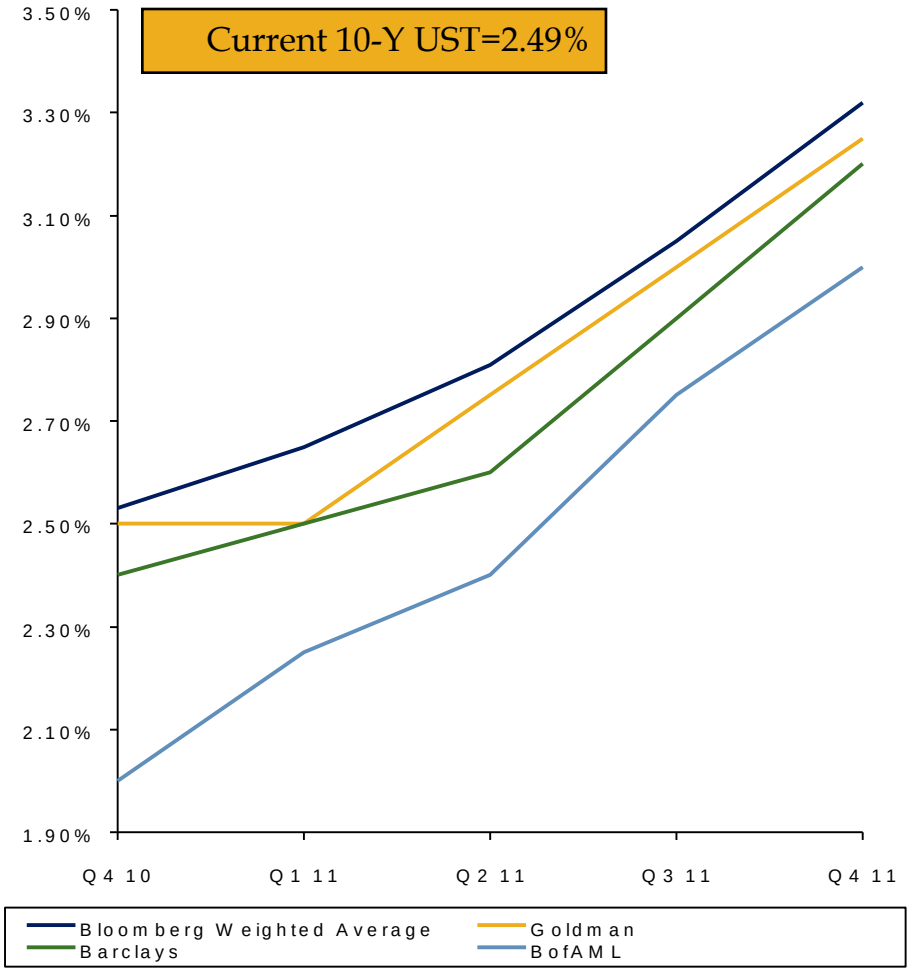
Municipal Market Presentation to

OKLAHOMA
Governor's
Water Conference

October 27, 2010

Market Update
Rate Forecast

Economists' 10—Year Treasury Forecast



BAML Interest Rate Forecast

Metric	2009 Q4	2010 Q4	2011 Q1	2011 Q2	2011 Q3
Fed Funds	0.25%	0.25%	0.25%	0.25%	0.25%
5YR T-Note	2.50%	0.80%	1.00%	1.10%	1.15%
10YR T-Note	3.45%	2.00%	2.25%	2.40%	2.75%
30YR T-Bond	4.30%	3.40%	3.50%	3.60%	3.75%

Economists' 10-Year Treasury Forecast (2)

Bank	2009 Q4	2010 Q4	2011 Q1	2011 Q2	2011 Q3
BoA Merrill Lynch	3.45%	2.00%	2.25%	2.40%	2.75%
Barclays Capital		2.40%	2.50%	2.60%	2.90%
Goldman	3.70%	2.50%	2.50%	2.75%	3.00%
Median	**3.58%**	**2.40%**	**2.50%**	**2.60%**	**2.90%**

(1) *Source: BAS/Merrill Lynch Research as of October 8, 2010.*
(2) *Source: Bloomberg Economic Survey as of October 8, 2010;; Weighted average of 62 participants.*

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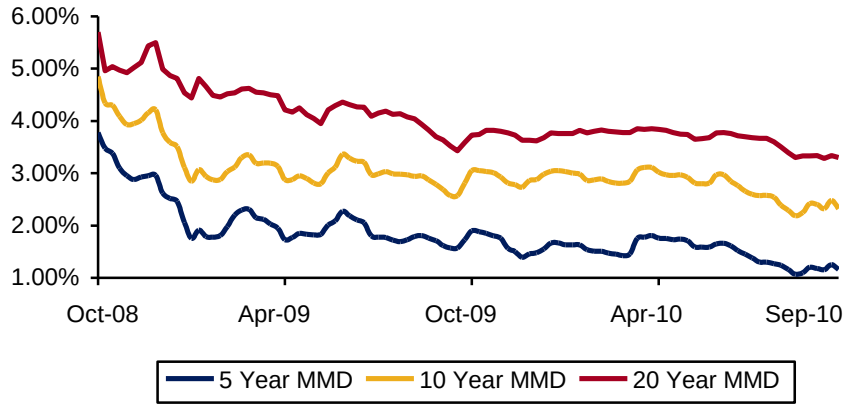
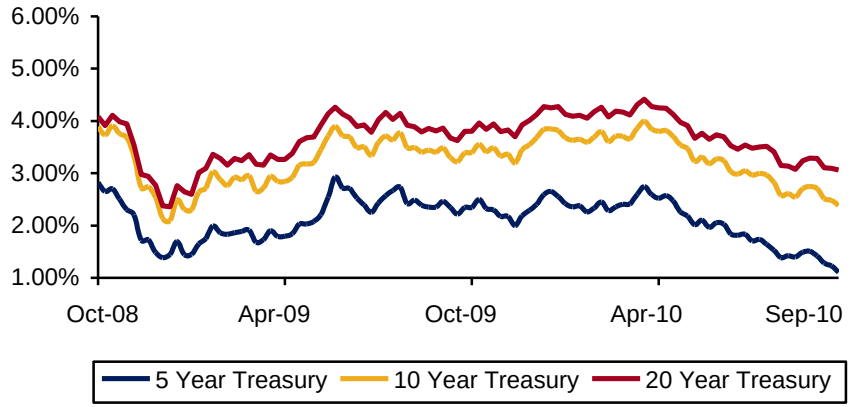
Municipal Market Update

Key Yields

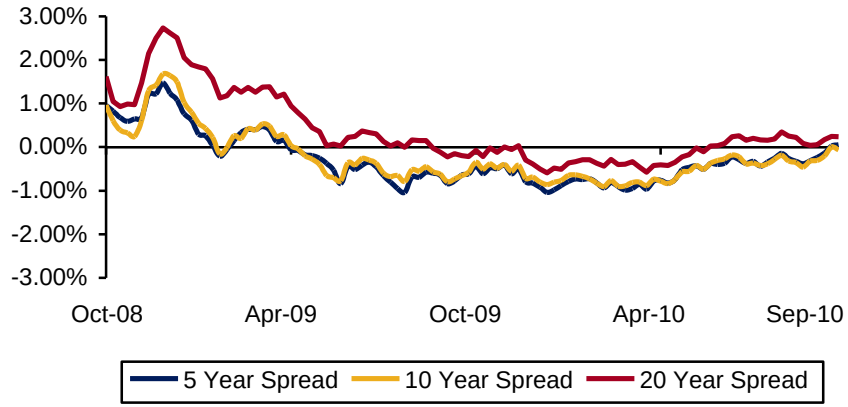
Muni AAA MMD Yields



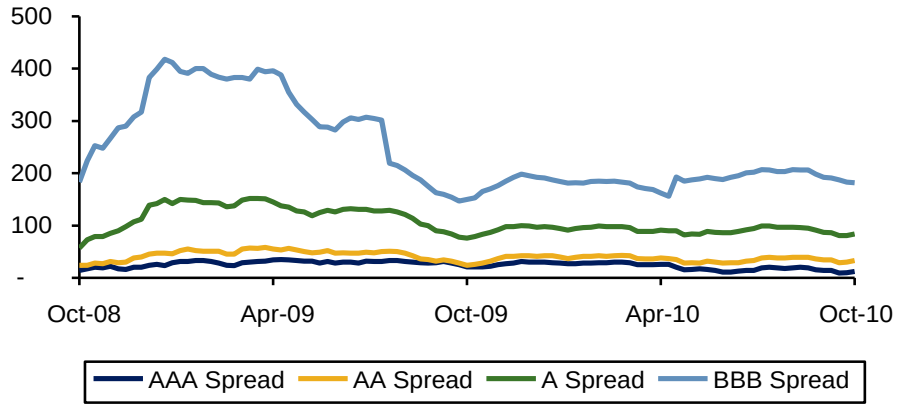
US Treasury Yields



Muni vs. Treasury Spreads



Municipal Credit Spreads Have Narrowed



(1) Source: BAS/Merrill Lynch Research as of October 15, 2010
(2) Source: Bloomberg as of October 15, 2010

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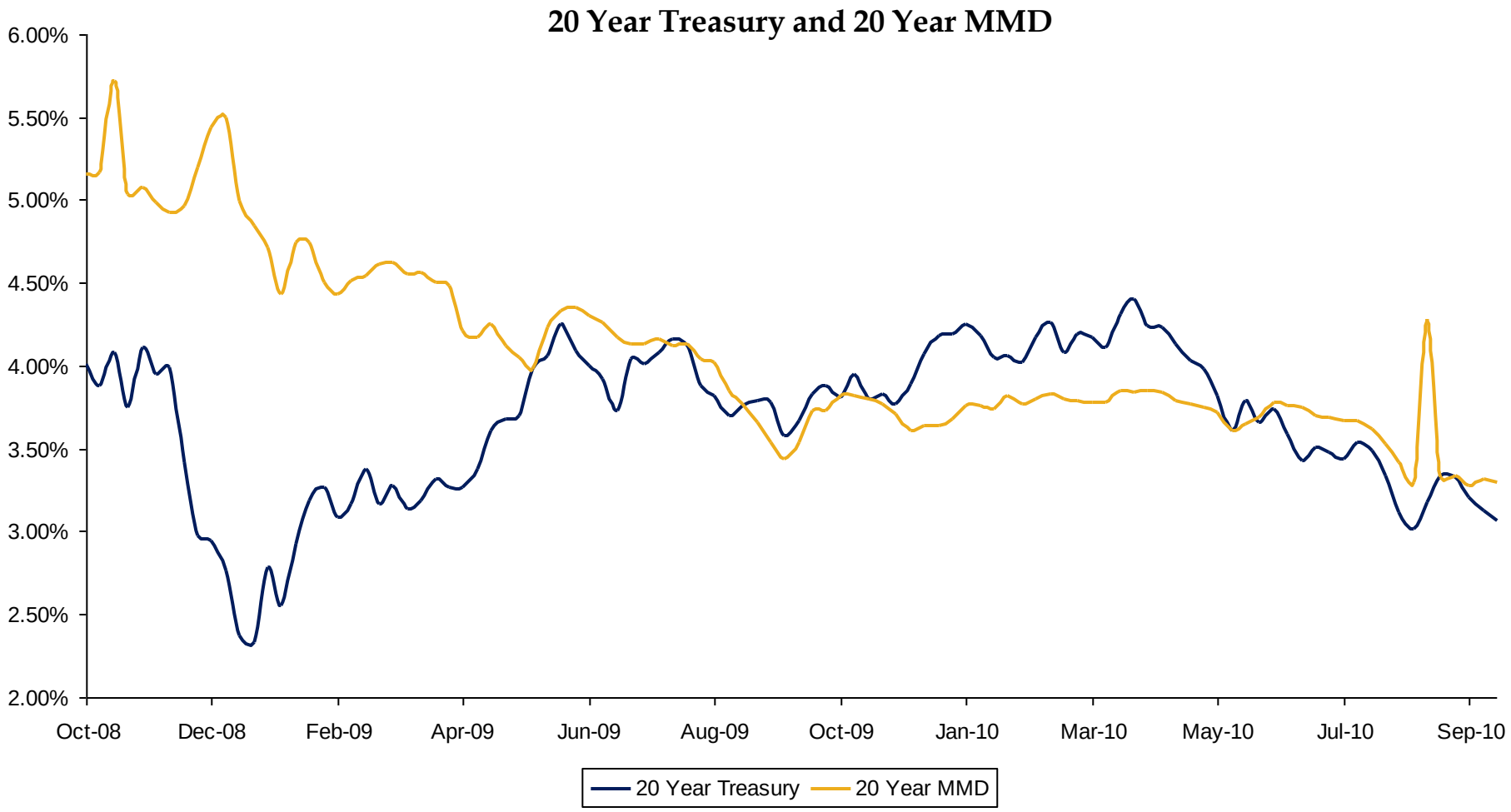
Municipal Market Update

Rates continue to decline - Significant volatility.



(1) Source: BAS/Merrill Lynch Research as of October 8, 2010
(2) Source: Bloomberg as of October 8, 2010

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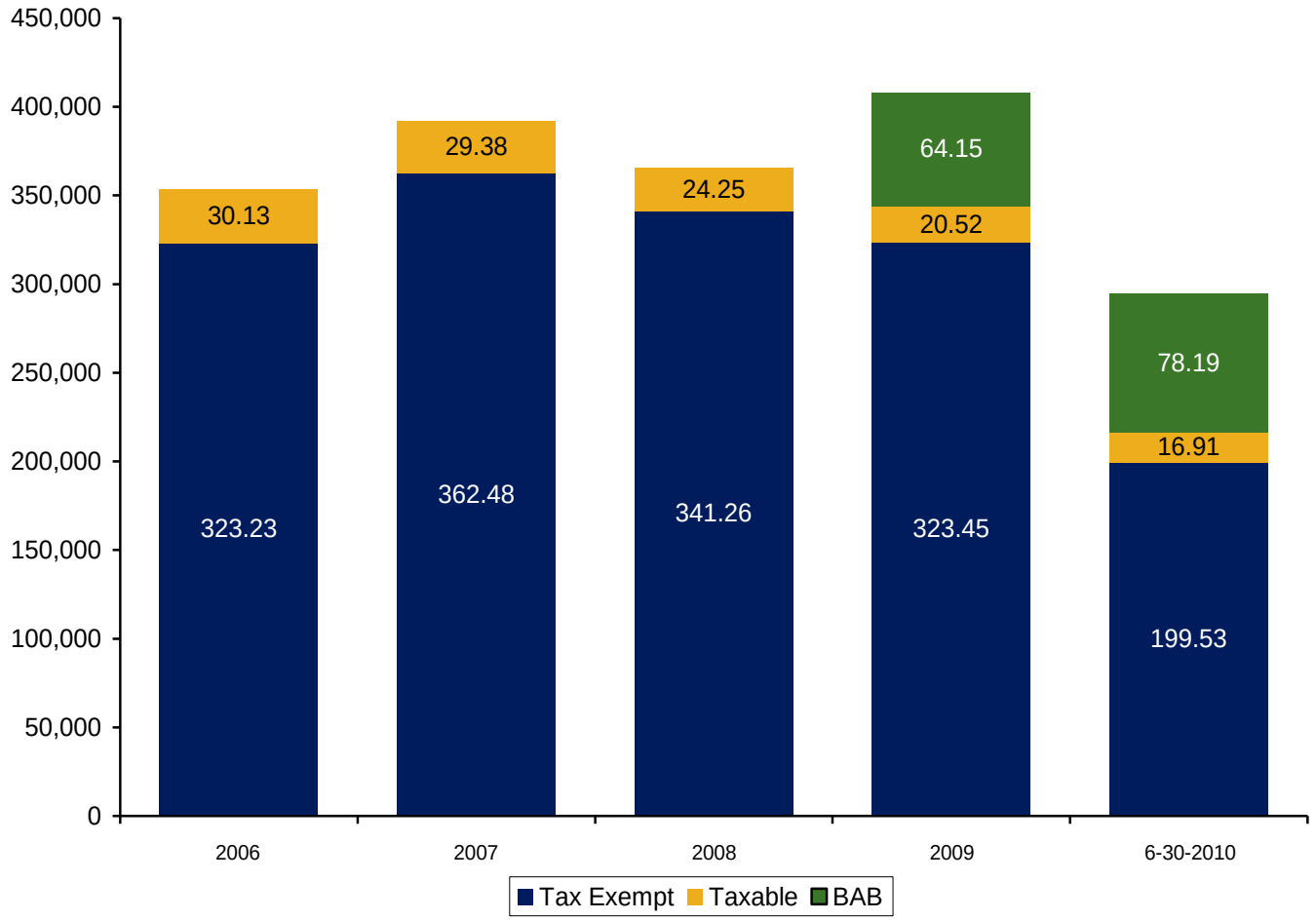
Municipal Market Update

Issuance Trend

BABs issuance has driven pricing, but its future is uncertain

- **Will BABs be extended?**
- **At what subsidy level?**
- **4th Quarter BABs wave?**



Source: Securities Data Corporation and Thompson Financial, Inc.

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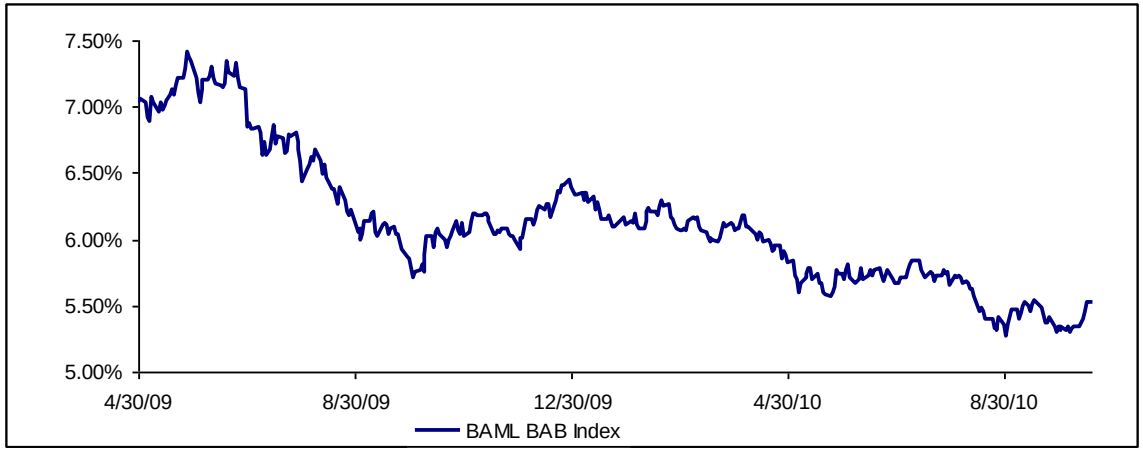
Municipal Market Update

BABs Roll On

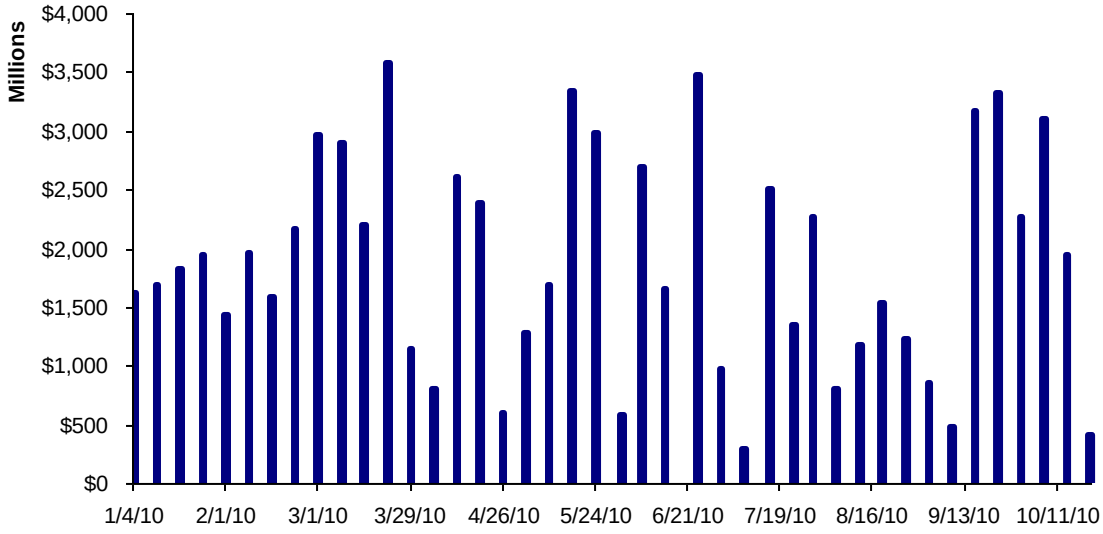
Build America Bond yields

BAB yields have trended lower, led by Treasuries and widening investor demand



Build America Bond issuance in 2010

Large deals drive weekly volume



Sources: BofA Merrill Lynch BAB Index, Securities Data Corp.

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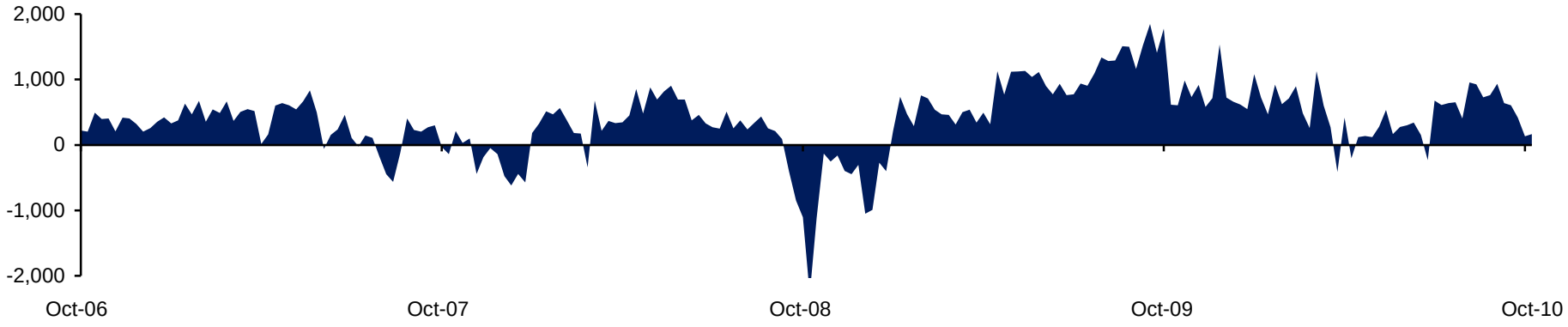
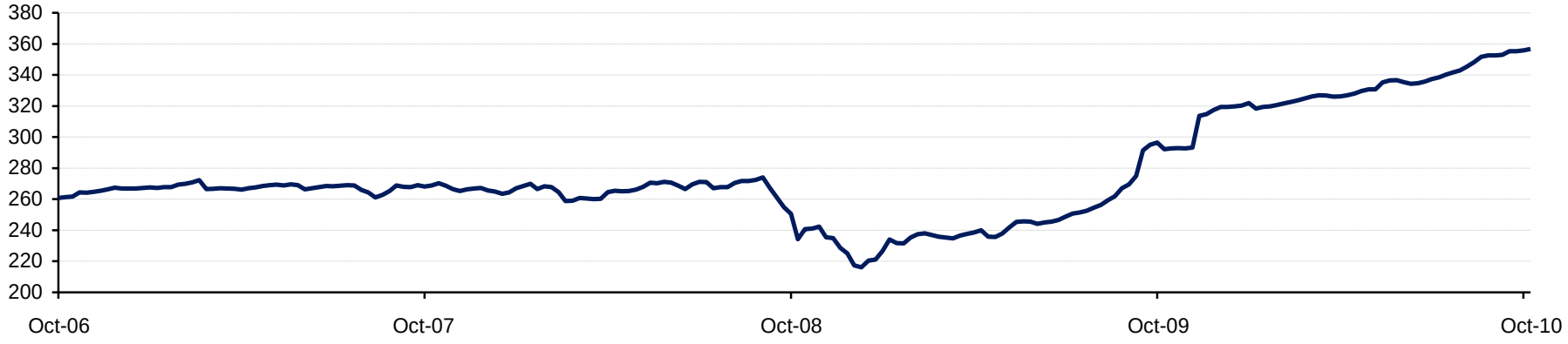
Municipal Market Update

Flows to Municipal Bond Funds

Historical Net Inflows to Municipal Bond Funds ($ millions)[1]



Assets Under Management ($ billions)[1]



(1) *Source: AMG Data*

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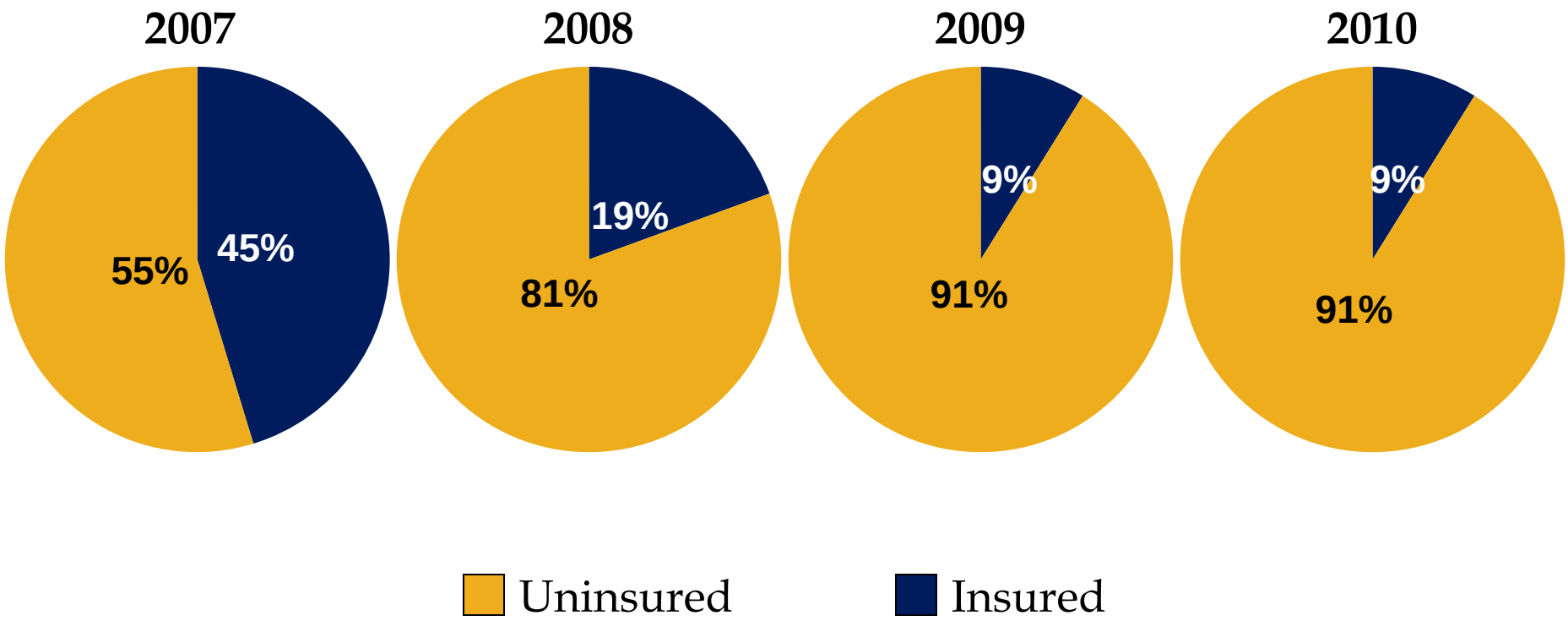
Municipal Market Update

Bond Insurance Declines and Stabilizes

Assured Guaranty is the only viable bond insurer at this time



(1) *Source: Securities Data Corporation Thomson Reuters.*

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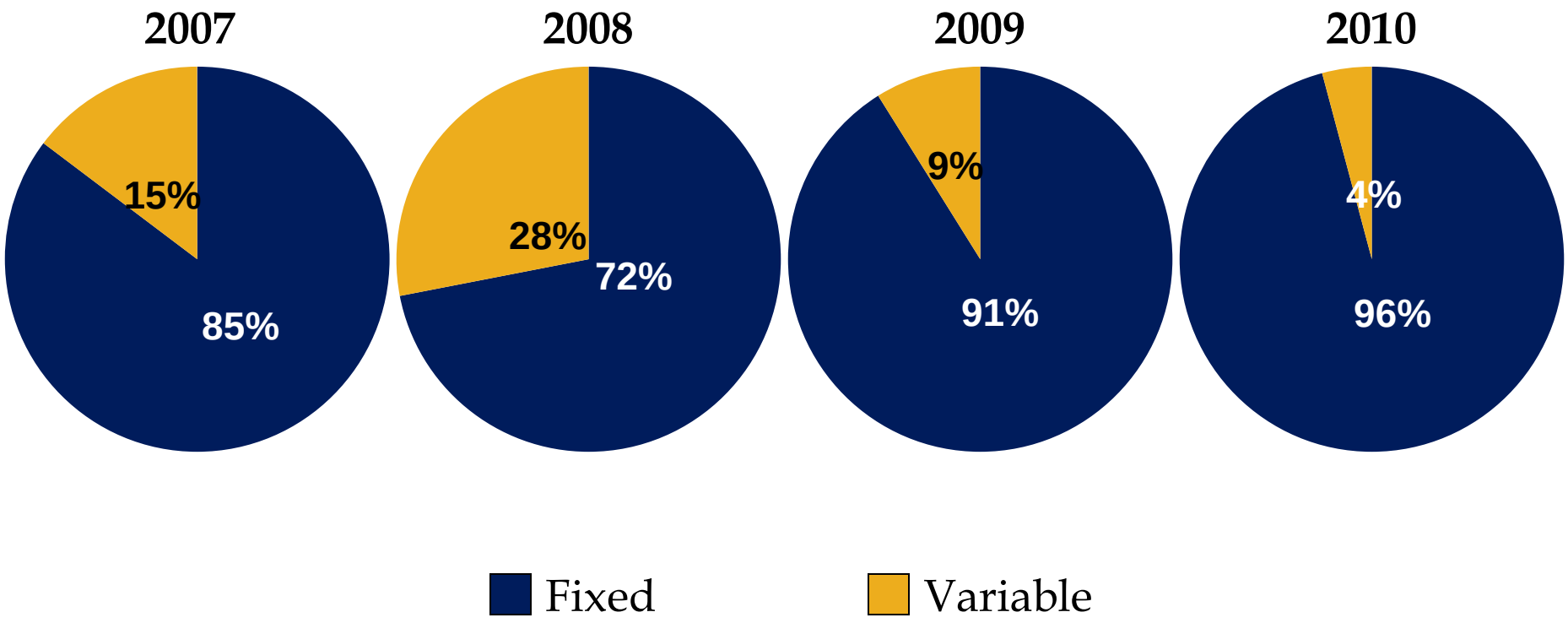
Short-Term Market Update

Variable-Rate Issuance Declines

A trend towards "permanent capital"



(1) *Source: Securities Data Corporation Thomson Reuters.*

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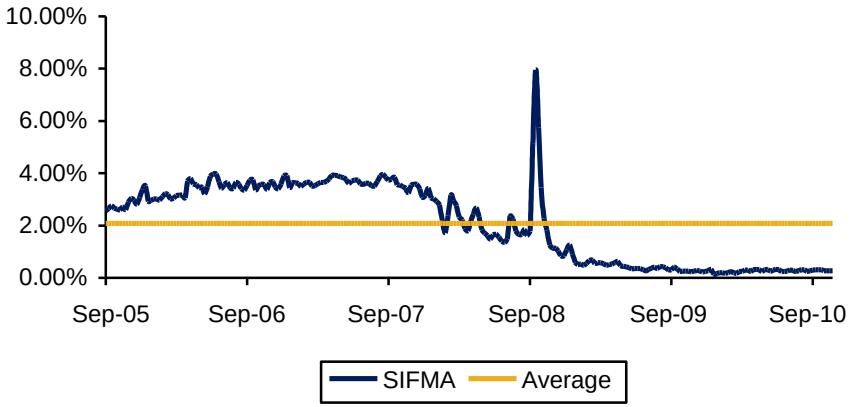
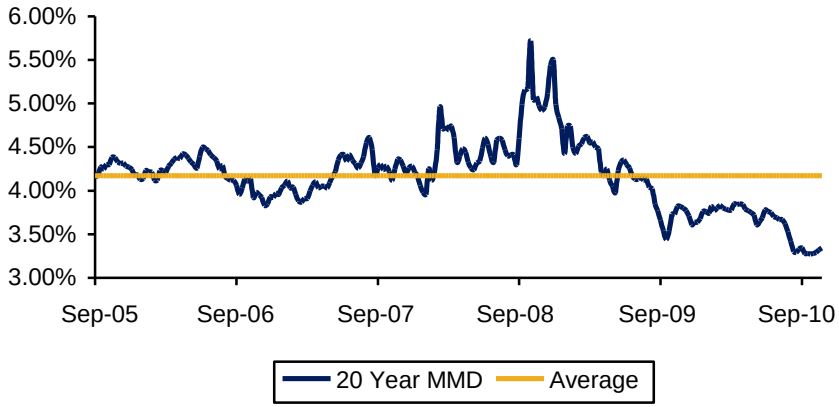
Short-Term Market Update

Key Rates

SIFMA Weekly Variable Rate



MMD Fixed Rates



SIFMA/LIBOR Ratios

LIBOR Yield Curve Term Spread

(1) *Rates as of 10/4//2010*

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Short-Term Market Update

Investor demand for short-term municipal bonds has waned

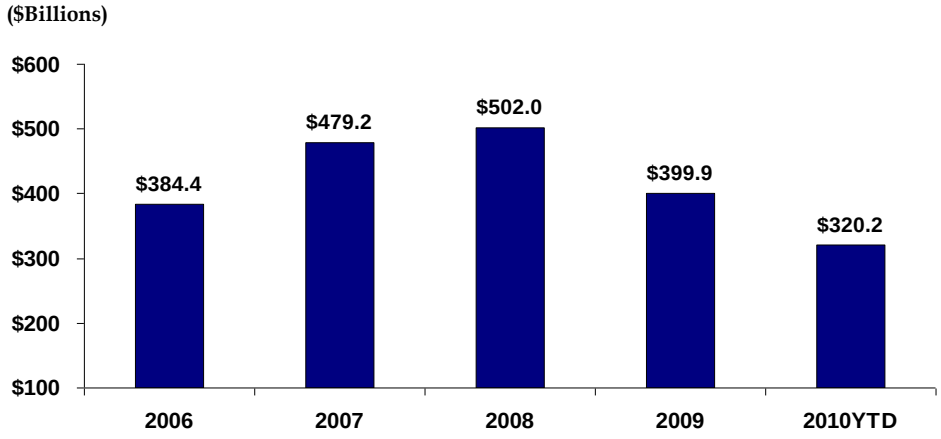
Market Observations

- Declining Money Market Fund ("MMF") demand has been balanced over the past two years by reduced new issuance
- Municipal Variable Rate Demand Bond ("VRDB") issuance decreased to $13.5 billion in YTD2010 from $41.4 billion in 2009
- Tax-exempt MMF assets have declined 36% from their peak of $528 billion in September 2008
- Bond funds have steadily increased assets under management over the past two years
- The ratio of Note issuance to MMF assets has continued to increase in recent years:

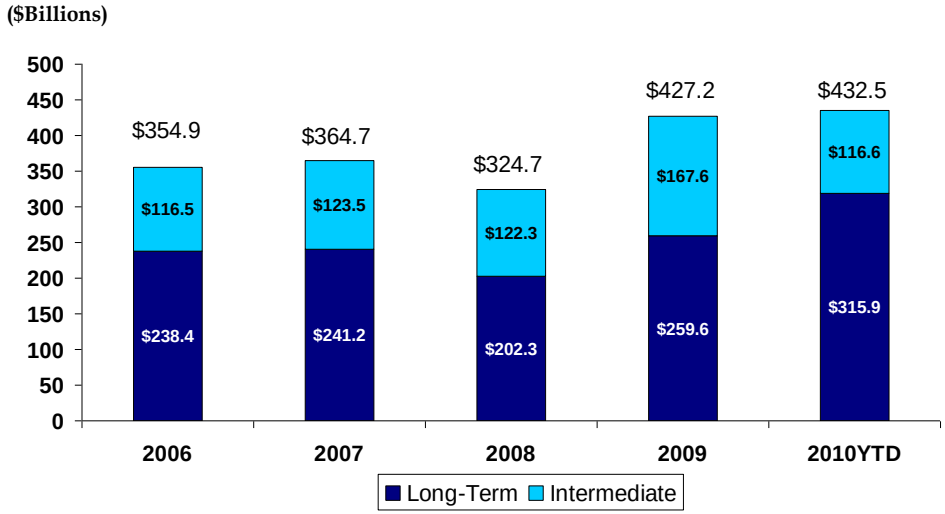
	2007	2008	2009	2010
Annual Note Issuance ($Bils)	$ 57	$ 61	$ 64	$ 41
MMF Assets (at June 1, $Bils)*	400	515	467	355
Ratio of Note Issuance to MMF Assets	14.35%	11.75%	13.70%	11.55%

**Assets estimated as of June 1 of 2007, 2008, 2009, 2010*

Year-End Tax-Exempt MMF Assets



Municipal Bond Fund Assets



(1) Source: Lipper/AMG Research 9/30/2010

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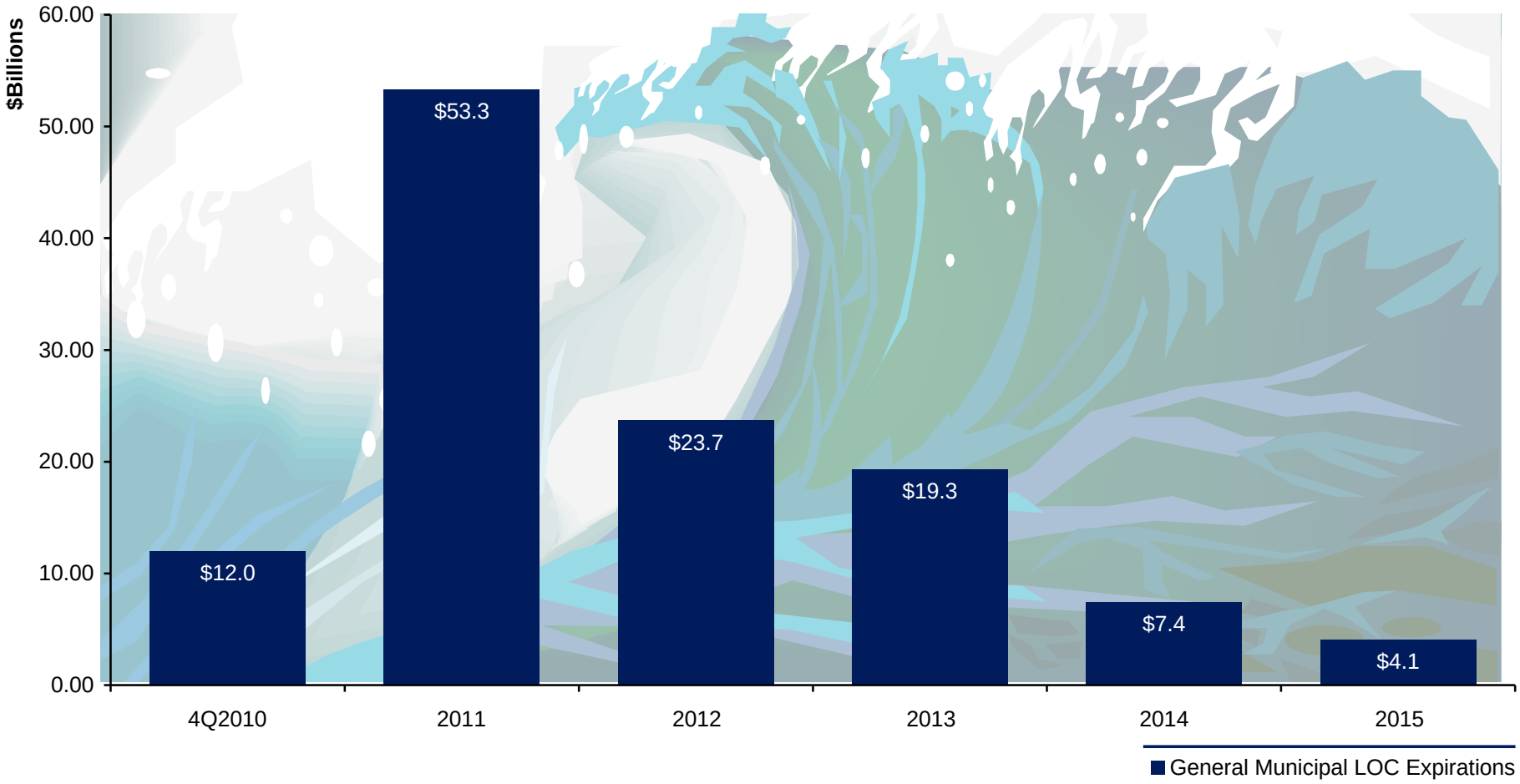
Short-Term Market Update

Upcoming yearly expiries of municipal credit facilities

Over $89 Billion is Expected to Expire Between 4Q2010 and 4Q2012



(1) *Source: Bank of America Merrill Lynch Research. Securities Data Corporation Thomson Reuters. LOC & SBBPAs*

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Short-Term Market Update

The bank market is consolidating among fewer banks

A Handful of Banks are Providing the Majority of Credit Enhancement

Credit Enhancers of Municipal New Issues (LOCs & Standby Purchase Agreements)

2009

Credit Enhancer Full to Each Manager	Principal Amount	Rank	Mkt. Share	Number of Issues
J P Morgan Chase	4,424.7	1	16.3	68
Bank of America Merrill Lynch	3,201.1	2	11.8	72
US Bank	3,139.0	3	11.6	73
Wells Fargo Bank	2,966.6	4	10.9	66
Royal Bank of Canada	1,706.9	5	6.3	5
SunTrust Bank	1,120.5	6	4.1	17
Branch Banking & Trust Co	1,107.3	7	4.1	38
TD Bank NA	690.8	8	2.5	22
PNC Bank NA	515.0	9	1.9	17
RBS Citizens NA	443.6	10	1.6	7
Landesbank Hessen-Thuringen	386.2	11	1.4	3
Citibank	365.5	12	1.4	4
Harris NA	359.6	13	1.3	12
The Bank of New York Mellon	348.1	14	1.3	9
Northern Trust Company	331.2	15	1.2	10
KBC Bank	329.8	16	1.2	5
Bank of Nova Scotia	305.4	17	1.1	7
Barclays Bank PLC	283.0	18	1.0	3
County Treasurer	246.8	19	.9	5
Sumitomo Mitsui Banking Corp	234.3	20	.9	4
Union Bank NA	211.0	21	.8	5
Fed Home Loan Bk of Des Moin	202.5	22	.8	5
Landesbank Baden-Wurttemberg	163.2	23	.6	1
Deutsche Bank	131.3	24	.5	10
Bank of Montreal Trust	126.1	25	.5	4
Industry Total	27,144.6	-	100.0	523

3Q 2010

Credit Enhancer Full to Each Manager	Principal Amount	Rank	Mkt. Share	Number of Issues
J P Morgan Chase	2,062.5	1	25.5	29
Bank of America Merrill Lynch	1,581.7	2	19.6	23
Royal Bank of Canada	774.0	3	9.6	1
Barclays Bank PLC	545.7	4	6.7	4
Wells Fargo Bank	338.0	5	4.2	13
PNC Bank NA	289.4	6	3.6	9
TD Bank NA	223.6	7	2.8	4
Citibank	217.3	8	2.7	4
US Bank	207.1	9	2.6	6
RBS Citizens NA	193.1	10	2.4	2
SunTrust Bank	185.0	11	2.3	2
Svenska Handelsbanken	161.0	12	2.0	2
Deutsche Bank	129.6	13	1.6	3
Manufacturers & Traders Tr Co	115.4	14	1.4	2
Landesbank Baden-Wurttemberg	102.9	15	1.3	1
Bank of Nova Scotia	100.0	16	1.2	1
Union Bank NA	92.1	17	1.1	3
Lloyds TSB Group plc	75.0	18	.9	1
CoBank ACB	66.0	19	.8	4
Regions Bank	56.4	20	.7	2
Harris NA	48.8	21	.6	4
The Bank of New York Mellon	48.5	22	.6	2
HSBC Bank USA	47.6	23	.6	4
Bank of Tokyo-Mitsubishi UFJ	40.0	24	.5	1
Branch Banking & Trust Co	39.1	25	.5	3
Industry Total	8,090.6	-	100.0	153

(1) Source: Thompson Municipal Data; 9/30/2010; Investors of new municipal LOC's and Standby Purchase Agreements. Full credit to each manager.

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Short-Term Market Update

Pricing determinants – back on the rollercoaster

The Five S's of Pricing

1. **S**ize of the Required Credit Capacity

   - Supply and demand for credit is the single largest determinant of pricing. Even a little competition results in a lower price, while large credit needs requiring multiple banks reduces competition and drives up pricing.

2. **S**tate

   - Some issuers/regions are already large consumers of bank credit capacity and will pay more for credit as long as capacity is limited. Others issue infrequently and have diversification value.

3. **S**ector

   - Some sectors are less popular with banks than others.

4. **S**ecurity

   - Quality and type of revenue pledge, lien position, collateral, etc., matter.

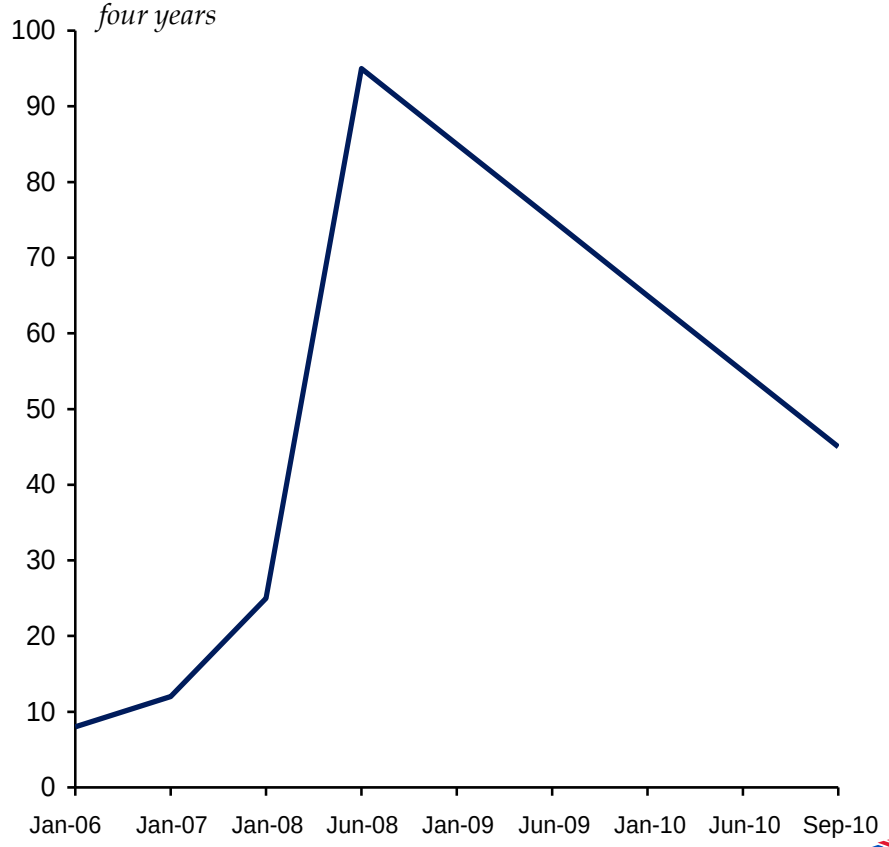
5. Cross – **S**ell

   - Increasingly banks are looking to establish a multi-product relationship so as to define public finance as one of its "core" businesses.

Pricing Rollercoaster

Credit / liquidity pricing exhibits rapid and sometimes violent price swings based on supply and demand, associated with other types of commodities

Hypothetical example of what a strong AA municipal issuer would pay for one year liquidity at various market entry points over the last four years



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New Liquidity Coverage Ratio expected to influence bank pricing

- In September, the Basel Committee on Banking Supervision published Basel III, a set of new capital and liquidity standards for banks.
  - New rules are expected to be adopted on November 11-12, 2010 and phased in through January 1, 2019
  - Banks will need to hold more liquid, high-quality assets against committed but unfunded liabilities such as letters of credit, liquidity facilities and revolving loan commitments
- A new liquidity coverage ratio ("LCR") takes effect on January 1, 2015.
  - LCR requires banks to collateralize all unfunded commitments with high-quality, liquid assets on one-to-one ratio, eliminating all leverage from businesses affected by it.
- Basel III may affect the municipal market in the following ways:
  - The cost of bank credit facilities will increase as banks pass along the costs of collateralizing their commitments
  - Bank facility supply will remain limited as the new rules present significant disincentives to both new entrants and existing banks that only offer credit products
- Basel III and industry responses are still works in progress –
  - 4-year "observation period"
  - Fed may opt to modify rules for US banks
  - LCR is based on a 30-day stress test – will VRDNs be structured around it?

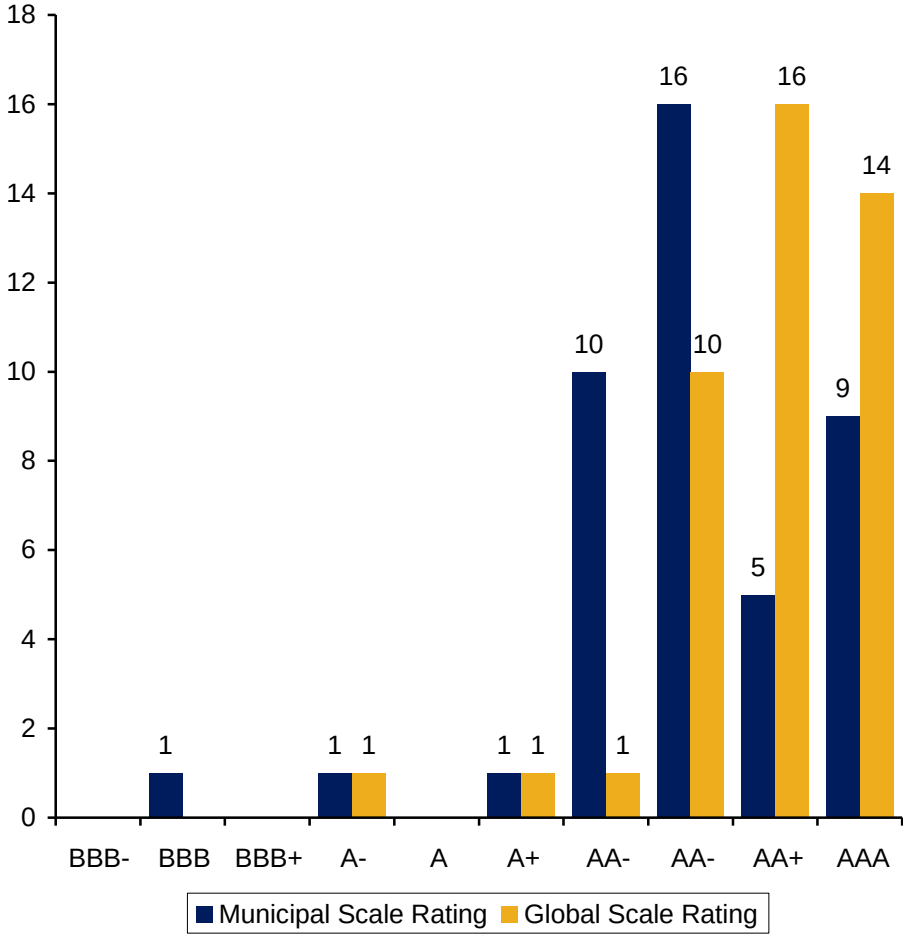
Ratings Overstate Implied Default Risk of Municipal Credits

- Rating agency studies show that historical municipal default risk is far below that of other, similarly-rated fixed income assets
  - Moody's found that A-rated corporate bonds have a 10-year default rate 68 times higher than A-rated municipal credits
  - When municipal defaults occur, investor recoveries tend to be much higher than for corporate bonds
- Each rating agency has begun to adjust its municipal rating scale to close the gap between ratings and default risk
  - Since 2006, S&P has been revising rating criteria sector by sector, resulting in thousands of upgrades
  - Moody's and Fitch recently opted to "recalibrate" ratings for tax-backed and municipal utility credits – including public higher education credits
- Pressure to adjust ratings is likely to continue
  - Dodd-Frank bill requires the SEC to consider requiring that ratings signify the same default risk across all fixed income asset classes

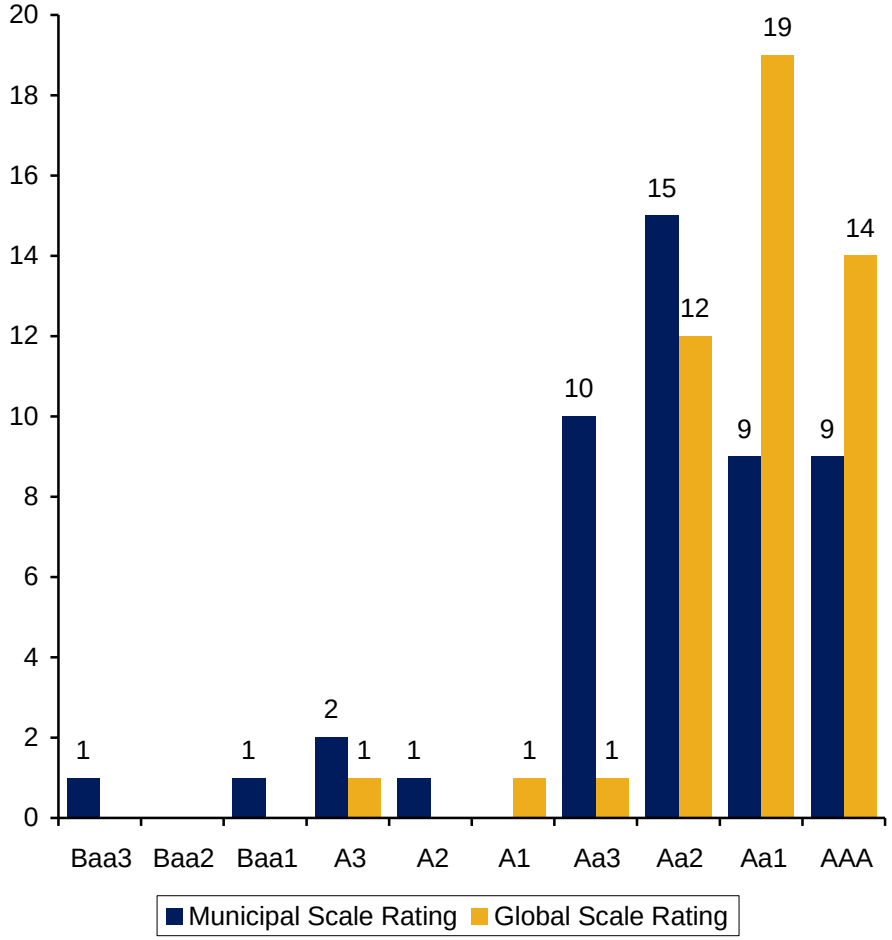
Credit Trends

Fitch and Moody's Recalibrate

Summary of Fitch ST GO ratings



Summary of Moody's ST GO ratings



(1) *Source: Moody's and Fitch*

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Year End Outlook

- Signs of acceleration in the economy
- Heavy volume; strong BAB issuance volume
- Heavier supply should shift and steepen the muni yield curve
- New Governors will be confronting sizeable gaps
- Uncertain federal aid outlook that will depend on composition of Congress
- Anticipating actions prior to federal income tax hike

Source: Bank of America Merrill Lynch Municipal Research

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