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Investors Just Want an Illinois Governor Who Will Avoid a Junk Rating.

- **Bondholders want next governor to pass budgets, fix pensions**
- **Rauner, Pritzker vie to lead state that's one step above junk**

Illinois investors are endorsing fiscal stability this election.

No matter who wins the gubernatorial race next month, bondholders want the next chief executive to avoid a repeat of the longest budget impasse in U.S. history, one that put Illinois on the brink of becoming the first junk-rated state. That gridlock — the result of a two-year standoff between Republican Governor Bruce Rauner and the Democrat-run legislature — drove unpaid bills to a record \$16.7 billion, forced cuts in social services, and sent borrowing costs to multi-year highs.

The fiasco also kept the state's leaders from making any real progress on fixing its biggest challenge — the government worker pension plans that are falling deeper into the red while consuming more and more tax dollars.

"We don't care if it's a Democrat or Republican, we just want to make sure that whoever is in the office knows how much new taxes and revenue increases are needed to make those hard decisions of trying to deal with pensions," said Dora Lee, vice president at Belle Haven Investments, which manages about \$7.5 billion in municipal bonds, including Illinois debt. "We just need someone who has the vision and the political capital to make those hard choices because time is kind of running out."

Prolonged Stalemate

Rauner, a former private-equity executive and multimillionaire, is running for re-election against Democrat J.B. Pritzker, the billionaire Hyatt hotel heir. Rauner took office in January 2015 as the state confronted a deficit amid expiring income-tax hikes. Rauner refused to raise taxes unless lawmakers agreed to an agenda that included property-tax cuts, limits on unions and changes to worker-compensation laws. Democrats balked. The stalemate didn't end until July 2017, when lawmakers, including members of his own party, overrode his veto to enact a spending plan that raised income levies.

Rauner is calling for reforms and says more tax hikes won't solve the state's problems. Pritzker is campaigning for a graduated income tax — instead of the current flat tax — that he argues will lower those on the middle class. That would require a constitutional amendment.

Pritzker held a 20-point lead over Rauner among likely voters, according to an Ipsos, Reuters and University of Virginia Center for Politics poll released Wednesday. Likely voters favored Pritzker 50 percent, compared to 30 percent for Rauner, the poll showed.

One party rule has worked to ease impasses in other places. California Governor Jerry Brown, a term-limited Democrat, is leaving office after amassing a surplus of about \$9 billion compared to the

\$27 billion deficit when he took over for his Republican predecessor in 2011. But single-party control is no guarantee. New Jersey's leaders have yet to right the state's finances since Republican Governor Chris Christie exited office in January, with Governor Phil Murphy and fellow Democrats struggling to find common ground.

Beyond Gridlock

Even though Rauner pushed for fiscal reforms that would have cut costs, none of those were enacted, said John Miller, head of municipals at Nuveen, which holds more than \$140 billion in state and local debt, including Illinois bonds.

"The concept that there could be a better, maybe a more productive dialogue where you could actually pass some fiscal changes that require legislation, that's got to be considered better than gridlock," Miller said. "I actually think the bond market would respond more positively to a change," said Miller, who noted that his comments were from a revenue, expenses and budgeting point of view and not a political perspective.

Investors have long punished Illinois for its fiscal woes. Yields on Illinois's 10-year general-obligation bonds jumped to as much as 3.4 percentage points above benchmark in June 2017 as credit-rating companies warned that Illinois could lose investment-grade status if the impasse wasn't resolved. That gap has since fallen to 1.8 percentage points but is still the highest among the 20 U.S. states tracked by Bloomberg.

"If there's unified government, whether you view that favorably or unfavorably, it does mitigate appropriation risk and decreases the chance of a government shutdown, and it also mitigates the risk of not having a budget passed," said Dennis Derby, a portfolio manager at Wells Fargo Asset Management, which holds \$39 billion of municipal debt, including Illinois bonds. "No matter who wins, going forward, we would want to see balanced budgets, attempts at pension reform and a reduction in the payables backlog."

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— *With assistance by Danielle Moran*