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WSJ: Illinois Draws Demand for First Debt Issue After Pension Vote.

Results of Thursday's Bond Sale Mark Latest Sign Investors Encouraged by State's Pension Reforms

Illinois sold $350 million of taxable bonds on Thursday at lower yield premiums than a similar sale in April, marking the latest sign that investors are encouraged by the state's pension reforms.

The state sold the bonds for infrastructure and school construction to Bank of America Corp. BAC -0.46% at an average yield of 5.4%, or about 2.5 percentage points above benchmark Treasurys, according to a state spokesman. That compares with an average yield of 4.97%, or more than 3 percentage points above Treasurys, at the April sale, he said.

The sale was Illinois' first test of the municipal bond market since lawmakers last month reached agreement to close a pension gap of nearly $100 billion. The unfunded liabilities have led to credit rating downgrades and reduced demand from investors, resulting in the highest tax-exempt borrowing costs among the U.S. states.

The agreement, signed by Illinois Gov. Pat Quinn last week, faces challenges by unions, however. The law would reduce future costs by shrinking cost-of-living increases for retirees, raising retirement ages for younger employees and capping the size of pensions.

"The state clearly paid less of a penalty," than in the past, said Kathy Bramlage, director at Treasury Partners, a unit of financial-advisory firm HighTower Advisors. "The issue is whether this [trend] will hold" because it's likely the reform measures will be fought in court, she said.

Standard & Poor's this week revised its outlook on Illinois to "developing" from "negative," reflecting consensus reached by state lawmakers on pension reform. S&P said it could upgrade Illinois' A-minus rating if the state moves forward with pension reform and takes measures toward a balanced budget.

Bank of America priced the longest-term part of the taxable deal at a yield of 1.75 percentage points over Treasurys, less pre-sale indications of levels above 2 percentage points. Before the pension agreement, yields on Illinois' long-term taxable debt traded around 2.1 percentage points, Ms. Bramlage said.

Yield premiums on Illinois' tax-exempt debt have also dropped despite record redemptions in tax-exempt muni bond funds. The spread on 10-year Illinois tax-exempt debt yields over the AAA benchmark rate has declined to 1.58 percentage points from 1.73 points in late November, according to Thomson Reuters Municipal Market Data.

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Dec. 12, 2013 6:26 p.m. ET

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