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MUNI MARKET UPDATE

August 23, 2010

INSIDE THIS ISSUE:

TAXPAYERS LOSE WHEN BABS ARE SOLD OUT OF U.S.

Or...How Issuers Can Help U.S. Taxpayers by Utilizing Retail Order Periods

The Build America Bonds ("BAB") program, implemented as part of the American Recovery and Reinvestment Act of 2009 ("ARRA"), has been well-received by both investors and issuers. With a 35% rebate on interest payments from the federal government, issuers of BABs have been able to realize significant savings than they would have otherwise.

One topic we have not seen addressed is the impact of the recent trend to market these bonds to foreign investors. While a larger and more diversified pool of investors should in theory enable issuers to sell their bonds at lower yields, issuers should keep in mind that foreign investors are taxed differently than domestic buyers of taxable securities.

As of August 18, 2010, $124.15 billion Build America Bonds have been issued, $60.05 billion of that in 2010. That represents $9 billion sold to foreign investors in 2010, based upon Citigroup's estimate that 15% of its BABs were sold

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MARKET UPDATE

Ireland pulled off an impressive performance last Tuesday, selling the maximum intended $ 1.9 billion (1.5 billion euros) of bonds in a sale that was closely watched for signs of trouble, given resurfacing worries about financial problems in the euro zone. Despite growing fears that Ireland might turn into the next Greece as one of its biggest banks tapped the government for more aid, Ireland has proven the strength of its financial position.

Treasury Secretary Timothy Geithner sketched out the administration's case last week for some type of continued, if limited, government guarantee of home mortgages as the administration's working plans to reinvent Fannie Mae and Freddie Mac will almost certainly include some role for government. The mortgage-finance debate is highly contentious because it requires a re-examination of just how much the government should subsidize homeownership.

The MSRB said last week said it is contemplating a rule change that would prohibit dealers from underwriting new negotiated or competitive bond issues if they served as the issuer's financial advisor on the transaction. The Board is seeking public comment on the draft changes to its controversial Rule G-23 through Sept. 30, 2010. Rule G-23 currently permits the firm to resign as financial advisor to be an underwriter on the transaction if the issuer waives the conflict of interest.

The Investment Company Institute reported bond funds took in $7.17 billion, down from $7.55 billion the previous week. Taxable bond funds had inflows of $5.79 billion, and municipal funds added $1.38 billion. With market gains, tax-exempt funds grew to a record $512 billion.♣

THIS WEEK'S CALENDAR

E.D.T.	Amount	Ratings	Issuer	State	Structure	
Monday, August 23						
11:15AM	10,555M	Aa2/NR	Southern Lehigh,PA Sch Dist	PA	2012-2023	BQ
Tuesday, August 24						
11:00AM	1,416M	UR/UR	Holland Patent CSD	NY	2011-2026	BQ
11:00AM	48,765M	UR/UR	Hennipen Co	MN	2011-2030	
11:00AM	16,695M	UR/UR	T/O Islip	NY	2012-2025	BQ
11:00AM	18,805M	Aaa/AAA	Palm Beach CO	FL	2011-2023	
11:00AM	94,540M	UR/UR	Prince George's Co	MD		
			$43,025M - Series A		2011-2020	
			$51,515M - Series B - BABs		2021-2030	
11:00AM	4,138M	UR/UR	T/O Randolph	MA	2011-2030	BQ
11:00AM	22,770M	UR/UR	T/O Southampton	NY	2011-2029	
11:15AM	9,619M	NR/A	Willingboro Twp	NJ	2011-2023	BQ
11;30AM	79,335M	UR/UR	Hennipen Co - TAXABLE	MN		
			$37,375M - RZEDs		2030-2035	
			$41,960M - BABs		2021-2029	
11;45AM	3,705M	UR/UR	Saddle Brook Twp	NJ	2011-2020	BQ
Wednesday, August 25						
11:00AM	12,770M	Aa1/AAA	T/O Branford	CT	2011-2025	BQ
11:00AM	6,300M	NR/AA-	Little Ferry Boro	NJ	2011-2025	BQ
	150,000M	Aa1/NR	S/O New Hampshire	NH		
11:00AM			$90MM - Series B		2012-2020	
11:30AM			$60MM - Series C - BABs		2021-2030	
11:00AM	10,000M	UR/UR	T/O Tonawanda	NY	2011-2025	BQ
11;30AM	22,930M	UR/UR	Sussex Co	NJ	2011-2020	BQ
Thursday, August 26						
11:00AM	2,195M	UR/UR	Kings Park	NY	2011-2024	BQ
11:00AM	1,358M	UR/UR	Tri-Valley CSD @ Grahamsville	NY	2011-2025	BQ
11:30AM	22,000M	UR/UR	T/O Trumbull	CT	2011-2030	

Click here for calendar updates.

VISIBLE SUPPLY

The 30-day visible supply of municipal bonds totaled $7.146 billion, up $576.9 million from the previous session, according to The Bond Buyer.

That comprises $1.387 billion of competitive bonds, which is up $226.6 million and $5.758 billion of negotiated bonds, which is up $350.2 million.

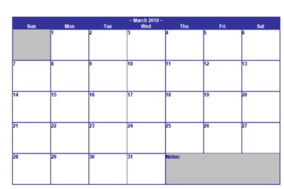
Week of August 23, 2010

Tax-Exempt:	$3.66B
Taxable/BABs:	$1.13B
Total:	$4.79B

The 30-day visible supply is calculated by The Bond Buyer and reflects the total dollar volume of bonds to be offered at competitive bidding and through negotiation over the next 30 days.

Source: Thomson Reuters. 8/20/2010.

ECONOMIC CALENDAR



TAXPAYERS LOSE WHEN BABS ARE SOLD OUT OF U.S. (CONT'D)

internationally. At an average 5.63% coupon, with an average maturity of 28.8 years (using the Wells Fargo Build America Bond index), that $9 billion of BABs could accrue up to $14.59 billion of untaxed interest payments through maturity.

Income that foreign investors earn that is passive in nature, such as interest, is generally taxed at a flat 30 percent rate with no deductions.

However, bilateral tax treaties are of great importance. Tax treaties between the U.S. and other countries can operate to reduce (or even eliminate) the rate of U.S. tax on certain types of U.S. income derived by foreign investors situated in the treaty-partner country, override various statutory source of income rules, and to exempt certain types of income or activities from taxation.

Therefore, certain international entities buying BABs may not be paying any taxes to the IRS, are therefore not supplementing the 35% payments the federal government is making to the issuer, and instead, are placing the burden on the U.S. taxpayer.

Increased International Demand

In an April 30, 2010 Bond Buyer article, Citi estimated that 15% of its BABs were sold internationally. However, certain issuances have sold higher percentages overseas, for example:

- In the March 2010 $3.4 billion State of California Various Purpose General Obligation Bonds taxable BABs issuance, run jointly by Bank of America Merrill Lynch and Citi, $730 million (21.5%) was sold to foreign investors.
- $35 million (22%) of the $130 million Central Texas Regional Mobility Authority ("CTRMA") issuance in February 2010 was privately placed with an Australian pension fund by JPMorgan. Maturing in 2040, with an initial offering price of $100, the taxable subordinate lien revenue bonds pay an interest rate of 11.625%.

Increasing the investor base should help in tightening spreads relative to other taxable debt, such as corporates and sovereigns. For its transaction, a spokesperson for the CTRMA is quoted as saying that "millions of dollars over the life of the bond" would be saved due to the diversified demand.

U.S. Taxation of International Investors

The following taxation-related information is excerpted with permission from "U.S. Taxation of Foreign Investors" by Richard S. Lehman & Associates.

The United States tax laws are very favorable to foreign investment, providing at times for the payment of tax free interest by U.S. taxpayers to foreign investors. Complex laws provide for numerous methods of deferring the payment of U.S. taxes to a later point in time.

Status for Tax Purposes

The United States has tax treaties with many countries. These treaties generally provide that the residents and corporations of each country to the treaty are entitled to a more liberal tax treatment than residents and corporations of non-treaty countries.

A foreign corporation is a recognized separate taxpayer for U.S. tax purposes. A foreign corporation for U.S. tax purposes, is a corporation that is not organized under the laws of the United States or any one of the states of the United States.

Two Types of Federal Income Taxation Patterns

Foreign Taxpayer

Foreign Taxpayers (both alien individuals and foreign corporations), pay U.S. tax on U.S. income in two entirely different ways depending upon whether the income the Foreign Taxpayer earns is from "passive" sources or whether the income results from the Foreign Taxpayer's conduct of an active trade or business in the U.S.

Furthermore, the U.S. tax rules for Foreign Taxpayers take into account the fact that the jurisdiction of the United States can extend just so far. Therefore, as a general rule a Foreign Taxpayer will only pay U.S. tax on their "U.S. Source Income" and not on income earned from outside of the United States. There are however exceptions.

In order to understand the two different types of taxation, it is important to examine the general rules that define whether a Foreign Taxpayer is conducting an "active business in the U.S." or a "passive investment" as well as the rules governing "source of income" and the "source of deductions". These definitions determine which one of the two sets of tax rules must be applied in order to calculate the U.S. tax liability of foreign corporations and nonresident alien investors.

There are a strict set of rules that govern the determination of whether income finds its source in the United States or a foreign place for U.S. tax pur-

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TAXPAYERS LOSE... (CONT'D)

poses. For interest payments, the source of interest income is generally determined by reference to the residence of the debtor; interest paid by a resident of the United States constitutes U.S. source income, while interest paid by nonresidents who are not U.S. citizens is generally foreign-source income.

The Taxation of Passive Income

If the income that a Foreign Taxpayer earns is passive in nature and does not result from the Foreign Taxpayer conducting an ongoing "trade or business"; the Foreign Taxpayer's U.S.-source investment income is taxed at a flat 30 percent rate (with no deductions). Generally, the passive types of income earned by investors are such things as interest, and dividends. Foreign Investors that earn only passive U.S. income are also generally not subject to tax on capital gains and other nonrecurring U.S.-source income.

Since as a general rule Foreign Taxpayers earning passive income in the U.S. have only limited ties to the U.S.; a tax "withholding system" is in place. This system essentially forces the U.S. person that is paying the passive income to a Foreign Taxpayer to collect the tax that is due and pay it to the United States. Failure to do so can result in the U.S. person that is responsible to withhold this tax being personally responsible for the tax.

Income Effectively Connected with a U.S. Business

Unlike a Foreign Taxpayer that is taxed on passive U.S. source income only; income of a Foreign Taxpayer that conducts a trade or business in the U.S. will pay tax on all of its United States source income and in limited circumstances, U.S. tax must be paid on income that is earned from foreign sources and not U.S. sources. Foreign source income that is attributable to a Foreign Taxpayer's U.S. trade or business activity maybe taxed by the U.S. and is called "Effective Connected Income".

Whether non-U.S. source income earned by a Foreign Taxpayer is taxed as "trade or business" income is determined by how closely the income is attributed to the Foreign Taxpayer's U.S. trade or business. In addition to certain foreign source income being subject to U.S. tax; U.S. passive source income may be taxed like trade or business income, if it is considered to be "effectively connected income."

It is possible that at times, U.S. source passive type income will be subject to a tax on net income and not the usual 30% tax that is applied to gross income.

For example, though interest income is normally considered "passive income"; it is "active business income" to a Foreign bank that holds deposits and conducts business in the U.S. Therefore, interest earned on such deposits would not be taxed at a flat rate. Rather it is taxed on a progressive rate that permits offsetting deductions for the foreign bank's cost of funds and other costs of doing business in the U.S.

The Effect of Bilateral Tax Treaties

The role of bilateral tax treaties in the taxation of Foreign Taxpayers on their U.S. source income is frequently of even greater importance than the basic statutory general rules just mentioned. Tax treaties between the U.S. and other countries can operate to (1) reduce (or even eliminate) the rate of U.S. tax on certain types of U.S. income derived by Foreign Taxpayers situated in the treaty-partner country;

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He has served as a law clerk to the Honorable William M. Fay, U.S. Tax Court and as Senior Attorney, Interpretative Division, Chief Counsel's Office, Internal Revenue Service, Washington D.C.

Mr. Lehman has been practicing in South Florida for more than 35 years. During Mr. Lehman's career his tax practice has caused him to be involved in an extremely wide array of commercial transactions involving an international and domestic client base.

Mr. Lehman has authored a number of articles on taxation and was the Editor and Contributing Author of "A Guide to Florida International Business and Investment Opportunities," an informative guide to foreign business persons published by the Florida Department of Commerce, and translated in German, Spanish and Japanese.

TAXPAYERS LOSE WHEN BABS ARE SOLD OUT OF U.S. (CONT'D)

BABs Payments ($ Billions)	Current Program 2009 - 2019[1]		If Extended 2011-2020[2]		Total	
Funded by Taxes on BABs	24	67%	80	91%	104	84%
Unfunded by Taxes on BABs	12	33%	8	9%	20	16%
	36		88		124	

[1] "The Budget and Economic Outlook: An Update" Congressional Budget Office, August 2010.
[2] "An Analysis of the President's Budgetary Proposals for Fiscal Year 2011" Congressional Budget Office, March 2010.

(2) override various statutory source of income rules (3) exempt certain types of income or activities from taxation, by one or both treaty-partner countries; and (4) extend credit for taxes levied by one country to situations where the domestic law would not so provide.

The principal purpose of the U.S. bilateral tax treaties is to avoid the potential for double taxation arising from overlapping tax jurisdictions (e.g. income source arising in one country while the taxpayer is resident in the other country.)

U.S. Taxpayers Footing the Bill – Again

In the example above, the $35 million of CTRMA's issuance with an Australian investor, that investor would have been obligated to pay 10% tax on the interest it receives from the CTRMA if it were not a financial institution.

As a financial institution, it is exempt from taxation on interest paid by U.S. obligors. That means that the full 35% payment by the federal government to CTRMA must be supplemented by the U.S. taxpayer.

For 30 years, the Australian investor will earn 11.625%, for a total of $112 million in interest untaxed by the U.S. government. The federal government will need to transfer $42.7 million of U.S. taxpayer dollars to the CTRMA in order to pay the 35% subsidy provided by ARRA.

Countries where interest is exempt from U.S. taxation include Austria, Canada, Commonwealth of Independent States, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Luxembourg, Netherlands, Norway, Poland, Russia, Slovak Republic, South Africa, Sweden, Switzerland, Ukraine, and the United Kingdom.

In addition to Australia, interest is exempt if the foreign taxpayer is a financial institution in Bulgaria, and is taxed at 4.95% for financial institutions in Venezuela.

Rates for other countries may be found in IRS Publication 910.

BABs Will Cost $36 Billion According to the Congressional Budget Office

The analysis of the President's proposals by the Congressional Budget Office ("CBO") is based on the agency's own economic assumptions and estimating techniques (rather than the Administration's) and incorporates revenue estimates from the staff of the Joint Committee on Taxation ("JCT") for tax provisions.

In its August 2010 report, "The Budget and Economic Outlook: An Update," released Thursday, the CBO estimated the cost of the BAB program through 2019 at $36 Billion, an increase of $6 billion from its January 2010 estimate of $30 billion.

The CBO noted that "more than two-thirds" BABs payments are "offset by higher revenues," meaning approximately $24 billion of payments are funded and $12 billion of payments are not.

In its March analysis of President Obama's fiscal 2011 budget, the CBO wrote, "The President proposes to expand and permanently extend the program but to lower the subsidy rate to 28 percent. By substituting taxable for tax-exempt bonds, the program increases taxable interest income. According to JCT, the proposal would increase revenues by $80 billion over the 2011–2020 period."

A footnote clarifies, "The subsidy payments made by the federal government to states and localities are recorded on the outlay side of the budget. The proposed changes would increase outlays by an estimated $88 billion over 10 years." Therefore, the incremental cost to taxpayers would be $8 billion.

Is it Really Only $36 Billion?

If Citigroup is correct and 15% of BABs are being sold to investors that *may* (again, it depends on tax treaties and other factors discussed above) not be paying U.S. taxes, then it is not likely that only 9% of the projected 2011-2019 BABs subsidy will

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PENSION OBLIGATION DISCLOSURE

The State of New Jersey (the "State") consented to the Order Instituting Cease-and-Desist Proceedings ("Order") instituted by the Securities and Exchange Commission ("SEC").

The SEC found that New Jersey violated "Sections 17(a)(2) and 17(a)(3) of the Securities Act in connection with the offer and sale of over $29 billion in municipal bonds from August 2001 through April 2007.

According to the SEC, in 85 municipal bond offerings, the State misrepresented and failed to disclose material information regarding its under funding of New Jersey's two largest pension plans, the Teacher's Pension and Annuity Fund ("TPAF") and the Public Employees' Retirement System ("PERS").

More specifically, the State did not adequately disclose that it was under funding TPAF and PERS, why it was under funding TPAF and PERS, or the potential effects of the under funding."

The SEC also found that "in disclosure documents prepared in connection with each of the bond offerings, including preliminary official statements, official statements, and Treasurer's Annual Reports (collectively, "disclosure documents" or "bond offering documents"), the State made material misrepresentations and omissions regarding:

(1) legislation adopted in 2001 (the "2001 legislation") which increased retirement benefits for employees and retirees enrolled in TPAF and PERS;
(2) special Benefit Enhancement Funds ("BEFs") created by the 2001 legislation initially intended to fund the costs associated with the increased benefits;
(3) the State's use of the BEFs to as part of a five-year "phase-in plan" to begin making contributions to TPAF and PERS; and,
(4) the State's alteration and eventual abandonment of the five-year phase-in plan.

These misrepresentations and omissions created the fiscal illusion that TPAF and PERS were being adequately funded and masked the fact that New Jersey was unable to make contributions to TPAF and PERS without raising taxes or cutting other services, or otherwise impacting the budget.

Accordingly, disclosure documents failed to provide adequate information for investors to evaluate the State's ability to fund TPAF and PERS or the impact of the State's pension obligations on the State's financial condition."

According to The Bond Buyer, Elaine Greenberg, chief of the SEC's municipal securities and public pensions enforcement unit indicated that "one of the goals of the enforcement action is to put other states and localities on notice about the importance of being accurate with disclosures about pension plans."

See the sidebar for remedial steps an issuer can take to strengthen its disclosure practices. ♣

STRENGTHENING PENSION FUNDING DISCLOSURES

- Hire disclosure counsel to advise the issuer on an ongoing basis regarding its disclosure obligations under federal securities laws.
- With assistance of disclosure counsel, review and enhance as necessary, formal written policies and procedures.
- Establish a committee comprised of senior issuer officials, representatives from the issuer's legal department, and disclosure counsel to review and make recommendations regarding the issuer's disclosures and disclosure practices.
- The official signing the Rule 10b-5 certification, certifying that the official statement did not contain any material misrepresentations or omissions, should read the official statement and not rely upon staff to ensure the accuracy of information contained in the documents.
- Implement a mandatory annual training program conducted by disclosure counsel for the issuer's employees involved in the disclosure process to ensure compliance with the issuer's disclosure obligations under the federal securities laws.

NEW YORK REDUCES ASSUMED RATE OF RETURN

Bloomberg reported that the State of New York will be decreasing its assumed rate of return on its investments from 8% to either 7.5%-7.75%. The fund reportedly has assets of about 107 percent of its future liabilities. ♣

TAXPAYERS LOSE WHEN BABS ARE SOLD OUT OF U.S. (CONT'D)

be funded by increased tax revenues due to BABs.

If the projections in the CBO's March 2010 analysis don't take foreign investors into considerations, then it is likely that the August 2010 report projecting a cost of $36 billion also does not. If so, the number may be significantly higher.

Sell American!

Issuers can successfully reach more U.S. retail investors by including a retail order period.

In the August 2010 $761 million New York City Transitional Finance Authority ("TFA") transaction, of which $614 million were BABs, the TFA included a two-day retail order period, on August 2nd and 3rd for the 2020 and 2024 maturities, totaling $166 million on day one and increased to $189 million at final pricing.

Rockfleet had retail orders for this TFA BABs transaction, as we had for TFA's May 2010 $592mm BABs transaction. With their vast retail networks, surely the major wirehouses and banks can reach out to retail investors well.

The inclusion of selling groups and a diverse group of co-managers, along with the utilization of retail order periods, will help issuers keep BABs in the U.S. where the individuals and institutions reaping the benefits of the program, not the general public, are taxed. ♣

MASS LAYOFFS & REGIONAL EMPLOYMENT

Mass Layoffs Summary

The Bureau of Labor Statistics, in its Economic News Release of August 20, 2010 summarizing mass layoff data, reported that employers took 1,609 mass layoff actions in July that resulted in the separation of 143,703 workers, seasonally adjusted, as measured by new filings for unemployment insurance benefits during the month.

Each action involved at least 50 persons from a single employer.

The number of mass layoff events in July decreased by 38 from the prior month, and the number of associated initial claims decreased by 1,835.

During the 32 months from December 2007 through July 2010, the total number of mass layoff events (seasonally adjusted) was 63,461, and the associated number of initial claims was 6,357,583. (December 2007 was the start of a recession as designated by the National Bureau of Economic Research.)

The national unemployment rate was 9.5 percent in July 2010, seasonally adjusted, unchanged from the prior month and essentially unchanged from 9.4% a year earlier.

The six-digit industry with the largest number of initial claims in July was elementary and secondary schools. Of the top 10 detailed industries, school and employee bus transportation reached a program high number of claims for the month of July. This includes both publicly and privately owned entities.

Regional and State Employment and Unemployment Summary

The Bureau of Labor Statistics, in its Economic News Release of August 20, 2010 summarizing regional and state employment and unemployment data, reported that regional and state unemployment rates were little changed in July. Eighteen states and the District of Columbia recorded unemployment rate decreases, 14 states registered rate increases, and 18 states had no change.

The national jobless rate was unchanged in July at 9.5% and little different from a year earlier (9.4%).

The West reported the highest regional unemployment rate in July, 10.8%, while the Northeast recorded the lowest rate, 8.8%. No region experienced a statistically significant over-the-month unemployment rate change. The Midwest was the only region to register a significant rate change from a year earlier (-0.6 percentage point).

Among the nine geographic divisions, the Pacific continued to report the highest jobless rate, 11.5% in July. The West North Central registered the lowest rate, 7.0 percent, followed by the West South Central, at 7.9 percent. The East South Central was the only division to experience a statistically significant unemployment rate change from a month earlier (-0.4 percentage point), and the West North Central was the only division to post a significant over-the -year jobless rate change (-0.6 point). ♣

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STUDY: PENSION CUTS ARE INADEQUATE

Bloomberg reports that, according to an academic study by Joshua D. Rauh, associate professor of finance at Northwestern University's Kellogg School of Management in Evanston, Illinois, eliminating cost-of-living increases and raising the retirement age for public employee retirees will not cover the estimated $3 trillion obligation.

Rauh estimates that if all states raised the retirement age to 74, "the unfunded liability for promises already made would still be more than $1 trillion."

He presented the paper on Thursday to the National Bureau of Economic Research's State and Local Pensions conference in Jackson Hole, Wyoming. ♣