

## Events in Illinois Affect S&P Dow Jones State General Obligation (GO) Indices

Market participants reacted warmly to developments related to the Illinois state budget in July, according to data from S&P Dow Jones Indices. The [S&P Municipal Bond Illinois General Obligation Index](#) rose 2.70% in July, compared to 0.65% for the [S&P Municipal Bond State General Obligation Index](#). Entities in Illinois are traditionally one of the largest groups of municipal issuers by state, ranking sixth in volume in 2017 and 2016. The state is the lowest rated with a 'BBB-/stable' GO rating, and it has taken a long and eventful journey to end a budget stalemate that lasted through two fiscal years. The rating was 'A-/WatchNeg' in May 2015, and in the following two years it was downgraded three times to its current rating, at one time holding onto its investment-grade status of 'BBB-' with a CreditWatch negative designation.

### ENDING ILLINOIS' BUDGET STALEMATE

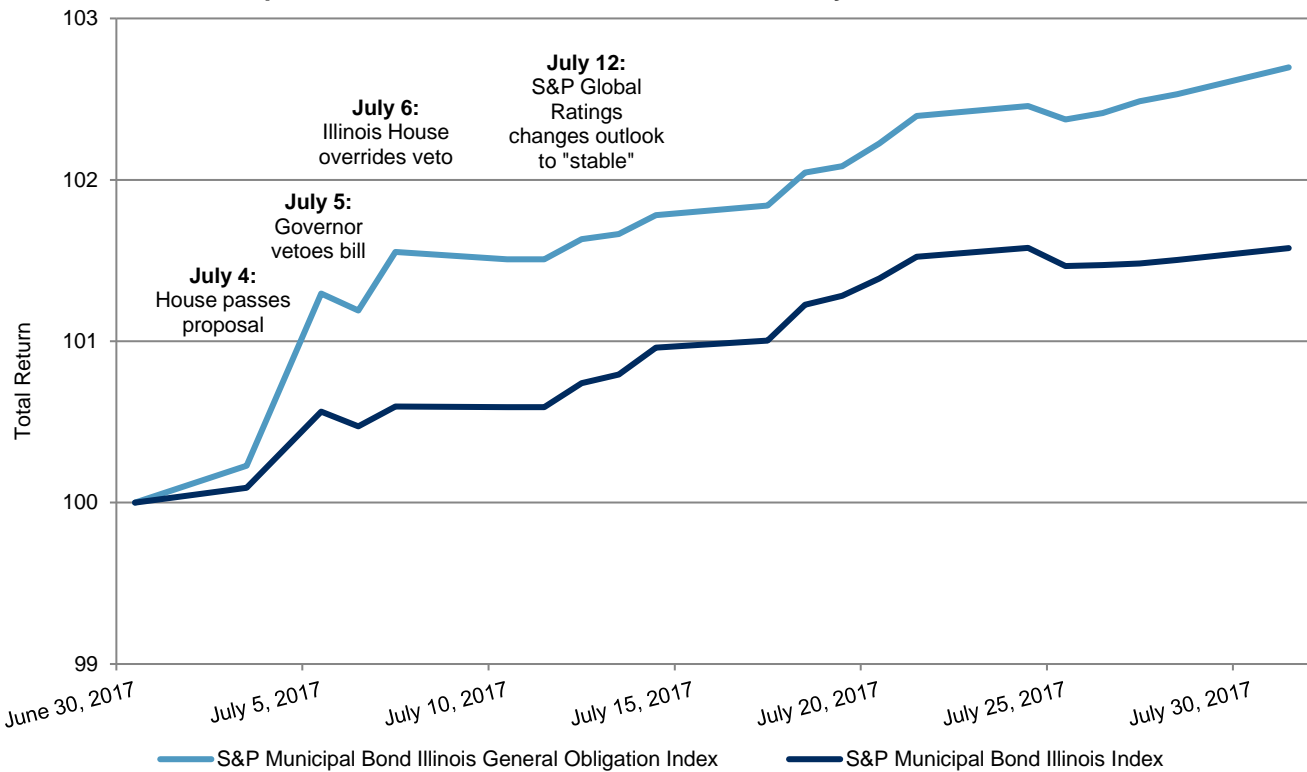
Last month's activity culminated in the passage of a budget after nearly two years of operating without a financial blueprint. On June 30, 2017, the last day of FY 2017, the Illinois House of Representatives passed an amendment to the Senate's budget proposal to fund FY 2018. Returning to session on July 4, 2017, the House passed the amended proposal, sending it to the governor's desk for signature. However, the governor vetoed the bill the same day. The Senate responded by overriding the governor's veto. Two days later, the Illinois House voted to override the veto as well, providing Illinois with its first budget since FY 2015.

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**Exhibit 1: S&P Municipal Bond Illinois GO and Illinois Indices – July Performance**



Source: S&P Dow Jones Indices LLC. Data as of July 30, 2017. Index performance based on total return in USD. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

S&P Global Ratings cited the passage of the budget when it changed its outlook on the ‘BBB’ rating to stable and removed the rating from CreditWatch with negative implications on July 12, 2017. The positive returns for Illinois general obligation bonds in July boosted the return of the S&P Municipal Bond Illinois General Obligation Index to 6.41% YTD, compared to 3.39% for the S&P Municipal Bond State General Obligation Index and 4.22% for the S&P Municipal Bond Local Government General Obligation Index. Comparisons to the state and local indices are relevant because the S&P Municipal Bond Illinois General Obligation Index includes GO debt of state and local issuers. All of the state GO indices include debt of state and local governments, so any conclusions derived from the performance of the indices must account for the variety.

**SIGNIFICANT RETURNS FOR ILLINOIS DEBT IN JULY**

The July returns of the S&P Dow Jones indices for Illinois GO debt and all municipal debt in Illinois reveal an interesting trajectory. Following passage of the budget in the Illinois legislature for the governor’s signature, the GO index rose 1.29% in two days. The governor’s veto of the budget on July 5, 2017, coincided with a loss in the index of 0.10% the following day. The override of the governor’s veto paralleled an increase in the index of 0.36% the next day. The index would continue to gain modestly, going up 0.8% through July 12, 2017, the day S&P Global Ratings removed the state’s GO rating from CreditWatch. With a stable outlook on the state’s GO rating, the index gained another 1.06% through the end of July.

July returns were not nearly as dramatic for other state GO indices included in this report. The other nine state GO indices were chosen for their high volume (California, Florida, New York, and Texas),

recent credit stress (Connecticut, Kansas, and Kentucky), or both (Illinois, New Jersey, and Pennsylvania). The lowest return in July was for Connecticut, which was downgraded to 'A+' from 'AA-' in May, at 0.30%. Most other July returns were between 0.51% and 0.80%.

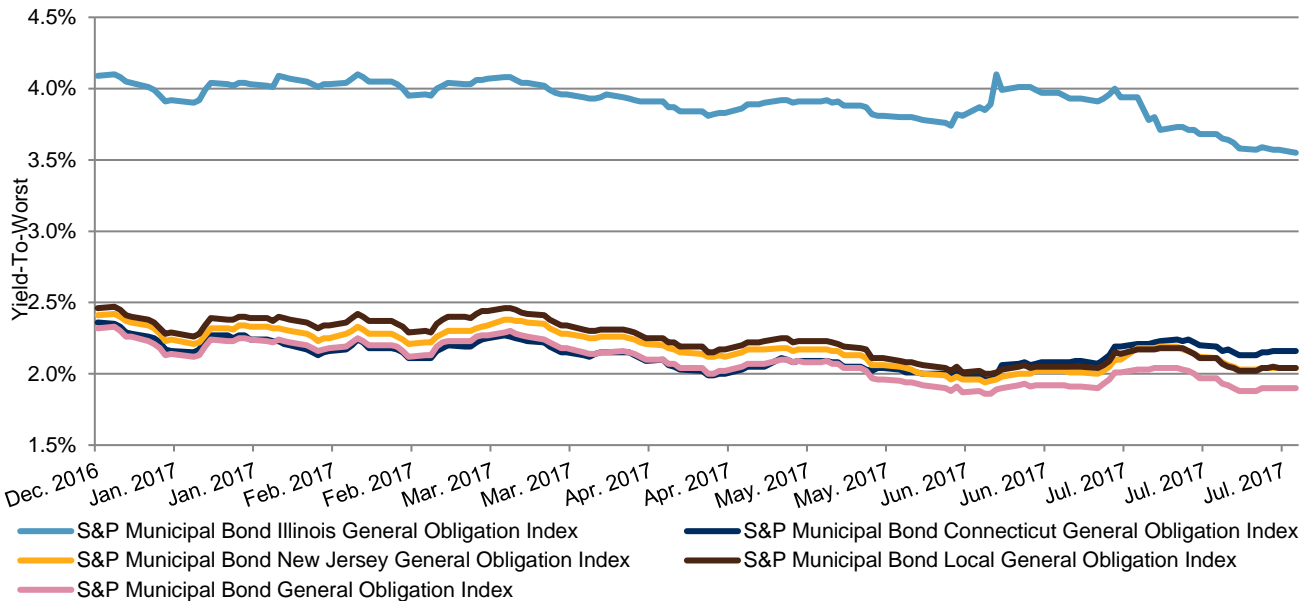
**Exhibit 2: S&P Municipal Illinois GO and Illinois Indices – July Performance**

INDEX NAME	S&P GLOBAL RATING	NO. OF CONSTITUENTS	WEIGHTED AVERAGE MATURITY	YIELD-TO-WORST DEC. 31, 2016	YIELD-TO-WORST JULY 31, 2017	1-MONTH RETURN	YTD RETURN	1-YEAR RETURN	3-YEAR ANNUALIZED RETURN	5-YEAR ANNUALIZED RETURN
S&P Municipal Bond Local Government GO Index	AA	23,859	10.73	2.46%	2.04%	0.82%	4.22%	0.02%	3.39%	3.03%
S&P Municipal Bond State GO Index	AA-	6,680	9.93	2.18%	1.74%	0.65%	3.39%	0.04%	2.56%	2.27%
<b>S&amp;P Municipal Bond Illinois GO Index</b>	<b>BBB+</b>	<b>1,214</b>	<b>11.56</b>	<b>4.09%</b>	<b>3.55%</b>	<b>2.70%</b>	<b>6.41%</b>	<b>1.51%</b>	<b>3.83%</b>	<b>3.03%</b>
S&P Municipal Bond Texas GO Index	AAA	4,593	11.56	2.33%	1.91%	0.65%	3.86%	0.16%	3.07%	2.74%
S&P Municipal Bond Florida GO Index	AA+	546	10.15	2.07%	1.60%	0.59%	3.34%	0.20%	2.68%	2.55%
S&P Municipal Bond California GO Index	AA-	6,210	13.28	2.37%	1.90%	0.80%	4.48%	-0.25%	3.74%	3.72%
S&P Municipal Bond Pennsylvania GO Index	AA-	1,269	8.88	2.53%	2.05%	0.74%	4.29%	0.81%	2.98%	2.64%
S&P Municipal Bond New York GO Index	AA	1,697	7.67	1.99%	1.48%	0.59%	3.47%	0.37%	2.61%	2.31%
S&P Municipal Bond Kansas GO Index	AA	315	10.99	2.43%	2.05%	0.70%	4.25%	0.09%	3.34%	2.92%
S&P Municipal Bond Kentucky GO Index	AA	20	8.33	2.07%	1.53%	0.51%	3.10%	0.58%	3.07%	3.27%
S&P Municipal Bond New Jersey GO Index	A+	604	6.27	2.41%	2.04%	0.64%	3.26%	0.41%	2.29%	1.96%
S&P Municipal Bond Connecticut GO Index	A+	811	7.05	2.35%	2.16%	0.30%	2.25%	-1.13%	1.85%	1.70%

Source: S&P Dow Jones Indices LLC. Data as of July 30, 2017. Index performance based on total return in USD. Past performance is no guarantee of future results. Table is provided for illustrative purposes.

The strong July performance pushed Illinois' total return to 6.41% YTD, however market participants are still demanding higher yields from the state GO index. On a yield-to-worst basis, the S&P Municipal Bond Illinois General Obligation Index delivered 3.55% YTD, nearly 140 bps more than that of Connecticut, and the second-highest yield-to-worst of all 50 state GO indices. Despite being significantly higher than other states, the yield-to-worst of the Illinois GO index tightened 55 bps since June 8, 2017 (see Exhibit 3). Conversely, the yields-to-worst for the Connecticut GO and New Jersey GO indices have widened 14 bps and 15 bps, respectively, since that same date.

**Exhibit 3: 2017 Yield-To-Worst**



Source: S&P Dow Jones Indices LLC. Data as of July 30, 2017. Index performance based on total return in USD. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

**ILLINOIS STILL FACES CHALLENGES**

While July brought some relief to Illinois in terms of its budget, and market participants saw gains in their bond values, the Illinois GO rating remains the lowest among the 50 states. In its analysis accompanying the change of the outlook on the rating to ‘stable,’ S&P Global Ratings cited the state’s depleted budget reserves, backlog of unpaid bills, distressed pension funding levels, and inability to deliver adequate funding for several important public services and institutions during the budget impasse. The low investment-grade rating reflects that Illinois is not well-positioned for economic performance that is weaker than expected. Furthermore, while returns were strong for holders of Illinois debt, those market participants still expect higher yields, placing additional strain on the state’s budget. The passage of the budget did not solve the fiscal problems facing the state, but signaled at least a first step toward improvement.

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