

Bond Case Briefs

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Fear Drives MTA, Illinois Yields to Emerging-Market Heights.

- **MTA offers 30-year tax-exempt bonds at 5.1%, matching Mexico**
- **After tax, Illinois bonds yielding about the same as Ukraine**

To judge by American bond buyers, New York's Metropolitan Transportation Authority is a riskier investment than the government of Mexico, which defaulted on its debt less than four decades ago.

Ukraine was forced to restructure its bonds in 2015 to emerge from a major financial crisis. But it's still paying roughly the same to borrow as Illinois, once the tax breaks on the state's debts are factored in.

A steady drumbeat of headlines about plunging tax revenue, massive budget deficits and sky-high unemployment are pushing yields to emerging-market levels for some of America's most financially stressed municipal borrowers.

The MTA, which is facing a \$8.5 billion budget deficit after the coronavirus decimated ridership, offered 30-year bonds Tuesday at a yield of 5.1%, tax-exempt, the equivalent to more than 10% on a taxable basis for New York investors in the highest tax-bracket. Mexico's economy is reeling from a combination of a plunge in oil prices and declines in exports and tourism. Its 30-year U.S. denominated debt yields 5.1%.

Meanwhile, Illinois's 10-year bonds are trading at 5.7%, akin to a taxable bond yield of 9.3%, roughly the same as Ukraine's dollar denominated debt with the same maturity. Illinois's economy is several time larger than that of Ukraine, which is still at war with Russia. And Illinois, like other states, can't go bankrupt, nor has it ever defaulted on its debts.

The municipal-bond market "is being hit by these headlines and confusion on what municipal credit is like," said Dan Solender, head of municipals at Lord Abbett & Co. "The MTA, they have a lot of cash, they have a lot of government support. As soon as things open up, whether people love the idea or not, they're going to use the subway to get around New York."

Even though state and local government debt is one of the world's safest investments, the individual investors who dominate the market are still prone to so-called headline risk, or bad news stories that undermine the market's well-deserved reputation as a haven.

From 1970 through 2018, the average five-year annual default rate for municipal bonds was 0.09%, according to Moody's Investors Service. Corporate bonds, which have lower ratings, had a 6.6% default rate over the same period.

Debt costs are typically a relatively small percentage of a state's or city's overall budget and is fully amortizing, like a mortgage. Corporations and nations that borrow money that must be paid in one lump sum when the debt comes due may be more vulnerable to rapid shifts in market sentiment.

Illinois spent about \$1.8 billion in interest in 2019, a small share of the government's \$81.5 billion budget, according to the most recent audited financial statements.

While the MTA's ridership has declined 95%, it has about \$3.2 billion in cash, reserves and lines of credit to provide a bridge until it can secure more state and federal aid or find other fixes for its deficit, according to bond offering documents. The MTA received \$3.8 billion from the federal CARES Act and has asked for an additional \$3.9 billion. Barring more aid, the MTA would have to make politically difficult choices to cut essential services or raise fares, take on more debt, or defer critical infrastructure spending.

Aaron Donovan, an MTA spokesman, declined to comment on Tuesday's sale.

Even so, New York state law specifically prohibits the MTA and its subsidiaries from filing for bankruptcy and the authority must pay debt before using revenue for operations. And the big yields appear to have drawn plenty of investors: the size of the deal was boosted to \$1.1 billion from some \$705 million, according to a person familiar with the matter.

Mixed messages from Washington on more aid for states and cities is giving investors pause, Solender said. Democrats want to send as much as \$1 trillion in more aid to deal with the fallout from the coronavirus, while Republican Majority Leader Mitch McConnell has voiced support for giving state's the power to file bankruptcy.

On Tuesday, Illinois delayed the planned auction of \$1.2 billion of short-term debt after its yield penalties surged to record highs.

"Given this environment, given the confusion and uncertainty, those are the kinds of yields they need to pay to raise money," Solender said.

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— *With assistance by Michelle Kaske*