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[Emanuel's Second Term: Chicago's Grim Fiscal Challenges.]

(Reuters) – Ballooning pension payments, difficult negotiations with labor unions and threatened state funding cuts are some of the challenges facing Rahm Emanuel, who won a second term as Chicago's mayor on Tuesday.

The third biggest U.S. city is teetering at the edge of a fiscal precipice brought on by years of insufficient pension contributions, high debt issuance and a reliance on nonrecurring revenue to plug budget holes.

As a result, rating agency Moody's Investors Service has dropped Chicago's general obligation credit rating six notches since 2010 to Baa2, two notches above junk. The only big U.S. city with a lower Moody's rating is Detroit, which exited bankruptcy in December.

Here are the grim details of Chicago's financial problems:

– Chicago's total bond debt, including general obligation and water, sewer and airport revenue bonds, was $21.4 billion at the end of 2014, 60 percent more than in 2004.

– The city's biggest liability is its pensions. It ended fiscal 2013 with an unfunded liability of $19.2 billion in its four retirement funds, leaving them only funded 37 percent, well below the 80 percent level considered healthy. In addition, the city's unfunded liability for retiree healthcare was nearly $1 billion.

– Chicago last summer projected its contribution to its four pension funds, which totaled $478.3 million this year, will spike to $1.1 billion next year and steadily climb to $1.638 billion in 2020. At that level it would represent 46 percent of the city's current operating budget. A looming $550 million increase is due to a 2010 Illinois law that requires higher payments to public safety worker pensions to reach 90 percent funding by 2040.

– An Illinois Supreme Court ruling is due soon on a union challenge to the constitutionality of public pension reforms. If it goes against the state, the ruling could unravel a 2014 law that cut benefits for two of Chicago's four pension funds, increasing the unfunded liability in the city's municipal and laborers' retirement funds by $900 million.

– Chicago's ratings could be downgraded if the reform law is tossed out. If its ratings continue to fall, the city could be forced to fund payments nearly equal to its operating budget of $3.53 billion. A default on bank letters of credit and other liquidity facilities could potentially force the city to repay nearly $3 billion of debt, the city said in a January court filing. It may also have to make $300 million in payments to banks for debt-related contracts linked to the city's ratings. If the ratings are cut to junk then that would also substantially boost borrowing costs for future Chicago bond issues.

– Under Illinois Republican Governor Bruce Rauner's proposed fiscal 2016 state budget, Chicago would lose about $135 million in state revenue sharing and the Chicago Transit Authority, which the mayor controls, would lose $130 million.

– The Chicago Board of Education, also under mayoral control, is mired in its own fiscal crisis, projecting a $1.11 billion deficit in its budget for the fiscal year that begins July 1. The school system ended fiscal 2014 with a $9.5 billion unfunded pension liability and a funding ratio of 51.5 percent, down from nearly 80 percent in fiscal 2008. A three-year contract with the Chicago Teachers Union expires June 30.

By REUTERS

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