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Illinois Budget Crisis Is About to Get Even Harder to Solve.

- **Starting Thursday, three-fifths majority needed to pass budget**
- **State at risk of being first cut to junk since at least 1970**

Illinois leaders will blow past a deadline that will leave the state careening toward the third straight year without a budget.

The Illinois House isn't voting on a budget on Wednesday, which means the gridlock-prone government won't pass a spending plan by midnight. That means approving a budget — a usually routine task that has eluded the state for 700 days — will become even more difficult because a three-fifths majority will be required. Democratic lawmakers, who control both chambers, and Republican Governor Bruce Rauner have repeatedly failed to agree on how to solve chronic budget deficits worsened by the expiration of tax hikes in January 2015.

"We are probably approaching that point of impaired ability to function at basic level," said John Humphrey, the Chicago-based head of credit research for Gurtin Municipal Bond Management, which oversees about \$10.1 billion of state and local debt and has steered clear of Illinois. "We've already probably passed that point. We haven't seen this in a modern state before."

The self-inflicted crisis has left the fifth most-populous state with a record \$14.5 billion of unpaid bills, ravaged entities like universities and social service providers that rely on state aid and undermined Illinois's standing in the bond market. Unless a surprise deal emerged before midnight, it's increasingly likely that Illinois enters its third fiscal year on July 1 without a budget.

Democratic House Speaker Michael Madigan, who controls much of the legislative agenda, blamed Rauner for "holding the budget hostage" to his agenda, and said in an emailed statement Wednesday that Democrats will keep working on a budget and hold public hearings, starting in Chicago on June 8.

In turn, Rauner criticized the Democrats, calling the failure a "complete dereliction of duty by the majority in the General Assembly" and said there should be no tax hikes without a property tax freeze and local control of those levies.

Bond-rating companies have warned of further ratings cuts, signaling that Illinois could be the first state since at least 1970 to lose investment-grade status.

Investors have long punished the state for its financial woes, and the penalty has only gotten worse amid the impasse. Its 10-year bonds yield 4.4 percent, 2.5 percentage points more than those on top-rated debt. That gap — a measure of the perceived risk — is the most since at least January 2013 and more than any of the other 19 states tracked by Bloomberg.

Rauner, who in 2015 became the first Republican to lead the state since 2003, wants any spending plan to be tied to his key priorities, such as property tax-freeze. The Senate on Tuesday approved measures that would lock most local real estate levies in place for two years, but Republicans said they didn't go far enough.

In the meantime, Illinois is spending more than it's taking in because of consent decrees, court orders and other appropriations that have kept the government from shutting down despite the lack of a budget. Its current-year operating deficit is about \$6 billion, Moody's Investors Service said in a March report.

Moody's and S&P Global Ratings have warned that Illinois could be downgraded deeper if no budget is enacted. The companies rank the state at Baa2 and BBB, respectively. That's two levels above junk.

The unpaid bills are also adding to the fiscal squeeze. The comptroller has estimated that the state will owe at least \$800 million in interest and fees on overdue bills by the end of June.

That backlog is "headed in the direction of being a factor that just by itself really threatens the sort of financial foundations of the state," Ted Hampton, Moody's lead analyst on Illinois, said in an interview, citing litigation from those demanding payment. "There is kind of an uncertain but very real legal and political limit to the state's ability to keep deferring payments."

A group of school superintendents from districts statewide held a press conference in the Illinois State Capitol on Wednesday, calling for the passage of a full-year budget, instead of just a temporary stopgap, and changes to the school funding formula. Illinois owes districts \$1.1 billion, which is "unconscionable," said Tony Sanders, chief executive officer of the state's second-largest school system, in Elgin.

Despite the gridlock, Illinois hasn't missed any bond payments and state law requires it to continue making monthly deposits to its debt-service funds. Still, the fighting has impeded any progress on bolstering a state retirement system that has more than \$129 billion of unfunded liabilities — a source of stress that has helped drive its rating down.

The Clock Is Ticking

State leaders still have the month of June to find an agreement before the start of fiscal year 2018 on July 1. Last year, lawmakers approved a six-month, stopgap budget to keep schools open and operations going.

So far, consensus has proven elusive. The Illinois Senate approved a spending plan on May 23, with only Democratic votes, that raised income taxes and expanded the sales tax levy. It still needed House approval as of Tuesday afternoon.

Rauner has called for freezing property taxes before raising any income tax increase is considered, but he rejected the two-year property tax freeze that the Senate approved Tuesday. Eleni Demertzis, a spokeswoman for Rauner, called the move "a phony two-year freeze riddled with holes." It exempted Chicago, and Rauner had pushed for a lengthier time frame.

The impasse is decimating social services agencies that help the most vulnerable citizens, including school children, the elderly and the mentally ill, according to a coalition of groups including the Civic Federation, which tracks the state's finances.

"Forty-nine other states would never try this experiment," Laurence Msall, president of the Civic Federation, said in a press conference last week. "Only Illinois, which has seen its credit rating crumble, which has seen its social service infrastructure weaken, which has seen its higher education punched into the stomach in terms of what its future looks like, would try this experiment. It's not working. We have to have a state budget to move forward."

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by Elizabeth Campbell

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