THE "ILLINOIS PENALTY"

Issuers of municipal bonds in the State of Illinois over the last several years have had to face the reality that they will pay higher interest costs than similarly rated issuers in other states. The premium Illinois issuers must pay is often referred to as the "Illinois Penalty" or "Illinois Effect". The penalty is due to a combination of several factors involving the credit quality of the State of Illinois.

In late 2010, it was the State's budget and liquidity issues that drove the penalty. The State had delayed passing its budget and was several months behind in paying bills and relaying revenues to local governments, making bond investors leery. More recently, the State's pension crisis and resulting rating downgrades have contributed to the penalty. In May, State lawmakers in the General Assembly adjourned the Spring legislative session without reaching a deal on pension reform. This was the fifth time in 12 months that they adjourned without agreeing on a solution. Days later, both Moody's Investors Service and Fitch Ratings downgraded the state to "A3" (Negative Outlook) and "A-" (Negative Outlook), respectively. Standard and Poor's rates the State as "A-" (Negative Outlook).

As a result of these ongoing credit issues, many municipal bond investors will not buy State of Illinois bonds or bonds sold by local governments within the State. This lack of demand has created a situation where the investors who are willing to purchase these bonds will demand a higher interest rate for their investment. While the magnitude of the penalty is always fluctuating, it generally has a lower impact on higher rated credits and a higher impact on lower rated credits or credits with more exposure to or reliance on the State.

The record low municipal interest rates realized over the last few years have helped local Illinois issuers ignore the full sting of the penalty. Many issuers have been able to take advantage of these low interest rates to refinance debt or to borrow for new capital projects despite the penalty. Should interest rates continue to trend upward as they have in recent months, local issuers may find themselves more concerned over the State's credit issues and how those issues directly affect their borrowing costs.

Visit our website www.speerfinancial.com for newsletters, training seminars, and to join our email list.

SUITE 4100 * 1 NORTH LASALLE STREET * CHICAGO, ILLINOIS 60602 * (312) 346-3700 * FAX (312) 346-8833
SUITE 608 * 531 COMMERCIAL STREET * WATERLOO, IOWA 50701 (319) 291-2077 * FAX (319) 291-8628