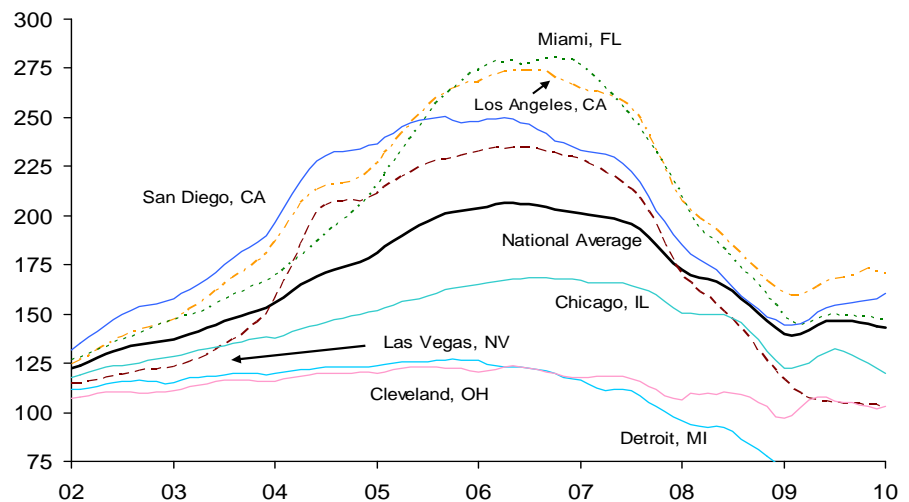


Current

Although we continue to see stabilization in the financial strength of states across most of the country, broader financial contagion out of Europe moving to the U.S. and our first look at 4th quarter state tax revenues do not look extremely encouraging. We suggest caution in investment portfolios as we move closer to the second half of the year

Chart 1: Case-Shiller Housing Prices, 02/28/10 (Index)



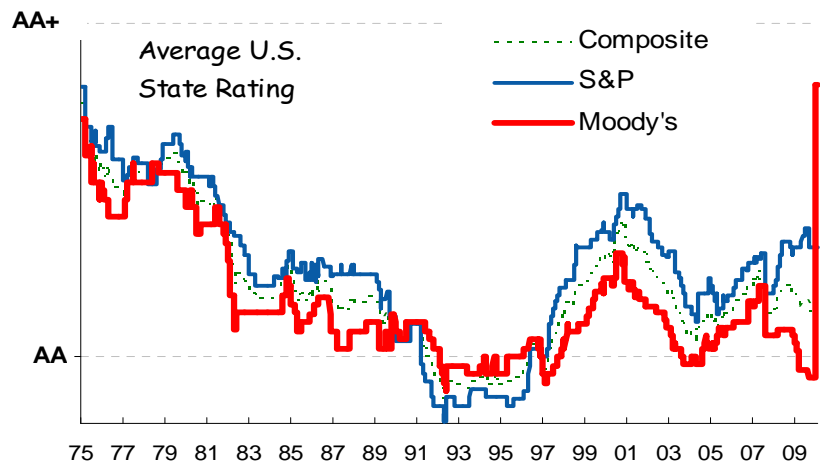
Executive Bullets

- Dispersion between state performances continues. State FSI improvements seen in 35 states since the beginning of April. 17 states have weakened, with a concentration in the Northeast.
- Housing prices began to weaken in the 1st quarter, as participants increasingly call for a 5-10% drop over the coming year. Of the top 20 metropolitan markets according to Case-Shiller data, everyone except LA weakened in the first two months.
- Quality spreads continue to suggest an up-in-quality trade.
- We continue to find unique value in Washington DC and areas of western Michigan.
- Annual tax revenues actually deteriorated in the 4th quarter from the 3rd quarter in 17 states. While this is a major improvement from the prior quarter's comparison (38 states saw a worse annual revenue picture), states continue to search for ways to improve revenue (e.g. New Jersey).
- The V-shaped growth in U.S. GDP has clearly helped individual states from a GDP and employment perspective. Philly Fed shows better stability of economic performances across most of the country.

Muni Recalibration

The April "recalibration" of ratings by Moody's (and Fitch) created the largest, by far, ratings revision (Chart 2) in 35-40 years of ratings history. While Moody's and Fitch risk being misunderstood with such a broad, upward change in ratings amidst a still difficult economic environment, municipal bonds have deserved higher ratings relative to the corporate and broader rated world. Moody's investment grade rated corporates defaulted 42x more often (2.50%) than Moody's investment grade rated munis (0.06%) over a 10-year cumulative period (1970 – 2009). Even when viewing munis against a worst case scenario like the Great Depression, total loss of principal and interest during the period amounted to approximately .5% of outstanding debt. Credit spreads generally tightened for states like California and Illinois following the recalibration.

Chart 2: Average U.S. state rating, Moody's and S&P



Sources: Moody's, S&P, BMO Capital Markets

* Indicates Primary Article Author

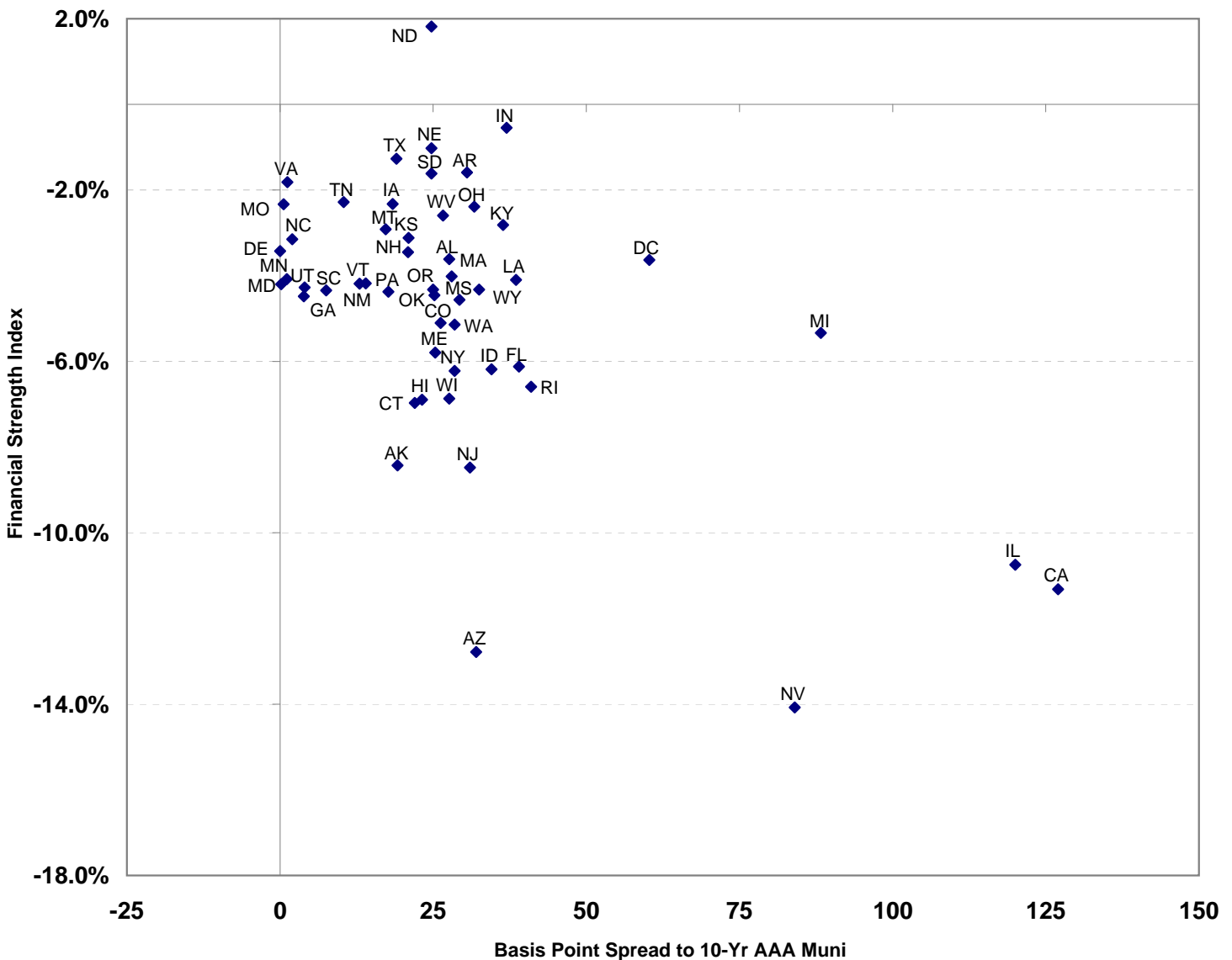


Comparing the Relative Financial Strength of the States

The deterioration of the U.S. economy in 2008, on what appears to be the broadest scale since the Great Depression, and the resulting extended recession has forced investors to evaluate bond portfolios on an ever more critical basis. While actions by states to decrease spending and increase taxes, along with Federal government support, have helped to support state finances, credit profiles at the state level continue to suffer. On the other hand, geographic and structural differences between state credits remains pronounced. This publication evaluates how U.S. states are performing on a blended measure of state financial health (risk) versus our calculated spreads to the AAA MMD curve in the 10-year area (reward) in order to gain a relative credit performance and relative value from a geographic perspective. The back page provides additional information on the data sources and calculation methodology for our Financial Strength Index. The chart below graphically evaluates the current data, while the supporting pages give greater historical detail and a regional breakdown of the data.

State breakdown on a financial strength measure versus 10-year G.O. spread to AAA MMD

Financial Strength Index (weighted levels for housing prices, coincident index, budgetary gaps, state tax revenues and relative quality ratings) for all states versus the estimated 10-year state G.O. municipal spread to AAA MMD (bps)



Sources: Philadelphia Fed, OFHEO, Center on Budget and Policy Priorities, MMD, Moody's, S&P, U.S. Census Bureau, BMO Capital Markets



Current State Level Data (YoY % Change)

State	10-year State G.O. Spread*	State Financial Strength Index	Budgetary Gap	OFHEO HPI	Coincident Index	State Tax Revenue	Rating (Moody's/S&P)	2010 State Issuance (Millions)	2010 Supply Rank
AK	19	-8.4%	-18%	-3%	-2%	-65%	Aa1/AA+	243	45
AL	28	-3.6%	-14%	2%	-3%	-7%	Aa1/AA	609	35
AR	31	-1.6%	-5%	2%	-4%	-1%	Aa1/AA	525	37
AZ	32	-12.8%	-39%	-13%	-4%	-10%	Aa2/AA-	1,556	24
CA	127	-11.3%	-35%	0%	-1%	-7%	A1/A-	18,775	1
CO	26	-5.1%	-20%	3%	-3%	-13%	Aa1/AA	1,120	28
CT	22	-7.0%	-23%	-3%	-3%	-10%	Aa2/AA	2,138	17
DC	60	-3.6%	-9%	0%		-5%	Aa2/A+	1,011	29
DE	0	-3.4%	-14%	-4%	-2%	-14%	Aaa/AAA	126	49
FL	39	-6.1%	-21%	-8%	-4%	-6%	Aa1/AAA	7,811	5
GA	4	-4.5%	-20%	-2%	-4%	-12%	Aaa/AAA	4,438	7
HI	23	-6.9%	-14%	-13%	-5%	-9%	Aa1/AA	1,487	26
IA	18	-2.3%	-16%	1%	-2%	-5%	Aaa/AAA	916	31
ID	35	-6.2%	-14%	-7%	-6%	-11%	Aa1/AA	250	43
IL	120	-10.7%	-30%	-5%	-6%	-8%	Aa3/A+	12,048	2
IN	37	-0.5%	-7%	2%	-2%	-9%	Aaa/AAA	2,122	18
KS	21	-3.1%	-13%	2%	-4%	-8%	Aa1/AA+	902	32
KY	36	-2.8%	-9%	2%	-2%	-6%	Aa1/AA-	1,538	25
LA	39	-4.1%	-14%	1%	1%	-10%	Aa2/AA-	744	33
MA	28	-4.0%	-16%	0%	0%	-9%	Aa1/AA	3,208	10
MD	0	-4.2%	-15%	-6%	-5%	-8%	Aaa/AAA	1,845	21
ME	25	-5.8%	-22%	1%	-3%	-5%	Aa2/AA	299	41
MI	88	-5.3%	-10%	-3%	-7%	-6%	Aa2/AA-	2,244	16
MN	1	-4.1%	-19%	-1%	-3%	-6%	Aa1/AAA	1,791	22
MO	1	-2.3%	-11%	0%	-5%	-9%	Aaa/AAA	1,865	20
MS	29	-4.6%	-14%	-2%	-2%	-7%	Aa2/AA	331	40
MT	17	-2.9%	0%	-3%	-7%	-15%	Aa1/AA	133	48
NC	2	-3.1%	-19%	0%	-2%	-5%	Aaa/AAA	2,803	11
ND	25	1.8%	0%	1%	9%	-11%	Aa1/AA+	162	47
NE	25	-1.0%	-6%	2%	0%	-9%	NR/AA+	558	36
NH	21	-3.4%	-15%	-1%	-1%	-1%	Aa1/AA	346	39
NJ	31	-8.5%	-30%	-4%	-3%	-10%	Aa2/AA	3,847	8
NM	14	-4.2%	-10%	-4%	-4%	-21%	Aaa/AA+	643	34
NV	84	-14.1%	-43%	-17%	-11%	-3%	Aa1/AA+	1,914	19
NY	29	-6.2%	-22%	-1%	-2%	-9%	Aa2/AA	9,249	3
OH	32	-2.4%	-12%	1%	-1%	-7%	Aa1/AA+	3,468	9
OK	25	-4.5%	-14%	3%	-5%	-18%	Aa2/AA+	969	30
OR	25	-4.3%	-18%	-7%	10%	-17%	Aa1/AA	1,711	23
PA	18	-4.4%	-16%	-1%	-4%	-6%	Aa1/AA	5,782	6
RI	41	-6.6%	-24%	-1%	-4%	-3%	Aa2/AA	264	42
SC	8	-4.3%	-20%	1%	-4%	-12%	Aaa/AA+	1,126	27
SD	25	-1.6%	-5%	2%	-1%	-3%	NR/AA	84	50
TN	10	-2.3%	-11%	-1%	-2%	-5%	Aaa/AA+	2,395	15
TX	19	-1.3%	-5%	1%	-3%	-12%	Aaa/AA+	8,298	4
UT	4	-4.3%	-15%	-8%	-3%	-11%	Aaa/AAA	523	38
VA	1	-1.8%	-15%	3%	-3%	-6%	Aaa/AAA	2,547	13
VT	13	-4.2%	-23%	-1%	-1%	0%	Aaa/AA+	230	46
WA	29	-5.1%	-16%	-5%	-5%	-5%	Aa1/AA+	2,697	12
WI	28	-6.9%	-20%	-1%	-9%	-4%	Aa2/AA	2,449	14
WV	27	-2.6%	-4%	-2%	-3%	-3%	Aa2/AA	245	44
WY	33	-4.3%	-6%	-6%	-6%	-18%	NR/AA+	22	51

Source: MMD, BMOCM; BMOCM; CBPP; OFHEO; Philly Fed; US Census Bureau; Moody's/S&P; Bloomberg, YTD
 05/20/10; 05/20/10; 02/25/10; 12/31/09; 03/31/10; 12/31/09; 05/25/10; 04/30/10

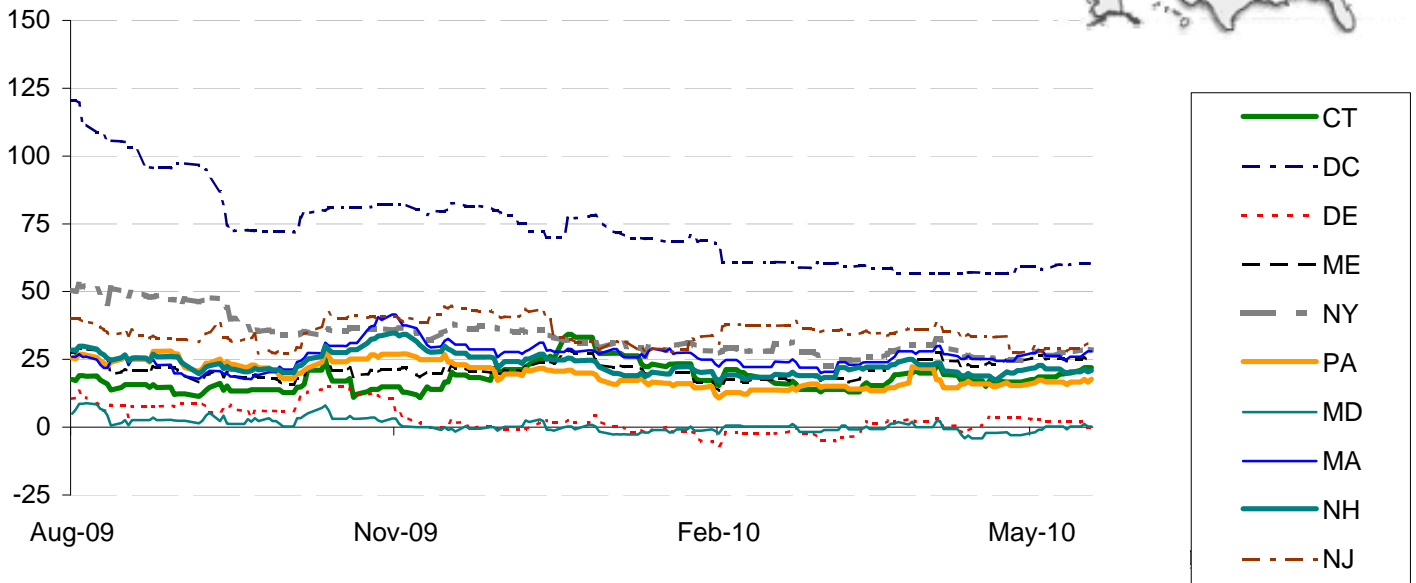
*Spreads levels are estimated for states that do not issue G.O. bonds

Regional and Historical Reports

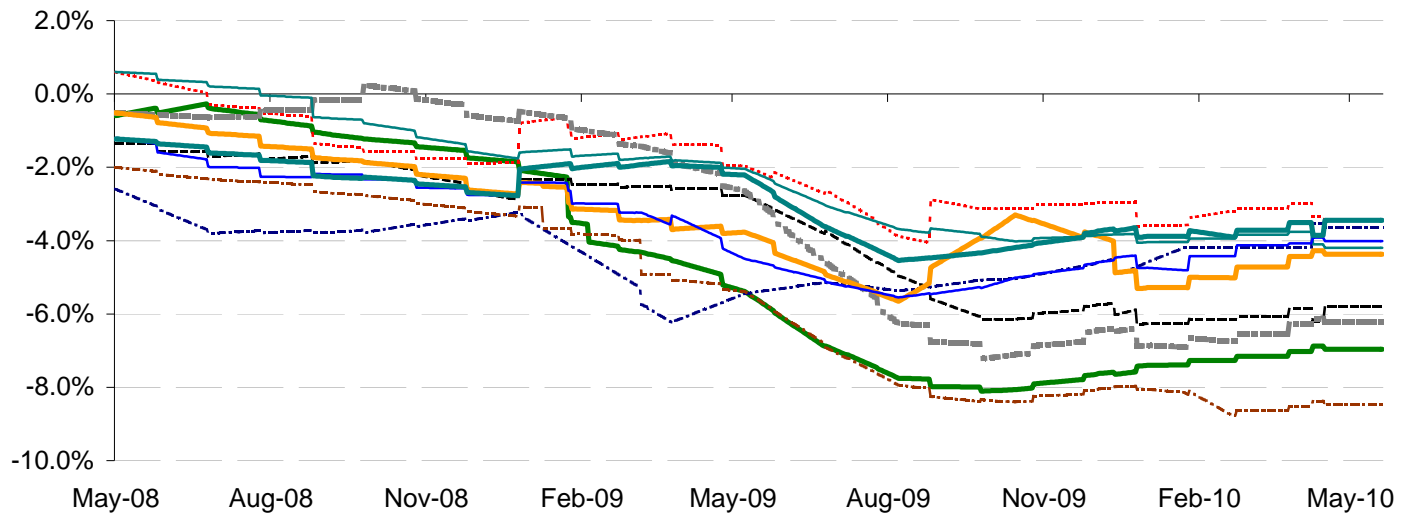
Northeast



Historical Spreads (10Yr, >1 Billion 2009 Issuance)



Historical Financial Strength Index (>1 Billion 2009 Issuance)



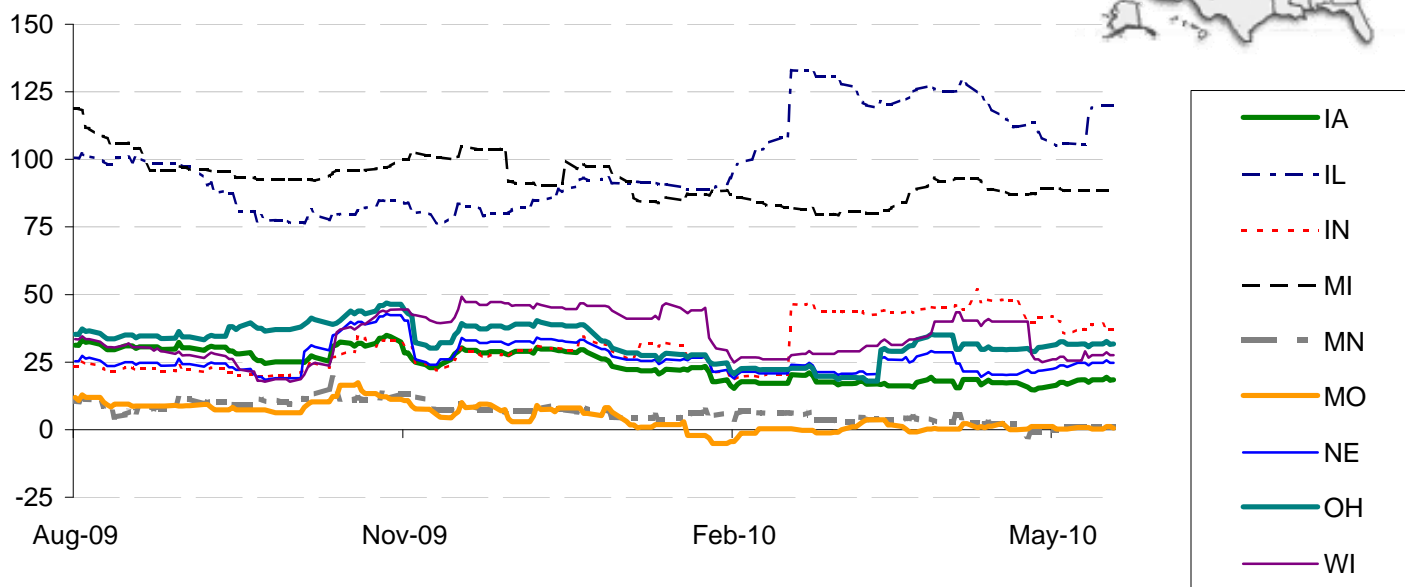
State	10-year State G.O. Spread*	Financial Strength Index	Budgetary Gap	OFHEO HPI	Coincident Index	State Tax Revenue	Rating (Moody's/S&P)	2010 State Issuance (Millions)	2010 Regional Supply Rank
CT	22	-7.0%	-23%	-3%	-3%	-10%	Aa2/AA	2,138	5
DC	60	-3.6%	-9%	0%	0%	-5%	Aa2/A+	1,011	7
DE	0	-3.4%	-14%	-4%	-2%	-14%	Aaa/AAA	126	12
MA	28	-4.0%	-16%	0%	0%	-9%	Aa1/AA	3,208	4
MD	0	-4.2%	-15%	-6%	-5%	-8%	Aaa/AAA	1,845	6
ME	25	-5.8%	-22%	1%	-3%	-5%	Aa2/AA	299	9
NH	21	-3.4%	-15%	-1%	-1%	-1%	Aa1/AA	346	8
NJ	31	-8.5%	-30%	-4%	-3%	-10%	Aa2/AA	3,847	3
NY	29	-6.2%	-22%	-1%	-2%	-9%	Aa2/AA	9,249	1
PA	18	-4.4%	-16%	-1%	-4%	-6%	Aa1/AA	5,782	2
RI	41	-6.6%	-24%	-1%	-4%	-3%	Aa2/AA	264	10
VT	13	-4.2%	-23%	-1%	-1%	0%	Aaa/AA+	230	11

Regional and Historical Reports

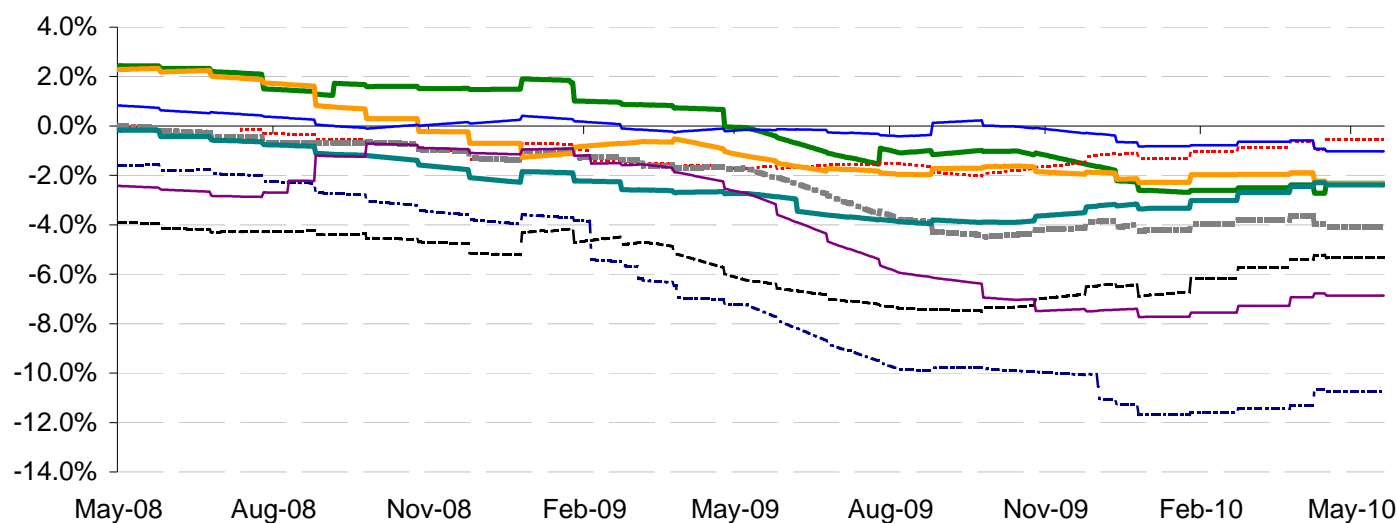
Midwest



Historical Spreads (10Yr, >1 Billion 2009 Issuance)



Historical Financial Strength Index (>1 Billion 2009 Issuance)



State	10-year State G.O. Spread*	Financial Strength Index	Budgetary Gap	OFHEO HPI	Coincident Index	State Tax Revenue	Rating (Moody's/S&P)	2010 State Issuance (Millions)	2010 Regional Supply Rank
IA	18	-2.3%	-16%	1%	-2%	-5%	Aaa/AAA	916	8
IL	120	-10.7%	-30%	-5%	-6%	-8%	Aa3/A+	12,048	1
IN	37	-0.5%	-7%	2%	-2%	-9%	Aaa/AAA	2,122	5
MI	88	-5.3%	-10%	-3%	-7%	-6%	Aa2/AA-	2,244	4
MN	1	-4.1%	-19%	-1%	-3%	-6%	Aa1/AAA	1,791	7
MO	1	-2.3%	-11%	0%	-5%	-9%	Aaa/AAA	1,865	6
ND	25	1.8%	0%	1%	9%	-11%	Aa1/AA+	162	10
NE	25	-1.0%	-6%	2%	0%	-9%	NR/AA+	558	9
OH	32	-2.4%	-12%	1%	-1%	-7%	Aa1/AA+	3,468	2
SD	25	-1.6%	-5%	2%	-1%	-3%	NR/AA	84	11
WI	28	-6.9%	-20%	-1%	-9%	-4%	Aa2/AA	2,449	3

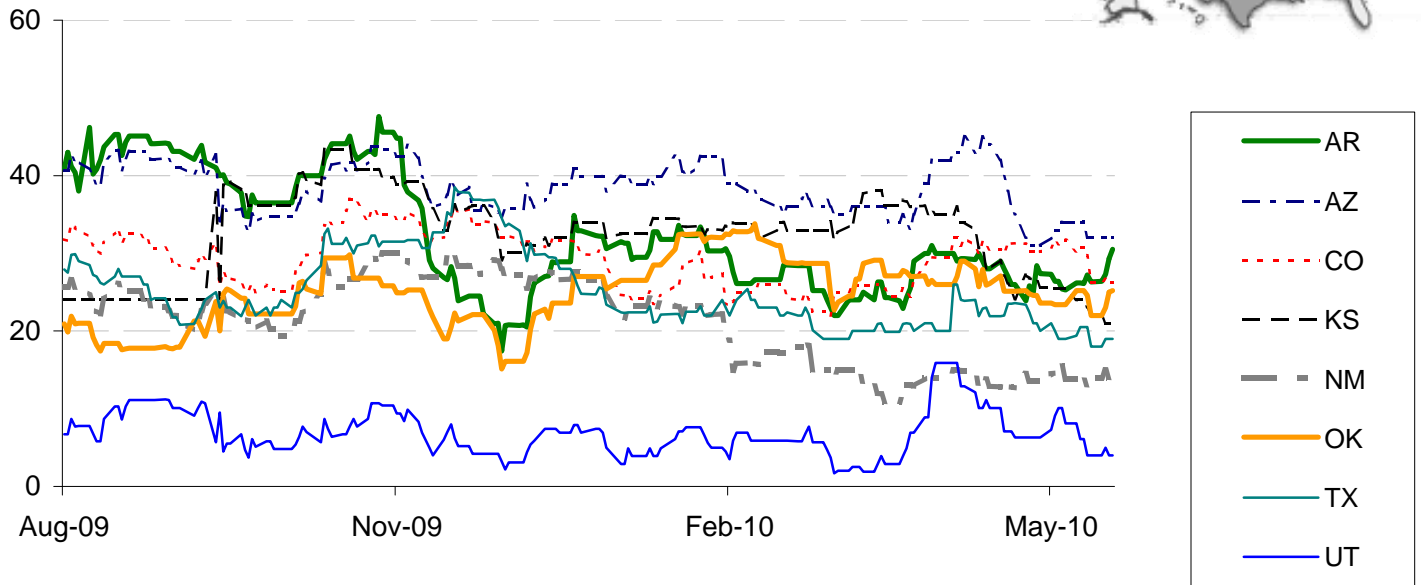


Regional and Historical Reports

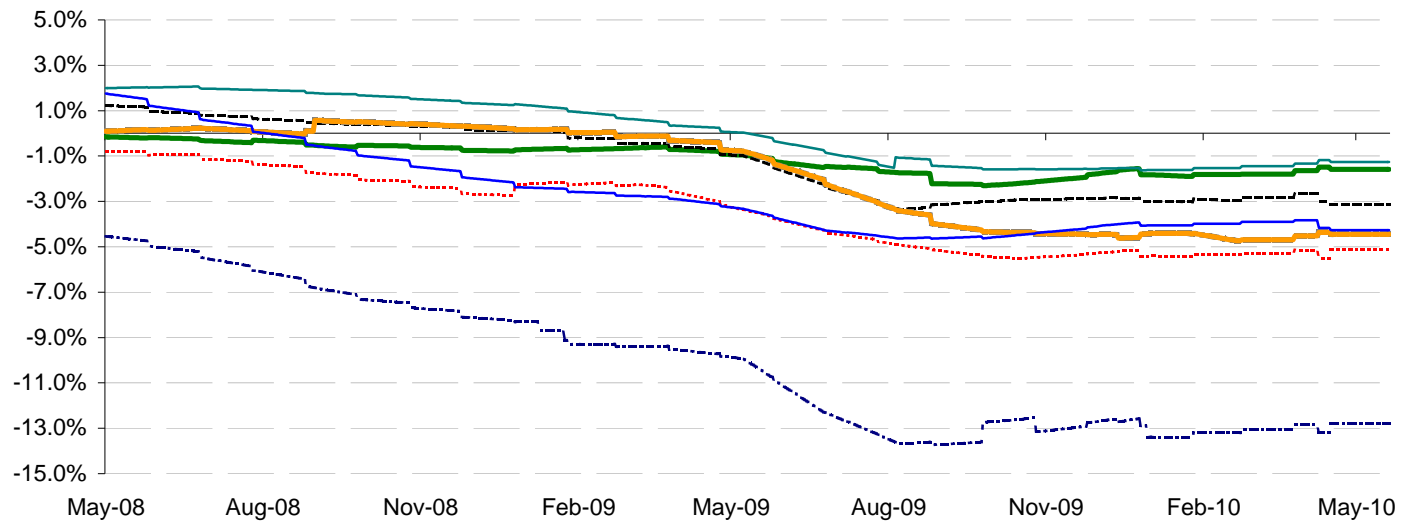
Southwest



Historical Spreads (10Yr)



Historical Financial Strength Index



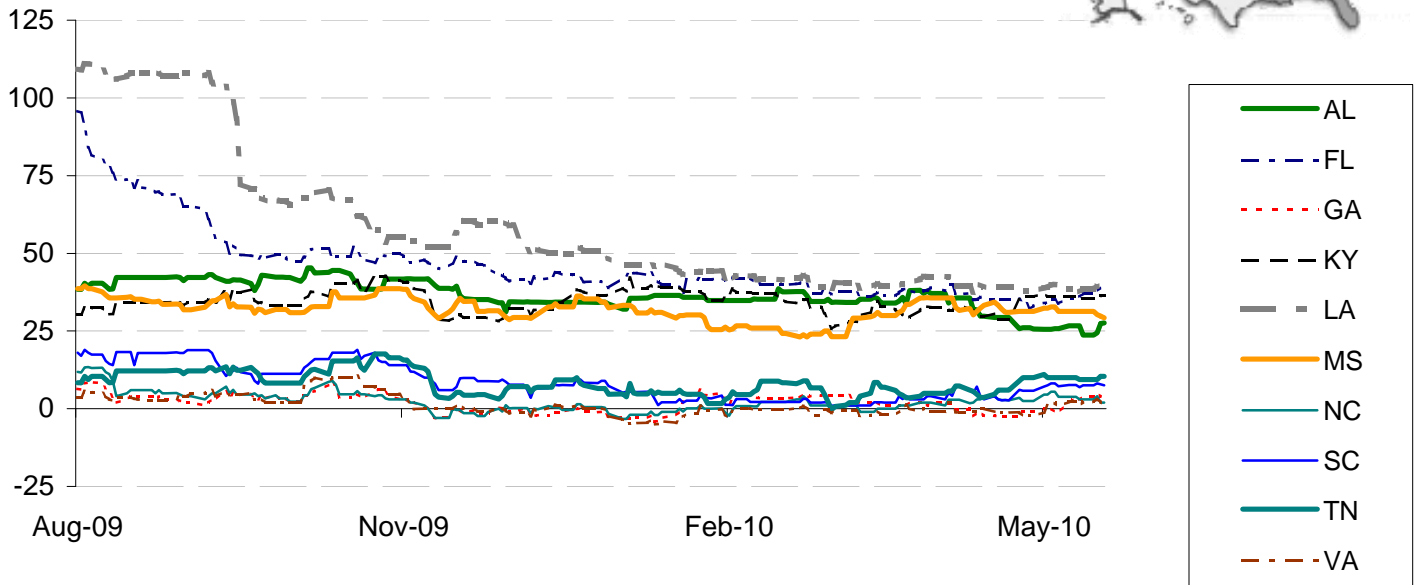
State	10-year State G.O. Spread*	Financial Strength Index	Budgetary Gap	OFHEO HPI	Coincident Index	State Tax Revenue	Rating (Moody's/S&P)	2010 State Issuance (Millions)	2010 Regional Supply Rank
AR	31	-1.6%	-5%	2%	-4%	-1%	Aa1/AA	525	7
AZ	32	-12.8%	-39%	-13%	-4%	-10%	Aa2/AA-	1,556	2
CO	26	-5.1%	-20%	3%	-3%	-13%	Aa1/AA	1,120	3
KS	21	-3.1%	-13%	2%	-4%	-8%	Aa1/AA+	902	5
NM	14	-4.2%	-10%	-4%	-4%	-21%	Aaa/AA+	643	6
OK	25	-4.5%	-14%	3%	-5%	-18%	Aa2/AA+	969	4
TX	19	-1.3%	-5%	1%	-3%	-12%	Aaa/AA+	8,298	1
UT	4	-4.3%	-15%	-8%	-3%	-11%	Aaa/AAA	523	8

Regional and Historical Reports

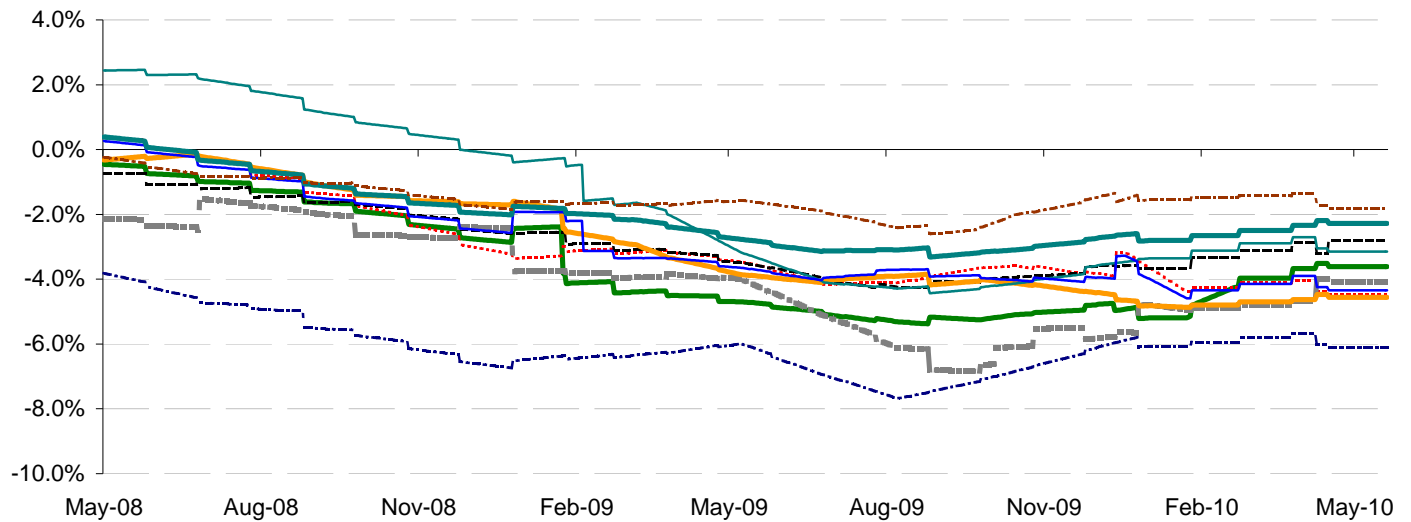
Southeast



Historical Spreads (10Yr, >1 Billion 2009 Issuance)



Historical Financial Strength Index (>1 Billion 2009 Issuance)



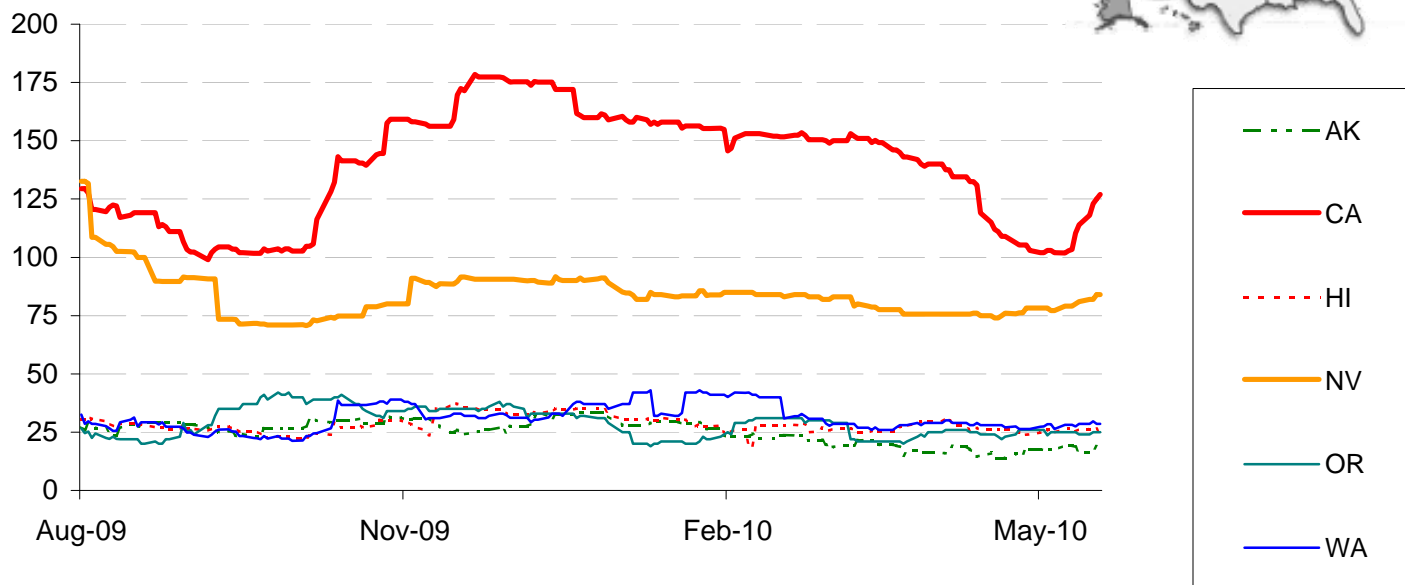
State	10-year State G.O. Spread*	Financial Strength Index	Budgetary Gap	OFHEO HPI	Coincident Index	State Tax Revenue	Rating (Moody's/S&P)	2010 State Issuance (Millions)	2010 Regional Supply Rank
AL	28	-3.6%	-14%	2%	-3%	-7%	Aa1/AA	609	9
FL	39	-6.1%	-21%	-8%	-4%	-6%	Aa1/AAA	7,811	1
GA	4	-4.5%	-20%	-2%	-4%	-12%	Aaa/AAA	4,438	2
KY	36	-2.8%	-9%	2%	-2%	-6%	Aa1/AA-	1,538	6
LA	39	-4.1%	-14%	1%	1%	-10%	Aa2/AA-	744	8
MS	29	-4.6%	-14%	-2%	-2%	-7%	Aa2/AA	331	10
NC	2	-3.1%	-19%	0%	-2%	-5%	Aaa/AAA	2,803	3
SC	8	-4.3%	-20%	1%	-4%	-12%	Aaa/AA+	1,126	7
TN	10	-2.3%	-11%	-1%	-2%	-5%	Aaa/AA+	2,395	5
VA	1	-1.8%	-15%	3%	-3%	-6%	Aaa/AAA	2,547	4
WV	27	-2.6%	-4%	-2%	-3%	-3%	Aa2/AA	245	11



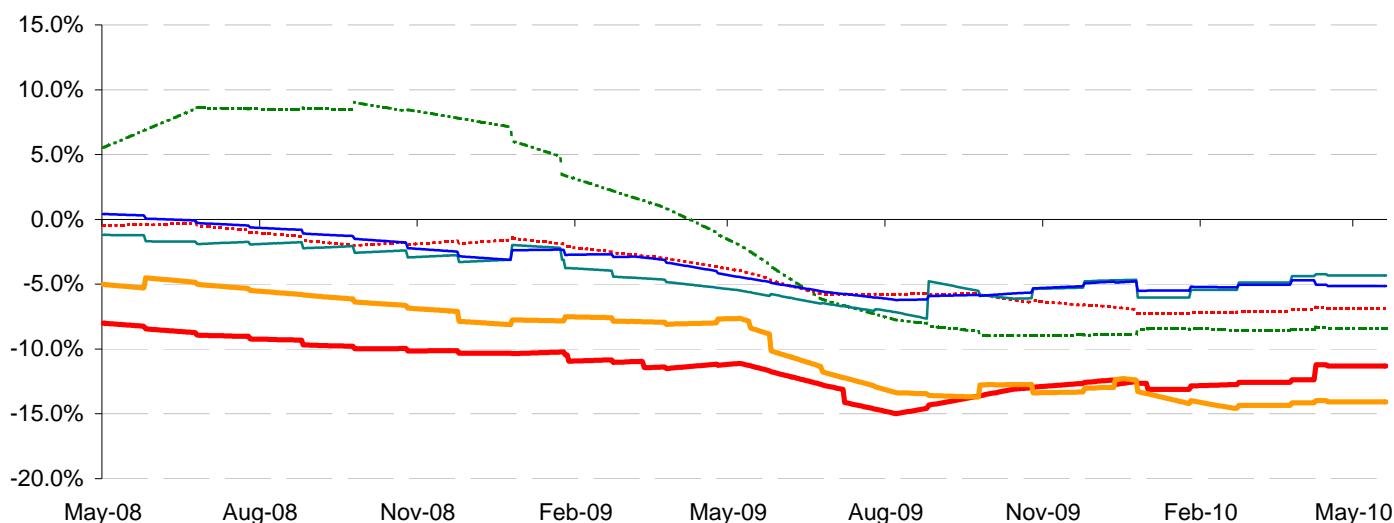
Regional and Historical Reports
Far West



Historical Spreads (10Yr, >500 Million 2009 Issuance)



Historical Financial Strength Index (>500 Million 2009 Issuance)



State	10-year State G.O. Spread*	Financial Strength Index	Budgetary Gap	OFHEO HPI	Coincident Index	State Tax Revenue	Rating (Moody's/S&P)	2010 State Issuance (Millions)	2010 Regional Supply Rank
AK	19	-8.4%	-18%	-3%	-2%	-65%	Aa1/AA+	243	7
CA	127	-11.3%	-35%	0%	-1%	-7%	A1/A-	18,775	1
HI	23	-6.9%	-14%	-13%	-5%	-9%	Aa1/AA	1,487	5
ID	35	-6.2%	-14%	-7%	-6%	-11%	Aa1/AA	250	6
MT	17	-2.9%	0%	-3%	-7%	-15%	Aa1/AA	133	8
NV	84	-14.1%	-43%	-17%	-11%	-3%	Aa1/AA+	1,914	3
OR	25	-4.3%	-18%	-7%	10%	-17%	Aa1/AA	1,711	4
WA	29	-5.1%	-16%	-5%	-5%	-5%	Aa1/AA+	2,697	2
WY	33	-4.3%	-6%	-6%	-6%	-18%	NR/AA+	22	9



Financial Strength Index Methodology:

We developed the Financial Strength Index (FSI) to analyze state G.O. financial health. The FSI is comprised of an average of five important indicators of state economic health by combining them into one measure. Generally, this measure combines state economic and employment health, blended quality ratings, housing price movements, annual changes in tax collections and budget imbalances over 3 years (2009-2011) to show one overall risk measure. Here are the specifics on the five measures:

- The coincident index, tracked by the Philadelphia Federal Reserve. This index combines four state-level employment indicators to estimate state economic and employment health. According to the Philadelphia Fed, “the four state-level variables in each coincident index are nonfarm payroll employment, average hours worked in manufacturing, the unemployment rate, and wage and salary disbursements deflated by the consumer price index (U.S. city average). The trend for each state’s index is set to the trend of its gross domestic product (GDP), so long-term growth in the state’s index matches long-term growth in its GDP.”
- The Federal Housing Finance Agency (formerly Office of Federal Housing Enterprise Oversight) Housing Price Index (HPI). The HPI measures housing strength in each individual state by tracking weighted, repeat sales or refinancing of single-family home prices. The information used is from the purchase only HPI and is obtained by reviewing repeat mortgage transactions on single-family properties whose mortgages have been purchased or securitized by Fannie Mae or Freddie Mac since January 1975. The HPI is updated each quarter. As housing problems have driven this economic cycle, housing price movements will likely play an outsized role in a states perceived ability to balance budgets and pay debt service over the next couple of years.
- The state budgetary gap measures average projected shortfalls for 2009, 2010, and 2011 budgeted revenues minus expenses, as reported by the Center on Budget and Policy Priorities (CBPP). A number of states have not reported 2011 budgets or budgetary gaps, therefore, we use 2009 and 2010 numbers in these cases. The gaps shown are projected shortfalls as a percentage of the total budget before adoption of a new budget plus mid-year gaps (for 2009 and 2010). Most states have passed reduced budgets and taken a number of measures to fill budgetary holes. The present economic malaise favors states that have remained conservative with regards to revenue and spending over the past cycle. This combination of factors can give an indication of a state’s relative economic strength versus peers.
- The U.S. Census Bureau tracks state tax collections on a quarterly basis. We utilize year-over-year percentage changes in tax revenue to minimize seasonal impacts and capture a longer-run impact on state collections.
- Finally, the FSI incorporates blended quality ratings from Moody’s and S&P in order to calculate an average for all states. States with above average quality ratings receive a positive value while states with a below average quality rating receive a negative value in proportion to the amount above or below the national average.



The views expressed in this report accurately reflect the analyst’s personal views. No part of the analyst’s compensation was, is or will be directly or indirectly related to any specific recommendations or views. This report is intended for the private use of the institutional investor to whom it was sent.

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