chief reason it is so is a little incident that occurred at the end of 1986, when the Kansas City, Kansas, Board of Public Utilities sold bonds that would result in the calling of some of its other bonds that had been escrowed to maturity. That was my story, but until I chatted with Kit Taylor recently, I didn't quite understand its significance. I remembered that when I had called him for a comment a quarter-century ago he responded, as always, with alacrity. But even his response was a little too quick. It was almost as if he had known this would happen. The existence of calls on escrowed-to-maturity bonds were "a material fact," the then-executive director of the MSRB told me. "It looks like underwriters assumed that escrowed-to-maturity bonds were not callable, and that's a big mistake. Somebody did not do their homework," he said. "The industry is supposed to disclose material facts at the time of sale, and it seems it is being faced with a tremendous information problem."

I asked him about that answer, and then he stitched the whole story together for me, about how dealers that summer had rejected the MSRB's proposed amendment to its Rule G-15, which would have required dealers to deliver to customers written information about the call provisions on bonds they purchased within five days, upon request. In a series of comment letters to the board, the dealers said they couldn't possibly tell their customers what all the calls on a bond might be, because they did not have access to all of the official statements for the bonds they might sell. That story was probably written out of the D.C. bureau. I can see now I didn't pay it much attention.

That excuse sounds a little improbable, today, even unimaginable—we can't tell you what the calls to the bonds we sold you are, because we don't know ourselves—and yet that was the situation at the time. The dealers gave what they regarded as a plausible answer. But they also suggested that maybe the MSRB could do the job, and that, with a few false starts and modifications, is where we are