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Illinois' $500 mln Bond Sale Gets Boost from Yield Hunters.

CHICAGO, April 25 (Reuters) – Investors seeking hefty yields helped Illinois’ $500 million bond sale on Wednesday result in narrower spreads over the municipal market’s benchmark scale.

Yields topped out at 4.88 percent for bonds due in 2043 in the two-part general obligation bond competitive sale won by Bank of America Merrill Lynch.

“It’s just a lot of money looking for yield,” said John Mousseau, fixed-income director at Cumberland Advisors.

As the lowest-rated U.S. state, Illinois has had to pay a substantial penalty to sell debt to investors worried about its ongoing political and financial problems, which include a huge unfunded pension liability and chronic budget deficits.

Spreads over Municipal Market Data’s benchmark triple-A yield scale narrowed roughly 3 to 15 basis points from where the state’s bonds had been trading in the secondary market, according to MMD, a unit of Thomson Reuters.

Still, the 4.55 percent yield on the deal’s 10-year bonds was much higher than 3.38 percent yield in the same maturity for similarly rated LaGuardia Airport bonds that were priced on Tuesday.

“It is difficult to understand why investors would be more comfortable with the 3.38 percent 10-year yield of a bond (subject to the Alternative Minimum Tax) secured by Delta Airlines over a 4.55 percent 10-year yield for Illinois general obligation bond, despite the state’s significant fiscal challenges,” said Alan Schankel, municipal strategist at Janney Montgomery Scott.

Nicholos Venditti, a portfolio manager at Thornburg Investment Management, said the Illinois bond yields should have been even higher given uncertainty over whether the nation’s sixth-largest state will pass a budget for the fiscal year that begins July 1.

An impasse between the state’s Republican governor and Democrats who control the legislature left Illinois without complete budgets for an unprecedented two fiscal years and widened the spread for 10-year bonds to 335 basis points last June. The enactment of a fiscal 2018 budget and income tax rate hikes over Governor Bruce Rauner’s vetoes in July saved the state’s credit ratings from falling into junk.

Illinois said it sold its latest debt at an overall borrowing cost of 4.72 percent.

“We are very pleased with the strong response that the state received on today’s competitive bids, particularly given the recent volatility in the municipal bond market,” Kelly Hutchinson, Illinois’ capital markets director, said in a statement.

Tax-exempt bond prices dropped on Wednesday, boosting yields 2 to 8 basis points on MMD’s scale.

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