



# SPEER FINANCIAL, INC.

*INDEPENDENT PUBLIC FINANCE CONSULTANTS SINCE 1954*

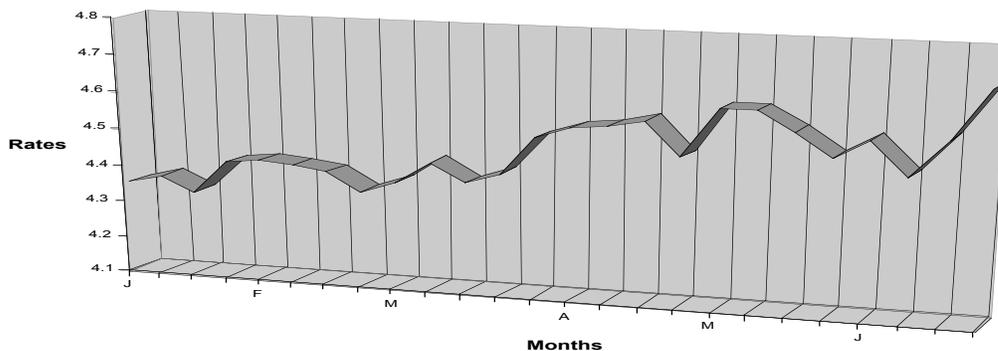
## THE MARKET

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 29<sup>th</sup> rate is 4.71%. The comparable revenue bond rate is 5.31%. The Index is used as a market barometer.

20-Bond G.O. Index

Monthly Rate Average	Jan 4.37%	Feb 4.41%	Mar 4.44%	Apr 4.58%	May 4.59%	June 4.60%
Week 1	5...4.35%	2...4.43%	2...4.39%	6...4.56%	4...4.63%	1...4.57%
Week 2	12...4.37%	9...4.42%	9...4.45%	12...4.57%	11...4.63%	8...4.48%
Week 3	19...4.33%	16...4.41%	16...4.40%	20...4.59%	18...4.58%	15...4.58%
Week 4	26...4.42%	23...4.36%	23...4.43%	27...4.59%	25...4.52%	22...4.68%
Week 5			30...4.53%			29...4.71%

20 G.O. Bond Buyer Index – 2006 Weekly Average



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## **ROLES – FINANCIAL ADVISOR; UNDERWRITER/BANKER**

### **MSRB –G-23**

The Municipal Securities Rule Board (MSRB) of the Securities and Exchange Commission (SEC) has a rule in place (G-23) which is aimed at protecting debt issuing governments from actual and perceived conflicts of interest. Financial advisors are deemed by the SEC to be fiduciaries to issuers while underwriters/bankers are not. A review of this rule was conducted in early 2006 with a recommendation from the National Association of Independent Public Financial Advisors (NAIPFA) that dealers should be required to advise issuers affirmatively that several actual conflicts of interest may exist and that these should be disclosed to the issuer by the dealer. It was stated that underwriters have fiduciary, statutory and regulatory obligations to their investors, whose interests often differ significantly from the interests of issuers.

The direct cost of an independent public financial advisor is more than offset by the lower interest rates paid compared to a sale where no independent third party exists to document that sale price and sale terms are 'fair' to the client and 'fair' to the underwriter for the securities being issued.

### **Price Competition – Interest Rates**

Bankers often argue that an independent public financial advisor is an unnecessary cost, but this is far from the truth. Given the complexity of the market, the normal self-interest of bond purchasers and lack of market knowledge and expertise by some issuers, this does not logically hold up.

In the 143 competitive sales held by Speer Financial, Inc. in 2005, the average interest rate variance between the low bidder and the high bidder was 0.3294%. Of the 100 competitive sales with an official statement, the average high/low variance was 0.2409%. As can be seen, a wide range of where "the market" is, is held by a number of firms. When the buyers compete, the issuer wins through lower lifetime borrowing costs.

The wide variance of opinion on the cost of money over time between banks that openly compete exists and is documented. When open competition does not exist among banks, and no independent pricing verification exists, the final terms frequently vary dramatically from other recent and similar issues, the sale results of which the issuer was not made aware of by the purchaser of the securities. Selective comparables versus the full universe of comparables is unfortunately more the rule than the exception.

### **Best Practice**

Governmental shopping (for the lowest priced contractor or supplier that meets the bid specifications) is a "Best Practice" governmental business standard. The lowest cost of money is just an extension of this best practice business principle. In a bond issue, the fact is that there may be two to four digits in front of the comma that represents the interest cost savings realized by finding the lowest cost lender.

In Speer's 2005 competitive sales, the most active bidder participated in 99 of the 143 sales (69%) as the lead manager (none as a syndicate member). They won 30.3% of the times they bid. The second most active underwriter bid 59 times (41%) as a bond manager and another 43 times as a syndicate member. They won 7.84% as the syndicate leader and 20.59% as a syndicate member where another underwriter led. While good relationships with potential purchasers of your bonds is a good business practice, no vendor for any product or service should feel immune from price competition.

Bidding bonds should be a standard business practice. Circumstances occasionally do override and call for a negotiated sale. An analysis of this large number of competitive sales finds a wide divergence of opinion exists in pricing bonds. Issuers need to realize that this divergence of opinion exists and that winning 30% of the time may be good if you're a baseball batter, but it's not so good when you have a fiduciary responsibility and you're supposed to protect your taxpayers' interests 100% of the time.

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## **IOWA TIFs**

TIF (Tax Increment Financing) as part of urban renewal is one of the best tools for economic and housing development in Iowa. Most cities and some counties across Iowa utilize TIF to its fullest potential with great success. With legal guidance from bond counsel, cities and counties can rest assured that they have complied with all of the requirements in developing an urban renewal plan. One of the biggest concerns that we hear is the inability to account and balance the urban renewal district with the general taxation. The fear is if the public agency levies too much in the urban renewal area, will it have enough increase tax value to operate the General Fund.

Several years ago Speer Financial, Inc. developed a TIF report for our Iowa clients. The report is a summary of the amount of debt that is outstanding, the amount of TIF debt that is outstanding, any tax rebates that have been authorized, the current debt capacity of the community and the amount of value and TIF taxes that are available for future development. The report is produced and distributed to city and county officials and is updated on an annual basis as valuations and debt capacity change. The report is produced to allow for easy updates. This report has proven to be a useful tool to identify and keep track of the financial health of an urban renewal area. Should you need additional information regarding the TIF report, please contact our Iowa office at 319-291-2077.

## **NOT FOR PROFIT BONDS**

A little known fact about public finance is that a not-for-profit 501(c)(3) organization can borrow money for a project at a tax-exempt rate the same as public agencies such as cities, counties and schools. Speer Financial has assisted many of these organizations in financing costs through what is called a conduit bond. The public agency, i.e. city or county, acts as a host for the financing, but is totally free of any liability for the repayment. This is a great opportunity for a public agency to assist a 501(c)(3) organization and help them finance their project. If you know of a 501(c)(3) organization, i.e. hospital, nursing home, etc., that is looking at locating in your community, please have them contact Speer Financial for assistance.

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## OTHER POST EMPLOYMENT BENEFIT OBLIGATIONS

Other Post-Employment Benefits (OPEB) obligations are non-pension benefits provided to current and future retirees, such as medical and dental health care, life insurance and long-term care insurance and any other non-pension benefit. The Governmental Accounting Standards Board (GASB) Statement Number 45 (GASB 45) is applicable to state and local government employers. GASB 45 requires measurement and reporting of OPEB obligations but does not require funding. Effective dates are being phased in beginning December 15, 2006.

Due to the increases in health care costs and the aging of the population, it is believed that OPEB obligations will be much greater than pension costs. Up until now governmental bodies that have been historically generous with their employee benefits have not had to quantify the fiscal impact of OPEB obligations. GASB 45 disclosures will most likely come as a shock to many state and local governments. Some states are estimating their OPEB liabilities to be in the tens of billions of dollars.

Management of OPEB liabilities can affect credit quality. How a government manages its liabilities, how such liabilities affect its finances or whether or not it borrows to fund its OPEB liabilities can all be criteria affecting ratings. The annual required contribution (ARC) to fund the unfunded actuarial accrued liability, advance funding or pay as you go technique can have a budgetary impact.

OPEB funding bonds, like pension funding bonds, can be a useful tool, however they are quite complex and require detailed analysis and are certainly not appropriate for every unit of government. Both OPEB funding bonds and pension funding bonds are taxable because they are interest rate hedging vehicles. The strategy is to replace unfunded actuarial liabilities with lower cost debt service on bonds. Unfunded OPEB liabilities and pension obligations are debt-like in nature. OPEB bonds and pension funding bonds are actual debt. For non-home rule units of government OPEB funding bonds and pension funding bonds can affect debt margin and impact debt financing for other needed capital improvements.

State and local governments should get started in addressing GASB 45 issues and begin thinking of strategies to successfully address their OPEB obligations.

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