Thoughts on the State of Illinois and the Municipal Bond Market

June 2, 2017

In the midst of a three year budget impasse, the State of Illinois hit another milestone yesterday. The State was downgraded to the lowest possible investment grade rating and remains on negative watch with an S&P/Moodys credit rating of BBB-/Baa3. To put this into perspective, no US State has ever been rated below investment grade.

By passing May 31st without a budget in place, the task of approving a budget has become even more difficult. Now requiring a three- fifths majority vote to pass a budget, Illinois which already faces billions in unpaid bills, severely underfunded pensions, and complete political gridlock has the unenviable task of digging themselves out of an even deeper hole.

The outlook for the State is grim as their constitution prohibits a number of already attempted fixes to some of their largest issues, i.e. pensions, in addition to the fact that the State is prohibited from filing for bankruptcy. While the severity of this situation is unique to Illinois, it bears watching as it plays out and what effects it could have on other states in the U.S.

We have been closely watching the public pension fund issues our country faces. The imbalances that exist between what has been promised and what has been set aside to fund those promises remain significant. This environment makes credit research and a focus on quality extremely important when structuring a municipal bond portfolio. We do not hold any State of Illinois debt and will continue to monitor the development of this story to understand its impact on the credits we do hold. Our emphasis on quality and balance should continue to set us up for success in an increasingly volatile municipal credit market going forward.

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