2013-Year End Summary

THE CITY OF JUNCTION CITY, KANSAS

An In-Brief Presentation of the City's Debt Profile

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Summary of Series 2013A

Series	Security	Purpose	Sale Date	Dated Date	Final Maturity	Call Feature	Size (000s)	Tax Status	TIC	PV Savings
2013A	General Obligation	To currently refund all the outstanding Series 2001 DK and 2003 DL Bonds, and to advance refund Series 2004 DN for economic savings while maximizing FY 2013 savings	6/4/13	7/2/13	9/1/24	Par call on 9/1/21	$8,050,000	Tax-exempt	2.09%	$651,355

Summary of Outstanding Transactions

General Obligation Bonds

Series	Dated Date	Original Par	Par Outstanding	Purpose	Tax Status	Final Maturity	Call Provision
2005 DO	6/29/05	$6,000,000	$4,355,000	Development Grants	Taxable	9/1/25	Par call on 9/1/15
2007 DP	5/30/2007	$28,430,000	$22,775,000	Capital improvements and to advance refund Series 2001DK and 2004DN	Tax Exempt	9/1/27	Par call on 9/1/2017
2008 DQ	5/28/2008	$3,270,000	$2,930,000	Internal improvements and refund temporary GO notes	Tax Exempt	9/1/28	Par call on 9/1/2018
2008 DR	5/28/2008	$10,265,000	$8,870,000	Development projects and to refund temporary GO notes	Taxable	9/1/28	Par call on 9/1/2018
2009 DS	9/15/2009	$369,337	$313,283	Rural Development Loan	Tax Exempt	9/15/28	Non-callable
2009 DT	3/1/2010	$1,950,457	$1,604,136	Rural Development Loan	Tax Exempt	9/1/24	Non-callable
2009 DU	5/21/2009	$34,280,000	$29,735,000	Capital improvements and to retire temporary GO notes	Tax Exempt	9/1/29	Par call on 9/1/2019
2009 DV	5/21/2009	$5,765,000	$2,960,000	Currently refund Series 1998DI	Tax Exempt	9/1/17	Non-callable
2010 DW	5/28/2010	$33,220,000	$30,450,000	Capital improvements and to refund a portion of the Series 2005 DO and 2001 DK, 2004 DN, 2007 DP and 2009 DU and to retire Series 2009-D Temporary Notes	Tax Exempt	9/1/31	Par call on 9/1/2020
2010 DX	5/28/2010	$5,690,000	$5,325,000	Capital improvements and to refund a portion of the Series 2005 DO and 2008 DR and to retire Series 2009-C and 2009-D Notes	Taxable	9/1/31	Par call on 9/1/2020
2011 A	7/27/2011	$3,835,000	$3,835,000	To currently refund the 2011 maturities of Series 2001 DK, 2003 DL, 2004 DN, 2007 DP, 2008 DQ, 2008 DS, 2008 DT, 2009 DU, 2010 DW	Tax Exempt	9/1/34	Par call on 9/1/2021
2011 B	7/27/2011	$825,000	$825,000	To currently refund the 2011 maturity of Series 2009 DV	Tax Exempt	9/1/36	Par call on 9/1/2021
2011 C	7/27/2011	$410,000	$410,000	To currently refund the 2011 maturities of Series 2005 DO and 2008 DR	Taxable	9/1/26	Par call on 9/1/2021
2013 A	7/2/2013	$8,050,000	$7,995,000	To currently refund all the outstanding Series 2001 DK and 2003 DL Bonds, and to advance refund Series 2004 DN for economic savings while maximizing FY 2013 savings	Tax-exempt	9/1/24	Par call on 9/1/21

Summary of Outstanding Transactions

Certificates of Participation

Series	Dated Date	Original Par	Par Outstanding	Purpose	Tax Status	Final Maturity	Call Provision
2006	12/15/06	$4,475,000	$2,935,000	For the acquisition of property and the construction of a park	Tax-exempt	9/1/22	Par call on 9/1/15

General Obligation Debt Service Profile

General Obligation Bonds

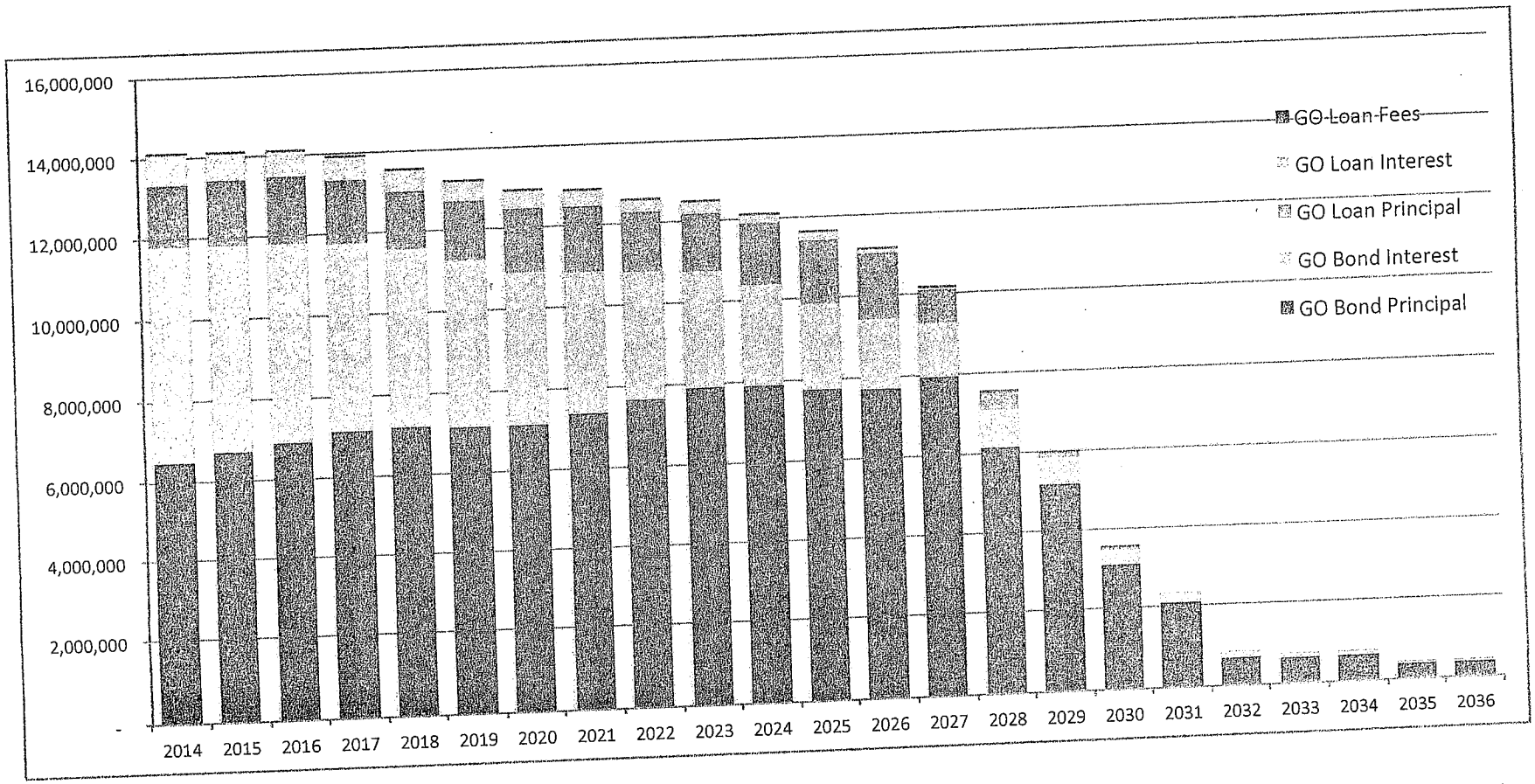
Fiscal Year	Principal	Interest	Total	Outstanding
				122,382,419
2014	6,481,543	5,323,984	11,805,527	115,900,876
2015	6,718,089	5,111,313	11,829,402	109,182,787
2016	6,919,942	4,883,659	11,803,601	102,262,845
2017	7,127,218	4,634,884	11,762,102	95,135,627
2018	7,209,840	4,363,962	11,573,802	87,925,787
2019	7,167,857	4,068,725	11,236,582	80,757,930
2020	7,141,270	3,774,101	10,915,371	73,616,660
2021	7,395,168	3,478,843	10,874,011	66,221,492
2022	7,674,505	3,159,083	10,833,588	58,546,987
2023	7,924,330	2,819,211	10,743,541	50,622,657
2024	7,914,650	2,460,935	10,375,585	42,708,007
2025	7,784,171	2,094,720	9,878,891	34,923,836
2026	7,710,168	1,719,739	9,429,907	27,213,668
2027	7,961,206	1,340,051	9,301,257	19,252,462
2028	6,162,462	946,541	7,109,003	13,090,000
2029	5,205,000	640,483	5,845,483	7,885,000
2030	3,080,000	389,485	3,469,485	4,805,000
2031	2,115,000	241,775	2,356,775	2,690,000
2032	685,000	138,625	823,625	2,005,000
2033	625,000	104,275	729,275	1,380,000
2034	625,000	72,900	697,900	755,000
2035	380,000	41,525	421,525	375,000
2036	375,000	20,625	395,625	-
	122,382,418	51,829,445	174,211,863	

General Obligation Debt Service Profile

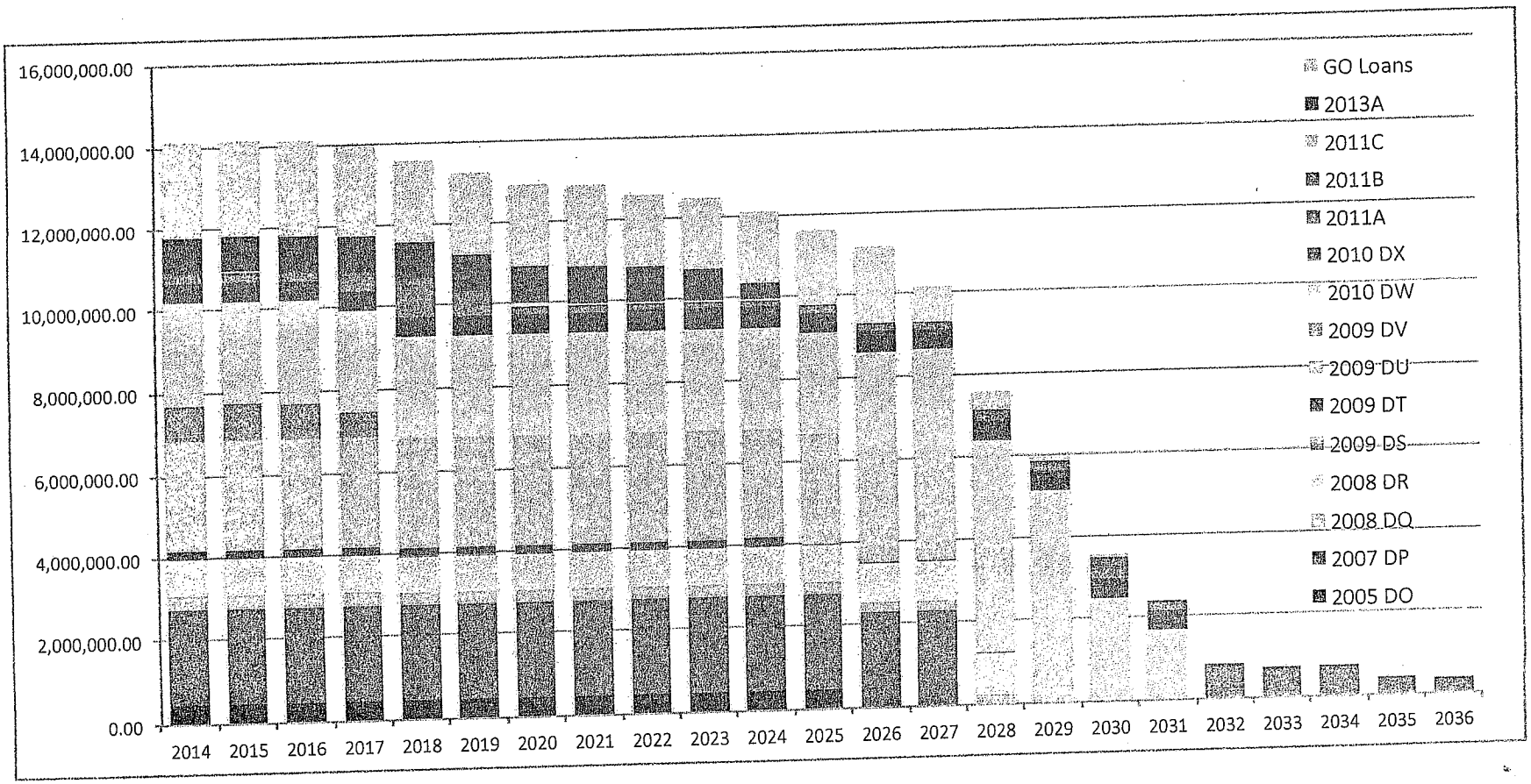
General Obligation Loans

Fiscal Year	Principal	Interest	Fees	Total	Outstanding
					21,441,224
2014	1,539,825	731,617	54,221	2,325,663	19,901,399
2015	1,596,525	678,839	50,299	2,325,663	18,304,874
2016	1,655,352	624,078	46,233	2,325,663	16,649,522
2017	1,580,107	567,259	42,017	2,189,384	15,069,415
2018	1,446,490	513,225	37,986	1,997,700	13,622,926
2019	1,499,333	464,082	34,285	1,997,700	12,123,593
2020	1,554,149	413,102	30,449	1,997,700	10,569,444
2021	1,611,014	360,214	26,472	1,997,700	8,958,430
2022	1,433,738	307,046	22,480	1,763,264	7,524,692
2023	1,459,238	258,682	18,875	1,736,795	6,065,453
2024	1,512,552	209,058	15,185	1,736,795	4,552,901
2025	1,567,860	157,575	11,360	1,736,795	2,985,042
2026	1,625,238	104,161	7,396	1,736,795	1,359,804
2027	789,471	51,179	3,534	844,184	570,332
2028	414,238	21,370	1,519	437,127	156,094
2029	111,325	5,041	441	116,807	44,769
2030	44,769	1,169	118	46,056	0
	21,441,224	5,467,697	402,870	27,311,791	

General Obligation Debt Service Profile



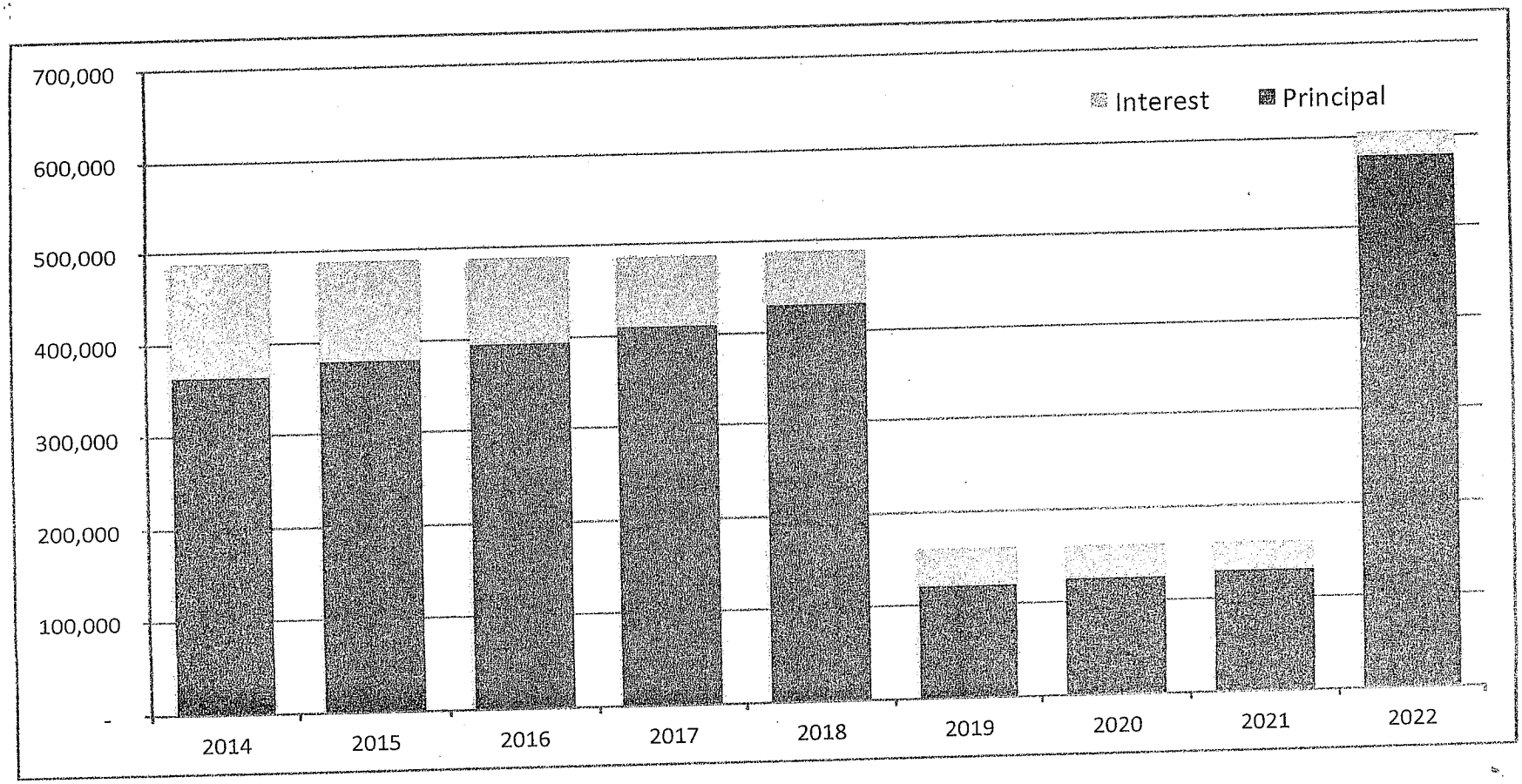
General Obligation Debt Service Profile



Certificates of Participation Debt Service Profile

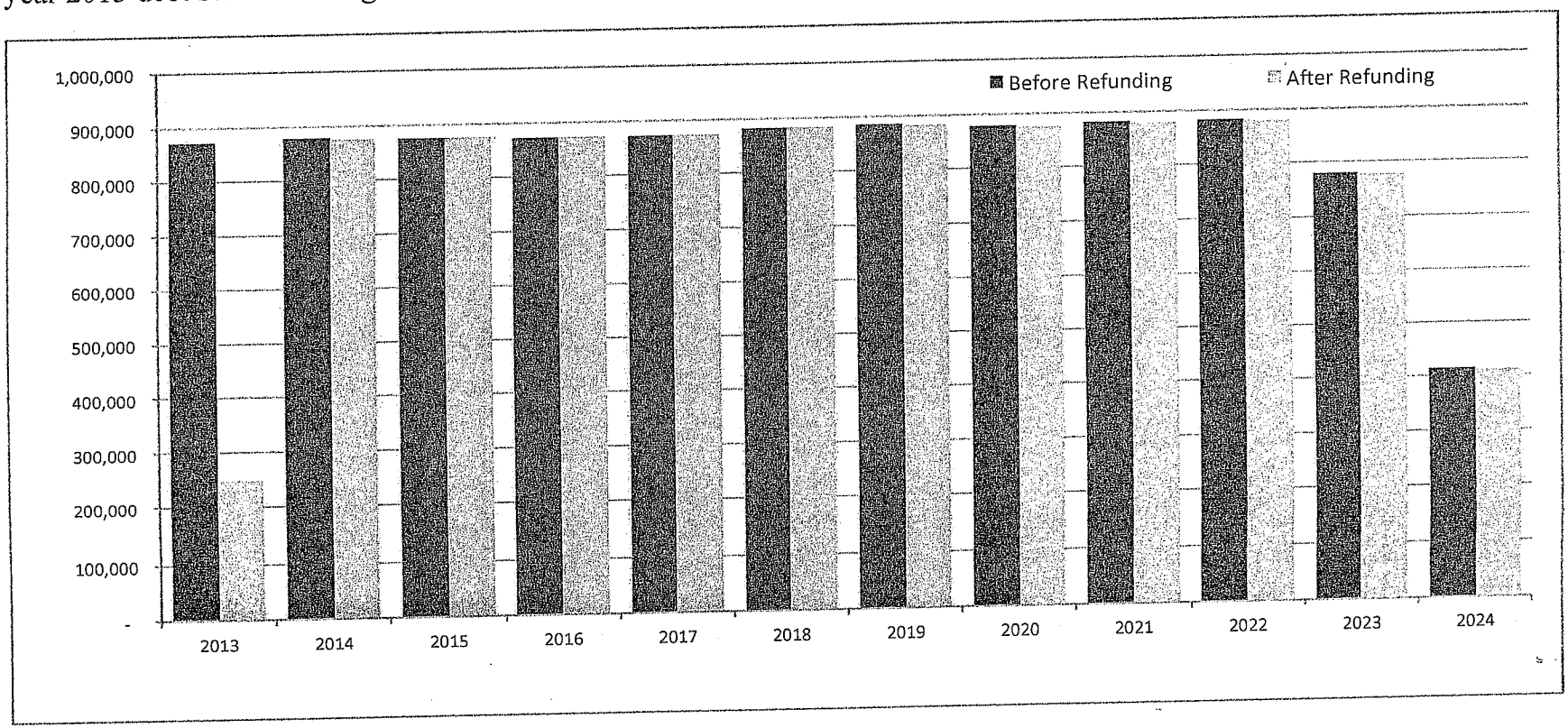
Fiscal Year	Principal	Interest	Total	Outstanding
				2,935,000
2014	365,000	121,888	486,888	2,570,000
2015	380,000	107,288	487,288	2,190,000
2016	395,000	92,088	487,088	1,795,000
2017	410,000	76,288	486,288	1,385,000
2018	430,000	58,863	488,863	955,000
2019	120,000	40,588	160,588	835,000
2020	125,000	35,488	160,488	710,000
2021	130,000	30,175	160,175	580,000
2022	580,000	24,650	604,650	-
	2,935,000	587,313	3,522,313	

Certificates of Participation Debt Service Profile



Results of Series 2013A

The City sold its General Obligation Refunding Bonds, Series 2013A on June 4, 2013 via competitive sale to currently refund all the outstanding Series 2001 DK and 2003 DL Bonds, and to advance refund Series 2004 DN for economic savings with a goal of maximizing fiscal year 2013 savings. The City's refunding was successful, generating a total of $651,355 of present value savings, or 8.4% of the principal amount refunded. Further, the City achieved $625,230 of fiscal year 2013 debt service savings. The chart below demonstrates the refunding savings the City achieved.



Series 2013 | Final Results

Par	8,050,000				8,550,000				1,360,000				2,790,000			
Issuer	City of Junction City, Kansas				City of Eldorado				Dodge City Community College				Butler County Community College			
Rev Source	General Obligation				GO ULT				COPS				COPS			
Sale Type	Competitive				Competitive				Competitive				Competitive			
Sale Date	6/4/13				6/3/13				5/28/13				5/14/13			
U/W	Robert Baird				UMB				First Banker's Bank				Country Club			
Rating	-/A/-				-/A+/-				-/A+/-				-/A+/-			
Call Option	9/1/2021				11/1/2021				4/15/2021				9/1/2021			
State	Kansas				Kansas				Kansas				Kansas			
Notes	Bank Qualified				Bank Qualified				Bank Qualified				Bank Qualified			
Maturity	Coupon	Yield	MMD	Spread	Coupon	Yield	MMD	Spread	Coupon	Yield	MMD	Spread	Coupon	Yield	MMD	Spread
2013	2.000	0.350	0.200	15												
2014	2.000	0.550	0.200	35	1.000	0.400	0.20	20	1.500	0.500	0.20	30	2.000	0.500	0.28	22
2015	2.000	0.650	0.300	35	1.000	0.550	0.30	25	1.500	0.700	0.29	41	2.000	0.600	0.43	17
2016	2.000	0.850	0.500	35	1.000	0.650	0.50	15	1.500	0.900	0.47	43	2.000	0.700	0.59	11
2017	2.000	1.100	0.720	38	1.000	0.850	0.72	13	1.500	1.100	0.66	44	2.000	0.950	0.78	17
2018	2.000	1.300	0.950	35	1.050	1.050	0.95	10	1.500	1.300	0.88	42	2.000	1.150	1.03	12
2019	2.000	1.550	1.260	29	1.250	1.250	1.24	1	1.500	1.500	1.16	34	2.000	1.350	1.27	8
2020	2.000	1.750	1.500	25	1.450	1.450	1.48	-3	1.700	1.700	1.39	31	2.000	1.550	1.49	6
2021	2.000	2.000	1.770	23	1.650	1.650	1.74	-9	1.900	1.900	1.63	27	2.000	1.750	1.67	8
2022	2.500	2.250	1.980	27	1.900	1.900	1.95	-5	2.000	2.000	1.84	16	2.000	2.000	1.83	17
2023	2.750	2.350	2.100	25	2.050	2.050	2.08	-3	2.100	2.100	1.99	11	2.500	2.100	1.94	16
2024	3.000	2.500	2.230	27	2.150	2.150	2.21	-6	2.250	2.250	2.12	13				

Series 2013 | Final Results

Par	8,050,000				4,600,000				3,390,000				1,520,000			
Issuer	City of Junction City, Kansas				Osage County Unified School District 434				Hunters Glen MUD				Illinois Valley Rural FPD			
Rev Source	General Obligation				GO ULT				General Obligation				General Obligation			
Sale Type	Competitive				Competitive				Competitive				Negotiated			
Sale Date	6/4/13				5/8/13				3/18/13				4/1/13			
U/W	Robert Baird				UMB				BOSC				Robert Baird			
Rating	-/A/-				-/A/-				A3/-/-				A3/-/-			
Call Option	9/1/2021				9/1/2023				4/1/2019				2/15/2022			
State	Kansas				Kansas				Texas				Illinois			
Notes	Bank Qualified				Bank Qualified				Bank Qualified				Bank Qualified			
Maturity	Coupon	Yield	MMD	Spread	Coupon	Yield	MMD	Spread	Coupon	Yield	MMD	Spread	Coupon	Yield	MMD	Spread
2013	2.000	0.350	0.200	15									2.000	0.800	0.20	60
2014	2.000	0.550	0.200	35	1.250	0.400	0.29	11					2.000	0.950	0.31	64
2015	2.000	0.650	0.300	35	1.250	0.500	0.43	7	2.000	0.950	0.46	49	2.000	1.100	0.47	63
2016	2.000	0.850	0.500	35	1.250	0.650	0.57	8	2.000	1.100	0.61	49	2.000	1.300	0.61	69
2017	2.000	1.100	0.720	38	1.350	0.800	0.75	5	2.000	1.350	0.86	49	3.000	1.600	0.83	77
2018	2.000	1.300	0.950	35	1.350	0.950	0.97	-2	2.500	1.650	1.11	54	3.000	1.850	1.05	80
2019	2.000	1.550	1.260	29	1.350	1.150	1.19	-4					3.000	2.100	1.27	83
2020	2.000	1.750	1.500	25	1.350	1.350	1.40	-5					3.000	2.300	1.50	80
2021	2.000	2.000	1.770	23	1.550	1.550	1.58	-3					3.000	2.500	1.71	79
2022	2.500	2.250	1.980	27	1.700	1.700	1.75	-5	3.000	2.500	1.97	53	3.000	2.700	1.89	81
2023	2.750	2.350	2.100	25	1.850	1.850	1.86	-1								
2024	3.000	2.500	2.230	27												

Debt Limit Calculation

Forward Looking Debt Limit Calculations					
Year	[A] Assesed Valuation (December 31)	[B] Debt Limit Percentage	[C = A x B] Debt Limit Amount	[D] Applicable Bonds Outstanding (July 1)	[C - D] Debt Margin
2014	187,715,072	37%	69,454,577	62,586,104	6,868,473
2015	187,715,072	37%	69,454,577	59,352,523	10,102,054
2016	187,715,072	34%	63,823,124	56,001,078	7,822,047
2017	187,715,072	34%	63,823,124	52,538,783	11,284,341
2018	187,715,072	34%	63,823,124	48,895,943	14,927,182
2019	187,715,072	34%	63,823,124	44,982,328	18,840,797
2020	187,715,072	30%	56,314,522	40,991,843	15,322,678
2021	187,715,072	30%	56,314,522	36,850,416	19,464,106
2022	187,715,072	30%	56,314,522	32,574,492	23,740,029
2023	187,715,072	30%	56,314,522	28,158,420	28,156,102
2024	187,715,072	30%	56,314,522	23,632,954	32,681,567
2025	187,715,072	30%	56,314,522	19,344,648	36,969,874
2026	187,715,072	30%	56,314,522	15,236,715	41,077,806
2027	187,715,072	30%	56,314,522	11,382,753	44,931,768
2028	187,715,072	30%	56,314,522	7,457,881	48,856,640
2029	187,715,072	30%	56,314,522	4,519,440	51,795,082
2030	187,715,072	30%	56,314,522	2,415,456	53,899,065
2031	187,715,072	30%	56,314,522	1,308,666	55,005,855
2032	187,715,072	30%	56,314,522	476,584	55,837,938
2033	187,715,072	30%	56,314,522	306,649	56,007,872
2034	187,715,072	30%	56,314,522	153,325	56,161,197

2014 Debt Management Priorities

Standard and Poor's Ratings Changes. Standard and Poor's recently released new rating criteria for local governments, transitioning to a "scorecard" style system that is much more quantitative than previous criteria. Columbia Capital has developed a proprietary model to evaluate our clients' ratings under these new criteria. Our assessment of the City's credit is that it fares well under the scorecard, implying that it should safely keep its current 'A' rating or even be upgraded. **However**, one key concern is Liquidity. We believe S&P will focus on what the City's projected liquidity is. Based on 2012 CAFR data, the City's liquidity score would cap them at a 'BBB+' rating (two notches below the current rating), but based on the Total Governmental Funds cash balance projection for 2013 that the City provided to S&P in 2013, that concern would be mitigated as that projected balance ($12.8 million) would give the City a high enough score to avoid a downgrade. We estimate the City needs to maintain about $10.3 million in cash and equivalents in Total Governmental Funds in order to protect its rating going forward.

We strongly encourage the City to work through Columbia Capital on any conversations or data requests with or from Standard and Poor's so that we may help the City shape its message in a way that presents it in the best possible light under the scorecard.

Refundings for Savings. Based upon current markets we do not anticipate the City to benefit from any refunding opportunities for savings during 2014. With the City well on its way to restoring its financial health, we also do not anticipate a need for any debt restructuring in the short term. As part of the City's capital improvement program development, we encourage the City to start discussing when and if it will begin a new program of routine borrowing for large and long-lived capital projects. We look forward to participating in those discussions.

Spin City Refinancing. The City's current bank facility on the Spin City building matures in March 2014. We are currently working with the City to extend the facility to permit repayment in full over five years and plan to recommend new bank documents for approval at the City Commission's first meeting in March.

CapGemini Refinancing. With the CapGemini lease expiring at the end of 2014, we recommend the City consider an approach to "municipalize" this building and refinance it on a tax-exempt basis. Given the size of the financing, we recommend the City do so through an annual appropriation structure (lease-revenue, certificate of participation, lease purchase or bank placement) rather than using General Obligation bonding capacity to do so. By using the facility for municipal purposes, we expect the City will be able to

both borrow at tax-exempt rates and keep the building off the tax rolls. We look forward to exploring ideas and opportunities related to this facility in conjunction with the City Attorney and bond counsel.

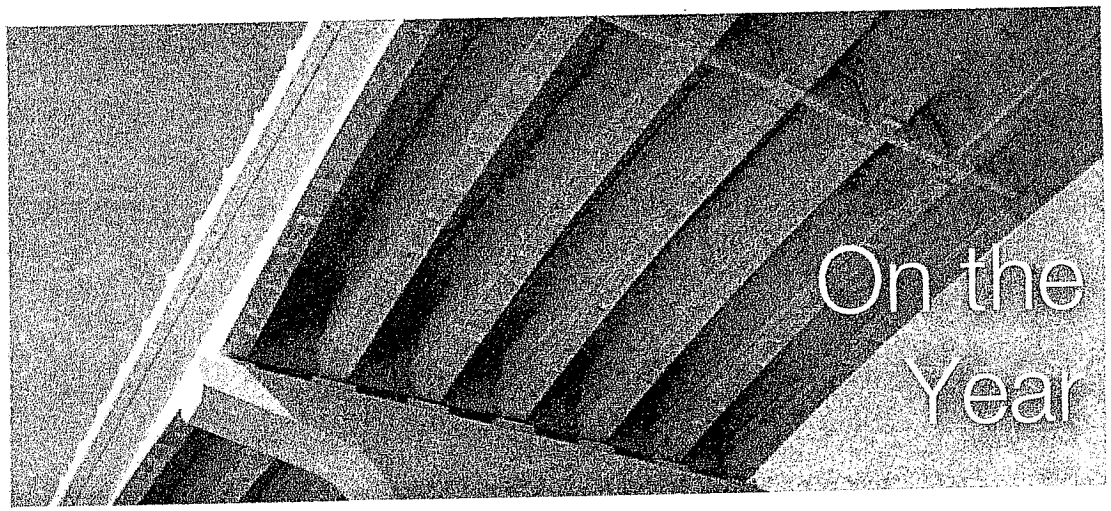
Roll-Out of Municipal Advisor Regulations. With the implementation of new "municipal advisor" regulations taking effect this summer, the municipal market will see a much clearer distinction between advisors and underwriters. We will be providing in-depth briefing materials later this spring as the regulatory environment begins to become clearer, but we want to reassure the City that Columbia Capital is registered as a municipal advisor and there is nothing the City needs to do to prepare for this regulatory change.

Post-Issuance Compliance Activities. We encourage the City to continue its efforts to implement its post-issuance compliance procedures. Columbia Capital remains available to assist in these efforts with our **munivault®** suite of post-issuance compliance services.

2013 Annual Municipal Market Summary

2013

Municipal Market Year In Review



10-yr 'AAA' MMD Rate	1.1% ↑
10-yr U.S. Treasury Rate	1.3% ↑
Total Long-term Borrowing ($)	12.8% ↓
Refunding Issues ($)	30.5% ↓
New Money Issues ($)	9.7% ↑

COLUMBIA CAPITAL
MANAGEMENT, LLC

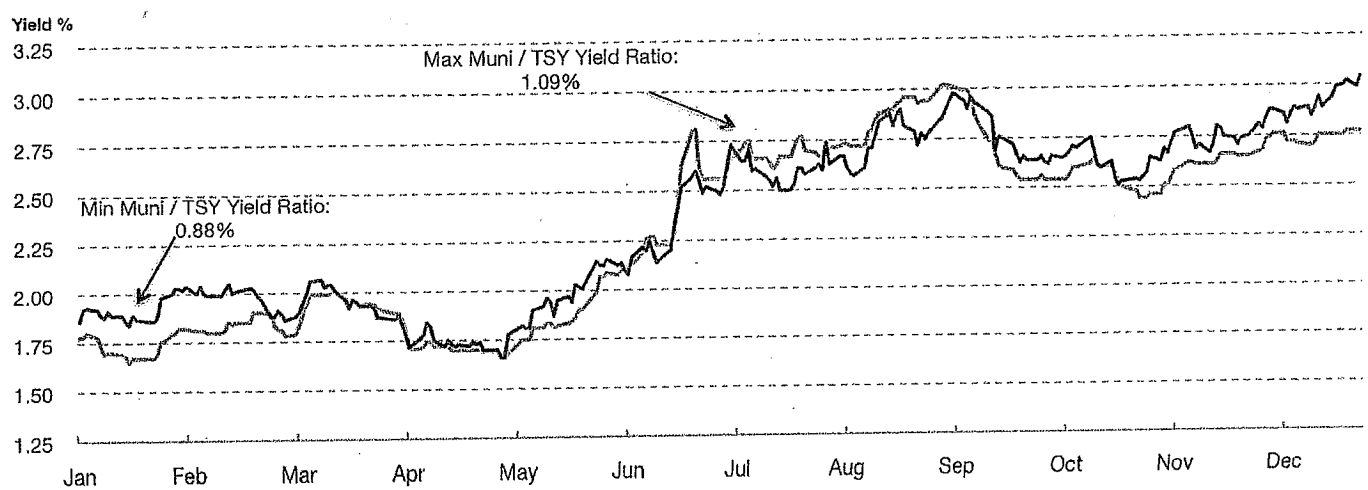
Intro A Year Beset With Volatility, Political Brinksmanship and Limited Market Volume

January, historically the lightest month for municipal market volume, began with a surge of new supply as long-term bond sales grew by more than 50% on a year-over-year basis, or approximately $9.6 billion. Reflecting a modest increase from December, this marked only the third time in the last quarter-century that long-term bond sales began the year with a month-to-month increase. This sharp uptick in January anchored first quarter supply, which would prove to be the year's only quarter to exhibit a year-over-year increase in volume.

Interest rates spent most of the year on the rise driven by a myriad of factors, including an improved economy, rallying equity markets, and indications, although often vague in form, from the Federal Reserve that a reduction in stimulus might be on the horizon. Muni rates embarked on their steepest climb between early-May and late-June amid weakening Treasury prices and surging equity markets. Fixed-income markets experienced particular weakening and volatility following Fed Chairman Ben Bernanke's indication on June 19th that the Fed might begin "tapering" its $85 billion-a-month bond-purchasing program before the year's end—a statement it would soften a few weeks later. Interest rates reacted strongly in response to the Fed's message, with the 10-year muni rate jumping 20 basis points (0.20%) on June 20th. The Fed's announcement also sparked massive withdrawals by tax-exempt investors as muni funds witnessed record outflows, pressuring rates to rise further. Investor redemptions from muni funds remained unabated through the balance of 2013.

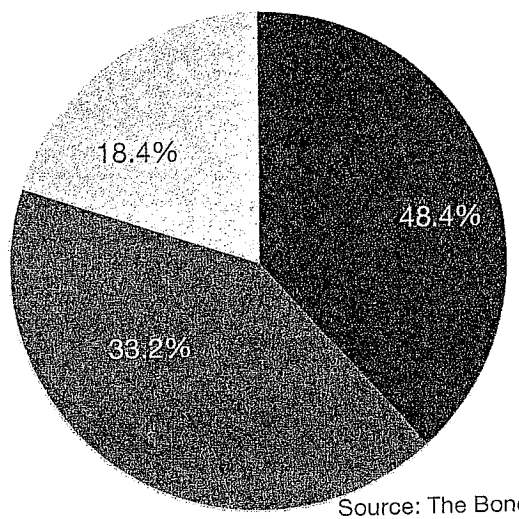
Interest Rate Movement —10-yr Muni —10-yr TSY

Interest rates rose sharply throughout 2013, a trend that began in earnest in the second quarter



A black cloud continued to hover over the municipal market throughout the third quarter, which included Detroit formally declaring bankruptcy in mid-July. The announcement, which marked the first time a state's largest city filed Chapter 9 bankruptcy, weighed on markets as both the State of Michigan and the municipal market as a whole faced unprecedented challenges. The market uncertainty translated to severe volatility, and "headline risk" weighed heavily on bond prices through early September. With issuers and investors both shying away from the market, the month of September experienced its lightest year for long-term bond sales since the 2001 terrorist attacks. On September 3rd and 4th, the 10-year muni rate recorded a 2013 high of 3.02%—up 137 basis points from January's low of 1.65%.

Municipal Bond Volume by Purpose



Source: The Bond Buyer

Fixed-income markets began a recovery in the late third and early fourth quarters as concerns regarding the national budget and looming debt ceiling deadlines drew investors back to the relative safety of fixed-income investments. Rates fell sharply between September and October as leaders of the Democratic and Republican parties failed on multiple occasions to compromise on a new 2014 budget. Failure between the parties culminated in a shutdown of the government's nonessential functions from October 1st to October 16th, temporarily setting the tone for interest rates that remained at moderately lower levels for the remainder of the year.

On the whole, 2013 was a light year for municipal bond issuance. Although borrowing for new projects increased 9% from 2012 levels, refunding issuance dropped by 30%. Total long-term borrowing reached approximately $330 billion, down 13% on a year-over-year basis.

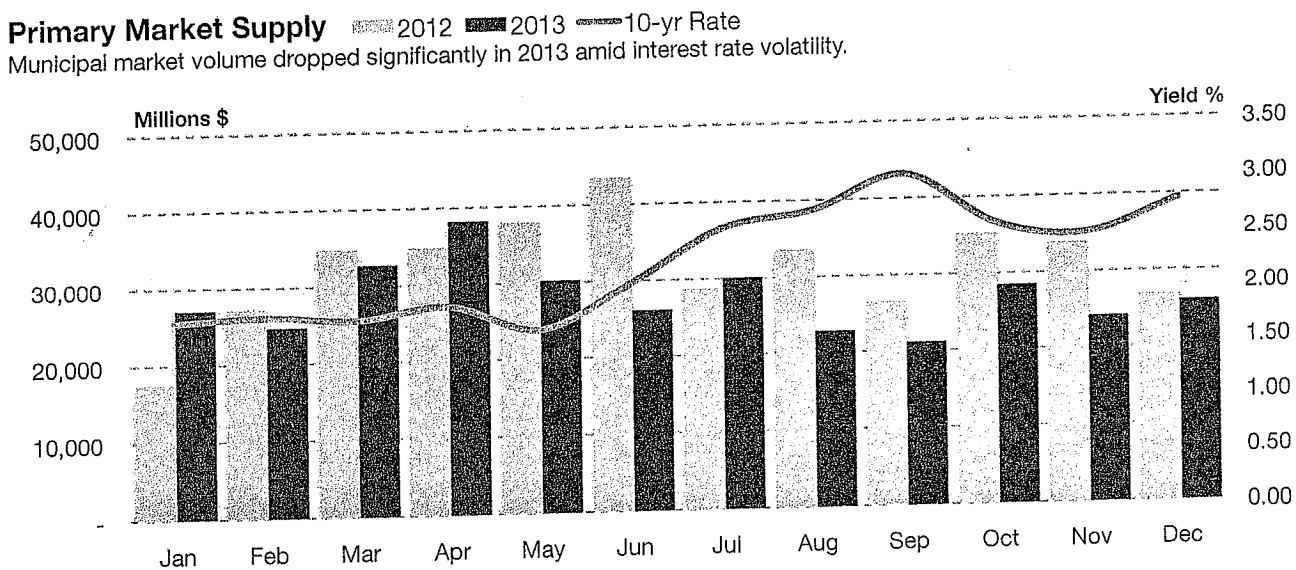
Q1 January Surge Props First Quarter Supply, Market Weakens as Equities Soar

The market began the year overshadowed by political wrangling, including serious concerns regarding the future of the municipal tax exemption stemming from ongoing budgetary woes in Washington. Although The American Taxpayer Relief Act of 2012—which delayed the implementation of the 2013 sequester—did not include the previously proposed 28% cap on the value of the exemption, it remained a hot topic with legislators.

Federal sequestration began in March, forcing the federal government to implement automatic spending cuts pursuant to the Budget Control Act of 2011. Issuers that took advantage of the government's taxable subsidized bond programs as part of the 2009 American

Recovery and Reinvestment Act (Build America Bonds, Qualified Energy Conservation Bonds, Recovery Zone Economic Development Bonds, etc.) saw immediate cuts to their subsidy payments as a result. The sequester also resulted in heightened scrutiny from rating agencies, which communicated that issuers with direct or indirect dependence on federal funding may see a negative rating impact stemming from the budget cuts.

Toward the end of 2012, many market pundits forecasted that new issue volume in 2013 would closely resemble, or even outpace, 2012 levels. Loop Capital Markets, for instance, predicted an increase in long-term bond sales by more than 6% to $400 billion on the year (source: Loop Capital Markets 5th Annual Outlook Call: 2013 in Focus). Loop's forecast seemed prescient in January when issuers brought to market $27 billion in bonds, representing an increase of over 50% from the prior year. This surge in supply was met with an equal surge in demand as cash flocked to municipal bond funds at the highest rate since September 2009. The sudden heightened demand for tax-exempt paper was attributable to (i) a respite from talks of reducing the tax-exempt benefit of municipal debt, and (ii) increased taxes for many high-income individuals. Stimulated by renewed demand, the market exhibited a temporary rally as the 10-yr 'AAA' tax-exempt borrowing rate fell 15 basis points between the 4th and 15th of January, outpacing the 10-year Treasury rate over this period, which fell nine basis points.



Muni bond supply slowed significantly in both February and March. Demand for municipal bonds also dropped as muni bond funds in March experienced monthly negative net cash flow for only the second time since August of 2011. January's rush of supply, coupled with unusually heavy taxable issuance, anchored first quarter volume, which increased by 6% on a year-over-year basis. Although tax-

exempt issuance declined by nearly 15% in the first quarter, a spike in taxable supply buoyed the market as investors took advantage of low interest rates to refund outstanding taxable debt. First quarter taxable issuance surged to $10.7 billion, a year-over-year increase of 86%.

Fixed-income markets ended the quarter on a weak note as encouraging economic data caused stocks to rally. Within a matter of two weeks, the 10-year tax-exempt 'AAA' muni rate rose from 1.78% (March 1st) to 2.00% (March 14th), and then improved over the latter half of the month to end the quarter at 1.91%. On the quarter, the 10-yr tax-exempt and Treasury rates rose 19 and 24 basis points, respectively, against a backdrop of strong economic data and surging equities. The S&P 500 and Dow Jones Industrial average indices rose 10.0% and 11.25%, respectively.

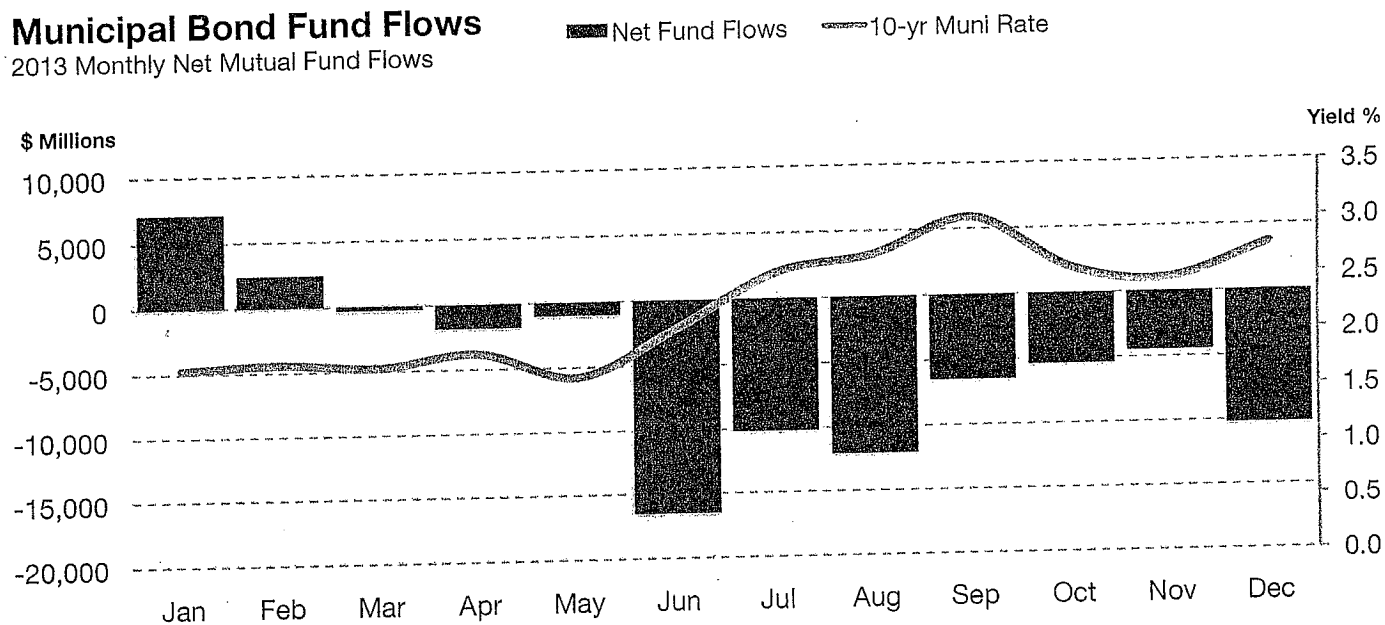
Q2 Weak Demand, High Rates Plague Second Quarter

The second quarter began with an encouraging April as a weaker-than-expected employment report, coupled with international uncertainty, namely in North Korea, sparked a fixed-income rally. Amid strong demand in both the secondary and primary markets, the benchmark 10-year muni and Treasury rates dropped 20 and 15 basis points, respectively, during the first week of the month. This trend continued into early May as relatively consistent demand for munis applied downward pressures on rates.

The bond markets took a sharp and sudden turn for the worse later in the quarter as encouraging economic reports started to indicate broad and sustainable economic improvement. An unexpectedly strong labor report released on May 3rd pushed equities higher on the day by 1% and sparked a sell-off in the Treasury market. The 10-year Treasury rate jumped 12 basis points on the day, pressuring tax-exempt paper to follow. The fixed-income sell-off was fueled further by Federal Reserve Chairman Ben Bernanke's indication to Congress on May 22nd that the Federal Open Market Committee (FOMC) might soon consider slowing, or "tapering," its bond-purchasing program at some point during subsequent meetings should economic indicators continue to improve—a statement that would fuel speculation regarding the timing of this anticipated monetary tightening for the remainder of the year. On the whole, the month of May witnessed a jump in 10-year borrowing rates for Treasurys and munis of 46 and 40 basis points, respectively, while the S&P 500 and DJIA indices grew by 2.1% and 1.9%, respectively, securing new all-time highs.

Bond markets continued to weaken throughout early June as better-than-expected employment data supported Bernanke's earlier comments regarding the improving economy. The unemployment rate rose during May (by 0.1% to 7.6%), and economists attributed this to strong labor force growth, which outpaced a substantive rise in household employment. Previous declines in the unemployment rate were a result of declining or flat labor force growth, and this change, while resulting in a higher unemployment rate, indicated a stronger underlying labor market. The release of these data increased the volatility of an already choppy and uncertain market as bond prices continued to plummet amid soaring equities and diminishing demand for tax-exempt paper.

With the FOMC's much anticipated June meeting less than two weeks away, market pundits wondered whether Bernanke would expound on the Fed's intentions to slow QE3 in the very near-term amid ongoing economic improvement, or instead, attempt to pacify the choppy bond markets by maintaining the Fed's bond purchase program at $85 billion a month. The FOMC chose a middle-ground, improving its economic forecast and mapping out a plan that, contingent upon consistent signs of economic improvement, entailed tapering the Fed's bond-buying program "later this year", and ending QE3 altogether as early as mid-2014. Both equity and fixed-income markets dropped sharply following the Fed's comments. The 10-year Treasury and muni rates ended the day up 13 basis points (2.33%) and 4 basis points (2.28%), respectively. This trend continued through late June as the 10-year rates climbed 27 (Treasurys) and 53 (AAA MMD) basis points in just three trading days while the market struggled to gain traction amid large mutual fund outflows and weak demand for fixed-income paper. Investors fled the market en masse during the record sell off as muni bond outflows surpassed $1 billion in each week of June, including $4.5 billion for the week ending June 26th, the largest withdrawal on record. Munis closed the quarter significantly underperforming Treasurys, as indicated by the 10-year muni-to-Treasury yield ratio which increased from 0.96% to 1.02%, recording a year-to-date high of of 1.09% on June 24th. The S&P 500 and DJIA indices closed the quarter up 2.4% and 2.3%, respectively.



Q3 Headline Risk, Soaring Equities Dissuade Muni Buyers

The market uncertainty and volatility that overshadowed the second quarter continued into the month of July as the 10-year muni and Treasury rates experienced 10 and 20 basis point jumps immediately following the July 4th holiday—a move triggered by better-than-expected June employment numbers. Interest rates remained range-bound throughout the rest of July with the 10-year muni yield hitting a low of 2.61% and a high of 2.77% over the second half of the month.

Headline scares plagued the market in mid-July sending bond yields higher. First, on July 17th, Moody's downgraded the City of Chicago's general obligation and sales tax-secured debt three notches from 'Aa3' to 'A3', citing the City's pension liability and resulting budgetary pressures. The downgrade came after the credit was placed on review (along with 28 other local governments) in April as part of the rating agency's new approach to analyzing state and government pension liabilities.

On July 18th, one day later, the City of Detroit formally declared bankrupty. Although the move was not unexpected, markets reacted strongly to the announcement, which marked the single largest Chapter 9 bankruptcy in U.S. history. It also marked the first time ever a state's largest city filed for Chapter 9 bankruptcy. Any long-term market ramifications for the state of Michigan, and the muni bond market as a whole, were—and remain—unclear. The 10-year muni rate increased four basis points the day following the announcement, while the ten-year Treasury rate decreased by six basis points. The 10-year muni bond and Treasury rates both rose the following week by seven and two basis points, respectively. Rates ended the month of July up 10 (munis) and 11 (Treasurys) basis points, as munis maintained cheap price levels relative to Treasurys, averaging a muni-to-treasury yield ratio of 103% throughout the month.

The 10-year Treasury rate jumped 14 basis points to begin August as better than expected employment data—namely initial jobless claims, which fell to their lowest level since January 2008—weighed on fixed-income markets. The benchmark 10-year muni rate rose only four basis points, breifly pushing the muni-to-treasury yield ratio below 100% for the first time in nearly a month. Interest rates continued their climb throughout August as other positive economic indicators, such as encouraging retail sales, weighed on bond prices. Heavy and persistent muni bond outflows also plagued the market. In a span of 10 trading days (August 12-23rd), the 10-year muni rate climbed 22 basis points from 2.72% to 2.94%. The spike in rates, partially attributable to weak demand for muni paper, forced many issuers to postpone their financings. Issuers hoping to refund outstanding debt were forced to reconsider entering the market altogether as the rapid hike in rates eroded the potential for economic savings. The result was a sharp decline in new bonds sales with volume in the month of August falling by one-third on a year-over-year basis. Muni rates rose sharper than Treasurys during this period, trading at unusually cheap price levels throughout the month and recording a muni-to-treasury yield ratio as high as 107% (August 29th).

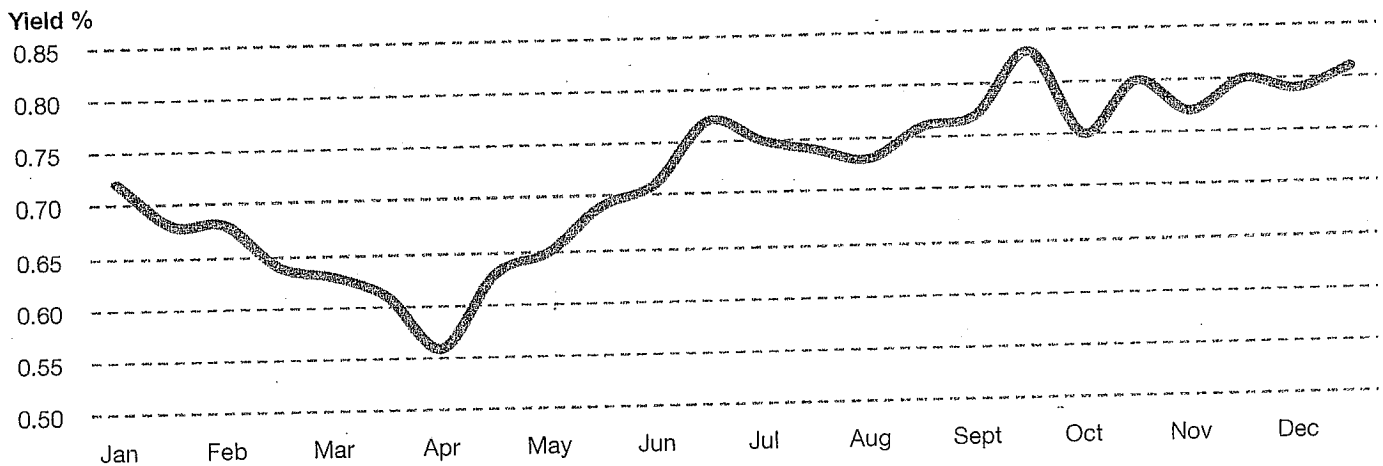
Uncertainty in Puerto Rico also weighed on muni prices throughout the fourth quarter. The month of August was particularly painful for the territory as its tax-exempt borrowing rate exceeded 10% amid growing concerns about its long-term economic viability. With a

population of 3.7 million, half of which lives in poverty, and nearly $70 billion in long-term debt, Puerto Rico's challenging financial condition is the result of chronic budget deficits, a weakening economic base and a failure to adequately address growing pension liabilities. Despite tax increases and cuts to retirement benefits, Puerto Rico will likely need to partially finance its 2014 budget. As Puerto Rico continued to face increasing interest rates, inhibited market access and deteriorating liquidity, Standard and Poor's downgraded the territory on Feburary 5, 2014, to 'BB', which falls below investment grade status.

The headline scares causing rates to jump throughout the third quarter also impacted credit spreads, which for lower-rated credits, peaked in September as rates reached higher. A credit spread is the cost of not being a 'AAA' borrower, measured as the difference between the 'AAA' benchmark rate and the rate at which a borrower's bonds price in the market. The wider the credit spread, the more costly the borrower's bonds are on a relative basis. On September 5th the 10-year muni rate hit 3.04%, a level it last saw in April 2011. This proved to be the high-water mark for tax-exempt rates on the year as an ensuing fixed-income rally caused rates to fall significantly through early October. This rally began in earnest during the week of September 9th as a light primary calendar combined with discouraging economic data fueled strong demand for tax-exempt paper in both the primary and secondary markets. On September 18th, flustered by stubborn unemployment data and meek inflation projections, the Federal Reserve unexpectedly announced its intentions to delay its previously publicized "tapering" program. Both bond and equity prices soared on this news. The 10-year muni and Treasury rates fell 7 and 17 basis points respectively, and both the S&P 500 and Dow Jones Industrial Average rose more than 1% to reach new closing highs.

10-yr Term Credit Spreads

'A' spreads to 'AAA' Yields Throughout 2013

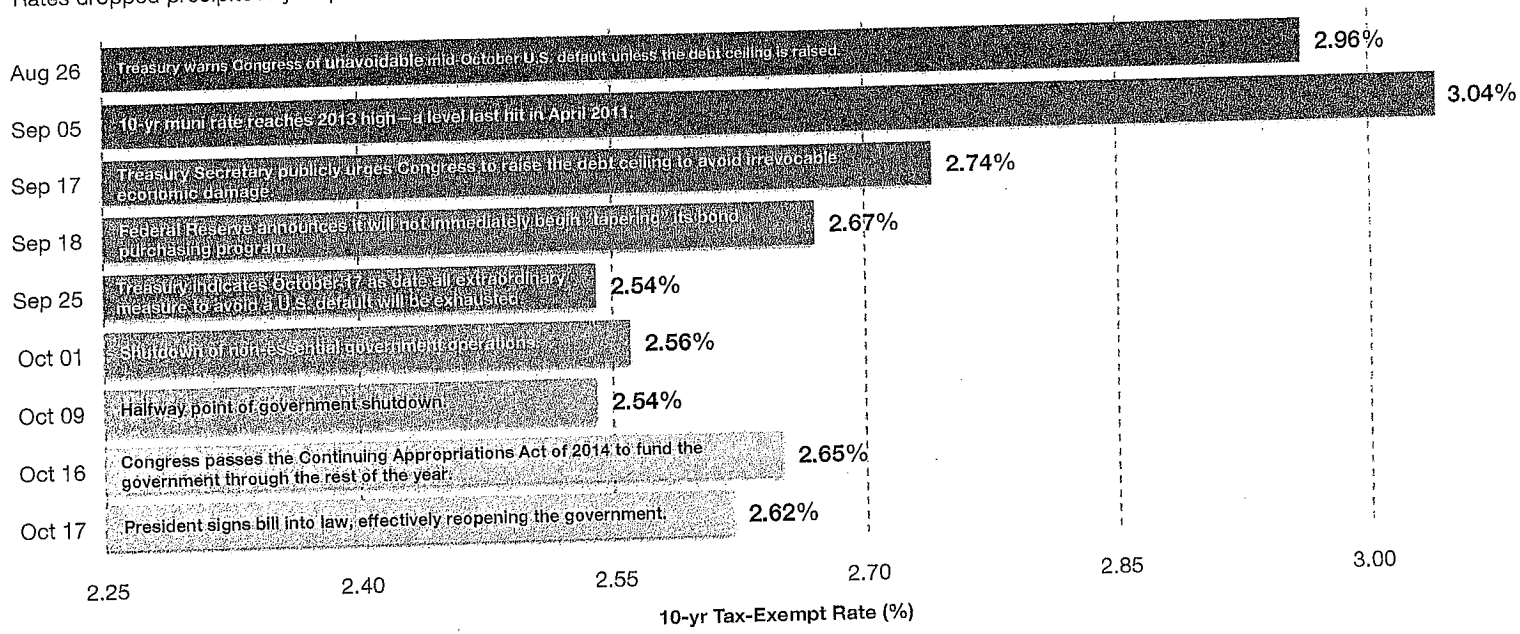


Q4 Political Uncertainty Fuels Market Recovery

The market continued to rally early in the fourth quarter amid political brinkmanship in Washington as leaders of the Democratic and Republican parties failed to reach an agreement to accommodate the latter's demands for reduced and delayed healthcare reform funding in exchange for an increased national debt ceiling.

Budget and Debt Ceiling Debate Timeline

Rates dropped precipitously as political brinkmanship in Washington fueled market uncertainty.



As the political gridlock intensified, the Treasury warned Congress of the potentially catastrophic and irrevocable economic consequences of allowing a partial U.S. default. The political standoff culminated in a shutdown of most of the federal government's routine operations following Congress' failure to reach a political comprosmise by October 1st to appropriate federal funds for the 2014 fiscal year. Leaders of both political parties continued the standoff for more than two weeks until agreeing to terms on October 16th—one day prior to the debt ceiling deadline. Between September 5th (10-year borrowing rate high of 3.04%) and the debt ceiling resolution on

October 16th, the benchmark tax-exempt 10-year rate fell 39 basis points. Rates continued to fall in the weeks following the debt ceiling crisis with the 10-year rate bottoming out at 2.44% to end October.

Muni yields rose to begin November amid encouraging labor data and belief that the Fed would announce its intention to begin tapering at its December FOMC meeting. A continued, albeit slowing, investor exodus from tax-exempt paper also weighed on bond prices as consecutive weekly outflows surpassed the six-month mark. The 10-year muni rate ended the month at 2.65%, up 21 basis points.

Detroit's bankruptcy picture became clearer in early December as the federal judge administering the case officially confirmed the City's eligibility for bankrupty protection. With over $18.5 billion in long-term liabilities to restructure, Detroit officially commenced the largest municipal bankruptcy in U.S. history. The judge also ruled that the City was allowed to enact pension cuts despite existing constitutional pension protection at the state level—a precedent that may have wide reaching implications for cities across the U.S. that face persistent pension funding shortfalls.

As many expected, the Federal Reserve announced on December 18th that it would begin scaling back its bond purchasing program beginning in January. The Fed also stated its intentions to keep the Federal Funds rate between 0.00% and 0.25%, even if the unemployment rate dipped below 6.5%, the Fed's previous threshold for warranting a possible rate increase. Stocks rallied on this news as both the S&P 500 and DJIA once again set all time highs. Treasury rates climbed in response, ending the day four basis points higher at 2.88%. The 10-year muni rate also weakened, closing up one basis point.

On the year, the benchmark 10-year Treasury and muni rates increased by 1.26% and 1.05% to 3.04% and 2.77%, respectively. The Dow Jones Industrial Average and S&P 500 stock indices ended the year up 26.5% and 29.6%, respectively.

2014 A Short Term Market Outlook

Interest Rates

The Fed has set the stage for interest rates to continue climbing as it begins to slow its bond buying program, and many market analysts anticipate primary market volume to continue to slump as the cost of financing projects rises and opportunities to refinance outstanding debt continue to dwindle. The municipal bond market has shrunk considerably in recent years, with the amount of outstanding debt falling seven of the last 12 quarters. In the third quarter of 2013 specifically, the market shrank at a record rate as total long-term municipal debt outstanding totalled $3.69 trillion, down from $3.72 trillion in the second quarter. This marks the lowest level of outstanding debt since 2009. The $35.3 billion quarter-to-quarter market contraction was the largest on record. Despite credit markets offering historically low-cost financing over the past few years, issuers have remained constrained by fiscal and political pressures to limit

borrowing—a trend we feel may continue throughout 2014. Those issuers that have consistently accessed the capital markets are often doing so to refinance existing bonds, which does not increase the pool of investment options for potential buyers. Although the continued prospect of limited supply moving forward may help stabilize bond prices as investors compete for a shrinking pool of tax-exempt investments, we anticipate interest rates will continue to drift upward in 2014. This is especially likely if investors continue to pull cash from muni funds like they did throughout 2013, and the economy continues to improve in line with the Fed's expectations.

Fundamentals

Moody's recently revised its general outlook for U.S. local governments to 'stable' from 'negative'—a move triggered by stable fund balances and an improving housing market. Although "the worst is over for local governments in most of the country", claimed the report, Moody's cautioned that economic conditions remain worse for local governments than they were prior to the Great Recession. Moody's currently rates 114 local goverments 'Ba1' or lower (that is, below investment grade), up from only 20 in 2008.

Conditions for state-level issuers are also improving, as states head into the new year on the heels of 14 consecutive months of revenue growth. State budgets, however, are the most susceptible to changes in federal spending, and Fitch Ratings cites the federal government as "the most significant threat to state budgets," stating that federal action—or inaction—can hurt the economy as a whole, adversely impacting state-level revenues.

Growing unfunded pension liabilities remain a concern for issuers across the U.S. Moody's recently reported that more than half of the 50 largest local governments in the U.S. (as measured by outstanding debt) have unfunded pension liabilities that exceed 100% of their annual revenues. Unfunded pension liabilities will remain a negative credit pressure for those issuers that maintain high pension burdens or persistently fail to meet the Actuarial Required Contribution ("ARC") on an annual basis. As Moody's puts it,"contribution shortfalls relative to actuarial standards indicate structrually imbalanced operations, which range from minimal to severe."

Economy

The U.S. economy finished 2013 on a positive note. Real GDP growth was 4.1% in the third quarter and 3.2% in the fourth quarter, an improvement from growth rates of 2.5% in the second quarter and 1.1% in the first quarter. Furthermore, the underlying components of GDP growth indicated continued strength in the private sector. Personal consumption and private investment growth were both stronger in the second half of the year relative to the first half. Government consumption and investment at the federal level continued to negatively impact overall GDP, but state and local government activity has stabilized and grown for the past three quarters.

Labor market conditions also improved steadily throughout 2013. The unemployment rate was 6.7% in December, an improvement of 1.2% since January 2013. Initial claims for unemployment insurance fell consistently during 2013 and have returned to pre-recession levels.

Congress recently came to terms on a budget deal—the Bi-Partisan Budget Act of 2013—to fund the government through the fall of 2015. This deal, which cancels approximately $65 billion in previous sequestration cuts over the next two years (but not the haircut to rebate payments on stimulus-era bonds), will alleviate any near-term concerns of repeating the October standoff. Plenty of uncertainty still surrounds the next debt-ceiling deadline, however, as the Treasury estimates the government's borrowing limit must be raised again by late-February or early-March to avoid a U.S. default. If the renewed debt-ceiling debate proves to be as contentious and drawn-out as it was in 2013, then it is very possible the municipal market will return to its volatile tendencies, similar to what we saw in late-August and early September.

Also in December, the Federal Reserve announced that it would begin tapering quantitative easing by $10 billion beginning January 2014. The Federal Open Market Committee stated that "improvement in economic activity and labor market conditions" warranted this change in policy. Furthermore, the committee stated that if conditions continued to improve, they would reduce the pace of asset purchases, but they were careful to note that "asset purchases are not on a preset course" and they would adjust accordingly. This enhanced forward guidance language was well received by the markets and helped to eliminate some uncertainty over monetary policy.