

# Bond Case Briefs

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## Chicago Faces Record Tax Hike as Pensions Compound Deficit.

Chicagoans are bracing for the biggest property tax increase in the city's history as Mayor Rahm Emanuel contends with a budget shortfall and soaring retirement bills that have sent its credit rating tumbling.

Emanuel, a Democrat, on Tuesday proposed raising property taxes by \$588 million over the next four years. That would inject cash into the city as it faces a \$426 million deficit and a pension-plan debt that's grown to \$20 billion, more than \$7,000 for each resident.

The tax increase would mark one of the biggest steps yet by Emanuel to shore up the finances of the third-largest U.S. city, which is under pressure from Wall Street as investors demand higher yields to buy its securities. Moody's Investors Service, Standard & Poor's and Fitch Ratings have all downgraded Chicago this year, giving it the lowest rating of any big U.S. city except for once-bankrupt Detroit.

"Our greatest financial challenge today is the exploding cost of unpaid pensions," Emanuel said during his budget speech, which ended with a standing ovation from the packed city council chamber. "It's a dark cloud that hangs over the rest of our city's finances."

"The bill is due today," Emanuel said. Without the new revenue, the city would need to lay off 2,500 police officers, close 48 fire stations and cut 2,000 firefighting jobs to cover pensions costs, he said.

### **Welcomed Move**

The prospect of higher taxes has been welcomed by investors. Federally tax-exempt Chicago bonds maturing in 2035 traded Tuesday for an average of 94.6 cents on the dollar, up from 88.7 cents on Aug. 27. That lowered the yield to 5.5 percent, about 2.5 percentage points more than top-rated debt, according to data compiled by Bloomberg.

"This is not kicking the can down the road," said Paul Mansour, head of municipal research in Hartford, Connecticut, at Conning, which holds Chicago debt among its \$11 billion of municipal securities. "We're actually going to do something here that is going to sting. We're moving from gamesmanship to action steps."

The financial squeeze on Chicago emerged after officials shortchanged the pension funds by more than \$7 billion over the past decade, freeing up cash for other uses. That's caused the projected retirement bill to swell to about \$1 billion next year, more than doubling since 2014, as it makes up for years of failing to set aside enough to cover pension checks for police officers, firefighters and other city employees.

The move to raise taxes, which needs the approval of the city council, is a shift for Emanuel, who won re-election in April after touting his record of not lifting property, gas or sales taxes. In May, Moody's cut Chicago's bonds to junk, saddling the city with higher interest bills as it refinanced

debt.

“I think that public service requires people to display courage and to take tough votes,” Alderman Edward Burke, chairman of the finance committee told reporters after Emanuel’s address. “This is going to be a tough vote.”

The property tax hike, which will be used for pensions, will start with a \$318 million increase in 2015 followed by an additional \$109 million in 2016, \$53 million in 2017 and \$63 million in 2018. A \$45 million special real-estate levy that state lawmakers approved in 2003 would also be enacted to ease overcrowding at schools.

“It’s a good faith example of what Chicago needs to kind of right their ship and improve their finances,” said Alan Schankel, a managing director at Janney Montgomery Scott LLC in Philadelphia. “It’s not going to solve all the problems of the world, but they’re taking the right steps and that’s important.”

Chicago’s next annual pension payment will jump 10 percent \$976 million, according to an annual financial analysis released July 31. That’s on top of the \$549 million it still owes to police and firefighter retirement funds for this year. While state lawmakers approved lowering this year’s payment to \$328 million, Republican Governor Bruce Rauner has yet to sign it.

The city is also fighting a court challenge to its effort to cut some employee benefits and require them to pay more into the retirement system. A state judge in July ruled that the steps are illegal, siding with the workers.

## **Business Opposition**

The tax-increase plan has already drawn some opposition from businesses. The burden may fall largely on commercial property owners, said Ron Tabaczynski, director of government affairs for the Building Owners and Managers Association of Chicago. Emanuel wants to exempt owners of homes valued at \$250,000 or less from the hike.

“Businesses start rapidly approaching that tipping point where it’s just not worth doing business here,” Tabaczynski said.

The fiscal pain is being shared in other ways. Residents who don’t already pay for garbage pick-up will have to pay \$9.50 a month for refuse collection, generating about \$62.7 million, according to Emanuel’s proposal. He’s also pitching higher fees on taxis and ride-hailing services like Uber Technologies Inc. to produce about \$48.6 million.

This tax increase is welcome step toward dealing with Chicago’s financial strains, said Dan Heckman, senior fixed-income strategist in Kansas City, Missouri, at U.S. Bank Wealth Management, which oversees about \$127 billion of bonds.

“Doing nothing is not going to solve it, and doing only a little will only prolong this,” said Heckman, whose firm doesn’t hold Chicago debt. “That’s a concern on a lot of investors’ minds.”

## **Bloomberg News**

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