

October 2016

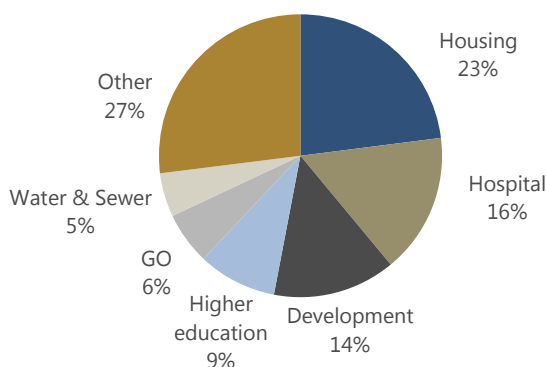
## *Municipal Market Update:*

# Municipal VRDNs Offer Liquidity and Tax Advantaged Income

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Money market mutual fund reform has caused a dislocation in the short term municipal market, reducing liquidity and increasing operational complexity for prime funds. Variable Rate Demand Notes (VRDN) are a vehicle for investors to meet their needs for principal preservation, liquidity and competitive yields, as well as a means to achieve the tax advantages of municipal bonds. Like fixed rate municipals, VRDNs are issued by state and local governments, and revenue authorities, mostly to finance public infrastructure projects. VRDN income is tax free, and adjusts on a periodic basis based on the yield of the Securities Industry and Financial Markets Association (SIFMA) Index, the municipal market's equivalent of LIBOR.

### VRDN Sectors



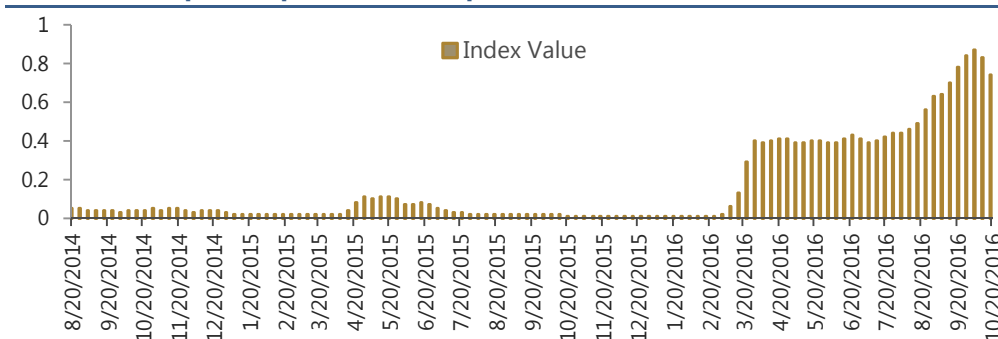
Source: SIFMA as of September 30, 2016

### Money Fund Reform and Skyrocketing VRDN Yields

In an effort to adapt to the new regulations, many financial institutions are substituting Municipal Money Market Funds with Government Money Funds as a sweep vehicle for uninvested cash in client accounts. Instead, the fully liquid, gate-free and \$1 net asset value (NAV) US Government Money Market funds are considered a more reliable substitute. On a year to date basis, assets in Municipal Money Market Funds have dropped by over \$120 billion, or 50%. Municipal money market fund demand for VRDNs has plummeted accordingly, and yields have risen. Indeed, while the yield on the SIFMA Municipal Swap Index had hovered in the low single digits for several years, it recently spiked to over .80% as the deadline for compliance with the new regulations approached. Notably, the dramatic increase in yields associated with these securities has occurred despite the fact that there has been no change to the credit fundamentals.

The interest payments and “put” is guaranteed by a letter of credit (LOC) from a highly rated bank, or a Standby Bond Purchase Agreement (SBPA) that backstops the issuer’s ability to meet the tender.

## SIFMA Municipal Swap Index Yield Spikes



## How VRDN’s Help Meet Liquidity and Principle Preservation Needs

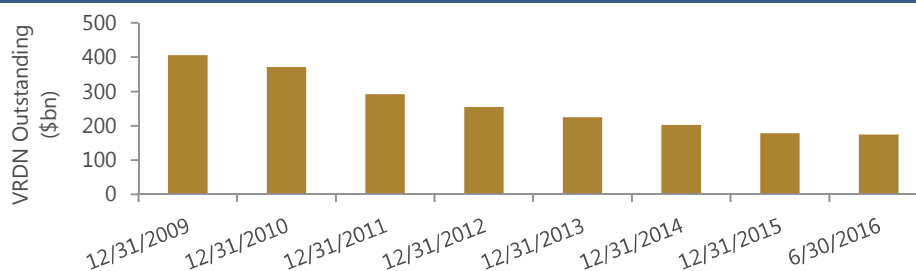
VRDNs deliver a floating market interest rate with daily, weekly or monthly tender at par, and a long final maturity. The coupon of a VRDN is reset based on the SIFMA Municipal Swap Index. The interest payments and “put” is guaranteed by a letter of credit (LOC) from a highly rated bank, or a Standby Bond Purchase Agreement (SBPA) that backstops the issuer’s ability to meet the tender.

	12/31/2015		9/30/2016		Change	Change
	Assets	# of	Assets	# of	Assets	%
	(\$mills)	funds	(\$mills)	funds	(\$mills)	
<b>Tax Free Money Market Funds</b>						
Tax Free National Retail	117,314.1	77	60,613.2	61	(56,700.9)	-48.3
Tax Free National Institutional	64,936.6	111	25,154.3	70	(39,782.3)	-61.2
State Specific Tax Free Retail	63,990.1	99	41,301.6	87	(22,688.5)	-35.4
State Specific Tax Free Institutional	8,064.9	72	1,431.6	26	(6,633.3)	-82.2

Source: iMoneyNet as of October 20, 2016

VRDNs represent over three quarters of the investments held in municipal money market portfolios. The over 50% shrinkage of municipal money market funds has resulted in a glut of VRDNs in the market, which must command significantly higher yields to clear the market.

## VRDN Market Contracts



## An Effective Investment Alternative

We believe VRDNs offer a compelling opportunity for investors to immunize short term liabilities, or to preserve a bastion of liquidity in perpetuity. VRDNs are liquid, high quality and produce attractive levels of tax exempt income.

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