

Update on California Municipal Bond Funds

Diversified California municipal bond portfolios may contribute to controlling exposure to the state's financial problems.

California, mired in a recession much worse than most of the U.S., is struggling to close a budget gap that has grown to more than \$20 billion. State leaders agreed to a \$42 billion package of solutions in February, including \$5.8 billion in initiatives that were subsequently not approved by voters. The current deficit reflects the \$5.8 billion rejected by voters, \$12 billion in expected further revenue deterioration, and \$3.0 billion in higher social service costs— in part— medical and welfare assistance. Without a credible budget in place, California cannot sell annual cash flow notes to fund its short-term borrowing needs, and the State Controller will need to begin to either defer payments or make payments with register warrants — effectively IOUs (not an option available to pay bondholders however who must be paid in U.S. dollars). Complicating passage of a state budget is the requirement of a two-thirds majority in both the California Assembly and Senate, with Democrats just shy of the necessary votes in each, and with Governor Schwarzenegger's vow to veto any tax increases.

Despite the severity of California's budget crisis, we do not expect the state to miss a payment on outstanding debt. California's state Constitution requires that payments are prioritized first to support the public school system and higher education, and second to pay principal and interest on general obligation bonds and commercial paper notes. Behind those priorities are lease payments to support lease-revenue bonds, state employee wages and benefits, pension funding and Medi-Cal claims. In past crises, the state has shown a commitment to honor its obligations, and earlier this year the state delayed income tax refunds, vendor payments and infrastructure projects to ensure that payments to public schools and debt service were made in a timely manner.

Impact on the market for California bonds

Perhaps consistent with the extremely high levels of bond price volatility over the past 18 months, yield spreads on California State general obligation bonds are at historically wide levels relative to U.S. Treasuries. Current yield spreads are about two times the levels reached during the 2003 state budget crisis when the state's rating fell to BBB by Standard & Poors ("S&P"). Direct obligations — general obligation bonds — of the state are currently rated A2/A by S&P and Moody's respectively — the lowest rating of any state in the country, with only Puerto Rico rated lower.

Both third-party rating agencies have the state on Watchlist/Credit Watch for possible downgrade, and may take action if they judge that there is a lack of progress in addressing the structural budget gap.

While issuance of new short-term and long-term general obligation debt is at a standstill pending a budget resolution, numerous California municipal entities continue to issue debt and garner interest from investors. Large and liquid markets in California-based essential- service revenue — private higher education, transportation revenue, municipal electric, and high quality local general obligation debt — continue to offer residents and investors double tax- exempt income (federal and State of California).

Columbia money market funds exposure

Columbia's money market funds are positioned conservatively in terms of California exposure given the state's budget situation. Our national tax-exempt and municipal money market funds had no California exposure as of June 19, 2009. Nor do we have exposure in our other specialty state tax-exempt and municipal money market funds, including New York, Massachusetts and Connecticut.

In the Columbia California Tax-Exempt Money Market Fund, we have emphasized short-term variable-rate demand notes (VRDNs). On June 19, 2009, more than 90% of the funds holdings consisted of short-term VRDNs that have no direct exposure to California's general obligation credit rating. These VRDN's are credit enhanced by bank letters of credit, unconditional bank purchase agreements, or a combination of financial guarantee insurance or a conditional bank or broker/dealer purchase agreement and therefore are not solely dependent on the issuer's ability to pay. The remaining 10% of holdings consists of short-term municipal notes with no exposure to California general obligation or housing issues— two issuers that may be more susceptible to short-term rating downgrades. The vast majority of the remaining 10% of holdings is invested in local California school districts, which hold top priority in the California budget process and also have separate revenue and reserve sources. Other investments include obligations of cities, counties and other municipal entities that we believe are better insulated from the State of California budget.

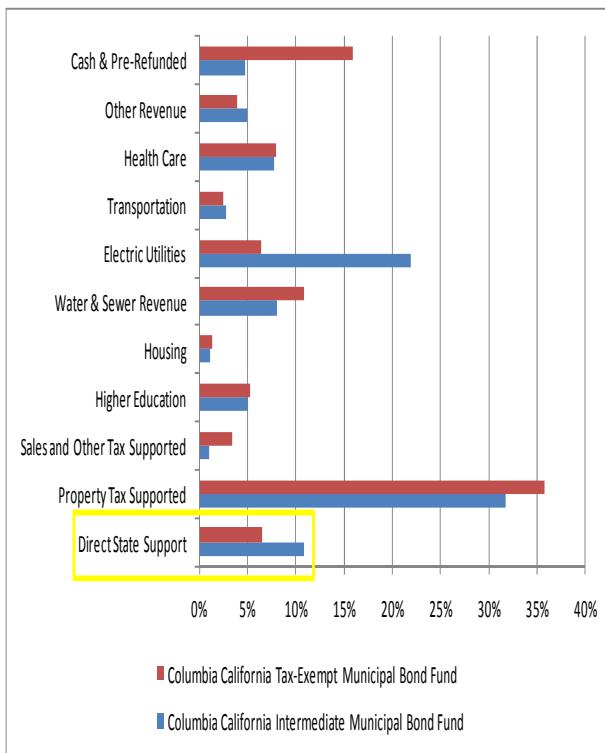
Columbia long-term funds exposure

As of May 31, 2009, Columbia's national and state municipal bond funds (with the exception of Columbia California Intermediate and Tax-Exempt Funds) had exposure of less than 5% to California State general obligation bonds.

Within Columbia's California Intermediate and Tax-Exempt

Funds, holdings of direct California state general obligation or state appropriation issues was 9.1% and 5.0%, respectively, as of May 31, 2009. A large majority of the portfolios of both funds were represented by exposure to a diverse array of municipal sectors that fund outstanding debt through various sources, including revenues generated from water and sewer bills, electric transmission and distribution, higher education tuition receipts, highway tolls and passenger airport fees. While many of these revenue sources are affected by the economic recession, they are completely independent of California’s state budget process. See Table 1.

Table 1: California Funds Sector Breakdowns*



Source: Columbia Management as of May 31, 2009

*The bars labeled Direct State Support include Puerto Rico securities in the amount of 1.5% for the Columbia California Tax-Exempt Municipal Bond Fund and 1.8% for the Columbia California Intermediate Municipal Bond Fund.

Outlook

California’s state general obligation debt service will constitute roughly 5.5% of general fund revenues in the 2010 fiscal year. When lease debt service is included – payments that are supported by general fund appropriations – almost 6.5% of general fund revenues directly support the payment of outstanding California municipal debt obligations. We continue to think it is quite unlikely that California will miss interest or principal payments-based on the constitutional protection afforded through the required priority of payments,

the potential consequences to future funding needs of disrupting bond market demand, and the State’s historical willingness to prioritize debt service payments.

While the federal government has a significant interest in seeing the largest U.S. state in terms of population and GDP regain a solid financial footing, officials to date have rejected the state’s overtures to provide further assistance in terms of market access or budget-balancing solutions. The federal stimulus package passed early in 2009 already provided substantial direct and indirect benefits to the State.

Although it is possible third-party rating agencies will lower California’s general obligation debt ratings further, we believe market prices and yield spreads may already reflect this possibility.

In money market funds, for California-focused municipal bond funds, and for more conservative investors, we believe there is very adequate supply available in California tax-exempt issues without direct exposure to the state budget process to maintain well-diversified portfolios for investors subject to California income tax.

The diversity of our California mutual and money market funds, both in terms of security and sector holdings, combined with rigorous ongoing credit oversight provides investors with an attractive investment alternative to purchasing individual California securities while still providing both the opportunity for total return and a stream of income exempt from both California and federal income taxes.

An investment in money market mutual funds is not a bank deposit, and is not insured or guaranteed by Bank of America, N.A. or any of its affiliates or by the Federal Deposit Insurance Corporation or any other government agency. Although money market mutual funds seek to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in money market mutual funds. Please see the prospectuses for a complete discussion of the risks of investing in money market mutual funds.

Portfolio holdings are subject to change periodically and may not be representative of current holdings. Current and future holdings are subject to risk, including but not limited to market and credit risk.

Please read and consider the investment objectives, risks, charges and expenses for any fund carefully before investing. For a prospectus, which contains this and other important information about the fund, contact your Columbia Management representative or financial advisor, or go to www.columbiamanagement.com.

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