## Bond Titan Spurns Illinois Rally Over ‘Pension Beasts’

- **Big investor won’t buy uninsured bonds from state, Chicago**
- **‘More likely than not’ bondholders would be hurt, firm says**

The municipal-bond market has shown some optimism recently that Illinois and Chicago will ultimately tackle their huge pension burdens. But one of the biggest buyers of state and local government debt isn’t so sure.

Franklin Templeton Investments, which manages more than $60 billion in municipal securities, said it won’t buy uninsured general-obligation bonds from Illinois and any debt from Chicago and the city’s public school system, citing the threat from “pension beasts.”

“Will Illinois’ governor and Chicago’s mayor eventually impair bondholders rather than push for sensible pension reforms? We think it’s more likely than not, unfortunately,” Franklin analysts led by Sheila Amoroso wrote in a blog post.

The comments buck the broader sentiment in the market, where Illinois bonds have rallied this year on optimism about Governor J.B. Pritzker’s plans to mend the state’s finances, in part by scrapping the flat income tax to raise more revenue.

But state and local politicians’ focus on levying new taxes or selling assets such as land won’t make the math work to solve a pension problem that for Illinois is a “fire-breathing monster that dwarfs Illinois’ revenue-generating capacity,” the Franklin analysts wrote.

When it comes to investing in Illinois, the firm favors so-called essential-service revenue bonds, such as toll roads, because the dedicated stream of income provides more security than debt backed only by a government’s promise to repay.

The analysts said they may change their minds if they see “a willingness of elected politicians to educate the public on the true scope of the situation and enact sensible pension reforms.”

States can’t go bankrupt, nor can Chicago under Illinois law, and no state has defaulted since the Great Depression. But investors would have reason to be wary: In the handful of municipal bankruptcies, bondholders have fared worse than pensioners.

Franklin has experience with such risks. The firm was one of the biggest investors in Puerto Rico, which was allowed to go bankrupt after Congress changed the law to rescue it from a worsening debt crisis. Franklin held about $2.3 billion of the territory’s bonds when the island first began defaulting in 2015. Franklin in 2016 closed its Double Tax-Free Income Fund, which directed almost half of its investments to Puerto Rico, as prices on the securities tumbled and investors pulled money from the fund.

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