SPEER FINANCIAL, INC.

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INDEPENDENT PUBLIC FINANCE CONSULTANTS SINCE 1954

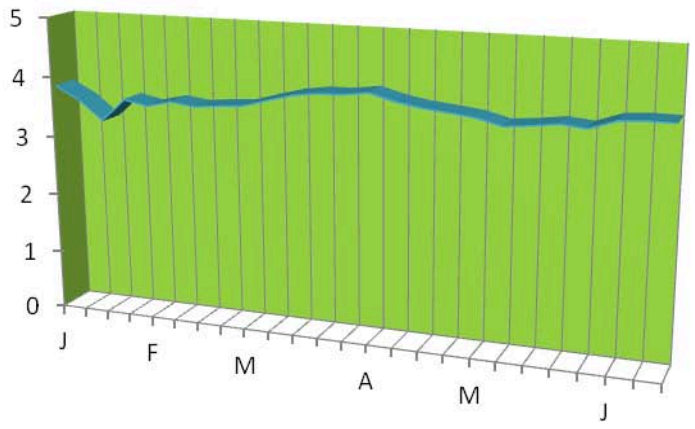
The Market

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 ratings averaging Aa2/AA and maturing in twenty years) is shown below. The June 28th rate is 3.95%. The comparable revenue bond rate is 4.69%. The Index is used as a market barometer.

20-Bond G.O. Index

Monthly Rate Average	Jan 3.60%	Feb 3.66%	Mar 3.90%	Apr 3.95%	May 3.77%	June 3.94%
Week 1	5…3.83%	2...3.60%	1...3.72%	4...4.08%	3…3.81%	7…3.92%
Week 2	12…3.62%	9...3.70%	8...3.84%	12...3.97%	10…3.71%	14…3.95%
Week 3	19...3.60%	16...3.65%	15...3.95%	19...3.90%	17…3.75%	21…3.95%
Week 4	26…3.68%	23…3.69%	22...4.01%	26…3.86%	24…3.81%	28…3.95%
Week 5			29...4.02%		31…3.77%	

20 G.O. Bond Buyer Index – 2012 Weekly Average



Issuers Should Care That Municipal Bonds Remain In Legislators Crosshairs

Members of Congress and their staff continue to have the tax exempt municipal bond market in their legislative crosshairs. As Washington investigates every possible way to reduce the federal deficit, the tax revenue that might be extracted from municipal bond interest remains a tempting target.

With the so-called "Taxmageddon" or the "Fiscal Cliff" hitting 12/13/2012, legislative action is very possible by the end of 2012. Taxmageddon and Fiscal Cliff refer to the expiration of the Bush Tax Cuts and the $500 billion in separate cuts to defense and domestic entitlements that will automatically take effect if Congress fails to pass a broad debt reduction package by the end of 2012.

What Has Been Proposed. Proposals targeted to reduce the costs to the Federal Government of the tax exemption for municipal bonds continue to be drafted. Most major fiscal reform proposals floated since the end of 2010 have aimed to revamp taxes broadly, seeking to simplify the tax code, to gradually eliminate tax expenditures and to reduce marginal tax rates. Those proposals affecting the tax exemption of municipal bonds include the following.

The Bowles-Simpson Commission called for eliminating special tax exempt treatment of interest on all new municipal bonds. Tax rates for individuals would be lowered across-the-board under the Bowles-Simpson plan, and municipal bond interest would be taxed at the ordinary income tax rate.

House Budget Committee Chairman Paul Ryan's 2012 budget proposal follows closely many of the Bowles-Simpson recommendations. The Ryan 2012 budget would effectively do away with the special treatment of municipal bond interest by eliminating taxes on all interest, capital gains, dividends and estates.

For his part, the President has proposed modifications or elimination of the tax exemption of municipal bonds in his American Jobs Act of 2011 (the "Jobs Act") and Debt Reduction Act of 2011 (the "Debt Reduction Act"). The Jobs Act would limit for certain individual taxpayers the value of certain deductions and exclusions, including the exclusion for tax exempt interest, to 28% irrespective of the actual marginal tax rate imposed on such taxpayers. The Debt Reduction Act would establish a steadily declining ratio for debt as a percentage of Gross Domestic Product and would impose a penalty in the event that Congress failed to meet the requirements, including automatic sequestration of spending and the reduction in the value of certain tax incentives, including interest on tax exempt municipal bonds, potentially (in the extreme) eliminating the exemption from taxation that tax exempt municipal bonds held at the time of issuance.

The Wyden-Coats bill seeks to spread the benefits of owning municipal bonds equally to all taxpayers, regardless of adjusted gross income. This proposal would replace the tax exemption of municipal bond interest with a federal tax credit for bondholders equal to 25% of the interest earned.

Why Issuers Should Care. If any of these proposals to limit the municipal bond tax exemption were enacted, issuers of municipal bonds would have to pay higher interest rates in order to produce returns to investors that are competitive with other fixed income instruments. One market analyst has stated that all but the most well-known, liquid municipal issuers would likely be assessed an additional liquidity premium in the marketplace, driving yields higher still.

If any of these pass in their current formulation, the resulting higher interest costs to issuers may not always be able to be passed on to taxpayers. This further strains issuers' budgets and credit ratings. Issuers may be pressured to further curtail the services they provide as well as limit future capital projects. Issuers would also have a much reduced incentive to refinance existing debt. The likelihood of issuers calling outstanding bonds declines markedly if current tax exempt debt can only be replaced with higher cost debt instruments.

A leading municipal bond industry analyst has concluded that even the Wyden-Coats proposal to replace tax exemption with a federal tax credit would result in higher borrowing costs to issuers. He stated that it would be impossible to overcome the massive complexity and liquidity problems associated with selling small pieces of annual tax credits along with small pieces of coupon income and a large amount of bond principal. This is because when a tax credit bond was issued, many purchasers cannot fully utilize the credit and so strip it off and sell it separately. Perhaps more fatal is the very narrow base of demand for taxable tax credit bonds; in 2009 and 2010, tax credit alternatives were available in the Build America Bond program but went almost completely unused.

Conclusion. Municipal bond tax exemption has captured the attention of Washington legislators. To date, the major proposals to limit this tax exemption are expected to result in higher borrowing costs and financial pressures on issuers. For updated information on these proposals and the expected impact on issuers, contact your financial advisor at Speer Financial, Inc.

Municipal Bond Buyers

For the first half of 2012, the volume of bond issuance is some 60% above that of 2011. This causes concern about who is purchasing the debt and what is the impact on rates. So far, the rate impact has been slight because the increase in volume is still below the combined amount of debt maturing and interest being paid. This means that there is still an imbalance of money available in the municipal bond market available for the purchase of new issuances. With basic supply and demand economic theory, rates, which reflect bond pricing, are staying low.

As to purchasers, the trend is currently away from individuals, that is, retail buyers. For the past several years retail has been very important, with bond issues often structured to appeal to retail buyers, as opposed to institutional investors. The likely cause of this decline in retail appetite is primarily “rate shock.”

Other reasons given are increased daily volatility and the increase of professionally managed accounts versus individual accounts directed by the individual owner. Rates are achieving low levels that are not attractive to individuals, who often buy for retirement. As tax exempt rates follow Treasury rates, tax exempts are yielding near 1% for 5 years and 2% for 10 years. These levels are appreciably lower than the 3% to 4% levels that individual investors saw on bonds purchased some 10 years ago, which bonds are now being redeemed.

As with most trends, this will probably change. However, until rates rise, it is unlikely that individuals will be net purchasers of tax exempt debt. If institutional purchasers and professionally managed accounts have sufficiently strong demand to keep rates low, issuers are likely to be fairly ambivalent.

Refundings

In the current extremely low interest rate environment, any bonds issued in 2002 or before with 10 year calls, or more recent issues with shorter calls, are very attractive to refund for savings. Even certain newer issues with negative arbitrage can be refunded in advance of the call date for significant savings.

Many issues being sold this year are refunding issues providing attractive savings to reduce debt service. In times of Equalized Assessed Value (EAV) reductions, this will reduce the tax rate or, if paid with other revenues, relieve some operating financial pressures.

Some of the refundings are being negotiated to assure hitting a savings target while many are being sold competitively if clearly above the minimal threshold. Savings are enhanced with a strong credit rating in today’s market while insured bonds have almost disappeared.

Naturally non-Illinois issuers don’t get dinged with the “Illinois Penalty” caused by investors’ concerns about the financial future of the State of Illinois where “balanced budget” is an oxymoron.

If you have an issue that you think is refundable for savings or where restructuring may be advantageous, please call your contact at Speer Financial, Inc.

“Finally, the End of Switching…”

In 2010 federal regulation changed with the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The regulatory changes were directed through the Municipal Securities Rulemaking Board (MSRB) and Securities and Exchange Commission (SEC).

One of the major resulting changes is to MSRB Rule G-23, which speaks to the activities of Underwriters (who purchase your bonds) acting in both the capacity of a Financial Advisor and Underwriter in connection with a bond sale.

In the past, a firm could act in both capacities as first the Financial Advisor and then as the purchaser or Underwriter of the bonds. The firm would resign as Financial Advisor, in writing, at the time of the sale. Once the Issuer accepted the resignation, in writing, the same firm would then act as Underwriter and purchase the bonds.

The Government Finance Officers Association (GFOA) considers this practice to be a conflict of interest which hurts Issuers and has established Best Practices to separate pricing and purchasing decisions. The Financial Advisor should be advising an Issuer on preparing the deal to receive the lowest interest rates, while an Underwriter is concerned with getting higher investment rates for their bond purchasers. This switching left an Issuer without any independent advice on the day of sale and any unbiased interest rate comparison to the market.

In May 2011, the SEC approved changing Rule G-23 to require a Financial Advisor/Underwriting firm to declare, in the early stages of the bond issuance process, that they will act as either a Financial Advisor or an Underwriter. The Rule change became effective for bond issues selling after November 27, 2011. This change provides Issuers with a clear picture as to what capacity a market participant is acting as.

Speer Financial is an Independent Financial Advisor, and registered Municipal Advisor with the MSRB, and has never been in the market as a purchaser or underwriter of bonds.

More rules and regulations are expected in the future by the MSRB and SEC changing the way municipal market participants are regulated. Please contact Speer Financial and we can inform you of such changes as they are adopted.

WE HAVE GONE GREEN

Visit our website www.speerfinancial.com for newsletters, training seminars, and to join our email list.

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