
WSJ: Illinois Dinged by Downgrade.

Illinois paid a premium to sell $600 million of sales-tax backed municipal bonds Tuesday, days after the state's general credit rating was downgraded by two rating companies.

Illinois sold a 10-year bond at a yield of 2.94%, 0.75 percentage point more than triple-A-rated debt on a benchmark scale kept by Thomson Reuters Municipal Market Data, as of Monday's close.

The so-called Build Illinois bond sale received a top triple-A rating from Standard & Poor's, and the second highest investment-grade rating of double-A-plus from Fitch Ratings. Market participants said the state paid a premium on the sales-tax bonds because of its fiscal troubles.

Legislators in Illinois again failed to pass pension overhaul recently. Last week, both Fitch Ratings and Moody's Investors Service cut the state's rating on its general-obligation bonds down a notch because of the state's inaction.

"The Illinois label is radioactive for some investors," said Brian Battle, director of trading at Performance Trust Capital Partners in Chicago.

But Mr. Battle said the protections on Tuesday's sales-tax bond are fairly strong.

The sales-tax revenue that repays the debt is kept in an account separate from the state's treasury. The amount of sales taxes available to repay the bonds exceeds debt payments by around 20 times.

Illinois' sales-tax bond sale comes against a tough bond-market backdrop. Muni prices slid again Tuesday, mirroring selling in Treasurys.

Meanwhile, investors yanked $1.5 billion out of muni mutual funds and exchange-traded funds last week, the largest outflow since mid-December 2012, according to Lipper FMI. Flows in and out of muni mutual funds are viewed as a proxy of demand.

Over the past two weeks, the yield on a benchmark 10-year muni has increased from 1.99% to 2.26%, as of Tuesday's close, according to MMD. Prices and yields move inversely.

Justin Land, senior vice president and portfolio manager at Wasmer, Schroeder & Co. in Naples, Fla., said the state will face a bigger test in about two weeks, when it sells a $1.25 billion general obligation deal.

The success of that sale may hinge on whether or not legislators are able to get anything accomplished on the pension in a special session Gov. Pat Quinn has called for next week.

"People are not very optimistic," Mr. Land said of the special session. "I will be very curious to see how it goes," he said of the state's next bond sale.

Mr. Land said Wasmer Schroeder, which oversees about $4.7 billion in fixed-income assets, didn't buy Illinois sales-tax bonds Tuesday.

Proceeds of the sales-tax bond deal will refinance older debt with higher interest rates.

John Sinsheimer, director of capital markets for Illinois, wasn't available for comment.

By KELLY NOLAN