How U.S. States can benefit from the Build America Bonds Program

Taxable bond option for government

- 35% credit to bondholders for 2009 and 2010

- 35% refundable credit to issuers for bonds issued in 2009 and 2010 (for obligations issued after date of enactment)

- Allows the State or local government to elect to receive a direct payment from the Federal government equal to the subsidy that would have otherwise been delivered through the Federal tax credit for bonds.

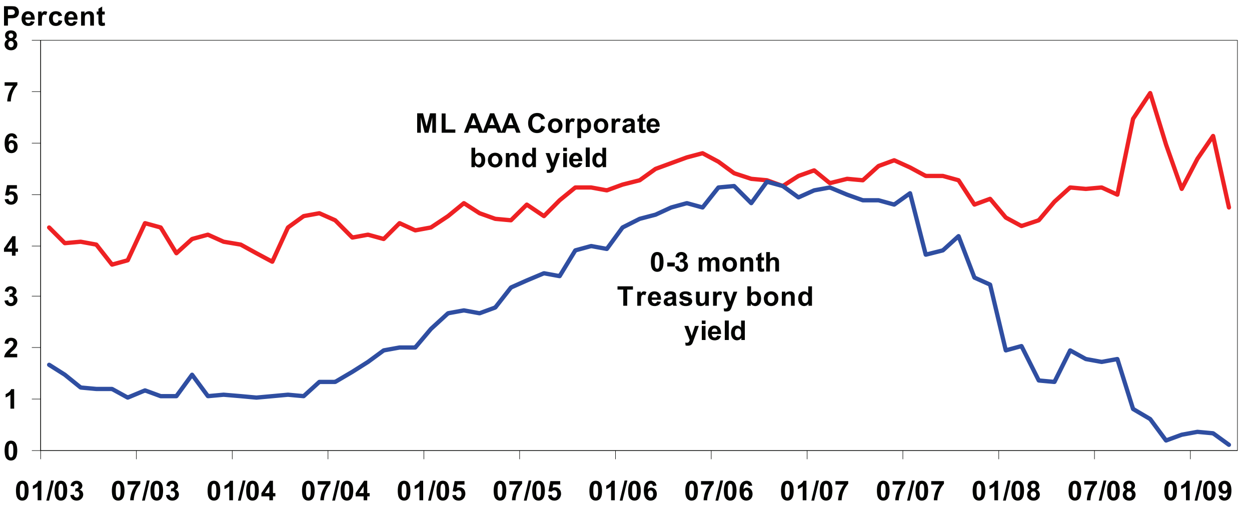
Sources: www. recovery.ca.gov.

What do analysts think?

- “By placing a large issuer's paper in the taxable market, BABs can free up capacity for the same issuer in the tax-exempt buyer base. In addition, in the short run, BABs reduce the supply of bonds in the tax-exempt area.” (Bank of America/Merrill Lynch)
- “The BAB bonds are giving investors the opportunity to diversify risk into an asset class which historically is very stable.” Deutsche Bank Private Wealth Management
- When issued in large amounts and structured differently than the typical municipal bond, these securities could attract nontraditional municipal bond investors, such as pension funds and foreign governments.

Sources: Wall Street Journal.

Widening spreads



Source: Bloomberg.

Widening spreads

Municipal bond

Source: Bloomberg.

Are BAB attractive for investors?

- A 30-year, tax-free municipal bond from the state of California yields about 5.0%. Even in the highest 35% tax bracket, an investor would need to earn 6.75% to make up the difference between paying taxes on the bond and earning tax-free income.
- The recently issued US$ 5.23 billion, 25 and 30-year California BABs pay an annualized rate of 7.4%.
- Investors interested in taxable income at attractive yields with high credit quality will find BABs interesting.
- However, BABs are not be as liquid as other bonds and they're likely better used as a long term investment.

Source: iStockAnalyst.com.

Milken Institute

Scott Minerd, CEO and Chief Investment Officer

Guggenheim Partners Asset Management, Inc.

American Recovery and Reinvestment Act

- Build America Bonds
  - Direct Pay BABs
  - Tax Credit BABs
- Recovery Zone Economic Development Bonds (RZEDBs)
- Qualified School Construction Bonds (QSCBs)

What Bonds Qualify as BABs?

Bonds that would otherwise qualify as tax-exempt, except for private activity bonds:

- General obligation needs/general funding
- Transportation
- Public power
- Water & sewer
- Public higher education

Potential BABs Investor Base

- Pensions and Endowments
- High Net Worth Individuals
- Mutual Funds
- Non-US Fixed Income Investors
- Banks

Benefits of BABs

- Allow state and local governments access to a broader universe of investors
- Flexible programs allow issuers to choose the lowest all-in funding levels for various maturities and structures, depending on taxable versus tax-exempt needs
- Create employment opportunities for people to manage and construct projects funded with BABs
- Purchase of materials required in the construction process will help stimulate the economy
- Fund essential purpose capital projects such as the construction, improvement and upgrading of public buildings, roads, utility, transportation, environmental and energy-related infrastructure

Terms of BABs

- BABs can be issued prior to January 1, 2011
- No dollar limit that can be issued in total or by any one issuer
- Issuers can be any state or local government issuer of tax-exempt bonds
- A “qualified bond” is any governmental bond that would otherwise be exempt under Section 103 of the IRS tax code so long as 100% of the available project proceeds of such issue are to be used for capital expenditures
- Projects financed with BABs must be government owned
- BABs can be issued for any capital purpose for which tax-exempt municipal bonds are regularly issued

Source: American Recovery and Reinvestment Act

Direct Pay BABs

- Borrower receives direct payments equal to 35% of interest paid on the bonds for the US Treasury in 2009 and 2010
- No current funding limit
- May only be used for new infrastructure financings or to replace interim financing

Source: American Recovery and Reinvestment Act

Tax Credit BABs

- Borrower elects to issue bonds or rates which provide federal income tax credits of 35% of interest payments
- Cash provided may be used for refunding, working capital, and new project financings
- No limit on amount of proceeds applied to costs of issuance
- Credit is treated as income to the investor
- Tax credit can be carried forward if investor income is not sufficient to freely utilize the credit in any given year
- Credits can be stripped and sold in the secondary market

Source: American Recovery and Reinvestment Act

Recovery Zone Economic Development Bonds

- Direct payment subsidies of 45% of interest paid
- $10 billion total volume cap for bonds issued in 2009 and 2010
- Issuers required to have populations of over 100,000
- Allocation to states based on rise in 2008 unemployment compared to the national average with a minimum allocation of 0.9% to each state
- Proceeds must be used in “Recovery Zones” (high unemployment and economically stressed areas) for infrastructure improvements, job training, education, and economic development
- Federal Davis-Bacon prevailing wage rules apply to projects financed with proceeds of RZEDBs

Source: American Recovery and Reinvestment Act

Qualified School Construction Bonds

Milken Institute

- Requirements:
  - 100% of the available project proceeds of the bond issue is used for the construction, rehabilitation, or repair of a public schools or for the acquisition of land on which such a bond-financed facility will be constructed
  - The bond is issued by a state or local government within which such school is located
  - The issuer designates such bonds as a Qualified School Construction Bond
- Allocations are divided between the states (60%) and certain large school districts (40%)
- Current proposal requires QSCBs to be structured within existing Section 54A tax credit bond parameters
  - Provides $22 billion of school bond volume for 2009 and 2010

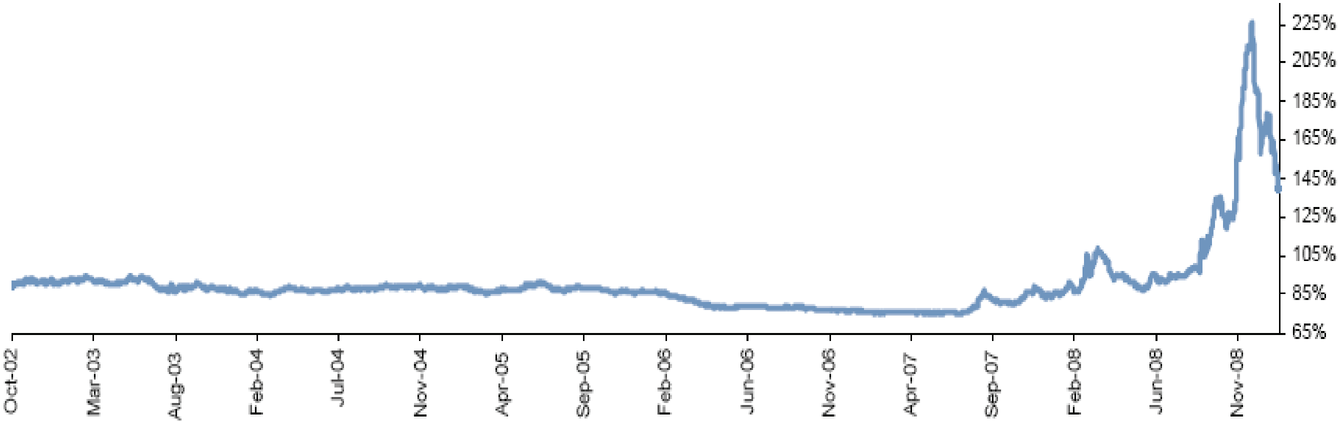
Source: American Recovery and Reinvestment Act

Qualified School Construction Bonds (continued)

- Bond interest is in the form of a tax credit which is “paid” to the investor in lieu of cash interest
- Total value of tax credit is deemed to be ordinary income in the hands of the investor
- Tax credit may be applied to current year liability to carried forward to future years in the event the tax credit exceeds current year tax liability

Source: American Recovery and Reinvestment Act

Historical 30 Year AAA Municipal Bond Ratio to LIBOR



Source: Thomson Financial

Largest Municipal Issuers (2003 – 2008)

Issuer	Amount ($mm)
State of California	38,593
City of New York	27,216
State of Illinois	15,089
Golden State Tobacco Securitization	12,785
Commonwealth of Massachusetts	11,232
California State Economic Recovery	11,101
New Jersey State Transportation Trust Fund	10,736
State of Washington	10,221
Tobacco Settlement Financing Corporation	9,834
New York City Transitional Finance Authority	9,393

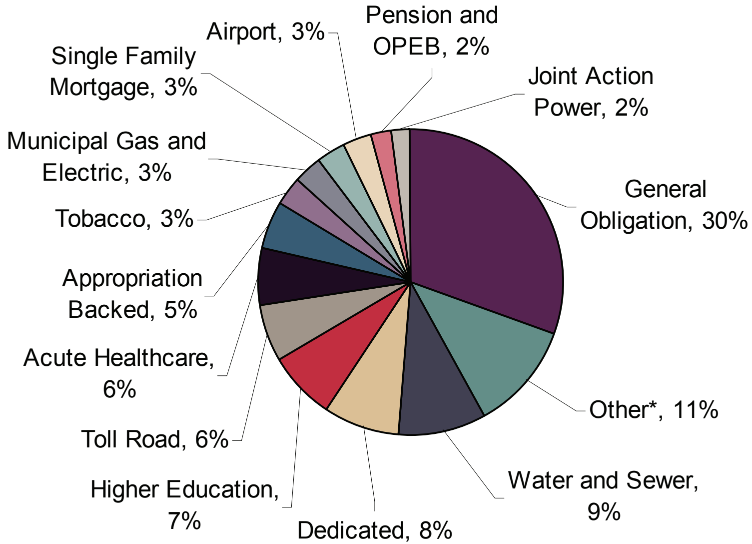
Source: SDC, The Daily Bond Buyer, and Goldman, Sachs & Co. estimates

Issuance by State (2003 – 2008)

State	Amount ($mm)
California	197,589
New York	151,400
Texas	97,003
Florida	67,668
Illinois	49,006
New Jersey	47,251
Massachusetts	37,766
Puerto Rico	37,055
Ohio	33,754

Source: SDC, The Daily Bond Buyer, and Goldman, Sachs & Co. estimates

Municipal New Issuance by Sector - 2008 YTD



*Other includes: Hotel and Convention Centers, Multi-Family Housing, Tribal Finance, Pre-Paid Gas, Co-Generation, Long Term Care, Student Housing, Airline Special Facilities, Charter School, Military Housing, Solid Waste, Land Secured, Project Finance, Transportation Revenue, Industrial Development, Cultural and Amusement, Ports, Student Loans, and Stadium Finance.

Source: SDC, The Daily Bond Buyer, and Goldman, Sachs & Co. estimates

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Amy Resnick, Editor in Chief

The Bond Buyer

Build America Bonds Break into the Market

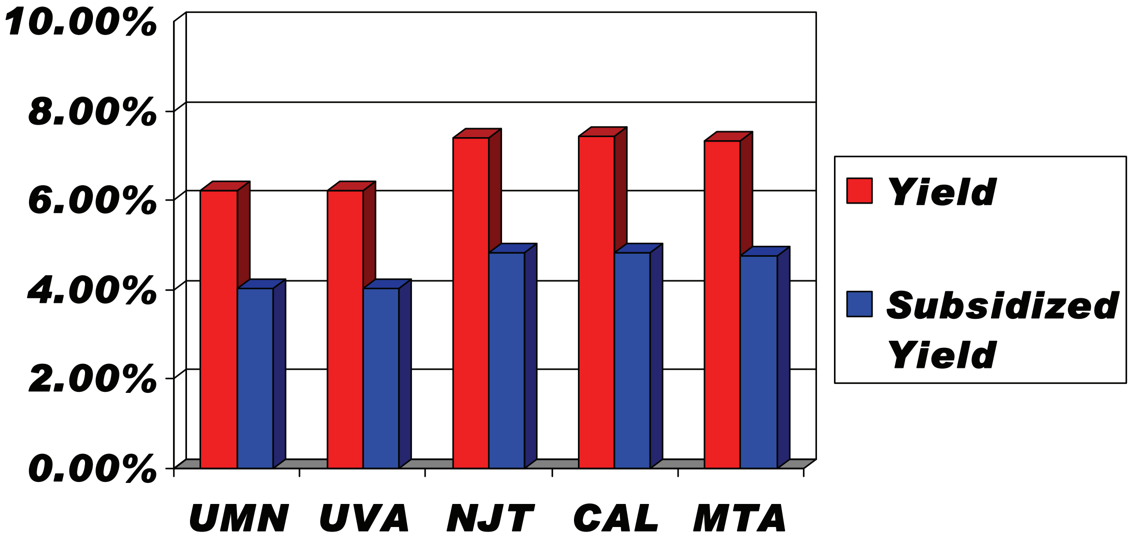
The Five Pioneers

Issuer	Pricing Date	Amount ($ in millions)	Rating Category	Spread to 30-Year
University of Minnesota	4/15	$37.5	AA	255
University of Virginia	4/15	$250	AAA	255
NJ Turnpike Authority	4/20	$1,300	A-Plus/A3	370
California	4/22	$5,000	A	365
NY MTA	4/23	$750	AA / A-Plus	350

Call Provisions: U. Of Minnesota issue is callable in 10-years; all others include a “make-whole” call provision.

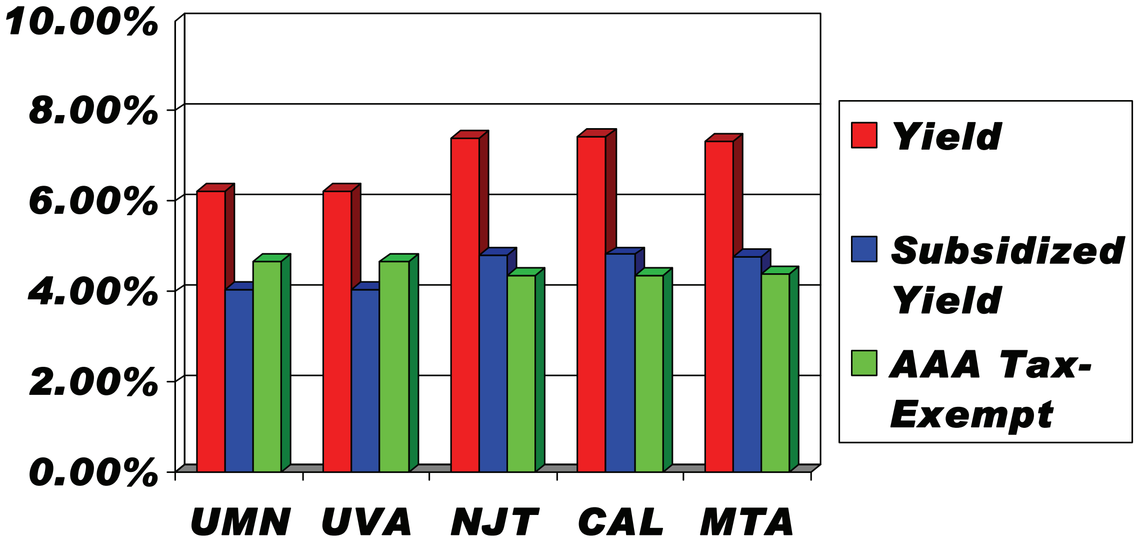
Source: Thomson Reuters

Federal Subsidies = Compelling Savings



Source: Thomson Reuters

The Best Deal Out There?



Source: Thomson Reuters