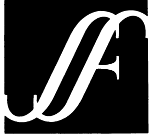


NEWSLETTER **JULY 2007**

SPEER FINANCIAL, INC.

INDEPENDENT PUBLIC FINANCE CONSULTANTS SINCE 1954

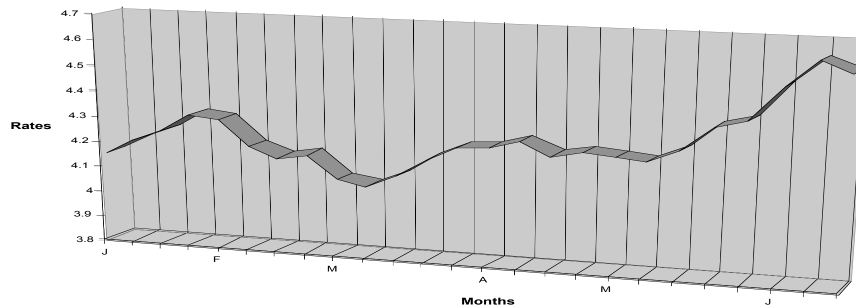
THE MARKET

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 28th rate is 4.60%. The comparable revenue bond rate is 4.71%. The Index is used as a market barometer.

20-Bond G.O. Index

Monthly Rate Average	**Jan** 4.23%	**Feb** 4.22%	**Mar** 4.15%	**Apr** 4.26%	**May** 4.31%	**June** 4.60 %
Week 1	4...4.15%	1...4.31%	1...4.10%	4...4.26%	3…4.25%	7...4.54%
Week 2	11...4.21%	8...4.21%	8...4.08%	12...4.29%	10…4.24%	14...4.64%
Week 3	18...4.25%	15...4.17%	15...4.13%	19...4.24%	17…4.29%	21...4.63%
Week 4	25...4.32%	22...4.19%	22...4.20%	26...4.26%	24…4.38%	28...4.60%
Week 5			29...4.25%		31…4.41%	

20 G.O. Bond Buyer Index – 2007 Weekly Average



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Supreme Court Consideration of Limited Tax Exemption

The U. S. Supreme Court has agreed to rule in a case brought that challenges the Kentucky policy of exempting from state income tax the interest on bonds issued by local issuers. While the case concerns just Kentucky issuers and taxpayers, the fact situation applies to more than half of all states. For instance, Illinois exempts interest only on certain state agency bonds and debt of Puerto Rico, while some jurisdictions exempt interest from state and local income taxes.

The argument is based on the commerce clause of the U.S. Constitution. The Appellate Court ruling stated that the policy of taxing out-of-state bonds, but not state debt, violated the constitutional provision concerning interstate commerce.

If the Court upholds the Appellate Court, individual states will need to decide whether to tax municipal bond interest from local government units or to not tax interest on any municipal bonds. The effect on state revenues can be significant.

If all bond interest is exempted, a significant state revenue for many jurisdictions will need to be replaced. On a social/tax policy view, the concern is a perception of favoring “rich” bond investors. If all bond interest is to be taxed, the value of various bonds will fall, as will many mutual funds that are based on certain high tax states. Local governments would need to pay higher rates on future bonds; public perception may be that local governments are being penalized.

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GFOA Committee Warns of Underwriter Conflict of Interest

The Government Finance Officers Association (GFOA) represents over 16,000 state and local finance officers and is the primary association representing municipal bond issuers. The Debt Committee of the GFOA approved a draft update of its best practices for issuing debt at its meeting held on June 9, 2007. The draft is to be discussed by the GFOA Executive Board in October.

The draft specifically addresses a concern that has been hotly debated in the public finance industry: Should an underwriting firm be able to serve a bond issuer as financial advisor and then be able to resign and serve as underwriter for the same bonds on which it has previously advised? The draft clearly says no:

> “Due to inherent conflicts of interest, the firm acting as a financial advisor for an issuer should not be allowed to resign and serve as underwriter for the transaction being considered.”

This statement seems to be a clear endorsement of a modification in the current Municipal Rulemaking Securities Board (MSRB) Rule G-23, which at present allows such role switching.

The National Association of Independent Public Finance Advisors (NAIPFA) started asking for a modification of Rule G-23 in letters to the MSRB in October 2005. Though the MSRB decided not to modify Rule G-23 in 2006, NAIPFA reinstated its request in a letter in 2007 and continues to identify what it believes are widespread abuses in the municipal bond market. With a GFOA endorsement for modification, pressure on the MSRB would increase significantly.

Commenting on the GFOA Debt Committee’s action, *Bloomberg News*, the leading financial reporting firm in the industry, stated that the real problem is not only the role switching but:

> “That many unsophisticated issuers don’t use financial advisers at all…Most issuers need objective, independent help when it comes to navigating the municipal bond market. Most of them [issuers] get it from their underwriters, hardly disinterested sources of advice.”

The article stated that less than half, and in most years less than a third, of municipal bond issuers use financial advisors.

LIBOR Based Index Bonds

This spring we sold LIBOR based index bonds to accomplish a refunding on behalf of one of our clients, a major Illinois issuer with superior credit ratings. LIBOR stands for London Inter-Bank Offered Rate. This structure has been used in municipal offerings for about a year although it has been used for some time in corporate finance. The basic financing plan was to issue variable rate bonds that were priced at percentage of Three-Month LIBOR plus a spread. In this case the percentage of the Three-Month LIBOR was 67%. The bonds pay interest quarterly. LIBOR based index bonds do not require a liquidity facility or remarketing agent because there is no "put" feature. That is, the bondholders do not have the right to present bonds to the issuer for payment prior to maturity, as is common with most variable rate bonds.

Concurrently, the issuer engaged in a swap agreement with a counterparty to exchange the variable rate interest payment obligation for a fixed rate interest payment obligation. The swap counterparty was selected through a competitive process.

As a part of the refunding transaction the issuer was able to receive a lump sum payment rather than achieving annual savings throughout the life of the bonds. The resulting debt service on the refunding bonds was substantially identical to the refunded bonds. The lump sum payment was helpful for the issuer because it could be used for an upcoming capital project. The bond issue was approximately $52.5 million and the upfront payment was $2.2 million. Because a swap is a derivative product the issuer adopted a debt derivative policy to be a guide in the use of derivatives. This is considered a best management practice.

The LIBOR based index bonds were attractive due to the flat nature of the yield curve, size of the refunding and the receipt of a lump sum payment to the issuer. As the yield curve changes this technique may not be as attractive in the future.

This type of financing is complicated and certainly not appropriate for every issuer. LIBOR based index bonds should be considered carefully in consultation with your independent financial advisor.

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Iowa News

Counties in Iowa have a new ability to issue Essential County Purpose Bonds for the construction and repair of roads and bridges. This authorization was extended to them by the 2007 Iowa legislative session. This has long been a concern for counties to issue any amount of debt for the construction and repair of roads and bridges as it fell under the General County Purpose portion of the law. During the legislative process, there was a provision attached to the bill that stated a project could be bonded for if it is tied to economic development. This means that counties will have to make a finding of economic impact on the issuance and expenditure of the bond money. Speer Financial stands ready to assist your county in developing a funding program for all of your county needs.

Open Auction Competitive Sales

Speer Financial, Inc. has conducted closed electronic sales since mid-1999. Identical to closed bids, these have the advantage of easy accessibility nationwide. With 275 sales, over $2.75 Billion has been issued on our Speer Auction.com site. Due to its efficiency and speed, the closed and blind sealed bid electronic sales enable the issuer to obtain the freshest bid possible and is now preferred by bidders to the "traditional" faxed bid method.

In mid-2006 Speer Financial began a selective initiation of an electronic open auction as the next step in the progression of bidding. The open auction is still a blind bid environment but it opens the information window to enable the bidder to see their bid placement (1st place, 2nd place, etc.) while they do not see other bidders or other bids. Knowing their place encourages increased competition and allows bidders to improve their bid if they wish to do so. This creates the possibility for a fluid exchange between bidders until the lowest and best bidder remains unchanged for two minutes. While not every open auction results in trailing bidders overtaking a leader, the fact that bidders can and do improve bids and eventually win creates an atmosphere of increased competition that tends to drive borrowing costs to lower levels. The technology encourages an exchange among the bidders and each bid improvement is to the issuers advantage.

A significant number of sales have seen improvement in bids in the $5,000 to $10,000 area, far outweighing the incremental cost of the process. One large issue realized $41,000 in savings.

To observe an Open Auction Replay, you can go to the www.SpeerAuction.com site and go to the Replay link and choose an auction to replay. The log-in ID is "demo-id" with your e-mail address, then select the replay speed (15 minutes real time up to 6X fast forward), then click "start replay." You'll observe that in some auctions, there is a give-and-take among the top bidders until one emerges whose bid is not bettered during the two-minute response time while in other auctions, the leading bidder is so far ahead, that they are not overtaken in spite of numerous incremental improvements by the trailing bidders.

Speer is aggressive in the use of technology on behalf of clients.

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