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Illinois Faces Risk of Junk After Voters Reject Tax on Rich.

- **Pritzker warns of 'painful' spending cuts after measure fails**
- **Citadel's Griffin wins in battle of billionaires over tax**

Illinois voters defeated a measure that would have allowed the state to raise taxes on its wealthiest residents, striking down a pillar of Governor J.B. Pritzker's plan for shoring up the state's finances and preventing its debt from being cut to junk.

The failure of the constitutional amendment that would have scrapped the flat income tax by a vote of 55% against sent the prices of Illinois's bonds tumbling, with those due in 2034 down about 7%. The costly campaign ended in a win for Citadel founder Ken Griffin who spent nearly $54 million to fund the opposition, while Pritzker, the billionaire heir to the Hyatt hotel empire, gave $58 million in support.

"The citizens of Illinois have delivered a clear message to our political leaders in Springfield," Griffin, the billionaire head of the Chicago-based hedge fund, said in an emailed statement on Wednesday. "Now is the time to enact long overdue reforms to save our state from fiscal ruin."

The loss adds a new challenge to the Democratic governor's effort to steady the finances of Illinois, whose rising pension-fund costs and chronic budget shortfalls left it with the lowest bond rating among U.S. states even before the pandemic struck. Failure of the measure won't automatically trigger a downgrade to junk. The three major rating companies, which all consider Illinois the lowest level of investment grade, said they'll be watching for the state's backup plan.

"There will be cuts and they will be painful," Pritzker said during a press conference on Wednesday. Without the additional revenue from the graduated income tax, the state will look at various options including cuts potentially for public safety, education and health services and may have to rely on its "regressive" tax system for more revenue, he said.

Downgrade Risk

If approved, the state would have been able to proceed with enacted legislation to apply higher rates to incomes over $250,000, raising levies on the highest earners. Rejection by voters means the "risk of a downgrade would increase" unless the state eventually increases the flat tax, Barclays Plc said in a report Wednesday.

"The amendment's failure makes greater reliance on deficit financing more probable and is therefore credit negative, but the state's likely pursuit of other recurring fiscal strategies mitigates this impact," Moody's Investors Service analysts led by Ted Hampton, said in a report on Wednesday. The likelihood of "credit-negative strategies" like deferring near-term pension contributions may also rise, Moody's said.

Even with the graduated income tax failure, Illinois has other options available, Carol Spain, S&P's director of U.S. public finance, said in an emailed statement. Illinois will need to look at other budget-balancing steps, Eric Kim, head of state government ratings for Fitch, said in an emailed statement.

Alternatives for Illinois include more borrowing, tapping the Federal Reserve’s Municipal Liquidity Facility for a second time, cutting spending or raising revenue with sales taxes and a higher flat income tax rate, Kim said.

‘Budget Crisis’

Previously, Pritzker has said budget cuts of 15% over two years or potentially borrowing from the Fed again are possible if the amendment failed and no more federal aid comes through.

“While the fair tax would have helped to address our budget crisis with the least damage to the working families of Illinois, the millionaires and billionaires opposed it to protect their own wallets, deceiving the public about its purpose and they ended up prevailing,” Pritzker said Wednesday. “Sometimes politics works against the best solutions.”

The business closures due to Covid-19 since March have added to the fiscal challenges and all three major rating companies have a negative outlook on Illinois, signaling that it could be the first state stripped of its investment grade rank. Such a step would likely add to its financial problems by saddling the government with higher interest bills and preventing many mutual funds from owning its debt.

Pritzker said Wednesday he considers the state’s investment grade rating “very important” and will continue to work to fix the state’s structural financial problems to avoid it going lower.

“In this election, Illinois voters sent a resounding message that with an $8 billion deficit and two massive tax hikes in the last ten years, we cannot trust Springfield Politicians with another tax hike,” the Coalition to Stop the Proposed Tax Hike Amendment, said in an emailed statement late Tuesday.

“We are undoubtedly disappointed with this result but are proud of the millions of Illinoisans who cast their ballots in support of tax fairness in this election,” Quentin Fulks, chairman of the Vote Yes For Fairness campaign, which supported the measure, said in an emailed statement on Wednesday.

“Now lawmakers must address a multi-billion dollar budget gap without the ability to ask the wealthy to pay their fair share,” Fulks said. “Fair Tax opponents must answer for whatever comes next.”

If enacted, the new graduated rates would have brought in $1.2 billion for fiscal 2021, which began July 1, and $3.1 billion for a full year, according to state estimates.

Red Ink

It was no panacea. Illinois has about $8.3 billion of unpaid bills, some $137 billion of unfunded pension liabilities, and its rainy day fund has just $68,459. With the bond market demanding high penalties to own its debt, it’s one of just two that have borrowed from the emergency lending facility the Federal Reserve rolled out after the pandemic.

“Illinois — it’s not a stretch to say — it was a net loser in the preliminary aftermath of the election,” said Ty Schoback, senior analyst for Columbia Threadneedle Investments, which owns Illinois debt as part of its $17 billion in muni assets under management. He cited the lack of expected Blue Wave and the graduated tax failure.

The state has budget flexibility and sufficient liquidity for now, he said, adding that market participants will look for willingness to fix problems with structural changes that may be unpopular rather than only borrowing more or one-time tactics.

“I don’t think the rating agencies have an itchy trigger finger and I think they are going to give the state a little bit of time,” Schoback said. “All that being said, the state is definitely on the clock with rating agencies and investors.”

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