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Near-Junk Illinois Faces Record Bond Penalties on Financial Risk.

- **10-year spread over AAA rated debt rises to 34O basis points**
- **Higher debt costs mean 'budget balancing harder': Fabian**

The extra yield that investors are demanding to own Illinois bonds has surged to a record high, surpassing even the levels hit three years ago when it was on the verge of seeing its rating cut to junk, as the coronavirus threatens to deal a devastating blow to its precarious finances.

The yield on the state's 10-year debt has climbed to about 340 basis points above the top-rated benchmark, according to Bloomberg's indexes, which were started in 2013. That's above the previous record in June 2017, during the height of a protracted two-year budget impasse that left the government contending with a swelling backlog of unpaid bills and threatened to turn it into the first state to be stripped of an investment-grade credit rating.

Since then, Illinois had gained some ground as lawmakers crafted plans to stabilize its budget and tumbling interest rates boosted demand for higher-yielding securities. But the market since last month has been rocked by a series of sell-offs and investors are on edge about the deep financial hit the pandemic-induced economic slowdown will deliver to Illinois, which already had $137 billion in unfunded pension liabilities, more than $7 billion in unpaid bills and almost nothing in its rainy day fund.

With its bonds rated just one step above junk by Moody's Investors Service and S&P Global Ratings, a downgrade could set off a round of forced selling by mutual funds that can only hold investment-grade debt.

"The situation is more precarious because they are currently rated just above investment grade," said Jason Appleson, a portfolio manager for PT Asset Management, which holds Illinois debt. "The more investors fear there's a chance for Illinois to get downgraded to below investment grade, the greater the chance of spread widening."

Illinois 10-year bond spread hits record ahead of tightening cash
Governor J.B. Pritzker has acknowledged the steep economic toll, though he has yet to provide estimates for how severe it will be.

Making matters more difficult, the state has joined those that pushed their annual tax-collection deadlines until July, creating cash-management challenges even with the $150 billion in federal emergency stimulus money about to flow to states and local governments. Illinois Comptroller Susana Mendoza said Friday the state will delay some payments in the coming months to pay more immediately needs such as equipment and services to curb the outbreak.

During previous fiscal crises, Illinois continued to cover its bond payments, and no state has defaulted on its debts since the Great Depression. Illinois's general-obligation debt is funded a year in advance, effectively insulating bondholders from a near-term default, said Matt Fabian, a senior analyst for Municipal Market Analytics.

“Because of the wider spread, they will have to pay more,” he said. “It will make their budget balancing harder. The spread widening does have real world consequences.”

Most states are “really cash poor this quarter” but Illinois is “going to have a much tougher time looking for short-term financing” than a highly rated state, said Dan White, head of public sector research for Moody’s Analytics.

“There’s going to be some real cash crunch time coming,” White said.

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