
S&P Bulletin: Illinois' Credit Faces Mounting Pressure As Stimulus Stalls

CHICAGO (S&P Global Ratings) Sept. 21, 2020–S&P Global Ratings today said the odds of Illinois (BBB-/Negative) balancing its budget without additional borrowing or a sizable increase in the bill backlog are looking slimmer as congressional agreement on further federal assistance remains elusive. Illinois had placed a sizable $5 billion placeholder in its fiscal 2021 budget for additional federal assistance, and we expect that any future stimulus bill will likely fall short of this assumption. When including $1.274 billion of projected graduated income tax revenues on the November ballot, speculative revenues account for nearly 15% of Illinois' fiscal 2021 budget. S&P Global Ratings expects that Illinois will likely cut spending if there is no further federal assistance by the end of September.

In a letter to congressional members, Illinois' governor recently suggested as much as 15% across-the-board budget cuts, which may be unpalatable to lawmakers–in particular, cuts to education. In a letter to department heads, the deputy governor and head of the Office of Management and Budget requested a 5% reserve of general fund appropriations in the current fiscal year and 10% to be considered in fiscal 2022 (with deviations allowed for agencies responsible for life, safety, and health in the state's COVID-19 response). All such actions would likely have negative downstream effects on the state's economy and revenues, and could limit its flexibility to make additional cuts in out-years.

In the meantime, Illinois finances are already suffering. As of Sept. 21, 2020, Illinois' general funds payable backlog was $7.65 billion, higher than it has been since fiscal 2018 and well above the $5.4 billion to close fiscal 2020. This excludes $2.25 billion in short-term borrowing that Illinois is required to repay, made up of $1.2 billion in short-term borrowing through the Federal Reserve's Municipal Liquidity Facility (MLF) and $1.05 billion under interfund borrowing authorization. As spending continues at budgeted levels without federal funding, the state's cash deficit will continue to grow. While the practical limits of Illinois' bill backlog are unclear, a past federal court ruling compelled the state to pay on deferred Medicaid bills, implying that it cannot return to its backlog peak of $16.7 billion. As delayed payments mount, we think it is likely that Illinois will issue bonds or again borrow through the MLF to meet cash requirements.

We expect that Illinois will enact some budget cuts in fiscal 2021, but these will not likely be timely enough or sufficient to address the entire budget gap. The next state legislative session is in November, and we expect lawmakers will act based on the outcome of the graduated income tax measure, likelihood of federal assistance, and revised fiscal estimates. Last week, the administration ordered departments to identify budget cuts of at least 5% for the current fiscal year and 10% for fiscal 2022. However, depending on the outcome of the graduated income tax, this still leaves the state with at least a 5%-10% budget gap for fiscal 2021.

The magnitude of the current budget gap and reliance on one-time measures make us question Illinois' ability to achieve structural balance in a reasonable time. Even if Illinois receives federal aid in fiscal 2021, we expect that it will face challenging budget gaps beyond the current fiscal year.

Before the pandemic, the state faced large budget gaps as a result of slow economic growth, weak demographics, rising fixed costs, and carried-over deficits. Illinois' pension plans, which are among the lowest-funded in the nation, employ funding methods that have resulted in deferral of costs and chronic underfunding of contributions. The potential for market volatility could contribute to larger pension cost growth. Illinois has already borrowed $1.8 billion from the federal government related to unemployment claims, and this liability could limit further general fund increases on corporate taxes or cause the state to incur further debt. Revenue recovery to pre-pandemic levels is unlikely in the near term. S&P Global Economics estimates that following the COVID-19 outbreak, it will take about two years for U.S. GDP to regain its year-end 2019 level, with unemployment remaining high, consumer spending depressed, and business demand recovering only slowly (see "The U.S. Faces A Longer And Slower Climb From the Bottom," published June 25, 2020, on RatingsDirect). The lack of additional federal stimulus increases the likelihood of a worse economic outcome. Furthermore, potential layoffs at state and local government levels could contribute to a lasting drag on Illinois' economy.

With the need for additional borrowing, an elevated bill backlog, and lingering substantial structural imbalance, Illinois could exhibit further characteristics of a non-investment-grade issuer. While borrowing would provide the state with cash flow relief, Illinois is required to repay the debt. Further federal assistance is possible within fiscal 2021, but it is far from certain and could fall short of what's needed to close the gap. We think that Illinois will face difficulty repaying a large borrowing within the three-year MLF timeline from its general fund, and taking out long-term debt to repay the short-term loan would add to fixed costs. Although the debt may lessen the state's cash flow pressures, it would add to the state's structural imbalance. Illinois has had strong market access, supported by the MLF, but if conditions change, its budget would be further stressed.

To date, Illinois' general fund budget has trended in line with expectations. Propped up by the $1.2 billion short-term borrowing through the MLF, the state expects to close fiscal 2020 with a surplus, on a cash basis, despite a $2.4 billion revenue shortfall. Through August 2020, general fund state sales tax receipts were down 1.4% compared with fiscal 2020. However, general fund personal and corporate income taxes were inflated, tied to the delayed July 15 filing deadline, up $1.25 billion and $276 million, respectively, making it difficult to discern underlying economic trends. Total general fund revenues are up $1.051 billion year-to-date. Without the support of enhanced unemployment benefits and other federal stimulus, tax receipts may soften, and Illinois' budget outlook will also hinge on the path of the pandemic and response.

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