

Bond Case Briefs

Municipal Finance Law Since 1971

Rauner's Tax-Free Illinois Budget Fix Has Skeptics.

(Bloomberg) — Illinois Governor Bruce Rauner has a recipe for plugging the state's \$6.2 billion deficit that relies on cuts and avoids new taxes. The approach is breeding skepticism at debtholders BlackRock Inc. and U.S. Bank Wealth Management.

The first Republican elected to lead the state in 16 years, Rauner inherited \$111 billion of unfunded pension liabilities and a budget that is set to run out of money by June 30 after lawmakers let a higher levy on income expire.

Illinois's debt investors, whom Rauner may wind up tapping to finance roads or other capital projects, say the lowest-rated U.S. state doesn't have the flexibility to lean so heavily on spending reductions.

"I'm very skeptical that his budget will be able to achieve balance by doing what he's doing," said Jim Schwartz, head of the municipal credit research team at New York-based BlackRock, which oversees \$116 billion in munis. "The best way from his view is let's cut spending, and I just look at it as very aggressive."

Governors in about 10 states, including some led by Republicans, are proposing tax increases, according to the National Association of State Budget Officers in Washington. Illinois faces greater fiscal challenges than most: It has \$6.4 billion in unpaid bills and the worst-funded state pension system.

Tax Rollback

A temporary tax increase, which raised personal and corporate income-tax levies by as much as two-thirds, expired Jan. 1. Its rollback will cost the state an estimated \$1.8 billion this fiscal year and \$4 billion in the year that starts July 1, according to the University of Illinois.

"I don't think they're going to be able to get to the level that they need to with budget cuts alone," said Dan Heckman, a senior fixed-income strategist in Kansas City at U.S. Bank Wealth Management, which oversees \$126 billion.

"There's going to have to be some balance between revenue enhancements and cutbacks on spending," said Heckman, whose firm holds less Illinois debt than indicated in its benchmark.

Neighbors' Levies

Residents of the fifth-most-populous state will pay a 3.75 percent income tax in 2015, down from 5 percent last year, according to a report this month from the Federation of Tax Administrators. By comparison, the top rates in Iowa, Kentucky, Missouri and Wisconsin range from 6 percent to 8.98 percent. Indiana's rate is 3.3 percent for all residents.

Rauner, 59, a former venture capitalist, wants to cut \$2.9 billion in employee benefits, \$1.3 billion in subsidies to localities and \$1.2 billion in health-care reimbursements.

"Asking for more of the taxpayers' hard-earned money without fundamentally reforming the structure of state government would further erode public confidence and accelerate our decline," Rauner said in his Feb. 18 budget address in Springfield.

"Illinois taxpayers are currently not getting value for their tax dollars," Catherine Kelly, a Rauner spokeswoman, said via e-mail Feb. 24.

House Speaker Michael Madigan, a Chicago Democrat who controls much of the legislative agenda, has said he wants revenue to be part of the deficit fix. Even Senate Republican leader Christine Radogno called the budget address "the opening shot" in negotiations. Lawmakers have until the end of May to approve the budget with a simple majority. After that, a three-fifths vote is required.

Campaign Talk

Moody's Investors Service said in a Feb. 24 report that the state's political landscape will make it tough to enact the governor's proposals without raising revenue.

During his campaign, Rauner promoted an expanded sales tax. He also called for tax changes during his budget speech, without providing specifics, and blamed the state's woes on years of poor decisions and budgeting gimmicks, rather than the expiration of the higher taxes.

Restructuring pensions is part of his plan. His budget includes anticipated savings of \$2.2 billion in fiscal 2016 by giving some public employees less generous retirement benefits.

The state Supreme Court is set to hear arguments next month on the legality of a 2013 law overhauling the pension system. Illinois's attorney general appealed after a judge in November said the legislation violated the state constitution's protection of public-worker retirement benefits.

Negative Outlooks

Illinois is paying for its financial struggles. Standard & Poor's, Moody's and Fitch have negative outlooks on its debt, signaling they could lower its credit standing. The companies already rank the state four levels above junk.

Its borrowing costs are the highest among the 20 states tracked by Bloomberg. Investors demand 1.3 percentage points of extra yield to own 10-year Illinois bonds instead of benchmark municipal debt, according to data compiled by Bloomberg.

Illinois plans to sell about \$1.5 billion of bonds, mostly in the year that starts July 1, as part of existing capital programs, according to Kelly, Rauner's spokeswoman.

As bondholders assess the state, they're waiting to see the fiscal solution its leaders produce. "The feeling out there is that they have a lot of room to raise taxes, and theoretically they could," said Peter Hayes, head of munis at BlackRock. "Eventually there will be some moment, some day of reckoning which makes everybody wake up and say we really need to pass something."

by Elizabeth Campbell & Brian Chappatta

February 25, 2015

To contact the reporters on this story: Elizabeth Campbell in Chicago at ecampbell14@bloomberg.net; Brian Chappatta in New York at bchappatta1@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net
Mark Tannenbaum, Stacie Sherman

Copyright © 2024 Bond Case Briefs | bondcasebriefs.com