Bond Case Briefs

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Cradle-to-Grave Debt Load Leaves No Chicagoan Unburdened: Bloomberg.

Chicago is now the city of big debt, where each of its 2.7 million residents — from infants in diapers to senior citizens on fixed incomes — is on the hook for about $20,000 in long-term pension promises and bond obligations. Like the relentless snow clogging the city's streets, it just keeps piling up.

Chicago isn't bankrupt Detroit, junk-status Puerto Rico or New York at the brink of insolvency in 1975. Yet the city of gleaming skyscrapers along Lake Michigan's shore tripled its debt load from 2002 to 2012, as it ignored annual pension payments and borrowed for capital and operating expenses. A $590 million payment for retirement obligations is due next year, threatening cuts in everything from police to garbage collection, a tax increase, or both.

The rescue Chicago Mayor Rahm Emanuel needs will have to come from another financial leaky boat, the state of Illinois, which has the lowest credit rating among U.S. states. Lawmakers in Springfield, the capital, on Dec. 3 approved retirement-benefit cuts to address a $100 billion state pension shortfall. Not, though, for Chicago.

"The legislature and the city council and the mayor need to come to fiscal reality and recognize this is not sustainable," said Laurence Msall, president of the Civic Federation, a nonprofit research group based in Chicago. "They've created a bigger problem down the road, and now we are down that road. And there is very little road left."

More Debt

The city is about to pile on more borrowing, worsening its status as the biggest carrier of per-capita debt among the nation's most populous cities. Chicago plans to sell $650 million of bonds in the coming weeks, adding to liabilities that soared in the past decade.

In the 10 years starting in 2002, the city increased its bonded debt by 84 percent, to $7.8 billion, according to the Civic Federation. That added $1,320 to the tab of each city resident. Among the 14 major cities surveyed by the group, only New York recorded a higher per-capita increase, $1,555 in that period. The average jump was $324.

At the same time, Chicago's per-capita pension obligations for teachers, police, firefighters, transit workers and other employees almost quadrupled, topping $11,800 in fiscal 2012. The combined debt burden from pensions and borrowing reached almost $19,600 per person in 2012, the federation said.

'Fiscal Cliff'

It took years for Illinois lawmakers to address pension shortfalls. Chicago doesn't have the luxury of a long debate. Like all other municipalities in the state, it must make higher retirement-fund payments next year, as required by a 2010 law.

“The work is far from finished,” Emanuel said in a December press release after lawmakers approved the bill cutting state pension benefits, saving Illinois an estimated $145 billion during the next 30 years. Chicago is “standing on the brink of a fiscal cliff.”

Moody’s Investors Service made a similar observation in July when it cut the city’s grade three steps to A3, six levels below the top, and tagged its general obligations with a negative outlook. A reduction of that magnitude was unprecedented for a U.S. city as populous as Chicago, according to Moody’s data since 1990.

The New York-based ratings company cited “large and growing pension liabilities and accelerating budget pressures” stemming from them.

Detroit Road

“Chicago is on the road to Detroit,” declared the headline on a Feb. 5 editorial in the Chicago Tribune. That’s an exaggeration, said Rachel Barkley, a municipal credit analyst at Morningstar Inc. (MORN) in Chicago.

“It is much more akin to New York — a diverse economy, third-largest city, economic heart of the Midwest, a stable population and a considerable tax base,” Barkley said. “However, they still need to address that liability.”

In a Jan. 16 report, she showed that Chicago’s debt load per person was the biggest among the 25 most-populous U.S. cities — and almost twice that of Puerto Rico, the U.S. territory that is groaning under $70 billion of bonds.

‘Flashing Yellow’

The downgrade means “flashing yellow lights for the investor,” said Richard Ciccarone, chief executive officer of Hiawatha, Iowa-based Merritt Research Services, which analyzes municipal finance.

“The good news is the breadth of their tax base and leadership, but they need some help from the state,” Ciccarone said. “They need the legislature to act — yesterday.”

Investors are demanding higher interest rates to own some Chicago bonds since the July downgrade. The extra yield buyers require over benchmark municipal debt on general obligations maturing in January 2022 has averaged about 3 percentage points since August, data compiled by Bloomberg show. That spread averaged only about 1.6 percentage points in the five months before the Moody’s cut.

Chicago plans to sell $650 million in general obligations by early March, Kelley Quinn, a spokeswoman for the mayor, said yesterday. Proceeds would go toward infrastructure, repaying debt and legal judgments against the city. The city hasn’t considered issuing pension bonds to meet retirement obligations, Quinn said.

‘Streaming Out’

In his annual budget address in October, Emanuel painted a portrait of residents and businesses “streaming out of Chicago” if the legislature doesn’t restructure the pensions.

“We will not preside over a city in which garbage is not picked up, graffiti is not removed, and libraries and other vital services must be shut down,” Emanuel said.

The city’s population shrank about 7 percent from 2000 to 2010, while New York and Los Angeles both grew at least 2 percent, Census data show.

Chicago’s debt-load challenge is complicated by a lawsuit filed last month by a coalition of labor unions claiming the state’s pension restructuring law violates constitutional protections against reducing benefits. Discussion with state lawmakers on how to resolve the city’s liabilities have included elements of the bill passed in December.

The outcome of the lawsuit is critical to easing the city’s debt load without driving away tax-paying citizens and businesses, said James Spiotto, a municipal bankruptcy specialist in Chicago.

“If you cut services and increase taxes, people will leave,” said Spiotto, managing director of Chapman Strategic Advisors. “And if you keep repeating it, you get into a death spiral. Eventually there would be fewer workers and fewer people to pay the pension debt.”

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