
Illinois Faces Millions in Extra Debt Costs From Budget Fiasco.

When Illinois returns to the municipal market after its unprecedented 18-month borrowing drought, it may find its budget impasse will cost taxpayers millions of dollars in the coming decades.

On a $1 billion offering of 25-year tax-exempt bonds, it would cost about $175 million more now than if an equal amount was issued with spreads at 2014 levels, based on data compiled by Bloomberg that assumes the yield equals the interest rate paid. Now in its fifth month without a spending plan, signs are mounting that debt sales for cash-strapped Illinois are only going to get more expensive.

After initially planning to sell $1.25 billion in general obligations for capital needs, the governor's office said in September that it wasn't ready to announce any amounts or sale dates. The state's credit rating has been cut by two of the three largest rating companies, it's missing pension payments, and yield premiums demanded by investors are hovering near the highest since 2013. Illinois last sold debt in April 2014 for a top yield of 4.5 percent, about 1.1 percentage points more than benchmark securities. That spread has widened by about 70 basis points.

"Investors are going to ask for wider spreads over the near term if there's not a resolution for this budgetary crisis," said Dennis Derby, a money manager in Menomonee Falls, Wisconsin, at Wells Fargo Asset Management, which holds some of the state's bonds among its $39 billion of municipal debt. "It's a headline risk. It's the potential for spreads to widen out even further."

The Land of Lincoln's lack of borrowing contrasts with localities nationwide that are selling bonds at the fastest pace since at least 2003. That's saving states and cities millions of dollars as interest rates are near the lowest in half a century. Meanwhile, Illinois is sidelined by political gridlock. Republican Governor Bruce Rauner and the Democrat-controlled legislature are showing no signs of nearing an agreement for a spending plan.

Catherine Kelly, Rauner's spokeswoman, said Illinois plans to sell bonds this fiscal year, which ends June 30. She declined to comment on why the state has gone so long without borrowing. Illinois can legally still borrow.

"Speaking very generally, state law allows bond sales in these circumstances," according to an e-mailed statement from the Office of the Attorney General Lisa Madigan.

Kelly Hutchinson, formerly of A.C. Advisory Inc., started Monday as Illinois's director of capital markets and will handle bond sales for the state.

But returning to the market would come at a cost, and the state doesn't have extra money to spend these days. Investors demanded 1.7 percentage points more yield to own Illinois 30-year bonds on Nov. 3 versus benchmark munis. That's the most of all 20 states tracked by Bloomberg.

Debt Service

Illinois is running out of funds on a daily basis, according to Comptroller Leslie Geissler Munger. Unpaid bills totaled $6.8 billion, as of Nov. 3. Still, debt service remains a priority “above everything else,” Munger said Oct. 14, after announcing the delay of a $560 million monthly pension payment in November because of the cash crunch. The December payment may also be postponed.

The postponed contributions led the State Employees’ Retirement System to request the largest-ever sum of cash from the Illinois State Board of Investment to cover retiree benefits. Its pensions are already underfunded by more than $100 billion after years of skipped contributions.

Moody’s Investors Service slashed Illinois’s rating to Baa1, three steps above speculative grade, on Oct. 22, following a downgrade from Fitch Ratings three days earlier to an equivalent BBB+. Moody’s also lowered the ratings of six public universities less than a week later, citing their exposure to the budget turmoil.

“The state’s low rating and trading levels preclude them from taking much advantage, if any, of lower interest rates,” said Paul Mansour, head of municipal research in Hartford, Connecticut, at Conning, which holds Illinois debt among its $11 billion of state and local securities. “It does hurt that way.”

Market Access

In the past, credit downgrades have delayed bond deals for the state. Illinois had to cancel a planned $500 million general-obligation bond sale in January 2013 because Standard & Poor’s dropped its rating five days before. Yet about two months later it returned with an even bigger $800 million offering that had narrower 10-year yield spreads than the market average.

Not everyone expects Illinois will stay a stranger to the $3.7 trillion municipal market despite its financial woes.

“We’ve seen them in the past when market access seemed to be somewhat tenuous come to market with a big deal that they priced very cheap,” said Jason Diefenthaler, who runs a high-yield muni fund at Wasmer Schroeder & Co. in Naples, Florida. The company owns Illinois bonds. “Problem issuers tend to come to market more often.”

Long-term, the budget situation is fixable, according to Ty Schoback, a senior analyst in Minneapolis at Columbia Threadneedle Investments LLC, which holds some Illinois debt among its $30 billion of municipal holdings.

“As long as there’s adequate compensation in price, in addition to us having a view that they will ultimately come to a fix and get past this political gridlock, we certainly would consider additional purchases,” said Schoback. “You need to be compensated for the headline risk and the political uncertainty and these BBB+ downgrades.”

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