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Investors Give Nod to Worst-Rated Illinois With Revenue Growing.

- **State's 30-year bond spread over AAA is tightest since 2015**
- **Pot sales, new taxes may raise funds to help pay pension costs**

As Governor J.B. Pritzker nears his one-year anniversary in office, investors are signaling that Illinois is making some gains even as the worst-rated state grapples with rising pension debt and the highest borrowing costs among its peers.

Pritzker, a Democrat, and other state leaders have earned credit from the $3.8 trillion municipal market for achieving some fiscal stability. Illinois's bond-market penalty, the premium that investors have long demanded to hold the state's debt, fell to the lowest since 2015 this week, which some debt holders say is due to optimism for potential new tax revenue and others attribute to overall strong demand for high-yield muni bonds.

"There is distinct improvement" over the past year, said John Ceffalio, a credit analyst for AllianceBernstein LP, which owns Illinois bonds among its approximately $47 billion of municipal debt. "The big thing from the credit side is increased political stability and economic and revenue growth."

In the past year, Illinois passed a budget on time, raised gas levies to fund the first capital plan in a decade and legalized recreational marijuana. Looking ahead, in November voters will consider a constitutional amendment to institute a progressive income tax. The new revenue is needed as the state faces roughly $6 billion of unpaid bills and $137 billion of unfunded pension liabilities, a drag on its credit rating.

General fund revenues for the state through December for fiscal 2020 rose 5.3% to $19.2 billion, according to a report from the Commission on Government Forecasting and Accountability.

The yield-penalty on Illinois bonds is still the highest of the 20 states tracked by Bloomberg, but it has narrowed. The spread on Illinois bonds due in 30 years fell to 1.19 percentage points this week, the lowest since March 2015, according to data compiled by Bloomberg.

Illinois has put itself in a "better position" given its revenue gains, willingness to raise taxes and planned infrastructure investment, Ted Hampton, an analyst for Moody's Investors Service, said in an interview.

Still, Illinois's "massive pension liability" has made it an "outlier" in terms of the scale of its fixed costs relative to its revenue, Hampton said. Illinois's so-called fixed-cost ratio is 36.4% in 2018, the nation's highest and four times the median of U.S. states tracked by Moody's, which didn't include a few states in its most recent calculation.

"Governor Pritzker is pleased to see the markets recognizing that Illinois is moving forward," Jordan Abudayyeh, a spokeswoman for the governor, said in an email.

During his first year in office, Pritzker worked to restore “faith in our government,” raise wages, pass a bipartisan balanced budget, set up a capital plan and invest in education to improve the state’s long-term fiscal health, Abudayyeh said.

Investors are looking for voters to approve the progressive income tax proposal at the ballot box in November.

“There is optimism they will get the votes to create the new tax structure, which will help them raise more revenue and better fund their pension,” said Dan Solender, a portfolio manager for Lord Abbett & Co., which manages $27 billion of munis, including Illinois debt.

This year’s legalization of recreational adult-use marijuana sales is among the tailwinds that may help. From Jan. 1 through Jan. 5, Illinois dispensaries sold $10.8 million in adult-use cannabis in 271,169 transactions, according to state records.

Pritzker is set to deliver his state of the state speech later this month and present his budget in February. A central focus is going to be on how the state lines up its revenue with costs, said Eric Kim, a senior director for public finance at Fitch Ratings.

“We want to see the state continue to make progress toward a structural balance,” Kim said.

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