Illinois' USD 115m issuance through conduit authority sparks questions
By Gunjan Banerji
18 November, 2015

Illinois' issuing debt through the Illinois Finance Authority (IFA) raises questions about the state's ability to sell debt by itself and make sound financial decisions amidst a prolonged budget impasse, said market participants.

The Midwestern state enlisted IFA to execute a USD 115m financing, enabling it to make good on payments to a litany of vendors awaiting funds such as personnel providing public safety and emergency 911 services. A series of consent decrees, court orders, and stopgap appropriations have patched a five-month-long budget impasse with band aids, but this financing indicates a heightened cash crunch as the state's backlog of bills approaches USD 7.3bn, said market participants.

A preliminary resolution for USD 115m in financing for the state was approved last week at an IFA board meeting and is now on a fast track to issuance, said Chris Meister, executive director of the IFA.

But it was unclear why the state opted tapped a conduit issuer in the first place. The state recently hired a debt manager and has historically issued tax anticipation notes for short-term financing.

Illinois' using longer-term bonds to fund operations is a red flag, said John Schomberg, a Chicago-based attorney at Clark Hill. Schomberg served as general counsel to former governor Pat Quinn. It indicates that crucial vendors such as 911 local call centers, food providers for veterans and inmates, and snowplow repairers will cease delivering goods and services without payment, Schomberg said. Topping it off, terming out accounts payable and attaching a moral obligation to the financing is a questionable financial decision, said a municipal credit analyst.

"This is unprecedented," Meister said of the issuance, which is underwritten by Citi. The authority also approved USD 12m of IFA's money to go toward the projects, debt service reserves, and costs of issuance.

The USD 115m in securities, with maturities ranging from five to ten years, may be issued as a direct purchase, a private placement, or a capital markets issuance. The securities will likely be taxable, according to board documents. Secured by Illinois' moral obligation, the financing will be subject to appropriation from the state, rather than general or special funds from the authority.

Strapped for cash

A fifteen-member board appointed by the Governor Bruce Rauner (R) and confirmed by the state Senate runs the IFA.

The state would not have turned to the IFA if issuing general obligation (GO) debt were possible at this point, Meister said. A spokesperson for the state did not respond to a request for comment.

"They're running out of options," Schomberg said.

The state, through the Office of Management and Budget, may not have the statutory authority to issue bonds for this specific purpose, Schomberg said. Generally, such bonds would require a super-majority vote of the General Assembly and the governor's approval, Schomberg said. In the absence of that authority, the state must turn to the IFA, which has broad, statutory bonding authority for "public purpose projects," Schomberg said.

This is the latest in a string of roundabout funding measures the state has taken amid its prolonged budget gridlock, during which it has had to prioritize which bills to pay on a daily basis. Lawmakers approved funding for some state operations such as schools, but left behind others such as higher education and a November pension payment, as reported.

Separate, but related

Illinois may have made this unusual move to protect its bond rating in the near term, Schomberg said. IFA is a separate "body politic and corporate," with its own rating.

Moody's Investors Service recently downgraded the state's USD 27bn in GO bond rating to Baa1/negative from A3, while Fitch Ratings knocked the credit to BBB+/stable from A-. The state is rated A-/watch negative by Standard & Poor's.

But the two bodies may not be as separate as the administration surmises.

Any future mishap with the moral obligation bonds could mar the state's bond ratings, which would affect its GO bonds as well, said a municipal credit analyst. Even though the state's newest issuance would be done through a conduit, and the GO bond retirement and interest fund is protected, Illinois' credit quality could be at risk down the road.

Repaying the loan or bond will hinge on the state's appropriation for this purpose as well as its moral obligation to do so, according to the IFA documents. The convoluted flow of funds from the authority, to the state, and then back to the authority in order to make good on payments also raises questions.

"At this point, investors need a specific collateral source rather than a promise," said Michael Comes, a vice president of research and portfolio manager at Cumberland Advisors. If these securities are priced, they will have to come at a concession, Comes said.

Illinois has lost the trust of investors due to issues with other appropriation debt amid the gridlock, Comes said. The state narrowly avoided default on the Metropolitan Pier and Exposition Authority's appropriation bonds, as reported. The moral obligation pledge is even weaker than an appropriation debt pledge, a municipal credit analyst said.

The two financial advisors are Acacia and Sycamore. The authority is also working with Katten Muchin, Meister said. The authority is looking for the most economical and expeditious structure, Meister said.

The IFA meets every second Thursday of the month—if the authority's deal team develops a structure and documentation for the financing that supports its closing and can do so before next meeting, Meister will consider calling a special meeting to expedite the process.

A USD 34m tranche of Series 2012A general obligation bonds issued by Illinois and maturing in 2025 last traded on 16 November at 98.0 yielding 4.25%according to *Electronic Municipal Market Access.*