Bond Case Briefs

Municipal Finance Law Since 1971

Illinois Ponders Pension-Fund Moonshot: a $107 Billion Bond Sale.

- **Retiree association floats idea for an unprecedented borrowing**
- **“If it makes sense, we’ll do it,” one state lawmaker says**

Lawmakers in Illinois are so desperate to shore up the state’s massively underfunded retirement system that they’re willing to entertain an eye-popping wager: Borrowing $107 billion and letting it ride in the financial markets.

The legislature’s personnel and pensions committee plans to meet on Jan. 30 to hear more about a proposal advanced by the State Universities Annuitants Association, according to Representative Robert Martwick. The group wants Illinois to issue the bonds this year to get its retirement system nearly fully funded, assuming that the state can make more on its investments than it will pay in interest.

It would be by far the biggest debt sale in the history of the municipal market, and in one fell swoop would be more than Puerto Rico amassed in the run up to its record-setting bankruptcy.

“We’re in a situation in Illinois where our pension debt is just crushing,” Martwick, a Democrat who chairs the committee, said in a telephone interview. “When you have the largest pension debt in the world, you probably ought to be thinking big.”

Illinois owes $129 billion to its five retirement systems after years of failing to make adequate annual contributions. Because the state’s constitution bans any reduction in worker retirement benefits, the government’s pension costs will continue to rise as it faces pressure to pay down that debt, a squeeze that has pushed Illinois’s bond rating to the precipice of junk.

Many American governments have sold bonds for their pensions, albeit on a much smaller scale. Illinois did so in 2003, when it issued a record $10 billion of them. New Jersey also tried it, only to see its pension shortfall soar again after the state failed to make adequate payments into the system for years. Detroit’s pension-fund borrowing in 2005 and 2006 helped push it into bankruptcy.

On the whole, the track record has been mixed, according to a study by the Center for Retirement Research at Boston College. Much hinges on timing the stock market: While most pension bonds have been profitable because of equity gains since the recession, those sold after the late 1990s rally or before the 2008 crash lost money, the study found. The S&P 500 Index climbed 19 percent last year and has continued to hit new highs.

The association, which represents members of the universities’ retirement system, says the plan will save the state $103 billion by 2045. That’s because Illinois’s current debt to its pensions grows at the rate that the retirement system expects to earn on its investments. That’s usually much higher than the interest rates governments pay to issue municipal bonds.

Martwick, who has no position on the proposal, said he wants to provide transparency and hearings for any ideas that could save the state money. While the proposal to issue the bonds is being drafted into a bill, it will only move forward if committee members back it, he said.

“if it makes sense, we’ll do it, and if it doesn’t we won’t,” Martwick said.

Municipal-bond investors would likely frown upon such a massive sale, to say the least.

“Those types of deals are not typically positively received by the rating agencies or investors,” said Eric Friedland, director of municipal research in Jersey City, New Jersey, for Lord Abbett, which holds about $20 billion of municipal debt, including Illinois’s. “That type of issuance could definitely be a credit negative.”

This kind of issuance contemplated by the association would significantly increase the state’s debt burden. Illinois had $26.3 billion of general-obligation bonds as of July, according to Moody’s Investors Service, and the state sold $750 million of bonds in November to pay down unpaid bills that had accumulated during its two-year budget impasse. The state still has $8 billion of unpaid bills even after that issuance, according to the comptroller’s office.

This kind of issuance “will not go over well in the bond market,’’ said Richard Ciccarone, Chicago-based president of Merritt Research Services LLC, which analysts municipal finance. “It absolutely increases default risk. There’s no cushion.”

Bloomberg Markets

By Elizabeth Campbell

January 26, 2018, 11:56 AM PST

— With assistance by Zachary Hansen