



AQUILA
GROUP OF FUNDS®

Tax-Free Fund of Colorado

Investment Commentary

February, 2012



TAX-FREE FUND
OF COLORADO

Fund Facts

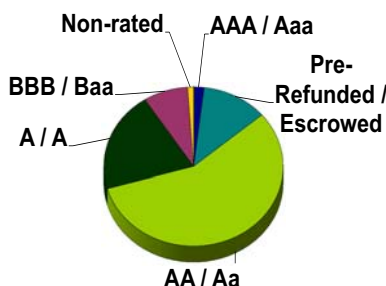
Portfolio Manager
Chris Johns

Inception Date
5/21/1987

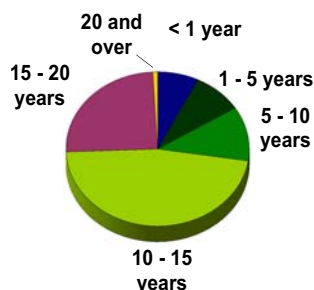
Assets Under Management
\$298.7M (as of 1/31/12)

Number of Holdings
155 (as of 1/31/12)

Credit Ratings ¹ (as of 1/31/12)



Maturity Allocation (as of 1/31/12)



¹Independent 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 credit worthiness of the underlying bonds in the portfolio. Where the independent rating services differ in the rating they assign 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/Escrowed bonds are issued for the purpose of retiring or redeeming an outstanding bond issue at a specified call date. Until the call date, the proceeds from the bond issuance are typically placed in a trust and invested in US Treasury bonds or state and local government securities. Non-rated bonds are holdings that have not been rated by a nationally recognized statistical rating organization.

2011 Market Review

Last year brought many financial stories that were fodder for a media circus. The United States government came within hours of defaulting, certain municipal governments now have higher credit ratings than the Federal Government and the Federal Open Market Committee reintroduced monetary policy from the 1960's in an attempt to spark economic growth. However, the most exaggerated story was a statement made by a banking analyst in 2010 claiming "hundreds of billions" of municipal bonds may default in 2011. Investors were unduly frightened by the unusual market volatility of a normally staid asset class, but the municipal credit based defaults proved significantly milder than suggested by the financial media's initial headlines. This "headline risk," has taken a toll on the municipal marketplace. Although distinct from credit risk, headline risk increased investor concerns, causing investors to exit the municipal market at an inopportune time as bond prices decreased and yields rose. Rising state revenues, meaningful expenditure reductions and attractive relative yields have overcome most fears and investors have returned to the municipal bond market.

Ironically, the impending default risk of the Federal Government proved less troublesome to the municipal market than the aforementioned headline risk. A last minute deal avoided a default, but the spectacle raised the eyebrows of citizens and investors questioning the ability of our Federal Government to make decisions about national debt and budgeting issues. The resulting effect on the municipal bond market is difficult to quantify since the event was spread over a long period of time and largely priced into the market by the time it ultimately unfolded. The resulting damage inflicted on the credit side was felt primarily by certain state and local governments dependent upon federal appropriations.

On August 5, 2011 Standard & Poor's downgraded the long-term sovereign credit rating of the United States for the first time. The rating was lowered one notch from AAA to AA+ and was largely attributed to the instability of American policymaking, specifically the partisan fight over raising the Nation's debt ceiling. The market, in general, still views the nation in a triple-A light with Moody's Investors Service affirming its Aaa rating and Fitch Ratings maintained the Nation's sovereign debt at AAA. S&P analyzes state and local government credit quality independent of the Federal Government, placing certain state and local governments in higher ratings categories than the nation for the first time in history. The negligible reaction of the municipal bond market to S&P's downgrade demonstrates the resiliency of the municipal bond asset class. Furthermore, the effect on Colorado municipal bonds has been minor; the primary result being increased scrutiny of credits relying upon Federal appropriations. Nevertheless, the downgrade of our Nation's credit rating reinforces the value of deep credit research and a disciplined approach to portfolio management.

The Federal Open Market Committee continues its efforts to reinvigorate the economy, this time with Operation Twist designed to lower yields on long-term bonds through the purchase of \$400 billion of longer-term Treasuries, and sale of \$400 billion of Treasuries that mature in three months to three years. The "twist" term refers to early 1960s-era operations wherein the central bank sold shorter-dated securities and bought longer-dated securities in an effort to drive down long-term rates and stimulate economic growth. The policy goal is to make home and business loans more attractive to encourage home purchases and business expansion. At the very least, we believe this policy will keep long-term rates on Treasuries low and have a corresponding effect on highly rated municipal bonds forcing investors who are seeking higher yields to look further out on the yield curve.



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Municipal Overview

The Colorado municipal market experienced a significant contraction in new issues as state and local governments are not inclined to borrow for capital projects in the face of uncertain revenue streams and voter resistance to increased taxes for debt and operating mill levy increases. New issuance totaled approximately \$3.8 billion for 2011 compared to \$7-8 billion annually in the previous 5 years. Notable new issues during the year included \$400 million Denver Public Schools, \$416 million Colorado Health Facilities, and \$203 million University of Colorado. We expect this low new issuance environment to remain as long as Colorado municipalities are required to make significant and difficult spending reductions to balance their budgets. It is important to note that the long history of Colorado municipalities' ability and willingness to take the painful steps to protect principal and interest payments is a positive credit characteristic for bondholders.

Portfolio Review

The portfolio characteristics of Tax-Free Fund of Colorado were largely unchanged for the year. The weighted average maturity remained just above 11 years, the majority of the holdings carry credit ratings ranging from AA to A and the average coupon rate on the bonds in the Fund was 5%. We continue to manage the portfolio for dividend stability by maintaining an average of over 6 years until the first call date across fund holdings.

The Tax-Free Fund of Colorado has maintained an investment strategy that emphasizes intermediate maturities and investment grade credit quality securities for the past quarter century. Our goal has always been, and continues to be, providing an above average double tax-exempt dividend and a relatively stable share price. We plan to accomplish this goal in 2012 by limiting our interest rate sensitivity over the course of the year by reducing exposure to longer duration positions. Although it is difficult to see a meaningful increase in interest rates in the short run, we think now is a good time to prepare the portfolio for this eventuality. Bond prices have rebounded sharply from their lows earlier in 2011 and now offer an opportunity to reduce the holdings that may be more volatile in a rising interest rate environment. Record low interest rates have tempted investors to add more risk to their portfolios by extending maturities to capture additional yield. We believe that it is prudent to resist that temptation and maintain a defensive position until more attractive yields are available.

Furthermore, we have reduced or eliminated positions where our analysis uncovered deteriorating underlying credit quality or issuers that were not meeting their disclosure requirements. We will continue to add to sectors where our credit research provides a competitive advantage to purchase bonds benefitting from wide credit spreads. Areas we have been targeting are those on the periphery of the credit spreads which still provide significant security such as unlimited tax backed general obligation bonds and revenue obligations with strong legal covenants. In addition, we have continued adding to some of the high quality positions the fund currently owns. We believe that our emphasis on research combined with a defensive interest rate posture will provide our shareholders with a stable share price and a reliable double tax-exempt income stream.

Symbol and CUSIP

Class A	COTFX	876933102	Class C	COTCX	876933201	Class Y	COTYX
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Before investing in the Fund, carefully read about and consider the investment objectives, risks, charges, expenses and other information found in the Fund prospectus. The prospectus is available from your financial advisor, and when you call 800-437-1020 or visit www.aquilafunds.com.

- NOT FDIC INSURED - NO BANK GUARANTEE - MAY LOSE VALUE -

- NOT NCUA INSURED -

For more information on this fund and the entire Aquila Group of Funds, please visit www.aquilafunds.com