Aquila Churchill Tax-Free Fund of Kentucky

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Candace Roane:
Hello, everyone. Welcome to another Aquila Group Of Funds podcast. I'm your host Candace Roane. Joining me today is Royden Durham, Portfolio Manager of Aquila Churchill Tax-Free Fund of Kentucky. In this podcast we'll cover Kentucky's economic situation, the municipal market, the Biden administration spending plans and rates and inflation. Welcome, Royden.

Royden Durham:
Hi Candace, how are you today?

Candace Roane:
Great. Let's start with an update on Kentucky's economy. How has revenue fared over the past year through the pandemic?

Royden Durham:
Well, through the end of March state revenue is up 5.9%. End of March alone, it was up 9%. The data matches nicely with a large jump in sales and gross receipts, which we are confident is coming from the sales, logistics, and fulfillment centers. This is a growth industry for Kentucky and the 1 million square foot McKesson vaccine distribution center, just across the interstate from Bernheim Forest, is an epitome of what I am talking about. The state has fared well during the pandemic and the added revenue has helped loosen the credit surveillance by the nationally recognized rating agencies, creating a more stable environment to invest in and helping overall bond performance. A small disappointment has been road revenue, but it could easily be picked up with the expected bounce back in GDP nationally.

Candace Roane:
Royden, looking back at the municipal market over the past year, where have you seen the most recovery?

Royden Durham:
Well, our portfolio along with our Kentucky Muni Fund peers suffered at the outbreak of the pandemic due to credit considerations since Kentucky ranks about 43rd in credit quality. Everyone was wondering what would happen to state revenue. Well, as I mentioned above, state revenue went on a tear and slowly investors and the rating agencies took note. The Fund had two pricing increases last July and another in February that helped increase overall total return versus other single state municipal funds. Sector wise, we were paying particular attention to Louisville Jefferson Airport, three private college holdings and hospitals. The hospitals and airports received help from the American Rescue Plan and the private colleges were able to cope with reduced student attendance, backed with plenty of their endowment funds. One of the private colleges has just started a $50 million sports complex, which actually makes me think they're even in better shape than our credit review indicated. Louisville Jefferson Airport employments for logistics help closed that airport revenue gap and ended up with only $29 million in rescue funds out of a budget of about $79 million. The airport even completed a $90 million modernization build out, which is aided by the lack of passengers.

Candace Roane:
The Biden administration has proposed a significant amount of spending this year. The American Rescue Plan was signed into law in March, that was the sixth policy response to COVID-19. And currently Congress is weighing the American Jobs Plan and the American Family Plan as is expected to be proposed shortly. How do you see this government spending coming together and impacting the market?

Royden Durham:
Well, they begin with the budget passed by the Kentucky legislature on March 17th does not include any Federal rescue dollars. Also, any Federal money may not be spent by the governor. All stimulus money must be expended by express consent of the General Assembly. That also has to be used within the guidance of the Federal Government as they lay it out. The latest stimulus package should put about $2.4 billion in the state's coffers. That's a huge amount of considering a state budget of only $12 billion annually. Even more money will go directly to cities, counties, and school districts. In aggregate, the legislature thinks there will be over $6 billion appropriate of the State

over a 14-month period. Not a penny will be expended by the Governor until he recalls a legislature to appropriate the funds. The project's expected to receive money... I'm going to outline then I'm going to go into some detail, $250 million for drinking water, $127 million school facilities replacement repair, $58 million for Frankfurt capital repair, $300 million for broadband deployment, and billions of ARPA funds will be expended for roads and bridges. Kentucky has a $1.3 billion in ARPA funds remaining that could be appropriated to infrastructure and allocated by the legislature. According to the science society of civil engineers 2019 study, this only puts a dent into the $14 billion of infrastructure needs for Kentucky over the next 20 years, which is comprised of $8.2 billion for drinking water and $6.2 billion in sewer improvements. Kentucky schools' needs are in the $7 billion range. In terms of the broadband build out, the middle mile has already been completed by KentuckyWired. The $300 million should go a long way to build out the final mile, but until a plan is put together, the experts say it's hard to tell how much funding will be needed. There is $300 million expenditure is backed up by another $300 million draw, if needed. The capital complex spending is for mechanical, electrical and plumbing upgrades, plus $5 million for exterior maintenance. The funds can be shifted to school funding if not deemed as an appropriate use by the Feds. We'll be putting out a more detailed analysis of the state budget on our website soon. Also the $600 billion the Biden administration earmarked for transportation infrastructure for the American Jobs Plan, Brent Spence Bridge, okay, which is a bridge connecting Cincinnati. That project is assumed to be one of the 10 major projects to be funded.

Candace Roane:
Great details about the state. Thanks for that, Royden. Let's talk about rates and inflation. Investors are certainly watching interest rates and thinking about inflation. The yield on the 10-year U.S. Treasury was back up to 1.63% yesterday after taking a dip at the end of March. It was up over 70% for the year. What are your expectations for the next several quarters around rates, inflation, Fed policy, and how do you have the portfolio positioned for this?

Royden Durham:
Well, the portfolio continues to be positioned slightly shorter with about a four year modified duration. With a rate rise, which has taken place as the pandemic affected economy, has picked up, we think a return to where we began 2020 with a 10-year U.S. Treasury of about 1.9% seems about right. So far munis have followed the Treasury. This is primarily due to a lack of supply and increase in demand, which seems to emanate from politicians calling for higher taxes in the middle of an economic recovery. The Fed seems willing to hold off tightening for a prolonged period of time, which seems sort of counterintuitive to what commodity prices are telling us.

Candace Roane:
As always, Royden, thank you for your insight and for your time today.

Royden Durham:
My pleasure.

Disclosure:

Thank you for listening to this podcast. The opinions shared are those of the portfolio managers and do not necessarily reflect those of the Advisor or Subadvisor of the Fund.

Before investing in the Fund, carefully read about and consider the investment objectives, risks, charges, expenses and other information found in the Fund perspective. The prospectus is available from your financial advisor when you visit www.aquilafunds.com or call (800) 437-1020.

Information regarding holdings is subject to change and is not necessarily a representative of the entire portfolio.

Mutual fund investing involves risk. Loss of principal is possible. Investments in bonds may decline in value due to rising interest rates, a real or perceived decline in the credit quality of the issuer, borrower, counterparty or collateral, adverse tax or legislative changes, court decisions, market or economic conditions. Fund performance could be more volatile than that of funds with greater geographic diversification.

The Fund seeks to provide a high level of income exempt from state and federal income tax as is consistent with capital preservation. Past performance does not guarantee future results. For certain investors, some dividends may be subject to federal and state income taxes, including the alternative minimum tax referred to as AMT. Please consult your tax professional.

Independent rating services such as Standard & Poor's, Moody's and Fitch assign ratings which generally range from AAA highest to D lowest, to indicate the creditworthiness of underlying bonds in the portfolio. Where the independent rating services differ in the rating assigned to an issue or do not provide a rating for an issue, the highest available rating is used in calculating allocations by rating. Pre-refunded or escrowed bonds are issued to retire or regain an outstanding bond issue at a specific call date. Until the call date, the proceeds of the bond issuance are typically placed in a trust and invested in US treasury bonds or state and local government securities.

Modified and effective duration both measure the value of a security in response to a change in interest rates. Effective duration also takes into account the effect of embedded options. The weighted average life, also referred to as weighted average maturity, is a reflection of the quickness with which the principle of an issue is expected to be paid.

A credit spread is a difference in yield between two bonds of similar maturity, but different credit quality.

Taxable equivalent yield is the return that is required on a taxable investment to make it equal to the return on a tax-exempt investment.

For certain investors, net investment income tax, known as NIIT may apply. NIIT is a 3.8% tax established by the patient protection and affordable care act that applies to the lesser of, the net investment income, or a taxpayer's modified adjusted gross income above an applicable threshold amount.

The acronym PERS (P-E-R-S), stands for public employee retirement system. The acronym PERA, (P-E-R-A), stands for public employees' retirement association. CARES Act Stands for Coronavirus Aid, Relief, and Economic Security Act.

Yield refers to the earnings generated and realized on an investment over a specific period. Yield is expressed as a percentage based on the invested amount, current market value, or face value of the security, and includes the interest earned or dividends received from holding a particular security.

The yield ratio represents the comparison of the expected yield of one bond to the expected yield of another. A yield ratio is important when deciding whether to invest in one bond or another. Generally, the higher yield is considered better.