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- Market Commentary
- Spreads and Ratios
- Municipal Sector Review
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- Historical default rates for municipal bonds are very low
- Lower supply and increasing demand are pushing tax exempt yields and ratios lower
- Highway traffic volume has leveled out and is starting to recover helping municipal toll facilities remain generally stable
- Recently published reports have exaggerated the risk of significant levels of municipal defaults and Chapter 9 bankruptcy – we reiterate the view that we do not expect a “Municipal Meltdown”
- Tax reform legislation introduced last month, has not received overwhelming support and it is unlikely to be enacted
- Philadelphia School District’s underlying rating was upgraded by Moody’s while Maryland CDA single family housing bonds were put on review for a possible downgrade, again

MARKET COMMENTARY

Municipal Market Overview

Two major themes created municipal market headlines in February. Senators Wyden and Gregg introduced legislation which, among other things, would end state and municipal issuers’ ability to issue tax free bonds. Although passage in this form seems unlikely, longer term the landscape may be shifting, with BABs being a first step. More on this in our Legislative Update on page 5. A second set of headlines developed as talk of bankruptcy in Harrisburg, Pennsylvania continued and Moody’s downgraded Pennsylvania’s capital city from junk to junkier. We look at the concepts and realities of default and bankruptcy in this issue.

Despite fiscal challenges faced by states and municipalities, as tax revenues are pressured by high unemployment rates and a slow to recover economy, the vast majority of municipal issuers are meeting their obligations. The pace of credit events, including defaults, has increased only modestly. Default information from Moody’s and S&P evidences the extremely low historical default history of municipal bonds, with fewer than a quarter of a percent of rated issues defaulting over time. By comparison, significantly more investment grade corporate bonds have defaulted. The table from Moody’s and S&P covers slightly different time periods, and each rating agency rates a slightly different universe of issuers, but the numbers offer strong comparative indicators.

Cumulative Default Rates

Ratings	S&P		Moody's	
	Municipal	Corporate	Municipal	Corporate
AAA/AA	0.06%	1.20%	0.03%	1.04%
A/BBB	0.45%	10.61%	0.19%	6.90%
All	0.22%	11.38%	0.09%	11.06%

Source: Moody’s, S&P and Janney FIS.

Fitch’s numbers are not as comprehensive or valid, since they rate far fewer municipals, but they show similar trends with a five year cumulative default rate from 1990 to 2007 of 0.1% for municipals and 1.2% for corporates. The bottom line is that the numbers show municipal credits in general to be safer than corporate bonds of the same rating – which begs the question of whether the rating systems are truly reflective of credit risk. The rating agencies have been talking about adjusting methodologies to bring taxables and munis into closer alignment, which presumable would lead to upgrades in the municipal world, but we don’t expect dramatic changes in the immediate future.

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Credit Spreads and Ratios

An indicator of market perception of credit risk is spread information comparing yields on lower rated bonds with AAA rated benchmarks. The graph shows historical yields and differentials (spreads), based on Municipal Market Data, between the high grade – AAA yields and low investment grade – BBB yields. As the economic crisis unfolded in 2008 and continuing into 2009, these spreads rose to as high as 275 basis points as investors engaged in flight to quality strategies. Since peaking in early 2009, spreads have been contracting, although they still have a ways to go. This narrowing of spreads results from buyers gaining comfort in moving down the credit curve as the economy begins to recover. Investors should consider picking up the additional yield available in lower rated categories on issues in the more favorable sectors.

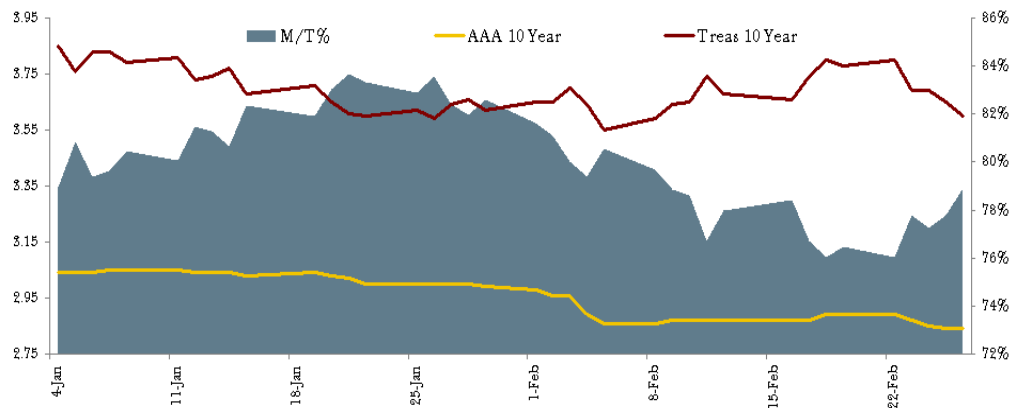
Municipal Credit Spreads - AAA versus BBB



Source: Thomson Reuters and Janney FIS.

Tight supply of tax exempts, fed by rising BAB volumes, helped the municipal market outperform Treasuries in February, with ten year ratios falling to as low as 76% before finishing around 78%. Although a few market observers opined that the Wyden/Gregg legislation, which proposes to eliminate future issuance of tax frees, will lead to increased demand for tax frees, we believe the longer term forces at work to push relative tax free yields lower include a combination of increased use of BABs and likely hikes to federal tax rates in 2011. Municipal new issue volume in 2010 is 24% ahead of the same period in 2009, but tax-exempt new issuance is down 16% for the year and almost 26% in February. **Investors seeking tax free income are finding fewer bonds available. We expect ratios to continue to decline.** BABs issuance is likely to continue, although the magnitude of the federal subsidy on issuer interest payments may be reduced.

Municipal and Treasury Yields and Ratios (10 Year)



Source: Bloomberg, Thomson Reuters and Janney FIS.

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MUNICIPAL CREDIT

Municipal Sector Review

The Municipal Sector Review is a summary of Janney FIS’s short term outlook for various municipal sectors, as introduced in our February Municipal Bond Market Monthly. We have not made any month to month changes to our sector outlooks. Below we have included a summary of the status of the toll facilities sector in order to support our “stable” outlook designation.

Janney Municipal Sector Outlook Review

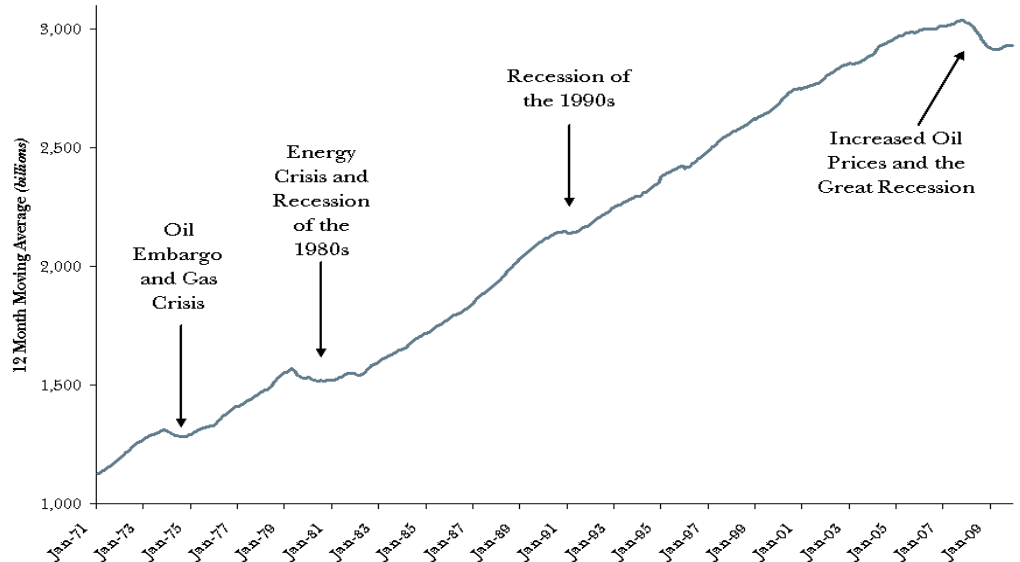
Sector	Janney Outlook	Change from Last Month	Key Sector Trends
State Government	Stable	Same	Should see improvement as impact of economy recedes
Local Government	Cautious	Same	Less support from states and declining revenue
School Districts	Stable	Same	State intercept programs offer strong security in addition to underlying ratings
Airports	Cautious	Same	Number of passenger and freight flights down YoY (See Feb 8 FIW)
Higher Education	Cautious	Same	Lower rated private schools face pressure (See Feb 1 FIW)
Health Care	Cautious	Same	Reimbursement pressures and uncertainty of federal healthcare legislation (See Jan 25 FIW)
Housing	Stable	Same	Single family is stronger than multi despite lower mortgage demand
Public Power (Elec.)	Stable	Same	Essential purpose, but exposure to energy volatility mitigates
Tobacco	Cautious	Same	Cigarette consumption declining faster than anticipated
Toll Facilities	Stable	Same	Traffic down, but most still have positive debt service coverage
Water and Sewer	Stable	Same	Essential purpose helps insulate from slow economy

Source: Janney Fixed Income Strategy.

Toll Facilities Sector is Currently “Stable”

We believe the worst is over for toll facilities throughout the US and that events such as the default of the South Carolina Turnpike expansion (Connector 2000 Association) bonds and the down-grade below investment grade of the Santa Rosa Bay Bridge Authority are the exceptions within the sector. Traffic volume declined starting in 2008 in response to lower business activity, but has since stabilized and begun to rise again. The pace of the economic recovery has been slow but we expect the economic recovery to gain momentum in 2010 and traffic volume should follow although, a return to 2008 traffic levels may be some years away.

Vehicle Miles Traveled



Source: US Federal Highway Administration and Janney FIS.

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> Recent published reports have exaggerated the risk for severe levels of municipal defaults and bankruptcy.

Credit Strengths Within the Toll Facilities Sector

- + Essential nature of systems such as the PA and NJ Turnpike as vital transportation routes
- + Many larger, congestion-relieving and established toll facilities have minimal competition
- + Vehicle miles of travel have stabilized

Credit Weaknesses Within the Toll Facilities Sector

- High fixed costs and increasing debt service requirements
- Exposure to variable rate bonds and liquidity facility renewal
- Slow traffic volume recovery, possibly fueled by higher oil costs

Overall, the credit profiles of the larger more established issuers within this sector remain stable, as shown in the below table. The majority still possess medium to high ratings with stable outlooks despite the fact that both Moody's and Fitch have negative outlooks on the sector as a whole.

Ratings of Select Toll Facilities

Issuer	St	Moody's		S&P		Fitch		Out. Debt (\$bill)
		Rating	Outlook	Rating	Outlook	Rating	Outlook	
Bay Area Toll Authority	CA	Aa3	Stable	AA	Stable	AA-	Negative	\$4.200
Florida Turnpike System	FL	Aa2	Stable	AA-	Negative	AA-	Negative	2.459
Miami-Dade Ex Authority	FL	A3	Stable	A	Stable	A-	Stable	0.975
Orlando-Orange Cty Ex Authority	FL	A1	Negative	A	Stable	A	Stable	2.100
Illinois St Tollway Authority	IL	Aa3	Stable	AA-	Stable	AA-	Negative	3.064
Maryland Trans Authority	MD	Aa3	Stable	AA-	Stable	AA-	Stable	1.859
Delaware River Port Authority	NJ	NR	-	A-	Stable	NR	-	1.148
New Jersey Turnpike Authority	NJ	A3	Stable	A+	Stable	A	Stable	4.732
New York St Thruway Authority	NY	A1	Negative	A+	Stable	AA-	Stable	2.343
Triborough Bdge and Tunnel Auth	NY	Aa2	Negative	AA-	Stable	AA	Negative	8.535
Ohio Turnpike Commission	OH	Aa3	Stable	AA	Negative	AA	Negative	0.657
Oklahoma Turnpike Authority	OK	Aa3	Stable	AA-	Stable	AA-	Stable	1.090
Delaware River Jt Toll Bridge	PA	A2	Stable	A-	Stable	NR	-	0.446
Pennsylvania Turnpike	PA	Aa3	Stable	A+	Stable	A+	Stable	2.737
Harris County Toll Road Authority	TX	Aa3	Stable	AA-	Stable	AA+	Stable	2.099
North Texas Tollway Authority	TX	A2	Negative	A-	Stable	NR	-	6.199

Source: Moody's, S&P, Fitch and Janney FIS.

The Risk of Defaults and Bankruptcies

Recent published reports have exaggerated the risk for severe levels of municipal defaults and bankruptcy. Several articles in the national and local press, including the February Wall Street Journal article, "Muni Threat: Cities Weigh Chapter 9," have sparked angst among municipal bond buyers. We reiterate the view that we do not expect a "Municipal Meltdown" or a high proportion of municipal bankruptcies or defaults. Governments will grapple with budgetary pressures through the year and revenue related municipal issuers may experience reduced revenue. In some cases these pressures may result in credit deterioration. There will be continued headline risk as stories are picked up by the press, but default and bankruptcy risk is minimal.

Why do we not expect there to be widespread defaults or municipal bankruptcies?

- Most municipal entities possess resilient credit profiles and work to avoid at all costs defaulting on bond payments
- The eligibility requirements for a municipal entity to file for Chapter 9 are very strict – Municipalities in only 26 states are authorized to file for Chapter 9 (states are not eligible to file for Chapter 9)
- Municipal bankruptcies have rarely occurred (especially among general obligation issuers) even in the worst of economic environments- only eight municipalities a year, on average, have filed for Chapter 9 since 1934

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> *Municipal issuers have historical low levels of default and muni bankruptcy is a rare occurrence.*

Municipal issuers have historical low levels of default (also see page 1). Some are experiencing revenue deterioration and may be faced with the politically difficult task of cutting future expenditures. Most municipal entities have a strong history of paying bondholders and have incentive to do so in order to ensure future access to the capital markets. Even in this trying economic period, defaults on municipal bonds have remained in the riskier sectors. There have only been approximately 171 (\$5.3 billion) issues file default disclosure with trustees since July 2009. This amounts to about 0.19% of the entire \$2.8 trillion municipal market. Only one of the issues was in the “safe sectors.”

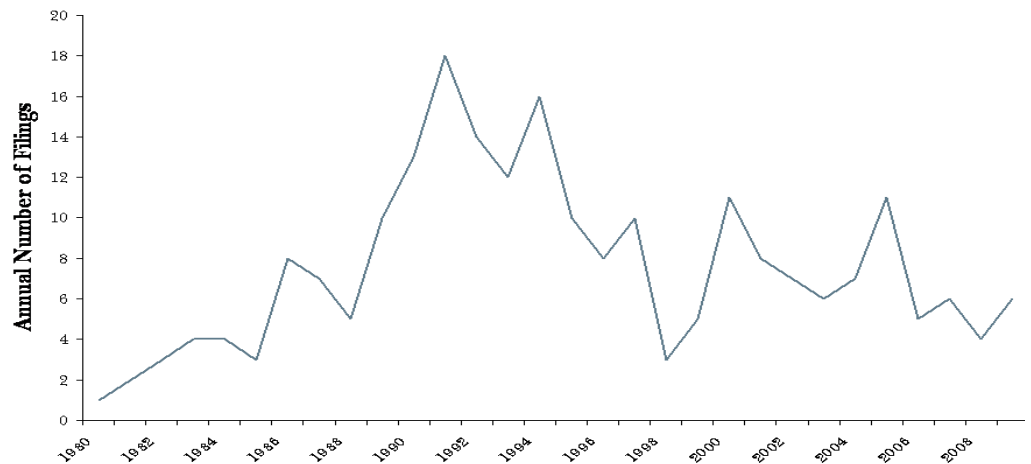
Default Notices and Credit Impairments since July 2009 (\$ in millions)

Sector	Default Notices		Tap Reserve Funds	
	Amt (\$)	Amt (#)	Amt (\$)	Amt (#)
Land Secured	1,044	71	1,442	75
Toll Road/Transit	876	2	771	2
Multi-Family Housing	615	31	123	7
Retirement	667	20	39	4
Hotel/Casino	1,454	8	115	3
Student Housing	87	3	42	2
IDB	198	11	160	7
Other Risky Sectors	396	24	453	23
Safe Sectors (GO, Wtr/Swr, Sales Tax)	10	1	226	13
Total	\$5,347	171	\$3,371	136

Source: Municipal Market Advisors as of March 1, 2010 and Janney FIS.

Municipal bankruptcy is a rare occurrence. The questions surrounding Harrisburg’s financial situation are a concern and should be monitored. There have been approximately 600 municipal bankruptcy filings since Chapter 9 was enacted in 1934. That is an average of eight a year and while we do expect that this number and the number of the defaults to slightly increase in 2010, we do not expect an overall “Municipal Meltdown.”

Municipal Bankruptcies



Source: American Bankruptcy Institute.

Legislative Update

Tax reform legislation introduced by Ron Wyden (D-OR) and Judd Gregg (R-NH) during the last week of February created an environment ripe for speculation on the future of tax-exempt municipal bonds. The Senators’ proposal included changes to tax law covering a broad range of issues such as income and capital gains rates, elimination of the AMT and not extending direct pay BABs authorization beyond 2010. The pages which caught our attention the most, however, contained proposals to end tax free bond issuance beginning in 2011, replacing state and local governments’ ability to borrow at tax free rates, with a tax credit scheme whereby bondholders could claim a tax credit equal to 25% of interest (taxable) received.



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> The Philadelphia School District was upgraded to Ba1 from Ba2 by Moody's.

Opposition was vocal and extensive, beginning with groups representing issuers and the financial industry and extending to unions and organizations representing construction interests. It seems unlikely that this broad tax legislation will be enacted, but it's useful to consider this in the context of BABs issuance and rising federal budget deficits. Elimination of municipalities' ability to borrow at low tax free rates has been a conversational topic for years in the halls of Congressional staffers, but the political unpopularity of such a measure squelched action. In this context, Build America Bonds might be considered a stalking horse for the elimination of state and local government tax free status. BABs have proven to be very popular with issuers, accounting for 28% of February new issues and the Wyden/Gregg legislative proposal notwithstanding, it is likely that BABs will be extended into 2011 and beyond.

Is a total replacement of tax free bonds with BABs type issues a future possibility? Not next year, but down the line it's possible. In any case, outstanding tax free bonds would not be impacted, except that reduced supply would make the relative value of tax free income more dear. If in future years, the 35% interest subsidy BABs issuers receive from Uncle Sam was cut—say to 30% or 25% — the cost to the federal government in lost tax revenue (tax free bonds) or interest subsidies (BABs) would, in theory also decline, thus benefitting future budget deficits.

Select Individual Credit News

- Assured Guaranty Corp.'s (Aa3/AAA) and Assured Guaranty Municipal Corp.'s (Aa3/AAA) ratings were withdrawn by Fitch Ratings at the request of Assured Guaranty Ltd. Both AGC and AGMC are currently rated Aa3/AAA with a negative outlook from both Moody's and S&P.
- Philadelphia School District, with underlying ratings of (Ba1/NR/BBB-) was upgraded by Moody's to Ba1 from Ba2 on March 2. The upgrade was due to positive general and operating fund balances as a result of three years of surplus operations. The school district also receives enhanced ratings of Aa3/A+/A+ from the Pennsylvania School District Intercept Program. For more detail about the intercept program please see Janney FIS's July 27, 2009 municipal credit review.
- Moody's placed \$2.2 billion of Maryland Community Development Administration single family Residential Revenue (Aa2/AA) debt on review for possible downgrade during the week of February 15. The warning was based on the mortgage portfolio's 9.11% exposure to the recently downgraded Republic Mortgage Insurance Company (Ba1 from Baa2) on February 4, 2010.
- The rating for the City of Los Angeles, CA (Aa2/AA-/AA) was downgraded to AA- from AA by Standard and Poor's during the last week of February, just a week after Moody's lowered their outlook on the city to negative from stable due to low reserve levels and the expectation of ongoing fiscal strain. S&P cited "overly slow approval of necessary budget-cutting measures in response to dramatically lower revenues and the resulting depletion of general fund reserves." The S&P rating action affects approximately \$1.3 billion of general obligation debt while \$1.9 billion of appropriation-backed bonds were also downgraded to A+ from AA-.

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Investment Grade Credit: Janney FIS ratings employ the "Barclay's U.S. Credit Index" as a benchmark.

High Yield Credit: Janney FIS ratings for employ the "Barclay's U.S. Corporate High Yield Index" as a benchmark.

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