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Fitch upgrade boosts Illinois ahead of GO bond sale

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Fitch Ratings upgraded Illinois Tuesday ahead of the state's general obligation bond sale later this month.

The upgrade to A-minus from BBB-plus brings the state's GOs into the single-A category from all three agencies that rate the state.

Illinois plans to issue $875 million of GOs in a competitive sale the week of Nov. 27, touting its "strongest fiscal position in a generation."

Illinois' once-enormous backlog of unpaid bills "is now a normal accounts payable situation," said Fitch Ratings analyst Eric Kim.

Ahead of the deal, the state received rating affirmations of A3 from Moody's Investors Service and A-minus rating from S&P Global Ratings.

Both S&P and Moody's upgraded Illinois earlier this year, reflecting the credit rating bureaus' belief that the state's once-dire economic outlook and financial decisions are steadily improving.

The new A-minus rating "reflects solid operating performance that remains below most other states, with a long record of structural imbalance primarily related to pension underfunding offset by continued progress towards more sustainable budgeting practices," Fitch's report said. "Illinois' deep and diverse economy is only slowly growing, but still provides a strong fundamental context for its credit profile."

The new-money issuance will include two tax-exempt series of $350 million each, and a $175 million series of taxable bonds. Proceeds from the taxable series "will be used to make accelerated pension benefit payments," according to a notice Illinois posted on the Municipal Securities Rulemaking Board's EMMA bond disclosure website.

The deal is competitive, which is required by Illinois state law for the first sale of the fiscal year.

In a presentation to the rating agencies last month, Illinois celebrated its "historic fiscal progress," driven by "tax revenue growth and sound fiscal policy." The state's accounts payable is down 94% in three years, it's invested $1.965 billion in its budget stabilization fund, and it's had a GAAP basis general fund surplus since 2022 — its first since the 1980s.

These are important metrics for a state that was recently drowning in financial problems exacerbated by a two-year budget impasse that ended in 2017. In the impasse, in which the conflict between Republican Gov. Bruce Rauner and the Democratic-led legislature left the state without a budget for two years, Illinois drained its rainy day fund, fell behind on paying vendors, and its rating fell to the lowest rung of investment grade.

Illinois was rated at BBB-minus or the equivalent across the board as recently as July 2021.

"We are continuing to right the past fiscal wrongs in our state with disciplined fiscal leadership, and credit rating agencies and businesses alike are taking notice of Illinois' remarkable progress," Gov. JB Pritzker said in a statement Tuesday.

The state has "underlying challenges that will remain in place for some time," Moody's said in its Monday report affirming Illinois ahead of the upcoming deal, "including heavy long-term liability and fixed cost burdens that constrain the state's financial flexibility and contribute to a weak financial position compared to other states, despite the steady improvement.

"The Illinois economy, while stable, has also expanded at a slower pace than most states and will likely continue to do so given a weaker population trend," the Moody's report added.

The use of taxable bond proceeds for accelerated pension benefit payments reflects Illinois' state employee retirement liabilities, according to Eric Kim, primary Illinois rating analyst for Fitch. Illinois set a target to fund up to 90% of pension liabilities by 2045, but that leaves around a $4 billion gap between the state's contributions and what actuaries determine is necessary.

Illinois created an accelerated pension benefit program, where it pays a percentage of retirees' benefits at once, instead of the full benefits over time. This month's will be the latest of several bond issuances that the state uses to fund this program.

"It definitely does reduce the pension liability to have these, but you offset some of that benefit by issuing debt," Kim said.

The state's other problems, according to Moody's, include "leaner financial reserves, and heavier long-term liability and fixed cost burdens make it more vulnerable than other states to a negative shift in the national or global economy."

All of the rating agencies agree that Illinois has been making more fiscally responsible choices, which continue in its 2024 budget.

The accounts payable tab is at $572 million, down from $5.9 billion in 2021 and its peak of $16.7 billion in 2017. Illinois estimates that the accounts payable will stand at around $527 million at the end of the fiscal year.

"What was the bills backlog is now a normal accounts payable situation," Kim said.

Illinois is also steadily increasing its reserves. The budget stabilization fund stands at $1.965 billion now and the state plans to add another $138 million by the end of the fiscal year. The fund is 4.2% of Illinois' enacted 2024 revenues, but the state has raised the target to 7.5% of revenues. Fitch's report said the state's rating could be raised if the fund reached 10% of state spending.

The 2024 budget creates long-term sources of funding for the budget stabilization fund, including 10% of cannabis tax revenues, and repayment over 10 years from the state's $450 million loan to the unemployment insurance trust fund.

Illinois' most recent issuance, $2.5 billion of GOs that were priced in April, drew $12 billion of orders from more than 130 investors. That deal also financed capital work and included a $200 million taxable series for accelerated pension payments.

That deal's 2047 maturity, which had a 5.5% coupon, was 14 times oversubscribed, while tranches with nearer-term maturities fared more poorly.

The full deal "came with a pretty hefty concession," Jason Appleson, managing director

and head of PGIM Fixed Income's municipal bond team, told The Bond Buyer at the time.

That deal, however, had to navigate a rocky market and fears of an upcoming recession. In its rating for this deal, S&P's financial projections were less extreme, although the report predicted a slowing economy and rising unemployment.

Illinois will likely issue more bonds later in the fiscal year, but it does not have an estimate of when or how much, according to Carol Knowles, Governor's Office of Management and Budget spokeswoman.

"We try to issue as funds are needed, so we would expect to enter the market again leading into the summer construction season," Knowles said in an email.

Chapman and Cutler LLP and Hardwick Law Firm, LLC are co-bond counsel. Acacia Financial Group is the municipal advisor.