

Bond Case Briefs

Municipal Finance Law Since 1971

Illinois Spreads Widen as Risk-Shy Investors Exploit Liquidity.

- **10-year spread hovers around level last seen 11 months ago**
- **Illinois index had worst loss among largest states in February**

Illinois, the worst-rated U.S. state, is seeing its penalty in the bond market jump to the highest in nearly a year in the current risk-off environment.

The debt penalty for the state's bonds over benchmark securities is at the highest since April. The rising spreads came as investors pulled about \$8 billion from muni funds this year.

While Illinois's credit outlook has improved, investors increasingly are showing a desire to raise cash and avoid risk in the \$4 trillion municipal bond market, traditionally a credit haven, said Dan Solender, director of tax-free fixed income for Lord, Abbett & Co., which holds Illinois securities as part of \$35 billion in muni debt.

"Illinois is an example of a large issuer with a lot of liquidity on the lower side of investment grade," Solender said in an interview. "It kind of moves down faster at the beginning of a down market because it gets traded more actively."

Illinois is underperforming the broader market. In February, the Illinois index fell 0.64%, the biggest decline among the largest state issuers in the Bloomberg Municipal Bond Index, which is down 3% this year. The Bloomberg Municipal Baa Index Total Return Index has fallen 3.5%.

Moody's Investors Service upgraded the state to Baa2 from Baa3 in June, bringing it to two steps above junk. S&P Global Ratings lifted Illinois to BBB from BBB- in July, while Fitch Ratings raised its outlook to positive from negative, but kept it at BBB- given challenges including underfunded pensions.

The state's 10-year bond spread on Feb. 25 reached about 106 basis points above AAA muni benchmark securities and is still hovering above 100 basis points. Those levels are the widest since April 2021, before Illinois's first rating upgrade in two decades.

While the penalty is far less than the 4.4% in May 2020 during the early days of the pandemic, the increase is still a near-doubling from the low of 53 basis points in December. The difference in the penalty that Illinois pays over New Jersey, the second-lowest rated state, tripled to about 63 basis points this week from Dec. 1, when Illinois last sold bonds. New Jersey on Wednesday got its first ratings upgrade since 2005.

Carol Knowles, a spokesperson for the Governor's Office of Management and Budget, said in a statement that the state doesn't comment on day-to-day market fluctuations.

"When the muni market is hot, spreads compress, especially with the recent upgrade and positive outlook," said Max Christiana, a portfolio manager for Belle Haven Investments, which holds \$16

billion in muni assets including Illinois. "And then in a weak market, it tends to widen out quicker than other muni securities."

The wider spread is due more to market technicals than the trajectory of Illinois as a credit, he said.

A rebounding economy has led the state's revenue to top projections and federal stimulus money has eased strains caused by the Covid-19 pandemic. The state also has taken positive budgetary steps and its spreads still are tighter than in the past, said Molly Shellhorn, a senior research analyst for Nuveen, which holds about \$1.4 billion in Illinois general-obligation debt as part of \$230 billion in muni assets as of Dec. 31.

Bloomberg Markets

By Shruti Singh

March 3, 2022