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Chicago Credit Rating Cut by Moody's to Two Steps Above Junk.

(Bloomberg) — Chicago had its credit rating cut to within two steps of junk by Moody's Investors Service because of mounting pension liabilities, underscoring the city's fiscal stress as Mayor Rahm Emanuel faces an unprecedented runoff election.

The one-step reduction to Baa2 affects \$8.3 billion of general-obligation bonds, which were already the lowest-rated among the 90 biggest U.S. cities, excluding Detroit. The outlook remains negative, signaling more cuts are possible, New York-based Moody's said Friday in a report.

"The city's credit quality could weaken as unfunded pension liabilities grow and exert increased pressure on the city's operating budget," Moody's analysts Matthew Butler and Rachel Cortez wrote. "We expect substantial growth in unfunded pension liabilities even if the city's recent pension reforms survive an ongoing legal challenge."

Chicago is obligated to pay \$600 million into four pension funds in next year's budget, though Standard & Poor's said the contribution may be delayed after Feb. 24 elections led to an unexpected runoff vote between Emanuel and Jesus "Chuy" Garcia. The former White House chief of staff failed to capture more than 50 percent of the vote.

"Moody's has been consistently and substantially out of step with the other rating agencies, ignoring the progress that has been achieved," Kelley Quinn, an Emanuel spokeswoman, said in an e-mailed statement.

Difficulties Ahead

Quinn noted that two other major credit raters affirmed the city's grade this week, recognizing the progress made under Emanuel.

"What we can agree with Moody's about is that the city continues to face serious fiscal challenges and that difficult work remains to continue strengthening the city's finances and securing our city's future," Quinn said.

While Illinois is the lowest-rated state, credit raters differ on Chicago's standing. S&P affirmed its A+ rating on the city today, citing its broad and diverse economy. That's the fifth-highest rank and four levels above Moody's. S&P may cut its rating if Chicago doesn't implement a plan by the end of 2015 to sustainably fund its pensions, analyst Helen Samuelson said in a report. Fitch Ratings ranks Chicago two steps higher than Moody's.

State Action

The third-most-populous U.S. city has \$20 billion in unfunded pension obligations that it can't address without the approval of the state legislature. Lawmakers in June restructured two city pension plans with about \$9.4 billion in underfunded liabilities for about 60,000 municipal workers

and retirees by making them pay more and reducing benefits. The changes didn't apply to the police and fire systems.

Labor unions in Chicago sued to block the law in December, and the litigation was put on hold pending the outcome of an Illinois Supreme Court ruling on a state pension overhaul.

The April 7 runoff is the first for the city of 2.7 million since it went to nonpartisan elections in 1999. Garcia's campaign called the downgrade another sign that the city needs new leadership.

"The downgrade is an objective verdict on Emanuel's lack of fiscal stewardship," Andrew Sharp, Garcia's campaign manager, said in an e-mailed statement.

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