



Investment Philosophy and Process

AIM High Income Municipal Fund

Investment Process

Universe Definition

Municipal revenue bonds, of which at least 80% of issuers are rated BBB or lower, or deemed to be of comparable quality. Nonrated bonds may comprise a significant portion of fund net assets.

Security Selection

Issuer review of:

- Financial statements
- Management, including site visits
- Environmental impact statements
- Feasibility studies
- Proprietary cash-flow analysis

Negotiation of issuer terms:

- Loan covenants
- Fair price (coupon/yield)
- Credit basis
- Collateral and/or security

Portfolio Construction

- Duration in line with competitors
- Diversification <1% per issue
- <25% industrial development revenue bonds
- Seek attractive yield with limited fluctuation of principal value

Investment philosophy

We believe a market opportunity may exist among relatively small, lightly followed municipal revenue bond issues. These bonds, backed by dedicated revenues from specific projects, may be priced incorrectly in the market in that the yield on the bonds does not accurately correspond with the risk factors of the securities. We believe a diversified portfolio of below-investment grade and/or non-rated municipal revenue bonds has the potential to provide a high level of tax-free income with limited fluctuation of principal value.

Universe definition

We invest primarily in municipal revenue bonds that pay interest, which is excluded from gross income for federal tax purposes.¹ The bonds are typically used to build or renovate a specific project, such as an airport, toll road, charter school, hospital or housing. The proceeds from the project – such as rents, tolls or user fees – are used to pay interest and principal on the bonds. We may invest in bonds subject to alternative minimum tax but intend to limit their exposure within the fund.

Security selection

The market for high-yield municipal bonds is fairly small and can, at times, be less liquid than investment-grade bonds. As a result, our initial project screen focuses on experienced managers, as well as projects we believe make good economic and business sense.

To determine if a potential project meets our investment criteria, we review the industry and project financial statements, perform site visits to talk to management about the project and facility, and review independent appraisals of the project. We also review environmental and feasibility studies on the project.

Our review includes the ability to negotiate terms with the issuer, such as calls and loan covenants, credit basis, and fair price (coupon) for the issue. Most purchases range from \$1 million to \$3 million in size. Following purchase, we maintain contact with facility management, make periodic site visits to determine if the project is meeting its operating goals, and review monthly and quarterly statements.

Portfolio construction

We seek to maintain an average credit quality of BB, using bonds rated by national rating services as well as internal ratings. Our focus is on revenue-related bonds that are backed by property and sales taxes, in addition to the regular stream of revenues generated by projects. In general, we prefer bonds with more stable revenue flow, which we actually find in the health-related and charter school sectors.

We seek to maintain an average duration in line with competition. Duration management, however, is not as critical to our investment process as is our focus on generating high federally tax-exempt income and income management through the diversification of assets.

¹ A portion of the fund's income may be subject to some state and local taxes. This information does not constitute tax advice. Please consult your tax advisor for more complete information.

Risk management

To manage risk, we generally limit exposure of any single bond issue to 1% of total net assets unless circumstances warrant a higher weight. We also perform extensive research and due diligence on each issuer, which includes site visits and financial, competitive and economic analysis of each issuer.

We take an active role prior to any investment – negotiating loan covenants, including quarterly financial and operating disclosures. Finally, we seek collateral from issuers, including first mortgages, liens on project revenues, debt service reserve funds and tax and insurance escrows.

Sell discipline

We intend to purchase and hold municipal bonds to maturity to avoid selling-related capital gains. However, there are times when we will sell securities, based on factors such as:

- Degrade in credit quality.
- Negative change in the outlook for a particular project.
- A conscious decision to shorten or lengthen the fund's duration.
- Limiting or reducing exposure to a particular sector or issuer.

About risk

Because many municipal securities are issued to finance similar projects, especially those relating to education, health care, transportation and utilities, conditions in those sectors can affect the overall municipal securities market and the fund.

Credit risk is the risk of loss on an investment due to the deterioration of an issuer's financial health. Such a deterioration of financial health may result in a reduction of the credit rating of the issuer's securities and may lead to the issuer's inability to honor its contractual obligations, including making timely payment of interest and principal.

The fund may invest in securities where the issuer has defaulted on the payment of interest and/or principal. Defaulted securities are speculative, involve risks that the principal will not be repaid and may be subject to restrictions on sale.

Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa.

The fund may use enhanced investment techniques such as derivatives. The principal risk of derivatives is that the fluctuations in their values may not correlate perfectly with the overall securities markets. Derivatives are subject to counterparty risk – the risk that the other party will not complete the transaction with the fund.

Lower rated securities may be more susceptible to real or perceived adverse economic and competitive industry conditions, and the secondary markets in which lower rated securities are traded may be less liquid than higher grade securities. The loans in which the fund may invest are typically noninvestment-grade and involve a greater risk of default on interest and principal payments and of price changes due to the changes in the credit quality of the issuer.

Leveraging entails risks such as magnifying changes in the value of the portfolio's securities.

Reinvestment risk is the risk that a bond's cash flows will be reinvested at an interest rate below that of the original bond.

There is no guarantee that the investment techniques and risk analysis used by the fund's portfolio managers will produce the desired results.

The prices of securities held by the fund may decline in response to market risks.

The value of, payment of interest on and repayment of principal for the fund as well as the fund's ability to sell a municipal security may be affected by constitutional amendments, legislative enactments, executive orders, administrative regulations, voter initiatives and the economics of the regions where the issuers in which the fund invests are located.

The tax-exempt character of the interest paid on synthetic municipal securities is based on the tax-exempt income stream from the collateral. The Internal Revenue Service has not ruled on this issue and could deem income derived from synthetic municipal securities to be taxable.

NOT FDIC INSURED | MAY LOSE VALUE | NO BANK GUARANTEE

Consider the investment objectives, risks, and charges and expenses carefully. For this and other information about AIM funds, obtain a prospectus from your financial advisor and read it carefully before investing.

Note: Not all products, materials or services available at all firms. Advisors, please contact your home office.

Diversification does not guarantee a profit or eliminate the risk of loss.

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Supplemental Information

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