

**Rating Action: Moody's Assigns Baa3 to Illinois' Payment Backlog Bonds;
Outlook Negative**

Global Credit Research - 09 Oct 2017

New York, October 09, 2017 -- Issue: General Obligation Bonds, Series of December 2017A; Rating: Baa3; Rating Type: Underlying LT; Sale Amount: \$655,000,000; Expected Sale Date: 12/05/2017; Rating Description: General Obligation;

Issue: General Obligation Bonds, Series of December 2017B; Rating: Baa3; Rating Type: Underlying LT; Sale Amount: \$95,000,000; Expected Sale Date: 12/05/2017; Rating Description: General Obligation;

Issue: General Obligation Bonds, Series of November 2017A; Rating: Baa3; Rating Type: Underlying LT; Sale Amount: \$500,000,000; Expected Sale Date: 10/17/2017; Rating Description: General Obligation;

Issue: General Obligation Bonds, Series of November 2017B; Rating: Baa3; Rating Type: Underlying LT; Sale Amount: \$500,000,000; Expected Sale Date: 10/17/2017; Rating Description: General Obligation;

Issue: General Obligation Bonds, Series of November 2017C; Rating: Baa3; Rating Type: Underlying LT; Sale Amount: \$500,000,000; Expected Sale Date: 10/17/2017; Rating Description: General Obligation;

Issue: General Obligation Bonds, Series of November 2017D; Rating: Baa3; Rating Type: Underlying LT; Sale Amount: \$4,500,000,000; Expected Sale Date: 10/24/2017; Rating Description: General Obligation;

Summary Rating Rationale

Moody's Investors Service has assigned a rating of Baa3 to the State of Illinois' planned issuance of \$6.75 billion of General Obligation Bonds in several series: Series of November 2017A-D and Series of December 2017 A & B. As described below (see "Use of Proceeds"), most of the debt is being issued to help reduce a backlog of bills that has hovered above \$14 billion in recent weeks; the \$750 million December series will finance capital projects. The state's rating factors in outsized net pension liabilities (see Exhibit 1) and other credit challenges, including a long history of imbalanced financial operations and payment deferrals.

These weaknesses in recent years have increasingly offset the economic and governance strengths listed below (see "Credit Strengths"), all of which are shared by other US states. As a consequence, Illinois has increasingly become an outlier among the 50 states, most of which carry ratings at the top of Moody's scale (either Aaa or Aa1).

The \$6 billion backlog financing - the state's largest issuance since a \$10 billion pension bond sale in 2003 - will boost net tax-supported debt by about 12%, net of estimated principal amortization on previously issued GO bonds. Considerations offsetting the debt burden increase include the fact that the state's outstanding late bills accrue interest at elevated rates under state law.

Rating Outlook

The negative outlook is based on expectations of continued pension liability growth and pension funding pressures; the fact that the state's budget remains imbalanced, despite the enactment of substantial tax increases; and the state's heightened vulnerability to national economic downturns or other external factors.

Factors that Could Lead to an Upgrade

- Adoption of a realistic, long-term plan to provide funding for pension obligations
- Progress in reducing the state's massive payment backlog, and formulation of a legal or policy framework to prevent renewed build-up of late bills
- Enactment of recurring fiscal measures that support the expectation of sustainable, structural balance

Factors that Could Lead to a Downgrade

- Structural imbalance that leads to renewed build-up of unpaid bills following issuance of debt to pay down backlog
- Efforts to obtain near-term fiscal relief by reducing pension contributions in a way that exacerbates the state's long-term funding burden or indicates a lack of long-term sustainability
- Difficulty managing the impacts of adverse exogenous factors, such as a national recession or a reduction in federal Medicaid funding

Legal Security

The state's general obligation bonds are secured by its full faith and credit pledge.

Use of Proceeds

The state is issuing \$6 billion GO bonds, to reduce a backlog of unpaid bills and to address a current-year operating deficit. Series of November 2017A-C - accounting for \$1.5 billion of the par amount -- will be priced through competitive bidding on October 17. The remaining \$4.5 billion, in Series of November 2017D, will be sold through negotiation, with pricing scheduled for the week of October 23. These bond offerings will help the state sharply reduce its backlog of bills. The state expects to use most of the proceeds to address accrued Medicaid and state employee health insurance program expenses. Separately, Series of December 2017 will provide \$750 million of bonds for capital and information technology needs.

Obligor Profile

Illinois is the fifth most populous state in the US, with estimated 2016 population of 12.8 million. Almost three quarters of its residents live in and around Chicago (Ba1 negative), the nation's third-largest city. The state is comparatively economically diverse and wealthy, with personal income per capita equal to 105.1% of the nation's.

Methodology

The principal methodology used in this rating was US States Rating Methodology published in April 2013. Please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

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