MOODY'S
INVESTORS SERVICE

OUTLOOK

2013 VRDB Market Review and Outlook:

Slower Decline in Market Size; Low Interest Rates and Regulatory Environment Remain Challenging

Table of Contents:

Analyst Contacts:

NEW YORK +1.212.553.1653

Coby Kutcher +1.212.553.3884
Associate Analyst
coby.kutcher@moodys.com

Thomas Jacobs +1.212.553.0131
Vice President - Senior Credit Officer
thomas.jacobs@moodys.com

Timothy Blake +1.212.553.0849
Managing Director - Public Finance
timothy.blake@moodys.com

Summary Opinion

The municipal VRDB market performed well in 2012 despite significant uncertainty brought on by credit pressure on the banks that provide credit and liquidity support and an evolving regulatory environment. Low and relatively stable variable financing rates persisted while the outstanding balance of US municipal variable rate demand bonds and similar bank supported variable rate instruments ("VRDBs") declined in 2012 for the 4th year in a row. Factors driving declining balances included:

1. Historically low long-term interest rates motivating issuers to lock in fixed rates rather than issuing or remaining in variable rate alternatives;
2. Shrinking pool of P-1 rated support providers;
3. Preference among some banks for on-balance-sheet assets over letters of credit and liquidity facilities supporting VRDBs; and
4. Concern about the future cost and availability of bank support in light of the liquidity coverage requirement in Basel III.

Key observations from 2012:

1. The ongoing decline in the balance of outstanding VRDBs and similar municipal instruments slowed relative to 2011;
2. Assets under management in tax-exempt money market funds declined for the 3rd consecutive year;
3. Bank credit remained under pressure resulting in downward migration of VRDB ratings; and
4. Market access was available to issuers whose support facilities expired – virtually all expirations were resolved through extension, substitution or refinancing.

Expectations for 2013:

1. Outstanding balances of VRDBs will continue to decline but at a slower pace, as conversion to fixed rate alternatives abates; long-term interest rates and the evolving regulatory environment will determine the extent of this year's decline;
2. Municipal issuers will opt to issue fixed rate debt, a continuation of 2012 trend; and
3. Recent changes in the Basel III liquidity coverage requirement will improve the depth of the market for support facilities and may encourage longer commitments.