NEWSLETTER JULY 2004

SPEER FINANCIAL, INC.

INDEPENDENT PUBLIC FINANCE CONSULTANTS SINCE 1954

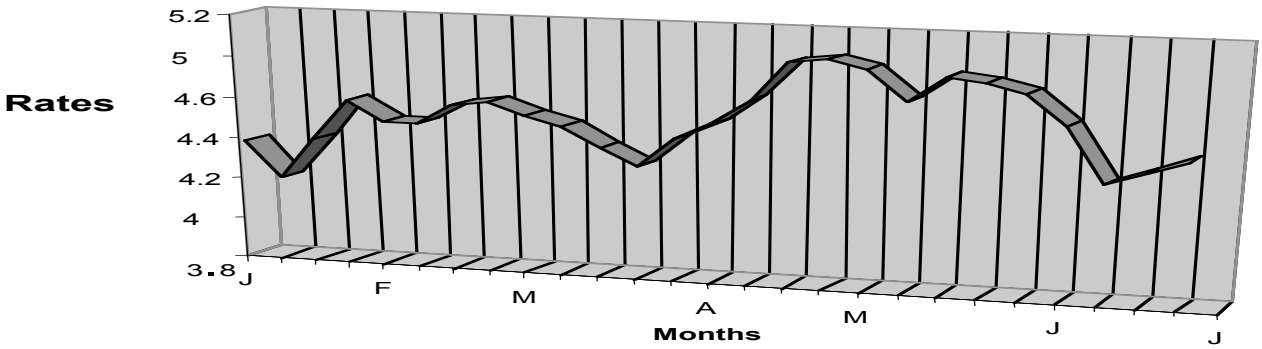
THE MARKET

The Bond Buyer Index for General Obligation Bonds (defined as the average tax-exempt market value, expressed in terms of yield, on general obligation bonds of twenty selected issuers with Moody's ratings ranging from Baa1 to Aaa, averaging A1, and maturing in twenty years) is shown below. The June 24th rate is 5.01%. The comparable revenue bond rate is 5.37%. The Index is used as a market barometer.

20-Bond G.O. Index

Monthly Rate Average	**Jan**….4.61%	**Feb** ..4.54 %	**Mar** ..4.41%	**Apr** ..4.81%	**May**....5.07%	**June**…5.04%
Week 1	8 ...4.64	5...4.68	4...4.54	1...4.59	6….5.01	3...5.03
Week 2	15....4.52	12...4.52	11...4.35	7...4.76	13….5.14	10...5.10
Week 3	22....4.57	19...4.50	18...4.35	15...4.89	20…5.13	17...5.05
Week 4	29....4.71	26...4.49	25...4.41	22..4.89	27…5.01	24...5.01
Week 5				29..4.95		

20 G.O. Bond Buyer Index – 2004 Monthly Average



SUITE 4100* 1 NORTH LASALLE STREET * CHICAGO, ILLINOIS 60602 * (312) 346-3700 * FAX (312) 346-8833
SUITE 608 * 531 COMMERCIAL STREET * WATERLOO, IOWA 50701 * (319) 291-2077 * FAX (319) 291-8628

The Importance of a Significant Fund Balance

Periodically clients ask us about the importance of having a significant fund balance. The discussion usually involves the main operating fund(s) and the focus is on unreserved fund equity. Depending upon the accounting method used and the type of governmental entity, a further focus may be on that portion of undesignated fund equity that is actually supported by cash and investments.

This is an on-going and important topic not only because of how it affects budgeting but also due to the significance in bond ratings.

When the economy is very strong, less emphasis is placed on fund balance from a budgeting view as surpluses are usual. With several years of a down economy affecting both local governments in their revenues and the states in their revenues available to support local governments, surpluses have disappeared and fund balances are being drawn down. Annual budgeting of drawdowns continues. From a governance viewpoint, this may be merely a temporary, if necessary, solution. However, rainy day funds can only support so many rainy days.

From a rating viewpoint, occasional draws for capital projects or to reduce an over funded fund balance are acceptable. Continual draws are not. While fund balance levels and policies are only one of many rating considerations, they are significant. And a reduction in fund balance has been cited as a major factor in recent downgrades.

What is the correct target? Unfortunately most printed material from rating agencies merely states that it varies upon need. Factors such as revenue source (property tax, sales tax, state aid) are important in their reliability and timing. However, while the rating services won't give a hard and fast number, they do publish statistics. Nationally, Standard & Poor's reports a mean of some 25% of unreserved fund balance as related to expenditures for "A" rated credits and above. In Illinois, Moody's reports that most "A" and above credits have a median of 30%. Both reports place BBB/Baa credits around 20%.

Our general advice is that, when affordable, aim for a minimum of 25%, equal to three months working cash. To this general target, various factors must be applied to achieve a workable target. For example, a village that is nearly all sales tax supported requires a greater fund balance than a school district with significant property taxes and state aid.

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One Benefit of Rising Rates – Escrow Restructuring

In periods of low interest rates, refundings are popular. However, the bond proceeds are often invested in escrows for a number of years until the call date and such investments are frequently earning less than federally allowable rates. As interest rates rise, it is possible to recapture some of these "lost" investment earnings. Not easy, but possible. We are involved in several and would be pleased to discuss this with interested parties.

Turning the Corner – A Case Study in Taxpayer Concentration

When taxpayer concentration or other type of concentration is present it becomes a major concern for credit analysts. Concentration is present when one entity comprises a significant portion of a tax base, is a significant user of a utility or is a company employing a significant number of people in a community. Concentration can negatively impact a rating, even preventing investment grade status, or prevent a bond issuer from qualifying for top grade bond insurance. Whenever taxpayer concentration, user concentration or employer concentration is present, concerns arise as to what happens if that entity goes away.

In the City of Zion, Illinois, that worst-case scenario came to pass in 1998 when Commonwealth Edison (now Exelon) announced the closure of its nuclear power plant located in the City. In tax year 1993 the various Commonwealth Edison parcels comprised approximately 60% of the City's total equalized assessed valuation (EAV) with the single largest parcel of property on which the plant stands having an EAV of some $230,000,000.

In 2000, in order to insure the orderly, phased reduction in EAV of this parcel of property, the City and the various overlapping bodies executed an agreement with Commonwealth Edison. In accordance with that agreement, the EAV of this parcel for the current year (2003) stands at $20,000,000. The final two reductions will occur in 2004 and 2005 to an agreed level of $10,000,000.

During this transition, the City has encouraged new businesses through economic development in order to diversify its tax base. Over a 14-year period, property valuation in the City has shifted from primarily industrial property (65% of the total EAV to 17%) to primarily residential (25% of total EAV to over 66%). During this same period commercial property has increased from 9% to over 15% of the total. This year the total EAV, even with the continuing phased impact of the Commonwealth Edison Agreement, reversed the downward trend and achieved an increase of some 2%.

Zion is a success story accomplished through planning and intergovernmental cooperation. Over the past several years the best the City was able to do was qualify for insurance that was rated AA. This year the City was able to qualify its Series 2004 Taxable General Obligation Alternate Bonds for AAA rated insurance for the first time. We want to congratulate Zion on turning the corner with respect to the difficult issues of taxpayer concentration.

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Illinois School Finance Consultant Hired

Jerry Gordon, the recently retired long term Superintendent of Bloomingdale School District No. 13, has joined the team at Speer Financial, Inc. and will specialize in school financings. Jerry is also a former Assistant Superintendent for Business and brings a fresh perspective, a practical expertise and a new dimension of understanding for providing creative financial solutions to local school districts.

Illinois Ethics Legislation

Illinois ethics is not an oxymoron in spite of past political stories about shoeboxes and envelopes. A House ethics bill was adopted in the fall of 2003. It was vetoed, and then over-ridden to become Public Act 93-0615. Not to be outdone, a Senate ethics bill was passed and signed into law as Public Act 93-0617. Both should be understood as two chapters of the same book. The Acts affect state and local government employees and officers. While local counsel will advise you in detail, we would raise some topic specific points for your consideration.

1) **Referenda** are more and more necessary in a tax capped environment. Voter authorization is needed for the G.O. Bonds for funding of many capital projects and for tax rate increases for operations and for capital purposes. Referenda are political campaigns and political activity is prohibited for officers and employees on compensated time. See the Acts for details, **but prohibited political activity** includes preparing for, organizing or participating in any political meeting, rally, demonstration or event; soliciting contributions; polling for or against any referenda question; soliciting votes for or against any referendum question; preparing or distributing literature, signs or other campaign material; managing or working on a campaign. Watch what you do and when. 2) A **Gift Ban** is in place. It, among other things, prohibits gifts of food or refreshments exceeding $75 per person per day. Watch the golf outing tabs.

Ethics in the sale of debt has been a longstanding issue, not only in Illinois but nationwide. Increasing scrutiny on how bond purchasers are selected for negotiated sales of debt has been partly addressed nationally by disclosing lobbyist relationships and compensation. This issue can best be addressed in selecting an independent financial advisor to serve as a market intermediary and then by selecting a competitive sale of securities wherever and whenever possible. Nothing like multiple bidders to demonstrate transparency and integrity to elected officials and to voters.

SPEER FINANCIAL, INC.
1 NORTH LASALLE
SUITE 4100
CHICAGO, IL 60602