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Illinois Debt Boosted After \$14 Billion Bond Challenge Dismissed.

An Illinois judge rejected attempts to question the validity of bonds sold in 2003 and 2017

Illinois municipal bonds rallied Friday after a judge dismissed a petition that sought to restrain state borrowing and prohibit Illinois officials from making any more payments on \$14 billion in debt.

After Sangamon County Circuit Court Judge Jack D. Davis II threw out the complaint challenging the validity of \$14 billion in Illinois general obligation bonds, their prices rose modestly, according to Municipal Securities Rulemaking Board data. A \$7.65 billion bond sold in 2003 to shore up the state's pension funds fetched as much as 108.9 cents on the dollar early Friday, up from 107 cents on Thursday before the ruling.

Those were among the securities that John Tillman, chief executive of the conservative Illinois Policy Institute think tank, had challenged in a lawsuit claiming the state had piled more debt on the state's taxpayers than its constitution allowed.

Mr. Tillman, joined by New York hedge-fund manager Warlander Asset Management LP, said Illinois broke a state rule prohibiting deficit financing by selling debt in 2003 to close a pension gap and in 2017 to pay down government vendors.

Mr. Tillman, a prominent foe of public sector unions in Illinois, had asked the county court for permission to move forward his arguments that the two issuances should be invalidated and further payments to bondholders stopped.

But Judge Davis found no reasonable grounds for the complaint, saying on Thursday it would "result in an unjustified interference with the application of public funds" and draw the courts into political questions that should be left to lawmakers

"Indeed, it resembles far more of a political stump speech than it does a legal pleading," the judge said.

In a statement, Mr. Tillman said he would appeal and disagreed with the conclusion that the validity of bond deals was outside the realm of the judiciary to decide.

His lawsuit revolved around a provision in the Illinois constitution barring the state from taking out long-term debt except for "specific purposes" or to refinance other obligations. If successful, the complaint would have declared the 2003 and 2017 debt sales unconstitutional and unenforceable.

Nuveen Asset Management and AllianceBernstein LP, which own those bonds, came to the state's defense and questioned whether Warlander had placed a short bet in the form of credit default swaps that would pay out if the lawsuit were successful. Under questioning from Judge Davis this month, an attorney for Mr. Tillman said Warlander did indeed own those instruments.

While state and local governments nationwide are grappling with how to cover bond payments, pension benefits and infrastructure needs, few are as strained as Illinois, where state courts have largely barred lawmakers from scaling back retirement obligations.

Illinois has found willing lenders despite its precarious finances, demonstrating how investors' appetite for returns can help governments borrow even with credit ratings teetering above junk territory. Yet analysts have questioned how long the municipal market will continue lending to Illinois at reasonable rates, especially if the economy dips into recession and the state's tax base shrinks.

No U.S. state has failed to pay bondholders since Arkansas in 1933, although the U.S. island territory of Puerto Rico defaulted in 2016 and was later placed under a court-supervised bankruptcy.

The complaint mirrors efforts by the board supervising Puerto Rico's finances to have certain bonds declared invalid. In January, the board filed court papers arguing that \$6 billion in general obligation bonds should be considered worthless because they layered more debt on Puerto Rico than its constitution allowed.

While no court has ruled on those arguments, a bankruptcy-exit framework proposed by the board last month takes them into account and offers a comparatively lower recovery to investors whose claims have been challenged.

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By Andrew Scurria

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