Illinois could sacrifice sacred cows amid drawn-out budget battle
By Gunjan Banerji
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The State of Illinois will skip a USD 560m November pension payment amidst a cash crunch, and may have to borrow from its most sacred funds, said a policy expert and public finance attorney.

Missing a pension payment compounds the state's problems and does not portray Illinois as either stable or predictable, said John Schomberg of Clark Hill after the Illinois Comptroller's announcement of skipped payment on 14 October. Schomberg is former general counsel to Illinois Governor Pat Quinn. The fact that Illinois will forgo a continuing appropriation item raises the question of what other obligations will or will not be met, Schomberg said.

The state's backlog of bills hit USD 7bn as it has dragged on without a budget for more than 100 days, making payments mainly from court orders and other mechanisms.

"The state is insolvent and it needs to prioritize among these creditors," said William Choslovsky, a partner at Fox Rothschild. Choslovsky intervened in a case on behalf of developmental disability providers and against the Illinois comptroller regarding human services payments that were neglected during the budget impasse. The case escalated to federal court.

Bond investors may see a dysfunctional state that cannot meet some of its basic obligations, Schomberg said. While the market is accustomed to financial mismanagement by the state, recent moves indicate an unprecedented level of dysfunction, a municipal credit analyst said.

Downgrades of the state's instruments are signs that Illinois is deteriorating even further, and perhaps not prioritizing bondholders, said the municipal credit analyst. Illinois let one of its best ratings, the AAA credit Metropolitan Pier, slide to BBB+, after the state legislature failed this summer to appropriate USD 20.8m for a required monthly payment to the bond trustee this summer, as reported.

This was corrected with legislation that allowed the state to funnel the funds during the impasse, but only after its rating was slashed several notches by Standard & Poor's and Fitch. The Chicago Motor Fuel Tax bonds saw a similar fate.

The market may be used to Illinois' transgressions -- Governor Rod Blagojevich issued a USD 10bn pension bond and took pension holidays in FY06 and FY07 -- but investors find solace in the General Obligation Bond Retirement and Interest (GOBRI) fund. Illinois as a state has some of the strongest protections for general obligation bondholders in the nation, Schomberg said.

But that might change.

Not so sacrosanct

Illinois has dipped into its GOBRI fund for inter-fund borrowing before, said a source familiar with the state's finances. The state borrowed USD 335m in FY09 on a short-term basis for a Hospital Provider Fund and repaid the money within a short timeframe, the source familiar said. The state does not have plans to borrow from the GOBRI currently, the source familiar said.

While it is arguable that inter-fund sweeps are temporary fiscal solutions for very large budgetary problems, dipping into the GOBRI fund is worse than borrowing from the other funds, said Ralph Martire of the Center for Tax and Budget Accountability. Protecting the GOBRI fund infuses market confidence in your fiscal management; investors like to know that those funds are completely reserved, Martire said.

Inter-fund borrowing will have to be one of the tools the state relies upon as it tries to hammer out a budget, Schomberg said. It is unlikely that Democrats and Republicans will muster support to close the entire USD 10bn budget deficit with just tax increases, especially in an election year, Schomberg said.

Liquidity stress is a key pressure point, the municipal credit analyst said. It is possible that the state could dip into the GOBRI again, Martire said.

“That’s the type of thing Springfield tends to do,” Martire said.

Illinois’ finances have already been artificially inflated by its inter-fund borrowing at the end of FY15, as reported. The administration executed a USD 454m inter-fund borrowing on the last day of FY15, and transferred USD 1.3bn from non-general funds to paint a brighter revenue picture.

To add to the state’s problems, not making the pension payment adds to a political quagmire that has pit retirees against bondholders time and time again. The Republican governor has tried to crush collective bargaining and made access to municipal bankruptcy a pillar of his turnaround agenda. It is unclear how the pension funds will react to this move.

The comptroller stated that the administration would have more cash to make the payments after peak tax collection times around the holidays and in the spring. However, with each passing day, balancing the state's budget becomes more difficult. The state could be reaching the point where even additional income tax revenue would not solve its problems, Martire and the municipal credit analyst said.

The state recently hired a debt manager, as reported. It has not disclosed plans to issue short or long-term debt.

The lowest rated state is pegged at A3 with a negative outlook by Moody’s Investors Service and A- and on watch negative by Standard & Poor’s. A tranche of USD 81m Series 2014 general obligation bonds last traded on 28 September at 97.6, yielding 5.17%, according to Electronic Municipal Market Access.

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