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Illinois Bonds an Opportunity for 'Bold' Investors, Citi Says.

- Debt paying highest yields over benchmark since at least 2013
- · Multi-notch downgrade into junk is unlikely, Citi says

Illinois's nearly two-year budget impasse has created a buying opportunity for municipal-bond investors willing to bear the risks, according to Citigroup Inc.

With the Democrat-led legislature and Republican Governor Bruce Rauner unable to forge agreement on how to close the state's chronic budget deficits, Illinois's 10-year bonds yield 4.43 percent, or 2.45 percentage point more than top-rated municipal borrowers, according to data compiled by Bloomberg. That's the biggest premium since the indexes were started in January 2013.

That may mean it's a good time to buy, according to Citigroup. Despite the governmental gridlock, the fifth most-populous state has "strong fundamentals" and the power to tax and grow its way out of the financial hole, the bank said in a report to clients this week, citing the diverse economy and strong legal security backing its debt. While Illinois hasn't had a full-year budget in place since June 2015, it hasn't missed any bond payments and state law has required it to continue making monthly deposits to its debt-service funds.

"The state's credit rating and bond prices have suffered and may present opportunity for a bold investor," analysts Vikram Rai, Jack Muller and Loretta Bu, said. "We strongly encourage investors to take advantage of the cheapness of the front and intermediate IL GOs."

The crisis stems from a fight between Rauner and the legislative leaders over how to plug budget shortfalls that were worsened by the expiration of income-tax increases in January 2015. With agreement elusive, entities like public universities have been stung by the loss of state aid, triggering cuts to their credit ratings.

Citigroup published its report before Illinois Senate Democrats approved an income-tax hike and spending plan without Republican support, making the outlook for a bipartisan, comprehensive solution even more uncertain. The Senate bills still need approval by the House. The state has until May 31 to approve a budget by a simple majority. Starting June 1, a three-fifths majority is needed, making a deal even more difficult.

Moody's Investors Service and S&P Global Ratings have warned of potential rating cuts if the state enters a third year without a budget. Many of Citigroup's clients expect a one-notch downgrade, and that drop looks like it's already been priced in, according to the bank's analysts. A multi-notch downgrade to junk isn't likely, Citigroup said.

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