Bond Case Briefs

Municipal Finance Law Since 1971

Chicago Doesn't Hire Moody's to Rate Its Latest Debt Refinancing.

Moody's Investors Service has missed out on a lucrative assignment for Chicago about a week after the credit-rating firm downgraded the third-largest U.S. city's debt to junk status.

Chicago instead hired rivals Standard & Poor's Ratings Services, Fitch Ratings and Kroll Bond Rating Agency Inc. to provide grades for a refinancing of $800 million in general-obligation bonds expected to hit the market in coming weeks, according to a sales offering document released Thursday.

The exclusion of Moody's is the latest fallout from a disagreement among large ratings firms about the city's fiscal health and its $20 billion pension hole. Moody's angered Chicago officials on May 12 when it lowered the rating on Chicago's bonds two notches into junk because of a pension deficit that is equivalent to about four years of annual operating budgets. Mayor Rahm Emanuel called the Moody's downgrade "irresponsible."

S&P, a unit of McGraw Hill Financial Inc., and Kroll have a more optimistic view of Chicago and rate the city's bonds much more favorably at A-minus—four notches higher. Fitch, majority owned by Hearst Corp., grades Chicago's bonds one note below S&P.

A spokeswoman for Mr. Emanuel declined comment on why Moody's was left out of the new offering and whether it had anything to do with the downgrade. The Moody's Corp. unit also declined comment.

"Issuers have walked away from one ratings firm or another over the years because of a bad rating," said Mitchell Savader, chief executive of a municipal- debt research firm and a former Moody's senior credit officer. "It can happen."

Mr. Emanuel hasn't minced words on the Moody's downgrade, accusing the firm last week of playing politics with the financial future of the city and questioning why it would lower the city's rating and not the state's, which is struggling with its own pension problems.

Moody's has defended its more aggressive methodology, which changed two years ago when it decided it would no longer rely on the investing return targets submitted by cities and states to calculate pension costs. Its own estimates are more conservative, meaning the city's pension problems look worse.

Still, the mayor likely doesn't face much political downside by taking on Moody's and its downgrade of the city's bonds, according to Dick Simpson, a political-science professor at the University of Illinois at Chicago and a former Chicago alderman.

"Since Moody's already downgraded Chicago to junk-bond status, there's not really much to be lost," said Mr. Simpson. "Moody's doesn't have any votes."

The mayor truly believes Moody's has made a mistake here, said Bill Daley, who served as chief of staff to President Barack Obama like Mr. Emanuel and has deep ties in Chicago with both his father and brother serving as mayors. But the politics also are on the mayor's side, Mr. Daley added, since the rating firms don't have many supporters amid frustration over their opinions leading up to the financial crisis.

"I don't think there are a lot of defenders of the ratings agencies. There is not a big consituency out there," he said.

Moody's has been absent from several recent Chicago debt deals despite its status as a major firm. It wasn't hired for a $300 million issuance in April for the city's board of education plus bond offerings last year of $178.1 million with the Chicago Transit Authority and a group of bonds tied to the Chicago Park District.

"I think you're going to see that more and more," said Howard Cure, director of municipal research at Evercore Wealth Management in New York. '"Ratings shopping' is the word."

Ratings shopping is a term used when debt issuers, who pay firms such as S&P and Moody's to rate their bonds, choose the highest grades over lower ones.

Until recently, Laurence Msall, president of the Civic Federation, a Chicago-based fiscal watchdog group, said the relationship between the city and the rating firms drew little attention because Chicago had an investment-grade rating and dropping to junk status didn't seem possible. "It was almost inconceivable five years ago that the city of Chicago would drop to less than investment grade," Mr. Msall said.

There are practical reasons why Chicago would want to omit Moody's from certain offerings, industry analysts and bankers said.

First, Moody's generally charges debt issuers more to rate their municipal-bond deals. Chicago has paid Moody's $824,000 since January 2014, versus $605,000 to S&P and $77,000 for Fitch over the same time period, according to the city's vendor, contract and payment information database.

Cities also can look beyond the three major firms because of new rivals that emerged following the 2008 financial crisis and ignore raters that offer lower credit grades. Cities pay higher interest rates for lower-rated debt.

In recent years even lower-rated issuers have tended to sell bonds at historically low rates, said Matt Fabian, partner at Municipal Market Analytics. "So what incentive does any borrower have to use the lower one?" Mr. Fabian said.

THE WALL STREET JOURNAL

By TIMOTHY W. MARTIN and MARK PETERS

Updated May 21, 2015

Write to Timothy W. Martin at timothy.martin@wsj.com