
Illinois Candidates Vie to Lead State With Nation's Worst Credit Rating.

- **Gubernatorial primary comes amid budget deficit, unpaid bills**
- **Investors want winner to resolve growing pension crisis**

Up for grabs in Illinois's gubernatorial primary on Tuesday: A chance to compete in a general election that will decide who will lead the worst-rated state — one whose massive financial problems aren't going away anytime soon.

Illinois is contending with $9 billion of unpaid bills, chronic budget deficits and $129 billion of unfunded pension liabilities. Its credit rating is only one level above junk, making its borrowing costs the highest of any U.S. state as bond buyers punish Illinois for its fiscal woes. Plus the Land of Lincoln is losing population, dropping to the sixth-most-populous state last year from number 5, U.S. Census data show.

"This is a pivotal election for Illinois, which has been struggling for almost a decade to stabilize its finances," said Laurence Msall, president of the non-partisan Civic Federation, which tracks the state's finances. "With only one notch separating Illinois from non-investment grade credit, the stakes are enormously high for whoever wins the primary and election to identify the financial path forward for the state."

Republican Governor Bruce Rauner, who has repeatedly clashed with the Democrat-controlled legislature during his first term, is seeking re-election, though he's facing a primary challenger, conservative Illinois House Representative Jeanne Ives.

Billionaire J.B. Pritzker, an heir to the Hyatt hotel empire, has invested at least $69.5 million of his own money so far to take a lead in the Democratic race. State Senator Daniel Biss and Chris Kennedy, son of late liberal icon Robert F. Kennedy, are also vying for the chance to defeat Rauner in November.

If Rauner, a former private-equity executive who's already put $50 million of his own fortune into his campaign, and Pritzker win their respective primaries as expected, the Illinois general election could be the most expensive governor's race in the nation's history.

Bondholders are closely watching the race. The yields on the state's 30-year general-obligation bonds have widened to the most over benchmark debt since July. Illinois yields are the highest among all 20 states tracked by Bloomberg. The spread is widening amid concerns that the financial problems facing Illinois, especially the growth in unfunded pension liabilities, won't go away, no matter who is elected, according to Richard Ciccarone, president of Chicago-based Merritt Research Services.

"There's anxiety that we're not going to accomplish much by just having an election here," said Ciccarone of Merritt, which analyzes muni finance. "The market really wants to see action and they want to see progress."

Little headway has been made in addressing what investors agree is the state's biggest challenge: unfunded pension liabilities. After years of skipping payments or not putting enough into the funds, the retirement system is only about 40 percent funded even as more and more of the state's dollars get eaten up by this expense. Pension costs are expected to make up about 22.9 percent of all general-fund spending in the current fiscal year, up from 6.8 percent a decade ago, according to the Civic Federation.

The election comes eight months after the end of an unprecedented two-year budget impasse that drove the state's rating to the edge of junk because of a showdown between Rauner, the first Republican to lead the state since 2003, and the Democrat-controlled legislature. Illinois avoided becoming the first U.S. state to lose its investment-grade rating after lawmakers on both sides overrode Rauner's veto of an income-tax hike in July, enacting a budget and easing the immediate financial threat.

Despite the end of the standoff, whoever wins the governorship will still have to contend with a precarious credit rating. All three rating companies consider Illinois to be in the lowest tier of investment-grade ratings. Moody's Investors Service and Fitch Ratings have a negative outlook on the state, signaling another downgrade is possible, while S&P has a stable view because of the budget passed in July.

"Any drop in their rating would have a big impact on their financing costs," said Dan Solender, head of municipal investments at Lord Abbett & Co., which manages $20 billion of state and local debt, including Illinois. He pointed out that the state's yields are already trading at a lower rating. "Already the number of buyers is more limited but it would shrink further."

No matter the outcome, municipal investors will be monitoring the election results Tuesday.

"The municipal investor increasingly needs to watch elections because there are ramifications as an investor," said Gabe Diederich, portfolio manager for Wells Fargo Asset Management, which oversees about $40 billion of state and local debt. "Politics, not necessarily whether a person votes Republican or Democrat, but how different parties working together and those policies are going to impact finances."

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March 20, 2018, 8:14 AM PDT

Bloomberg Politics

— With assistance by John McCormick