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Illinois Dodging Boycott as Bond-Market Vigilantes Lose Punch.

Illinois can thank plunging global interest rates for saving the state from the consequences of its spreading financial disarray.

The state sold $550 million of bonds on Thursday for a top yield of about 4.1 percent on securities due in 2041, or about 2 percentage points more than benchmark debt, according to data compiled by Bloomberg. Illinois's first offering since January came after yields on German and Japanese debt slipped deeper below zero and Treasuries veered back toward levels not seen for more than half a century at least.

Rock bottom payouts have sent money pouring into state and local debt as investors search for even modest returns, which allowed Illinois to borrow easily from bond buyers once referred to as vigilantes for imposing discipline on spendthrift governments.

"It's obviously a very favorable environment to sell anything, Illinois included," said Matt Fabian, a partner at Municipal Market Analytics, a research firm based in Concord, Massachusetts. "People are more worried about yields going negative than they are rising, so there's clearly demand for strong positive yield like in Illinois."

The worldwide rally has pushed Illinois's 10-year yields down over the past three months by more than a quarter percentage point to 3.3 percent, despite a record-long budget impasse that caused Moody's Investors Service and S&P Global Ratings to downgrade it last week to the lowest level for a state in over a decade.

BlackRock Inc.'s Peter Hayes, who oversees $119 billion of municipal bonds for the world's largest money manager, suggested investors consider not buying Illinois's debt to pressure elected officials, a call that didn't keep the state from returning to the market.

"Clearly the political inaction has soured the taste for many investors," said Gabe Diederich, a portfolio manager in Menomonee Falls, Wisconsin at Wells Fargo Asset Management, which manages about $39 billion of munis, including Illinois debt. "Investors will lend them money again at a very steep penalty relative to the rest of the market, but with the expectation that ultimately the state will take the appropriate steps to fix their issues."

Governor Bruce Rauner, a first-term Republican, and the Democrat-led legislature have been unable to agree on a budget since temporary tax-increases expired last year. Stop-gap measures to keep the government running have left it spending more than it brings in, with a deficit of as much as $6 billion projected for the year ending June 30. The political discord has also kept Illinois from finding a way to pay down its $111 billion pension-fund debt, which is the biggest among U.S. states.

Moody's lowered Illinois's credit grade on June 8 to Baa2, two steps above junk and its lowest for a state since Massachusetts in 1992. S&P followed the next day by cutting the state to BBB+, one rank higher than Moody's. Fitch Ratings warned it may downgrade Illinois, too.

The diminished standing on Wall Street has extracted a cost, preventing Illinois from capturing the full benefits as municipal-market rates hold at the lowest since 1965. The 10-year portion of the bonds sold Thursday yielded 1.86 percentage points more than benchmark debt, according to data compiled by Bloomberg. Bank of America won the bonds after an auction among underwriters.

Rauner, a former private equity executive, told reporters in Chicago on Tuesday that bond buyers support reforms he has pushed as a way to stoke the Illinois economy. Since he took office, Rauner has tried to tie any spending plan to changes in Illinois worker-compensation laws, property-tax reductions and limits on unions, an agenda that's drawn opposition from Democrats who say it would hurt lower-income residents.

"They're fed up with the financial mismanagement of the state of Illinois," Rauner said, referring to investors. "This has been going on for decades."

Still, Illinois remains investment grade and isn't seen at risk of default. Illinois law gives debt service priority over other expenditures and requires the state to make monthly deposits for interest and principal payments. And given the decline in yields around the world, Illinois may look appealing.

Investors have added money to municipal-bond mutual funds every week since October, the longest stretch since 2010, Lipper US Fund Flows data show. At the end of March, foreign buyers held a record $89.2 billion of state and local debt, almost triple what they owned a decade ago, according to the Federal Reserve Board.

"Instead of just on the surface saying no to potentially deteriorating credits, they're going to take a really hard look because that's the only place to go to get any kind of yield in the public fixed income markets," said Adam Buchanan, senior vice president of sales and trading at Ziegler, a broker-dealer in Chicago. "Borrowers will benefit from that, no doubt."

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By Elizabeth Campbell

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