Lead Up to the "Great Recession"

- Mortgage loan lending standards went out the window
- Rating agencies (Moody's, Standard & Poor's, Fitch) failed to recognize the slack mortgage underwriting standards, thus the ratings assigned to mortgage bonds did not reflect actual risk
- Investors were starved for higher yields
- Bond insurers backed billions of mortgage-backed securities, earning slightly higher premiums than their traditional product line (municipal bonds)
- The assumed homeowner default rates inherent in the bond ratings were far too optimistic given the underlying security
- Bursting real estate bubble led to massive mortgage-backed bond defaults

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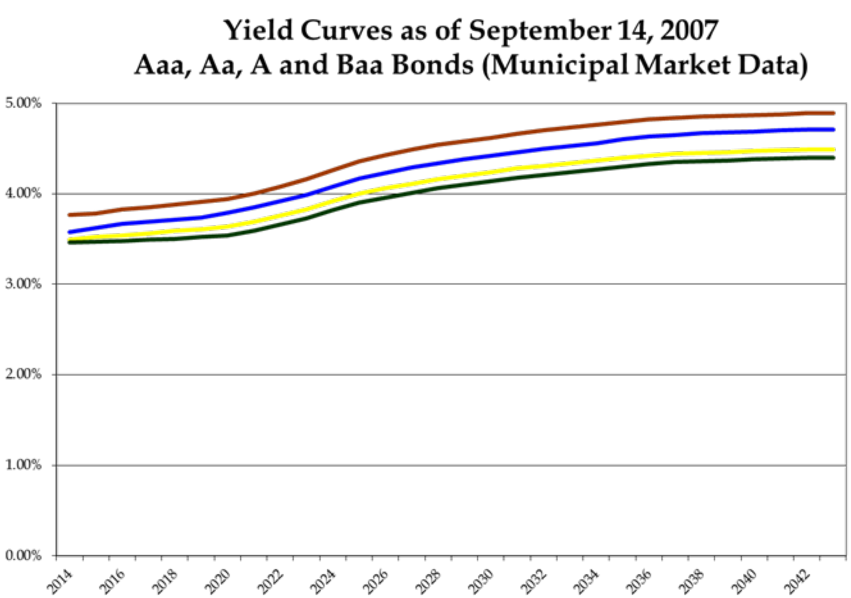
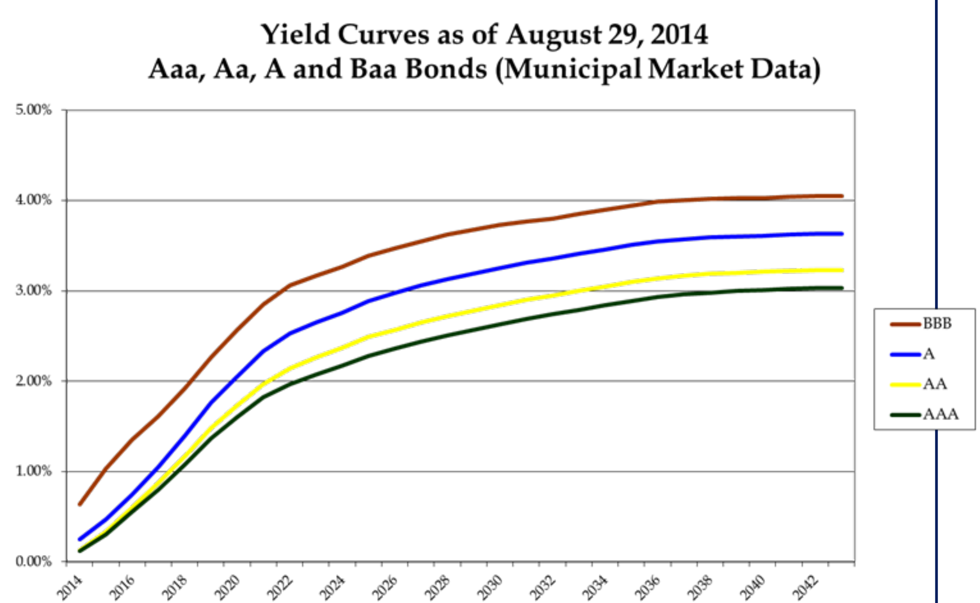
Municipal Bond Market Changed Profoundly as a Result of the "Great Recession"

- Capital market access to municipal issuers, particularly smaller, less frequent issuers, is now more challenging
- Interest rates, while near historic lows overall, are relatively higher for lower-rated credits





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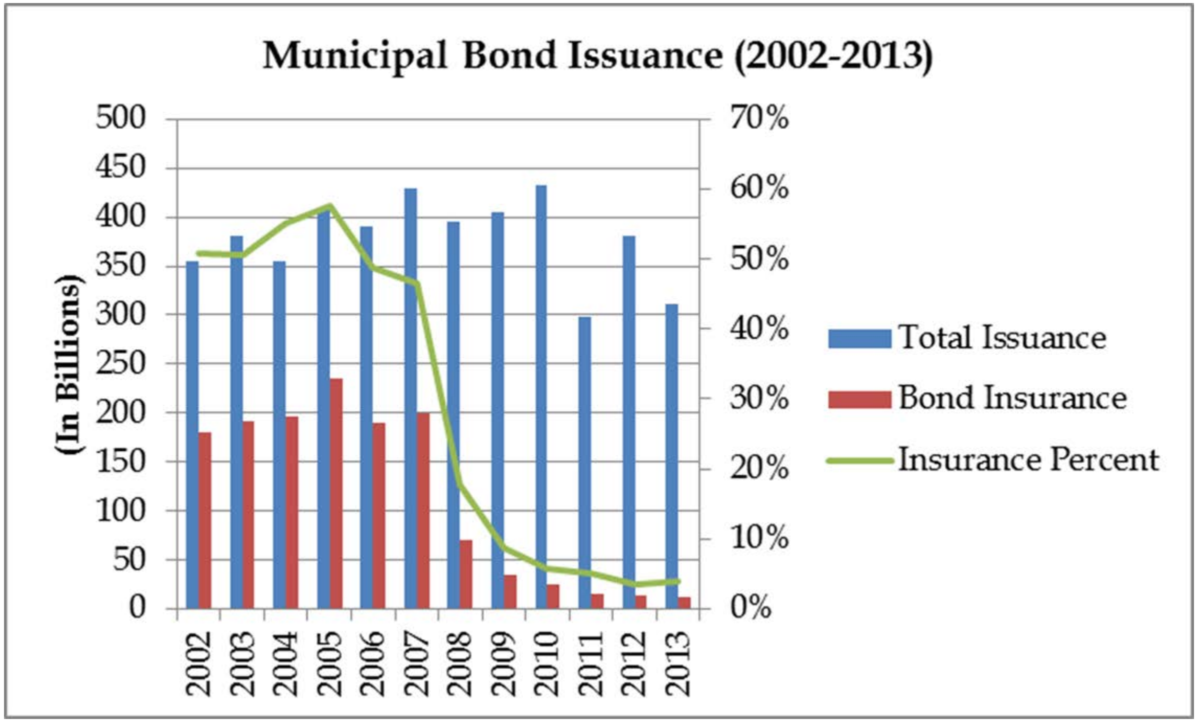
Municipal Bond Market Changed Profoundly as a Result of the "Great Recession"

- Ability to improve ratings with bond insurance are very limited



- This makes the NMFA's AAA/Aa1 Public Project Revolving Fund ("PPRF") bond ratings very important to New Mexico communities

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Municipal Bond Market Changed Profoundly as a Result of the "Great Recession"

- Introduction of Dodd-Frank reforms have added complexity to the bond issuance process
  - Municipal Advisor rules complicate traditional relationships between municipal issuers, bankers and financial advisors
  - Likely to lead to industry changes that may disadvantage smaller communities that issue bonds
- Unprecedented level of scrutiny and oversight of the municipal bond industry by federal regulators (specifically, the Securities and the Exchange Commission ("SEC") and the Internal Revenue Service ("IRS"))
- Enforcement actions by the SEC and IRS are likely to increase

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For Decades Municipal Finance Has Been Largely Unregulated

Enter Dodd-Frank (enacted July 2010)

- Changes the way municipal issuers interact with participants in the bond issuance process
- Requires registration of “Municipal Advisors” (“MA’s”)
- Elaborates on the fiduciary responsibility of a municipal advisor (disclose conflicts, documentation of relationship)
- Specifies contractual requirements of Municipal Advisors

Dodd-Frank Imposes Regulatory Burdens on All Participants

- Issuers, broker-dealers, Municipal Advisors
- Record-keeping, documentation of recommendations, qualifications

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Smaller communities that issue bonds less frequently have generally been served by smaller advisory firms and broker-dealers

Aspects of Dodd-Frank are likely to disadvantage smaller advisory firms

- For example, disclosure related to professional liability insurance which is unavailable to smaller firms in some sections of the country, or only available at high cost

Costs of complying with Municipal Advisor rules will result in higher costs to advisory firms and industry consolidation

Reduced competition can be expected to result in higher costs to smaller communities

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Long-term Implications of the new Municipal Advisor Rules

- Costs and effort associated with compliance will drive some existing firms out of the business or toward consolidation with larger firms
- Smaller issuers will find fewer advisory options and, as a result, smaller issuers will be faced with one of two choices:
  - work directly with a broker-dealer, recognizing that at the point that the bonds are sold, the issuer and broker-dealer have different interests
  - select a municipal advisor from a diminished pool of firms, likely paying higher fees for advisory services
- Large issuers will always have attention from advisors and broker dealers

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Implications of the Municipal Advisor Rules for the NMFA

- As public employees, NMFA Staff are exempted from MA Rules
- NMFA can continue to provide guidance and assistance to local governments during a period when the municipal bond industry is undergoing significant changes
- The role that NMFA staff play in working with its municipal clients, particularly smaller, less-frequent issuers will become increasingly important as the full impact of the MA rules are felt
- NMFA staff typically work with local officials in the following areas:
    - credit and debt capacity analysis
    - loan structuring assistance
    - evaluation of refinancing opportunities

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SEC's Municipalities Continuing Disclosure Cooperation Initiative

- Known as the MCDC Initiative, the SEC is attempting to identify "potentially widespread violations of federal securities laws by municipal issuers and underwriters of municipal securities"
- The focus is on representations made in a municipal bond prospectus (known as an "official statement") that the issuer was compliant in meeting its continuing disclosure obligations, when in fact it was not
- Broker-Dealers must report any "materially" inaccurate statements by September 10th – municipal issuers have until December 1st
- Underwriting firms taking advantage of the MCDC face penalties of no more than $500,000, but doing so does not protect against SEC action against individuals
- MCDC has, in many cases, pitted bankers against their issuer clients

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Internal Revenue Service Activities

- Nearly $4 trillion of municipal bonds outstanding
- IRS estimates that $310 billion of federal taxes will not be paid from 2012 through 2016 as a result of tax exempt municipal interest
- The audit activity by the IRS of municipal issues has doubled in the past 10 years
- IRS is aggressively pursuing post-issuance audits to insure compliance with federal tax rules for municipal bonds
- According to a 2012 report, the IRS issued $84 million in sanctions between 2005 and 2010
- Most IRS audits do not result an any findings of non-compliance by the municipal issuer

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Market Scrutiny of Municipal Credits is Increasing

Investors are demanding more details related to credit

- Pooled loan programs are inherently more complicated
- The revenues pledged to Public Project Revolving Fund bondholders come from hundreds of underlying borrowers; cities, counties, special districts, the State, etc.
- The Governmental Gross Receipts Tax ("GGRT") provides a "homogenizing" aspect to the Public Project Revolving Fund

Investors Are Increasingly Interested in Information about GGRT

Without Data on GGRT-producing Activities, NMFA cannot address investor questions

- As number and type of PPRF borrowers become more diverse, access to underlying GGRT information will become increasingly important