

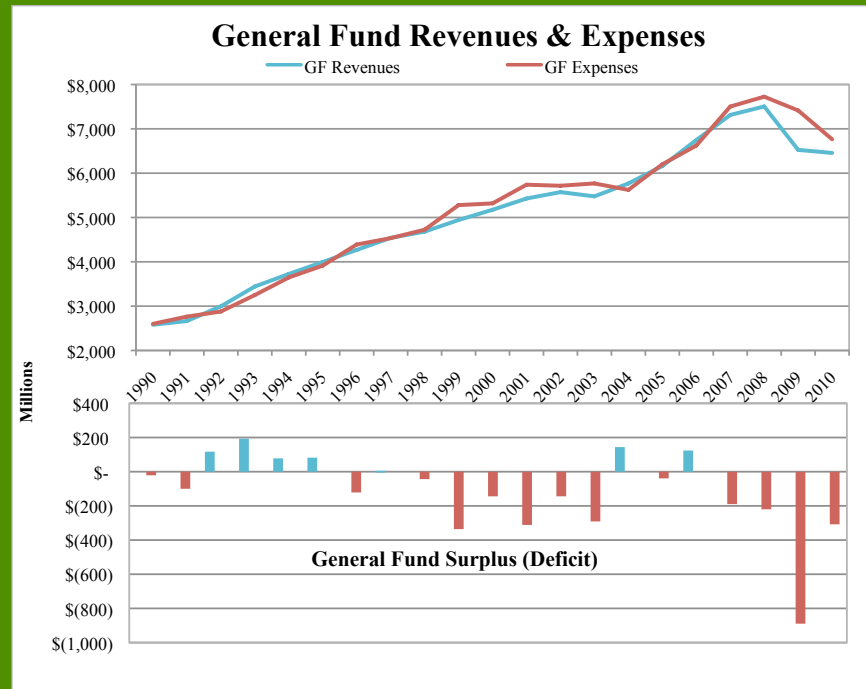
Colorado Municipal Bond Report

MARCH 2011

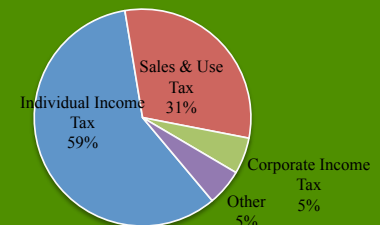
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This bond report is a continuation of the discussion on the State of Colorado's fiscal challenges. The chart below illustrates the difficulty our State faces matching revenues to expenses, even during growth periods. Now, as revenues have declined, the difficulty has turned serious. Citizens are reluctant to give up important benefits and services. Meanwhile, certain programs have forced growth mandates which collide with recent revenue declines. Without structural fiscal reform, each year budget negotiations become emergency decisions. The following charts help explain why.

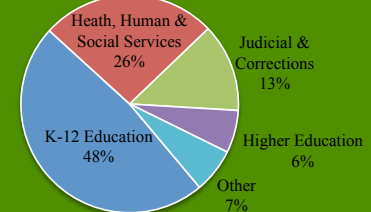
Colorado's General Fund Analysis



General Fund Revenues

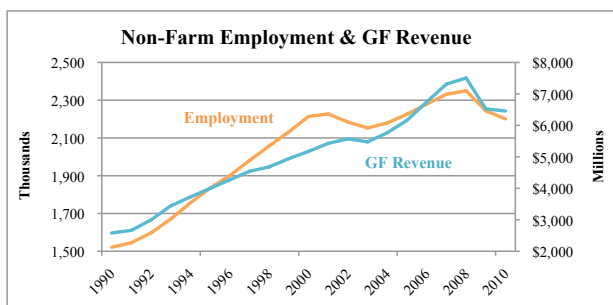


General Fund Expenses



REVENUES

- Revenues of the State's general fund are mostly made up of income taxes and sale taxes. These two items combined amounted to 95% of total GF revenues in 2010. The revenues of the state can be increased by two main factors: tax rates and job growth. While increasing tax rates in the short term may help, the ability for the state to increase taxes diminishes as tax rates get higher, so the long term solution in our opinion is getting people back to work. As evidenced by the chart below, when people are employed the State gets more money.



EXPENSES

Colorado has an Expense Problem

- Due to mandatory expense increases related to Amendment 23, Colorado is forced to spend more on K-12 education every year.
- Further complicating the problem, is the continued growth of health, human and social service expenses. Medicaid enrollment is up more than 121% since 2000 while the state population is up just 17%. Rising healthcare costs further compounds the issue.
- The K-12, health and human service expense items now account for 74% of the entire general fund budget. It is imperative that these costs be managed with a relationship to revenue streams versus continued auto pilot growth.**
- With K-12 education and health services taking an increasing portion of the budget, fewer dollars are available for higher education, corrections and infrastructure.
- Federal aid in 2009 helped soften the previous budget cuts, but with the expiration of the federal stimulus package our state will be forced to focus on the basic economics of matching revenues to expenses.

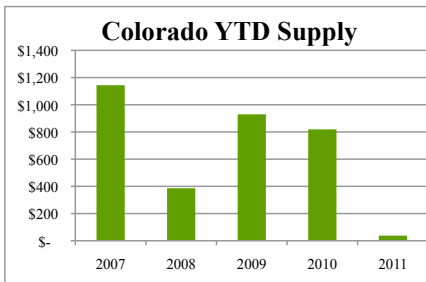


Equus is a fee-based SEC registered investment advisor specializing in Colorado municipal bonds. We are proud to offer our research insight to those looking for further information. If you are interested in obtaining more information about the quality and content of our municipal holdings free of charge, please contact Ron Speaker at (970) 963-9254.

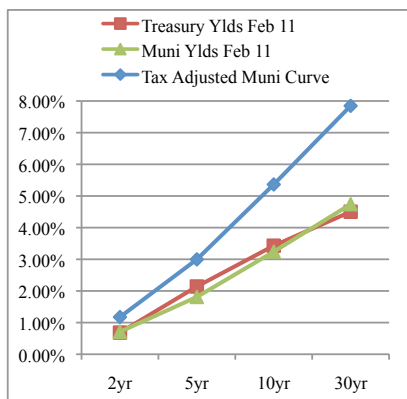


Early 2011 Colorado Muni Market Update

The Colorado municipal bond market is off to a slow and quiet start. Performance year-to-date February is +.54% for the Barclays Colorado index. New issue volumes are down dramatically due to the expiration of the BAB's program and the turmoil in the market. This has postponed new money and refinancing opportunities.

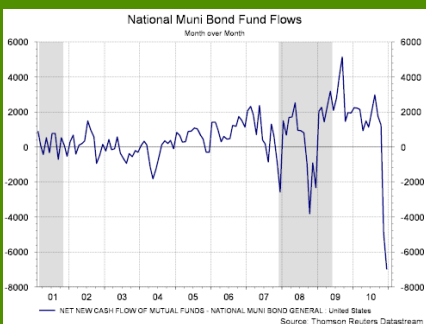


The municipal bond yield curve remains steep, which has created excellent yield pick up opportunities and roll down strategies. As you can see below, municipal bonds yield as much or more than Treasuries on a nominal basis. When the municipal yields are adjusted for taxes, the comparisons are dramatic.



Outflows in the municipal arena

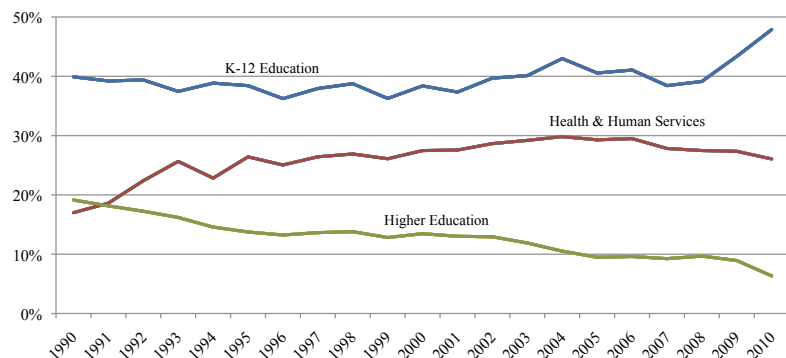
After strong inflows in 2009 and early 2010, municipal bond investors recently responded to national level default concerns by reversing course. As displayed in the following chart, fund outflows have been significant starting in late 2010. This caused negative performance and created opportunities for informed buyers.



STATE OF COLORADO General Fund Income Statement

Year Ended June 30
Dollars in Millions

| | 1990 | 1995 | 2000 | 2005 | 2010 |
|--|--------------|--------------|---------------|---------------|--------------|
| General Fund Revenues: | | | | | |
| Net Individual Income Tax | \$ 1,381 | \$ 2,106 | \$ 3,718 | \$ 3,421 | \$ 3,777 |
| Corporate Income Tax | 104 | 191 | 289 | 293 | 350 |
| Excess TABOR Refunds | - | - | (192) | - | - |
| Net Income Tax Revenue | 1,485 | 2,297 | 3,815 | 3,714 | 4,127 |
| Sales and Use Taxes | 913 | 1,316 | 1,775 | 2,146 | 1,979 |
| Excess TABOR Refunds | - | - | (750) | (41) | - |
| Net Sales & Use Revenue | 913 | 1,316 | 1,025 | 2,105 | 1,979 |
| Other | 182 | 383 | 334 | 342 | 350 |
| Total General Fund Revenues | 2,580 | 3,996 | 5,174 | 6,161 | 6,456 |
| 5 year % change | | 55% | 29% | 19% | 5% |
| General Fund Expenditures | | | | | |
| K-12 Education | 1,038 | 1,504 | 2,041 | 2,514 | 3,239 |
| Health, Human & Social Services | 442 | 1,034 | 1,461 | 1,816 | 1,763 |
| Judicial & Corrections | 238 | 347 | 576 | 715 | 887 |
| Higher Education | 498 | 538 | 716 | 588 | 429 |
| Other | 385 | 492 | 524 | 567 | 446 |
| Total General Fund Expenditures | 2,601 | 3,914 | 5,318 | 6,200 | 6,764 |
| 5 year % change | | 50% | 36% | 17% | 9% |
| Excess Revenues over Expenses | (21) | 82 | (144) | (39) | (308) |
| Total Fund Balance | <i>n/a</i> | <i>n/a</i> | \$ 257 | \$ 239 | \$ 16 |
| Fund Balance % of Total Expenditures | | | 4.8% | 3.9% | 0.2% |
| % of Total Expenditures | | | | | |
| K-12 Education | 39.9% | 38.4% | 38.4% | 40.6% | 47.9% |
| Health, Human & Social Services | 17.0% | 26.4% | 27.5% | 29.3% | 26.1% |
| Higher Education | 19.1% | 13.7% | 13.5% | 9.5% | 6.3% |



SUMMARY

A larger perspective of the State's general fund income statement reflects a steady rate of increase in K-12 education spending from 1990 through 2010. In 2009, when sales and income tax revenues declined by 13%, there was a significant increase in K-12 funding as a percentage of total expenses from 40% to 48% in 2010. The percentage of spending on healthcare and human services also increased from 17% in 1990 to almost 30% in 2005 due to rising costs and a sharp increase in Medicaid applicants. As a result of forced increased spending in K-12 education and healthcare services, higher education funding has dropped from 19% in 1990 to 6% in 2010. Lower state funding for higher education incentivizes colleges and universities to look elsewhere for financial resources. This has resulted in higher tuition and fees and an increase in out-of-state students. Colorado has a structural budget problem that needs to be addressed. An astonishing 14 out of the last 21 years have resulted in a general fund deficit even while revenues have increased 2.5x over the same time period. **The budget process must disentangle itself from the ever growing expense desires of the populist.**

Source: Colorado Office of Personnel & Administration; Office of State Controller/Reports; 2010 CAFR, Statistical Section. Employment data was retrieved from the Colorado Department of Labor and Employment.

Tax Laws Create Fiscal Imbalance

TABOR Amendment

Overview

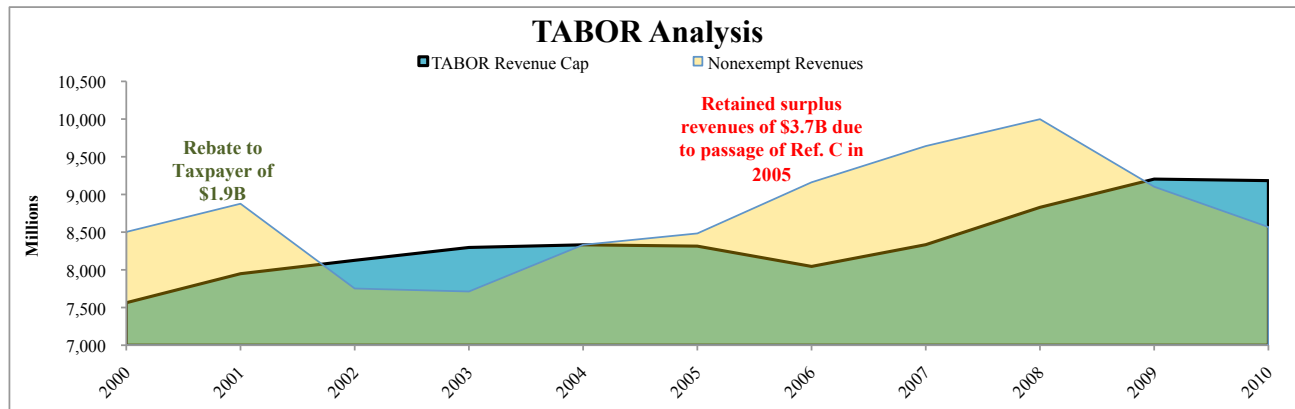
- Passed in 1992, limits tax revenue growth to a factor of population growth plus inflation.
- Requires voter approval for tax increases.
- Surplus revenues above the TABOR limit are refunded back to taxpayer. As illustrated in the chart below, the state refunded \$1.9 billion to taxpayers.

TABOR keeps government spending in check. However, during times of severe economic contraction and reduced tax collection, TABOR limitations make it difficult to reach previously obtained revenue levels as economic conditions improve.

Amendment 23

Overview

- Passed in 2000, mandates growth of K-12 spending by a minimum of inflation plus one percent for the first 10 years and then by the rate of inflation thereafter.
- Due to the sharp decline in income and sales taxes in 2008, the portion of state revenues dedicated to K-12 education increased dramatically over the last two years and has crowded out funding to other public services, including higher education, infrastructure needs and the department of corrections.



Referendum C: TABOR Timeout

- Passed in 2005 with a five year horizon and viewed as a way to avoid TABOR limitations. The five year hall-pass expired in 2010.
- Allowed State to retain excess revenues above TABOR limitation and maintain spending even in down economic years.
- The State was able to retain over \$3.7 billion in excess revenues over the five year horizon.

| Date: 3/1/2011 | | | | | Moody's Underlying Rating | Yield -to- Maturity | Tax Eq Yield |
|----------------|-------------------------------|-----------|--------|------------|---------------------------|---------------------|------------------------|
| Maturity | Issuer | Structure | Coupon | Maturity | | | 35.0% Fed 4.63% St. |
| 5 Yrs | Colo Dept of Transportation | Rev | 5.00% | 12/15/2015 | Aa2 | 2.46% | 4.07% |
| 5 Yrs | Denver Convention Center | Rev | 5.25% | 12/1/2015 | Baa3 | 4.05% | 6.71% |
| 5 Yrs | Regional Transportation Dist. | COP | 5.00% | 12/1/2015 | Aa2 | 2.81% | 4.65% |
| 8 Yrs | Denver Metro Wastewater | Rev | 5.00% | 4/1/2018 | Aa1 | 4.16% | 6.89% |
| 10 Yrs | Denver International Airport | Rev | 5.00% | 11/15/2020 | A1 | 4.16% | 6.89% |
| 10 Yrs | University of Colorado | Rev | 5.00% | 6/1/2020 | Aa2 | 3.71% | 6.15% |
| 10 Yrs | DURA - Stapleton TIF Proj | Tax Inc | 5.00% | 12/1/2020 | Aa3 | 4.03% | 6.67% |
| 14 yrs | E-470 HWY | Rev | 5.50% | 1/1/2024 | Baa2 | 5.58% | 9.24% |
| 23 Yrs | Childrens Hospital | Rev | 5.00% | 12/1/2033 | A1 | 5.34% | 8.85% |
| 29 Yrs | Denver Public Schools | G.O. | 5.00% | 12/1/2029 | Aa2 | 4.65% | 7.70% |



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