Municipal Update

Municipal Insurer Update

JANNEY FIXED INCOME STRATEGY AUG 19 2009

Municipals: Insurer update

Nearly two years after concerns about triple-A municipal insurers first emerged, only four bond insurance companies with investment grade ratings remain. They are: Assured Guaranty Corp. (Assured), Berkshire Hathaway Assurance Corp. (BHAC), Financial Security Assurance (FSA) and National Public Finance Guarantee Corp (NPFG), formerly MBIA. The below chart includes a list of all of the ratings and outlooks for companies who insure(d) municipal issues.

Monoline Insurer Credit Ratings

Company	Moody's Rating	S & P Rating	Fitch Rating
ACA Financial	Not Rated	Not Rated	Not Rated
Ambac	Caa2 Outlook Developing	CC Negative Outlook	Not Rated
Assured Guaranty	Aa2 Under Review for a Downgrade	AAA Negative Outlook	AA Negative Watch
Berkshire Hathaway Assurance Corp.	Aa1 Stable Outlook	AAA Negativ Outlook	Not Rated
CIFG	Ba3 Outlook Developing	CC Negative Outlook	Not Rated
Financial Guarantee Insurance Corp.	Not Rated	Not Rated	Not Rated
Financial Security Assurance Inc.	Aa3 Under review for a Downgrade	AAA Negative Outlook	AA+ Negative Watch
MBIA	B3 Negative Outlook	BBB Negative Outlook	Not Rated
National (formerly MBIA of Illinois)	Baa1 Outlook Developing	BBB- Negative Watch	Not Rated
Radian	Ba1 Stable Outlook	BBB- Negative Watch	Not Rated
Syncora	Ca Outlook Developing	R	Not Rated
ACA Financial	Not Rated	Not Rated	Not Rated

Source: Janney FI Strategy; Moody's; S&P; Fitch

>*Only four monoline bond insurers have managed to mantain investment grade credit ratings amid losses on structured finance insurance products.*

Over the past two years it became apparent that the so called monoline insurers were in fact not monoline. The insurers were backing not only municipal market credits, but had ventured into the business of insuring riskier structured products backed by residential mortgages. As the value of the residential housing market fell, so did the value of the structured products. These losses led to record claims on the insurance companies who insured them. As a result, the municipal bond insurance business, although still considered valuable by investors, is a business currently under a tremendous about of review by the rating agencies. The rating agencies have continued to question the viability of the municipal insurance business, especially as volumes have declined. Recently, the trend has been for municipal insurance companies to return to their roots and keep their municipal businesses separate from the other riskier businesses. The long term viability of the municipal insurance business remains a question that will only be answered as the market continues to adjust to the "new normal."

Municipal Insurance in the First Half of 2009

Municipal entities use of bond insurance dropped 60% in the first half of 2009 versus the same period of 2008. Of the ten companies insuring municipal debt at the beginning of 2008, only three companies, Assured, FSA and BHAC, insured municipal debt in the primary market in the

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first half of 2009. Assured was once a relatively minor player in the municipal insurance business but, they insured the most municipal bonds in the first half of 2009 with 803% share of the $21.5 billion market. FSA participated in the market and is now poised to take an increased amount of business in the second half as a result of their merger with Assured (see more in Insurer Update below). BHAC was very selective in choosing issues to insure, which is not surprising based on Warren Buffett's view of the municipal bond insurance business as illustrated in his Feb. 2009 Letter to Shareholders: "Insuring tax-exempts, therefore, has the look today of a dangerous business - one with similarities, in fact, to the insuring of natural catastrophes." In the first half of 2009 BHAC only insured five issues but continues to actively review municipal opportunities in the new issue markets.

Insurer Rankings - 1H 2009

Rank	Firm	Amount ($) (in billions)	Market Share	# of Issues
1	Assured Guaranty Corp.	$17.789	83%	866
2	Financial Security Assurance	3.067	14%	313
3	Berkshire Hathaway Assurance Corp.	0.583	3%	5
	Total	$21.439	100%	1,184

Source: Janney FI Strategy; Thompson Financial

>Assured Guaranty (now merged with FSA) and BHAC are the only two insurers that are presently active in the muni marketplace, though several new entrants are looking to start operations.

Although the use of municipal insurance significantly decreased, its value when underwritten by Assured/FSA or BHAC, still exists. So issuers are still using municipal insurance when the cost-benefit makes sense. Issuers are trending away from selling insured bonds with no underlying ratings. Now, more bonds are being sold with underlying ratings of the issuing entity in addition to an insurance wrap. In most cases we are seeing issuers paying for underlying ratings because investors are relying more on the underlying ratings and less on the insurance. We are seeing individual credit analysis making a comeback. Over the past ten years, municipal issues were commoditized as a result of triple-A bond insurance. Spreads to high grade indices narrowed as it was the credit of the insurers not the credit of the issuer investors considered. The decreased use and availability of municipal insurance has re-introduced the credit curve, meaning larger spreads among yields for lower rated credits. Educated investors will be able to weed out value in select sectors based on in depth analysis of the underlying credit quality of a given issuer, which is a shift from traditional reliance on insurance and credit ratings alone.

BOND RATINGS AND INSURER DOWNGRADES

There are typically two scenarios for municipal ratings of outstanding debt in the event a company that insures municipal bonds is downgraded below investment grade. If the issuer possesses an investment grade underlying rating the rating will default to the issuer's underlying rating. Or, if there are no underlying ratings on the bonds the rating agencies withdraw the insured rating and assign a no rating designation.

INSURER UPDATE - REVIEW OF MUNICIPAL BOND INSURANCE COMPANIES

Tier 1 Municipal Bond Insurers - Companies currently underwriting new insurance business:

Assured/FSA - Assured Guaranty announced on July 1, 2009 that their acquisition of Financial Security Assurance Holdings is complete. The organizations will remain as two distinct insurers and both will continue to write municipal insurance policies. Going forward, FSA will only insure municipal issues while Assured will also underwrite new municipal business and remain in the troubled structured finance business.

Berkshire Hathaway Assurance Corp - BHAC lost its triple-A rating back in March 2009 along with its parent. The municipal issues BHAC insured on the first half of 2009 were in the utility and airport sectors. BHAC continues to insure bonds in the secondary market. For example, BHAC insurance was recently added to a $12.5 million piece of an Aqua-Pennsylvania Pennsylvania Economic Development Financing Authority bond originally sold in July 2009.

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Other Municipal Insurance Companies

Ambac - In the middle of June Ambac postponed its efforts to start Everspan, its new municipal bond insurer. Ambac was not able to successfully raise enough third party capital to finance the new insurer. Also, Ambac's ratings were downgraded below investment grade by all rating agencies at the end of July. The company is now effectively in run-off mode. In other words, they will not underwrite new insurance business and we do not expect them to re-enter the market.

MBIA/National - MBIA split its insurance business into two pieces containing its public finance business and structured finance products. The public finance business is now National Public Finance Guaranty Corp. (National) although National is not currently underwriting new business and it does not look like they will reenter the market anytime soon, if at all. MBIA is now facing legal opposition and more ratings downgrades in response to the separation of the public finance entity. Additionally, a recent J.P. Morgan analysis concluded that MBIA, National's parent, will spend all of its cash in the next two years. MBIA stock fell almost 13% as a result of the report.

Municipal Infrastructure and Assurance Corp. - The Municipal Infrastructure and Assurance Corp. (MIAC) was licensed by the New York State Insurance Department in October 2008 and is a new a partnership between Macquarie Group and Citadel Investment Group. While the company is waiting for ratings so it can begin insuring municipal issues, MIAC is expected to only insure investment grade municipal credits which are "essential to the daily functioning of the communities in which they reside." We anticipate a focus on the sectors with less risk such as general obligations and water and sewer facilities for example. We also expect MIAC to be among the Tier 1 insurers when they receive their ratings but we do not expect them to be rated triple A by all rating agencies as we believe the triple-A municipal insurer rating to now be unattainable.

> Municipal insurance is likely to take a different form in future years, and one proposal for a "co-op" of issuers to insure bonds holds particular promise.

Syncora - Syncora, (formerly XL Capital) which is also in run-off mode, announced that their recent restructuring should allow them to return to compliance with the New York State Insurance Department (NYSID). Syncora is now waiting for final approval from the NYSID and then they will be able to pay out on their municipal claims. The insurer failed to make a $46 million payment for their portion of the defaulted Jefferson County, AL water and sewer bonds on July 1, 2009.

Conclusions

We expect municipal issuers to continue to incorporate insurance as it makes financial sense and investors see value in it. Volume will continue to decline when compared to previous years but we, unlike the rating agencies, believe that a key reason for the decrease in the use of insurance is its lack of its availability. We do not expect volume to reach former levels but it should slightly increase as participants compete for business. The new entrants like BHAC and MIAC are carefully choosing the areas where they will do business and we do not expect them to insure riskier sectors or lower credits.

Providing municipal insurance using other business plans has been proposed throughout 2009. In May 2009 The League of Cities (LoC) proposed the creation of the "Issuers Mutual" insurance company. Their proposed company would be financed with $5 billion from the US Treasury. We do not yet know Treasury Secretary Geithner's response to the LoC's proposal. But, we suspect that the subject of insuring municipal bonds is a subject far down on the list of the Treasury Secretary's priorities. Another recent idea that has not gained much traction came from the State of New York where it was proposed to utilize state pension funds to create a bond insurer. At some point we may see a user funded or government funded entity which insures municipal bonds. It may make sense because of the low default rates especially on general obligation and essential services. But for now we will have to wait and see what the remaining months in 2009 bring.

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Definition of Outlooks

Positive: Janney FIS believes there are apparent factors which point towards improving issuer credit quality issuer which may result in potential credit ratings upgrades

Stable: Janney FIS believes there are factors which point towards stable issuer credit quality which are unlikely to result in either potential credit ratings upgrades or downgrades.

Cautious: Janney FIS believes there are factors which introduce the potential for declines in issuer credit quality that may result in potential credit ratings downgrades.

Negative: Janney FIS believes there are factors which point towards weakening in issuer credit quality that will likely result in credit ratings downgrades.

Definition of Ratings

Overweight: Janney FIS expects the target asset class or sector to outperform the comparable benchmark (below) in its asset class in terms of total return

Marketweight: Janney FIS expects the target asset class or sector to perform in line with the comparable benchmark (below) in its asset class in terms of total return

Underweight: Janney FIS expects the target asset class or sector to underperform the comparable benchmark (below) in its asset class in terms of total return

Benchmarks

Asset Classes: Janney FIS ratings for domestic fixed income asset classes including Treasuries, Agencies, Mortgages, Investment Grade Credit, High Yield Credit, and Municipals employ the "Barclay's U.S. Aggregate Bond Market Index" as a benchmark.

Treasuries: Janney FIS ratings employ the "Barclay's U.S. Treasury Index" as a benchmark.
Agencies: Janney FIS ratings employ the "Barclay's U.S. Agency Index" as a benchmark.
Mortgages: Janney FIS ratings employ the "Barclay's U.S. MBS Index" as a benchmark.
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.
Municipals: Janney FIS ratings employ the "Barclay's Municipal Bond Index" as a benchmark.