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## **Fitch: Illinois' MLF Borrowing Reflects Deep Challenges, but Options Remain**

Fitch Ratings-New York-22 December 2020: Illinois' \$2 billion borrowing from the Federal Reserve's Municipal Liquidity Facility (MLF) illustrates the depth of its budget challenges, but the state also retains fiscal tools to address them, Fitch Ratings says.

The loan provides a short-term solution for a \$3.9 billion fiscal 2021 gap. The governor also recently announced \$711 million in budget reductions, and the 2021 legislative sessions will include further action to address the gaps in 2021 and future years. Available options include further expenditure cuts, revenue increases and non-structural solutions.

Fitch considers Illinois notably more constrained in its fiscal choices than other U.S. states. Illinois' 'BBB-' Issuer Default Rating (IDR) and GO ratings and Negative Outlook reflect Fitch's anticipation of a fundamental weakening of the state's financial resilience given its already tenuous position entering the pandemic. Illinois will be challenged to maintain its investment-grade IDR.

Before the most recent MLF loan, Illinois faced a sizable budget gap the governor estimated at \$3.9 billion on a roughly \$43 billion general funds budget. Pandemic-driven shortfalls reportedly account for about half of the gap with the remainder reflecting underlying structural issues that are a key factor in the state's relatively weak credit profile.

Revenue performance has been well ahead of expectation in May's enacted budget. Both the Governor's Office of Management and Budget and the legislature's Commission on Government Forecasting and Accountability revised revenue forecasts upwards by more than \$2 billion in November, even while assuming slowing economic growth and additional coronavirus mitigation measures.

The revisions are consistent with trends in many U.S. states as economic activity has rebounded faster than originally anticipated from the spring's coronavirus-driven trough, as noted in our on-demand webinar US States' Path to Economic Recovery. Gains have been slowing in the face of rapid virus spread and resultant mitigation responses. Recently enacted federal stimulus should support near-term stabilization of economic activity, and dependent tax revenues, in Illinois and elsewhere (New Federal Aid to Steady State and Local Budgets, published Dec. 2020 on [www.fitchratings.com](http://www.fitchratings.com)).

The \$2 billion MLF borrowing follows the state's \$1.2 billion MLF cashflow borrowing in June. The state will use proceeds primarily to pay down Medicaid bills, leveraging over \$1.1 billion in federal matching revenue. To address the remaining \$1.9 billion gap for fiscal 2021, the governor announced \$711 million in budget reductions last week, most of which will be imposed unilaterally. The reductions do not include any change in education funding.

Despite failure of the graduated income tax ballot initiative, Illinois retains legal authority to implement various revenue enhancements, though political willingness is uncertain. In February 2019, the Commercial Club of Chicago Civic Committee outlined up to \$6.4 billion in recurring

revenue options, although these estimates relied on pre-pandemic economic expectations.

While the governor has ruled out one suggestion, \$1.9 billion from taxing retirement income, other options including raising the personal and corporate income taxes by 1 percentage point (\$3.7 billion and \$300 million respectively), and a sales tax expansion to more services (\$500 million) could generate significant recurring revenue. Changes to income tax credits could be paired with a rate increase to mimic a graduated income tax rate structure.

Fitch anticipates the legislature will consider revenue options and further expenditure changes in early 2021, along with non-recurring options such as further bill deferrals, fund sweeps or utilization of remaining Coronavirus Relief Funds. While the state retains broad legal capacity, Illinois also has a history of deferring or avoiding difficult fiscal choices and instead implementing short-term, non-recurring budget measures that add to long-term challenges. This repeated inability to address its structural challenges remains a key negative rating consideration.

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