It’s So Bad in Illinois Its Bonds Pay Like a Reviled Jersey Mall.

- **American Dream yields only slightly above worst-rated state**
- **State remains a better buy than the mall: AllianceBernstein**

Illinois’s finances are so troubled that investors can make nearly as much money betting on the worst-rated U.S. state as they can on the American Dream mall project, perhaps the most despised structure in New Jersey.

An unfinished, multicolored hulk in the Meadowlands beside the Turnpike, former Governor Chris Christie called it “the ugliest damn building in New Jersey, and maybe America.” Yet bondholders are asking to get paid nearly as much to own Illinois’s debt as they are demanding in return for holding the long-delayed mall’s unrated revenue bonds — a consequence of the state’s perennial budget distress that’s left it teetering near junk grade.

The yield on Illinois general-obligation bonds that mature in 2028 averaged 4.5 percent in March, compared to an average of 4.99 percent on unrated bonds due in 2050 sold for the American Dream mall project, the shopping and entertainment center that’s years behind schedule, according to data compiled by Bloomberg.

Despite the close yields, the state’s debt is still the better bet, according to AllianceBernstein LP, which oversees about $41 billion of municipal fixed income securities. No state has defaulted since the Great Depression, after all, while the shopping mall industry is being challenged by the growth of Internet retailing.

“Fundamentally, when you look longer-term, you would take a state over any single project,” said Guy Davidson, director of municipal investments at AllianceBernstein. “The hard part is the noise in between. Right now, a single project could be on budget and has the money set aside to pay debt service along the way, you don’t expect any noise, and right now given the politics in Illinois, you’re going to have noise.”

Illinois has $8 billion of unpaid bills, chronic budget deficits and $129 billion of unfunded retirement liabilities. Little progress has been made on its pension crisis amid fighting between Republican Governor Bruce Rauner, who is up for re-election this year, and the Democrat-led legislature.

Partisan gridlock led to an unprecedented budget impasse last year. In July, Illinois narrowly avoided becoming the first junk-rated state after lawmakers overrode Rauner’s veto of an income tax-hike to enact a spending plan.

Still, investors should have room to buy if Illinois yields rise further, relative to top-rated debt, especially since it doesn’t seem like the news will improve, according to Davidson. Illinois holdings make up about 2 percent of AllianceBernstein’s municipal bond portfolio.

The gap between Illinois’s yields and the benchmark has widened this year as the sixth-most populous state faces uncertainty around its deteriorating finances, and spreads will likely widen further, said Neene Jenkins, a vice president and municipal credit analyst at AllianceBernstein. Illinois is already rated Baa3 by Moody's Investors Service, with a negative outlook, and BBB- by S&P Global Ratings with a stable outlook. For both companies, that's the lowest level of investment-grade.

"If we don't have a budget that's been passed on time, there's a good chance one of the rating agencies could lose patience," Jenkins said.

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