

MUNICIPAL BOND MARKET NOTE

JANNEY FIXED INCOME STRATEGY

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What does “bank-qualified” mean? “Bank-qualified” or “BQ” bonds are sold by small qualified issuers and banks who own them can deduct 80% of their carrying or interest costs.

What does “bank-eligible” refer to? Banks became “eligible” for the IRS 2% De Minimis interest expense deduction allowing those that purchase new money, non bank-qualified, tax-exempt bonds sold in 2009 and 2010 to deduct 80% of the carrying or interest costs of the bonds, up to 2% of the banks assets.

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“Bank Qualified” Expansion and “Bank Eligibility” Interest Expense Deduction Offer Opportunities

- Temporary incentives from the ARRA expanded “bank-qualified” eligibility for bonds sold in 2009 and 2010.
- These changes helped double bank qualified issuance in 2009 and 2010.
- Banks and financial institutions can still deduct up to 80% of the carrying costs or interest expense allocable to bank-qualified bonds.
- Temporary favorable tax treatment under the ARRA made banks eligible for the IRS 2% De Minimis interest expense deduction.
- The interim change allows banks to deduct up to 80% of the carrying costs and interest expense for all new money, non-bank qualified, tax-exempt bonds (including private activity bonds) sold in 2009 and 2010, up to 2% of the bank’s total assets.

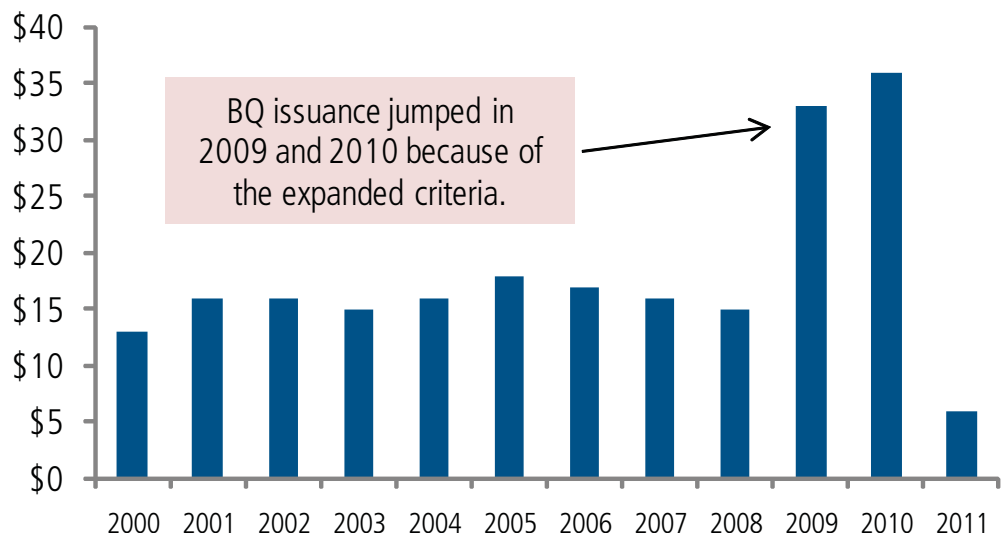
TEMPORARY CHANGES FROM ARRA ARE HELPFUL FOR BANKS

Section 265 of the Internal Revenue Code was temporarily revised by the American Recovery and Reinvestment Act of 2009 (ARRA) and the revisions encouraged banks and financial institutions to invest in tax-exempt bonds issued in 2009 and 2010 in several ways. These revisions were instituted to stimulate financial activity, expand issuers’ base of potential investors, provide access to capital, and lower costs for smaller government and 501(c)(3) issuers.

ARRA Helped to Double Bank Qualified Issuance

A temporary change the ARRA instituted expanded the definition of “bank qualified” small issuers to those which sell less than \$30 million of tax-exempt bonds a year, up from the traditional \$10 million limitation. Another temporary change was that the \$30 million limit was applied at the borrower level in the case of issues sold as pools or by conduits. This was important because prior to the temporary change, a conduit issuer’s bonds could not be bank qualified if it issued more than

Bank Qualified Issuance Increased Significantly in 2009 and 2010 (\$ in billions)



Source: Thomson Reuters and Janney Fixed Income Strategy.

501 (c)(3) and pooled financings are treated as separate issues at the borrower level making many more issuers eligible to sell bank qualified bonds in 2009 and 2010.

The \$30 million ceiling expired at the end of 2010 and some proposed legislation would restore it.

All new money, non-bank qualified, tax-exempt bonds (including private activity bonds) sold in 2009 and 2010 are "bank-eligible," up to 2% of the bank's total assets.

\$10 million in the aggregate of governmental and 501(c)(3) bonds for all borrowers. Therefore many governmental and 501(c)(3) issuers who issued through conduits were effectively prevented from taking advantage of bank-qualified bonds. These provisional changes helped to greatly increase the issuance of "bank-qualified" bonds sold in 2009 and 2010.

Benefits of Bank Qualified Issues

The bank-qualified small issuer designation is a special exception under the 1986 Tax Reform Act which allows banks to deduct 80% of the carrying cost (the interest expense incurred to purchase or carry the bond) of a "qualified" tax-exempt obligation. To qualify an issue must be sold by a "qualified" small issuer. A qualified small issuer is one that sells the bond for a public purpose (no private activity bonds, except for 501(c)(3) issuers) and only sells up to \$10 million of bonds annually (up to \$30 million in 2009 and 2010).

Political Support for Re-Instatement of the \$30 million BQ Ceiling

The potential re-instatement of the \$30 million bank qualified ceiling, while supported by some Washington lawmakers, is currently uncertain. But, we believe it has an above average chance of passage. There are currently several different forms of legislation before Congress that would reinstate the \$30 million ceiling for bank qualified bonds and measure the limit at the borrower level.

- U.S. Senator Jeff Bingaman (D-NM) introduced, in the middle of May 2011, the Municipal Bond Market Support Act of 2011, S.1016.
- U.S. Representative Sander Levin (D-MI) launched legislation in March 2011 called the Building American Jobs Act of 2011, HR 992.

We believe banks, financial institutions and small issuers would all benefit from the expanded ability to purchase and sell these bonds.

BANKS ARE NOW ELIGIBLE FOR THE IRS 2% DE MINIMIS RULE

Another temporary change to Section 265 of the Internal Revenue Code expanded favorable tax treatment for banks. It allowed banks, who purchased most tax-exempt bonds sold in 2009 and 2010, to deduct 80% of the carrying or interest costs of the bonds, up to 2% of the bank's total assets. In other words, the bank can deduct 80% of carry expenses related to tax-exempt obligations in an amount up to 2% of the bank's average adjusted base of all assets.

Which Bonds are Eligible for the 2% De Minimis Rule?

All new money, non-bank qualified, tax-exempt bonds (including private activity bonds) sold in 2009 and 2010 are eligible. Refunding bonds are only eligible if the original new money bonds were sold in 2009 or 2010.

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