



DAILY BRIEF: MUNI

- DIARY -

Illinois Investors Endorse Fiscal Stability

BY ELIZABETH CAMPBELL

Illinois investors are endorsing fiscal stability this election.

No matter who wins the gubernatorial race next month, bondholders want the next chief executive to avoid a repeat of the longest budget impasse in U.S. history, one that put Illinois on the brink of becoming the first junk-rated state. That gridlock – the result of a two-year standoff between Republican Governor Bruce Rauner and the Democrat-run legislature – drove unpaid bills to a record \$16.7 billion, forced cuts in social services, and sent borrowing costs to multi-year highs.

The fiasco also kept the state's leaders from making any real progress on fixing its biggest challenge – the government worker pension plans that are falling deeper into the red while consuming more and more tax dollars.

“We don't care if it's a Democrat or Republican, we just want to make sure that whoever is in the office knows how much new taxes and revenue increases are needed to make those hard decisions of trying to deal with pensions,” said Dora Lee, vice president at Belle Haven Investments, which manages about \$7.5 billion in municipal bonds, including Illinois debt. “We just need someone who has the vision and the political capital to make those hard choices because time is kind of running out.”

Rauner, a former private-equity executive and multimillionaire, is running for re-election against Democrat J.B. Pritzker, the billionaire Hyatt hotel heir. Rauner took office in January 2015 as the state confronted a deficit amid expiring income-tax hikes. Rauner refused to raise taxes unless lawmakers agreed to an agenda that included property-tax cuts, limits on unions and changes to worker-compensation laws. Democrats balked. The stalemate didn't end until July 2017, when lawmakers, including members of his own party, overrode his veto to enact a spending plan that raised income levies.

Rauner is calling for balanced budgets and reforms and says more tax hikes won't solve the state's problems. Pritzker is campaigning for a graduated income tax – instead of the current flat tax – that he argues will lower those on the middle class. That would require a constitutional amendment.

Pritzker held a 20-point lead over Rauner among likely voters, according to an Ipsos, Reuters and University of Virginia Center for Politics poll released yesterday. Likely voters favored Pritzker 50%, compared to 30% for Rauner, the poll showed.

One party rule has worked to ease impasses in other places. California Governor Jerry Brown, a term-limited Democrat, is leaving office after amassing an \$8.9 billion surplus compared to the \$27 billion deficit when he took over for his Republican predecessor in 2011. But single-party control is no guarantee. New Jersey's leaders have yet to right the state's finances since Republican Governor Chris Christie exited office in January, with Governor Phil Murphy and fellow Democrats struggling to find common ground.

Even though Rauner pushed for fiscal reforms that would have cut costs, none of those were enacted, said John Miller, head of municipals at Nuveen, which holds more than \$140 billion in state and local debt, including Illinois bonds.

“The concept that there could be a better, maybe a more productive dialog where you could actually pass some fiscal changes that require legislation, that's got to be considered better than gridlock,” Miller said. “I actually think the bond market would respond more positively to a change,” said Miller, who noted that his comments are from a revenue, expenses and budgeting point of view and not a political perspective.

Investors have long punished Illinois for its fiscal woes. Yields on Illinois's 10-year general-obligation bonds jumped to as much as 3.4 percentage points above benchmark in June 2017 as credit-rating companies warned that Illinois could lose investment-grade status if the impasse wasn't resolved. That gap has since come fallen to 1.8 percentage points but is still the highest among the 20 U.S. states tracked by Bloomberg.

“If there's unified government, whether you view that favorably or unfavorably, it does mitigate appropriation risk and decreases the chance of a government shutdown, and it also mitigates the risk of not having a budget passed,” said Dennis Derby, a portfolio manager at Wells Fargo Asset Management, which holds \$39 billion of municipal debt, including Illinois bonds. “No matter who wins, going forward, we would want to see balanced budgets, attempts at pension reform and a reduction in the payables backlog.”

- HEADLINES -

Speculators are increasing their bets against some of the biggest municipal-bond exchange traded funds, wagering the share prices will drop as rising interest rates sting the state and local government debt market. Traders have boosted their short positions in State Street's \$2.8 billion SPDR Nuveen Bloomberg Barclays Municipal Bond ETF to the highest on record, according to the most recent figures. Read more on Bloomberg [here](#).

The volume of state and local government debt sales looks likely to drop as requests for trading tickers for municipal securities fell 9.6% in September from the previous month. The drop "coincided with historic high yields on U.S. Treasuries, possibly indicating that the rising rate environment will crimp the growth of new security issuance in the months to come," said Gerard Faulkner, director of operations for CUSIP Global Services, in a statement.

J.B. Pritzker, the Democratic candidate for governor of Illinois, has a 20-point lead over Republican Governor Bruce Rauner among likely voters, according to an Ipsos, Reuters and University of Virginia Center for Politics poll released Wednesday. Likely voters favor Pritzker 50% to 30% over Rauner, with 6% for Conservative Party candidate Sam McCann.

Ned Lamont, the Democratic nominee for governor in Connecticut, has an 8-point lead over Republican Bob Stefanowski, bolstered by a 22 percentage-point margin among women, according to a Quinnipiac University poll released Wednesday. Likely voters favor Lamont 47 to 39%, with 11% for independent candidate Oz Griebel.

- DATA WATCH -

- **Primary market:** Chicago is planning to sell \$665 million of sales tax securitization bonds, according to Fitch Ratings. The city's sales tax securitization corporation is planning to sell the bonds via negotiation the week of Oct. 29, Fitch said on Wednesday.
- **Fund flows:** Investors pulled \$202 million out of municipal-bond funds in the week ended October 3, marking the second straight week of outflows, data from the Investment Company Institute shows.
- **Secondary market:** MSRB par amount traded: \$16.5 billion; PICK par value offered: \$31 billion.
- **Most active:** The most actively traded security on Wednesday was the 5% Golden State Tobacco Securitization Corp. due in 2047: 25 trades worth \$106 million.
- **In the pipeline:** Nashville and Davidson County, \$724 million in GO bonds, via auction 10/16; Minneapolis, MN, \$112 million in GO bonds, via auction 10/16.

AAA Benchmark Yields

TERM	CURRENT	PREVIOUS
1 Year	1.99	1.98
2 Year	2.07	2.06
5 Year	2.35	2.33
10 Year	2.78	2.75
20 Year	3.33	3.30
30 Year	3.48	3.44

Source: Bloomberg

Benchmark States 10-Year Yields

STATE	YIELD	SPREAD /AAA	CHG
CA	2.83	8	0.03
FL	2.9	15	0
IL	4.59	184	0.01
NY	2.72	-3	-0.01
PA	3.29	54	0.04
TX	2.88	13	0

Source: Bloomberg

- INSIGHT -

Tobacco Bonds Burned as Funds Sell to Raise Cash

BY MARTIN Z. BRAUN

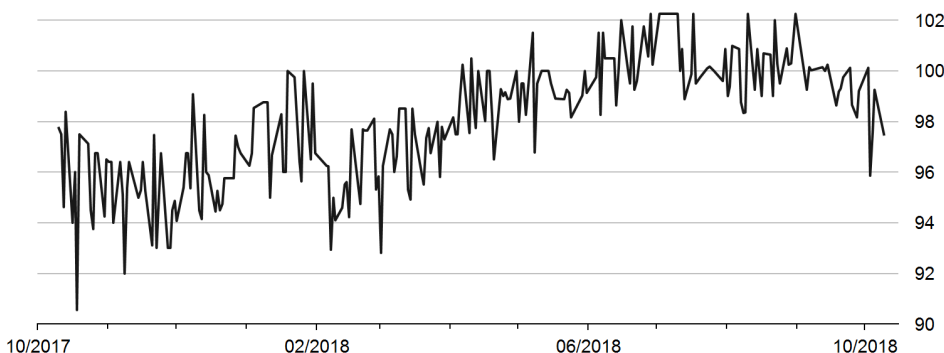
Junk-rated state and local government bonds backed by payments from a 1998 settlement with tobacco companies, the most liquid high-yield municipal securities, have posted some of the market's biggest losses this month as funds sell the securities to meet redemptions.

The bonds have declined 2.5% in October, more than twice the 1% loss for the Bloomberg Barclays Muni High Yield Index, as mutual funds focused on municipal debt saw investors pull out cash for the past two weeks. An October 4 downgrade of \$2.2 billion of Ohio's tobacco-settlement bonds may be contributing to the decline, said Brian Steeves, a portfolio manager at Belle Haven Investments.

"You have funds that are experiencing and anticipating outflows," Steeves said. "They usually will look for their most liquid investments to sell."

BUCKEYE'S PLUNGE

BUCKEYE TOBACCO SETTLEMENT FINANCING AUTHORITY 5.875s OF 2047



SOURCE: BLOOMBERG

Traditional tax-exempt debt mutual funds saw investors withdraw \$470 million in the two weeks through October 3, according to the Investment Company Institute. And exchange traded funds posted outflows of \$220 million in the last week, according to data compiled by Bloomberg, with BlackRock's iShares National Muni Bond ETF and the VanEck Vectors High-Yield Municipal Index ETF seeing the biggest pullback. Six of the Vectors fund's top 10 holdings are tobacco bonds from Ohio and California.

More than \$80 million of California tobacco bonds changed hands Wednesday, making them one of the most actively traded municipal securities. The prices of Golden State Tobacco bonds maturing in 2047 declined to an average of 99.7 cents on Wednesday from 101.4 cents on October 4.

Last week, Moody's Investors Service cut the rating on Ohio's Buckeye Tobacco Settlement Financing Authority bonds to Caa3, its third lowest rating, from Caa1 in anticipation that the decline in cigarette sales will continue to cut into the payments that back the securities.

The bonds, sold in 2007, have less cushion against default than other tobacco debt and have drawn on reserves to pay investors. Moody's currently expects that U.S. cigarette shipments will fall at a long-term average rate of 3% to 4% per year as more Americans kick the habit.

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