
Chicago and Mayor Emanuel Face a $20 Billion Reckoning.

Chicago Mayor Rahm Emanuel sat on a stage at a community college gymnasium for nearly two hours as residents stepped up to the microphone to plead for more money for buses, schools and programs for the mentally ill.
The mayor jotted notes as the crowd erupted into angry chants and jeers. Then he explained there was little extra cash to be had. “We have a budget deficit and then pension payments,” Emanuel, a Democrat, said at the end of the meeting Monday at Malcolm X College. “We have changes we’re going to have to make.”

Chicago is facing a $426 million budget shortfall next year and needs to pay down a $20 billion debt to its workers’ retirement funds that’s left it with a lower credit rating than any big U.S. city except Detroit.

After its bond prices tumbled this year when investors demanded higher premiums to lend to the third-largest city, Emanuel is under growing pressure to stanch the fiscal bleeding by raising taxes, cutting spending and putting more into a pension system the city has shortchanged for years. He’s set to release a spending plan on Sept. 22.

“Chicago is really at a crucial point here,” said Ty Schoback, a senior analyst in Minneapolis at Columbia Threadneedle Investments, which manages about $30 billion in municipal bonds, including some Chicago debt. “It’s going to be within Chicago’s control to demonstrate to the market that they have the willingness to make the difficult but necessary fiscal decisions.”

While Chicago’s economy recovers, the population grows and its tax revenue rebounds from the toll of the recession, the city is facing a fiscal reckoning from years of failing to save enough to pay the benefits it promised employees. Over the past decade, Chicago has put $7.3 billion less into the pension funds than actuaries recommended, which is pushing up its bills. The city’s next annual pension payment is projected to jump to $976 million, an increase of 10 percent.

The mounting debt led Moody’s Investors Service to lower its rating on Chicago’s $8.1 billion of general obligations by two steps to Ba1 in May. Standard & Poor’s and Fitch Ratings followed by downgrading the city to BBB+, three levels above speculative grade.

The downgrades have caused the price of Chicago bonds to tumble. A portion of $58.5 million of taxable securities maturing in 2033 traded Tuesday at an average of 88.6 cents on the dollar, down from 99.7 cents on April 30.

That pushed the yield to 6.3 percent, 3.6 percentage points more than benchmark debt. That gap is up from 2.5 percentage points at the end of April.

When Chicago sold bonds in July, investors demanded yields of 5.67 percent on 20-year federally tax-exempt securities, about 2.5 percentage points more than benchmark municipal debt.

“Their big issue continues to be their long-term liability in the form of pension obligations,” said

Peter Hayes, the head of municipal bonds for New York-based BlackRock Inc., which oversees $116 billion of the securities. He said the firm isn't adding to its Chicago holdings. "How they build some of the elements of that into the budget is going to be very, very critical. If they truly address this liability from the revenue standpoint and that becomes credible, the bonds would have the ability at improve."

Chicago's effort to reduce its pension liabilities hit an obstacle in July, when a judge ruled the benefits cuts it sought to implement were illegal. The city will appeal the decision to the Illinois Supreme Court, which in May threw out a pension overhaul adopted by the state, saying workers' pensions are protected.

On top of next year's deficit, the city still hasn't come up with the $549 million it needs to put into its police and firefighter funds this year. While Illinois's Democrat-led legislature passed a plan to lower that payment to $328 million, Republican Governor Bruce Rauner has yet to sign it.

Emanuel, who took office in 2011, hasn't raised property, gas or sales taxes. During his reelection campaign this year, he said an increase to real-estate taxes, which generated $824 million last year, would be a last resort.

As the mayor entered the town hall meeting Monday, he was met with the chant "Rahm don't care" by those angered at neighborhood school closings. Over almost two hours, he listened as residents suggested boosting taxes on liquor, regulating ride-hailing companies such as Uber Technologies Inc., taxing trades at Chicago's options and commodities exchanges, and suing banks to recoup fees the city had to pay to back out of derivative trades after its credit rating was cut.

Wilhemenia Taylor, 58, who owns a home in the city, said she's concerned about what the budget will bring.
"I'm worried about cuts to the public school system, and higher taxes," Taylor, a teacher's assistant, said in an interview while sitting on red bleachers. "And the neighborhoods are going down."

Despite the difficulty, it's important for Chicago to demonstrate to investors and credit-rating companies that it's taking strides to meet long-term obligations that have been neglected for years, said Richard Ciccarone, Chicago-based chief executive officer of Merritt Research Services, which analyzes municipal finance.

"They've got to come up with a plan to show some willingness to pay," Ciccarone said. "We need to show the city's ability to tap that economic base that it has."

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