

# Municipal Credit Synopsis

## NORTH AMERICA

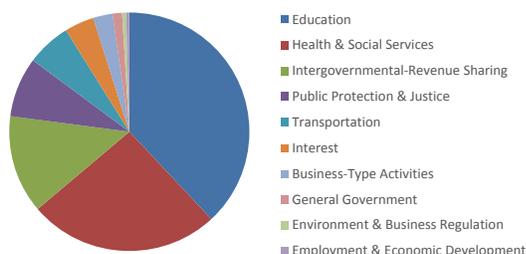
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### Credit Ratings & Outlooks

- Moody's
  - S&P
- Baa3 / Negative Watch  
BBB- / Stable

### Net Expense Breakdown<sup>2</sup>



### State of Illinois



<sup>2</sup>FY2016 CAFR

Source: Morgan Stanley Wealth Management Municipal Research, Moody's, Standard & Poor's, U.S. Census Bureau, IL General Obligation Official Statements, State of Illinois

## State of Illinois

### General Obligation Unlimited

#### Issuer

Illinois is the nation's fifth most populous state and home to one of its largest and most diverse economies. Situated on the southwestern shore of Lake Michigan within the Midwestern region of the United States, the state is as an integral hub for industry, transportation, and trade.

#### Bond Security

The bonds are general obligations of the state and are secured by Illinois' full faith and credit. Please confirm security with your Official Statement.

#### Credit Strengths & Weaknesses

The state passed an operating budget for the first time in two years on July 6. The accord seeks to permanently raise personal income taxes from 3.75% to 4.95%, increase the corporate income levy from 5.25% to 7.00%, reduce expenditures, and issue debt to help pay down Illinois' sizeable accounts payable backlog. (We will elaborate upon the operating budget below.) We reiterate that the statutory provisions of the state's General Obligation Bond Act are among the most important strengths for bondholders at this time, as they establish that GO debt service holds a priority over many of the state's expenditures. Illinois also benefits from its dominion over one of the nation's largest taxpayer bases and its strong sovereign authority (states versus locals) to raise revenues, reduce expenditures, and utilize interfund borrowings to protect its profile.

However, the state continues to confront considerable fiscal hurdles moving forward. The aforementioned include Illinois' sizeable unfunded pension liabilities and very large overall debt burden. Additionally, a recent Federal court ruling mandates that Illinois negotiate with/pay its Medicaid providers. Though the state may achieve interest savings by issuing debt to reduce its payables, this action only exacerbates its hefty long-term liability profile while the US economy may be in a late cycle.

#### Summary

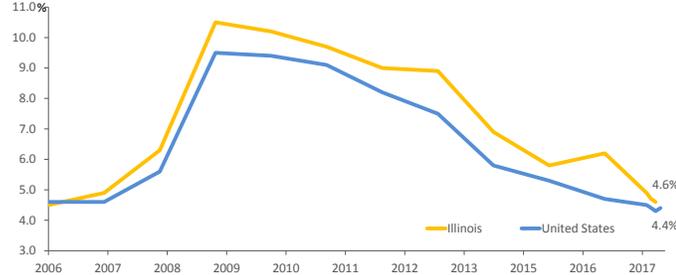
Though the budget's passage has been viewed positively, as Illinois has made progress toward stabilizing its position, many of the state's long-term fiscal challenges remain unaddressed. We believe recent spread compression (price advancement) is not indicative of considerable credit improvement, but more a recovery in value following significant concerns the state may lose its investment grade rating. However, though S&P recently affirmed Illinois' BBB- rating as stable, Moody's may still downgrade the credit on implementation concerns due to the state's highly partisan environment (among other factors). If so, a downgrade would likely impact the credit's institutional and household buyer base. Investors should anticipate volatility until the state implements a plan to further address its long-term challenges. Consequently, suitability is important with regard to position size, risk tolerance, and other factors.

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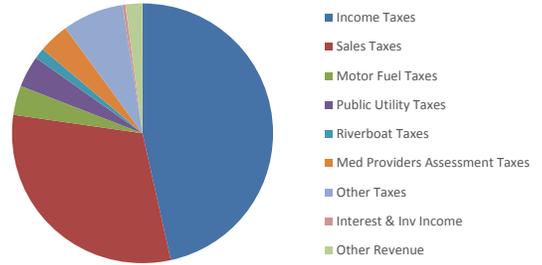
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Select Issuer Data\* – State of Illinois

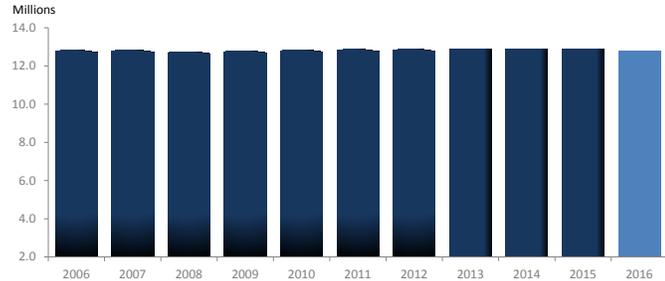
**Unemployment Rate<sup>1</sup> – Slow Recovery; Some Employment Progress**



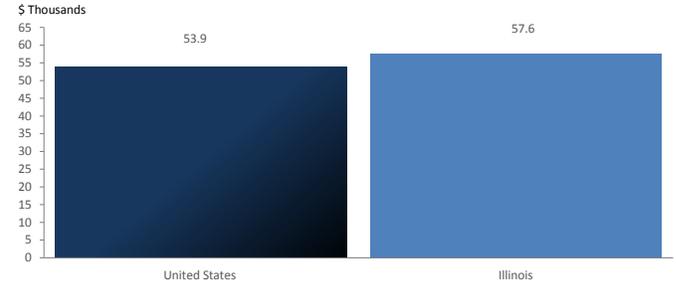
**Rev Breakdown<sup>2</sup> – Budget Should Bolster Major Revenue Sources**



**Population – Minor Population Loss During Recovery (Negative)**



**Median Household Income<sup>3</sup> – Above-Average Income Levels (Positive)**



**GO Spread – Spread Tightening Following Budget Passage**



**Rating Changes – Moody's Downgrade Watch; S&P Outlook Stable**

	Ba1/BB+	Baa3/BBB-	Baa2/BBB	Baa1/BBB+	A3/A-	A2/A	A1/A+	Aa3/AA-	Aa2/AA
Moody's	Current	Negative Watch 07/05/17	Negative 06/08/16	Negative 10/22/15	Negative 06/06/13	Negative 12/31/12	Negative 09/23/10	Stable 05/04/10	Stable 01/06/12
S & P	Current	Stable 07/12/17	Negative 06/08/16	Negative 06/09/16	Negative 12/23/15	Neg Watch 05/03/15	Negative 07/23/14	Dev 12/10/13	Stable 08/29/12

	Annual 6/30/16	Annual 6/30/15	Annual 6/30/14	Annual 6/30/13	Annual 6/30/12	Annual 6/30/11	Annual 6/30/10	Annual 6/30/09	Annual 6/30/08	Annual 6/30/07	Annual 6/30/06
<b>Economic Data</b>											
Population	12,801,539	12,859,996	12,880,600	12,882,136	12,875,256	12,859,752	12,840,460	12,796,778	12,747,038	12,831,970	12,814,204
<b>Pension Funded Ratio</b>											
	35.60	40.20	41.30	39.30	40.40	43.40	45.40	50.60	54.30		

\*The metrics above conceptually exhibit select financial attributes; they are not intended to be the sole determinant for an investment decision.

<sup>1</sup>Seasonally adjusted. Most recent unemployment rates are preliminary and subject to revision

<sup>2</sup>FY2016 CAFR

<sup>3</sup>2011-2015

Source: Morgan Stanley Wealth Management Municipal Research, Moody's, Standard & Poor's, Thomson Reuters, United States Census Bureau, Bureau of Labor Statistics, Bloomberg, State of Illinois Comprehensive Annual Financial Reports (CAFR), State of Illinois

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## Moody's and S&P Ratings Scale

	Moody's	S&P
Investment Grade	Aaa	AAA
	Aa1	AA+
	Aa2	AA
	Aa3	AA-
	A1	A+
	A2	A
	A3	A-
	Baa1	BBB+
	Baa2	BBB
Baa3	BBB-	
High Yield	Ba1	BB+
	Ba2	BB
	Ba3	BB-
	B1	B+
	B2	B
	B3	B-
	Caa1	CCC+
	Caa2	CCC
	Caa3	CCC-
	Ca	CC
	C	C
	WR	D
NR	NR	

Source: Bloomberg

Credit ratings throughout this report are cited from Standard & Poor's and Moody's given they are two of the most widely followed credit agencies in the fixed income markets.

Credit quality is a measure of a bond issuer's creditworthiness, or ability to repay interest and principal to bondholders in a timely manner. The credit ratings shown throughout this report are based on each issuer's security rating as provided by Standard & Poor's and Moody's, as applicable. The credit quality of the issuers listed in this report **does not represent the stability or safety of the bonds**. Credit ratings shown range from AAA, being the highest, to D, being the lowest based on S&P's classification (the equivalent of Aaa and C, respectively, by Moody's). Ratings of BBB or higher by S&P (Baa or higher by Moody's) are considered to be investment grade-quality securities. Within Moody's classification, "WR" stands for "withdrawn rating." Reasons for withdrawals include: debt maturity, e.g., calls, puts, conversions, etc.; and business reasons, e.g., change in the size of a debt issue or the issuer defaults. "NR" stands for "not rated" by the agencies.

## **Risk Considerations**

**Bonds** are subject to interest rate risk. When interest rates rise, bond prices fall; generally the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate.

**Bonds rated below investment grade** may have speculative characteristics and present significant risks beyond those of other securities, including greater credit risk and price volatility in the secondary market. Investors should be careful to consider these risks alongside their individual circumstances, objectives and risk tolerance before investing in high-yield bonds. High yield bonds should comprise only a limited portion of a balanced portfolio.

Interest on **municipal bonds** is generally exempt from federal income tax; however, some bonds may be subject to the alternative minimum tax (AMT). Also, municipal bonds acquired in the secondary market at a discount may be subject to the market discount tax provisions, and therefore could give rise to taxable income. Typically, state tax-exemption applies if securities are issued within one's state of residence and, if applicable, local tax-exemption applies if securities are issued within one's city of residence. The tax-exempt status of municipal securities may be changed by legislative process, which could affect their value and marketability.

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(as of date June 30, 2017)

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Closed-End Fund (CEF) Rating Category	CEF Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	34	35.8%	15	44.1%	44.1%
Equal-weight/Hold	43	45.3%	13	38.2%	30.2%
Underweight/Sell	18	18.9%	6	17.7%	33.3%
Total	95	100.0%	34	100.0%	

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