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Moody's Says State Withholding Harvey Money is "Credit Negative" for all Illinois Municipalities.

On p. 32 of its new Credit Outlook this week, Moody's notes last week's decision by the Illinois comptroller partially denying the City of Harvey's request for relief from revenue withholding under a state law requiring minimum pension contributions is the latest in a series of events involving Harvey that reinforce strong protections for pensions to the detriment of bondholders, and is thus credit negative for Illinois' local governments. The comptroller's response has important implications for other municipalities in the State of Illinois (rated Baa3/negative outlook) struggling to provide services and pay pensions because it clearly prioritizes underfunded pensions over municipal services.

Harvey is structurally insolvent, with an available fund balance of negative \$56 million, or negative 199% of revenue, as of the fiscal year that ended April 30, 2017. The city has already racked up numerous general obligation bond defaults, missing two debt service payments in fiscal 2016, six in fiscal 2017 and as of February had missed four in fiscal 2018. Harvey historically has underfunded actuarially determined contributions (ADCs) for its public safety pension plans, contributing very little to its firefighter pension fund from 2009-2013, and even its far higher 2017 contribution fell far below the ADC.

Local pension plans in Illinois can request that the state withhold revenue from a sponsoring municipality if that municipality does not make minimum contributions. Harvey's public safety pension funds have made such requests, and the state has withheld more than \$2 million to date. In protest, Harvey warned that it cannot afford to provide essential public services. The city asserts that it will soon be unable to meet payroll, and last month announced layoffs. The state comptroller's office has responded that it has no discretion under state law to consider Harvey's hardship.

Now facing solvency challenges, Harvey's pension funds have won legal judgments that mandate city funding. Following a host of judicial rulings and appeals over the state's revenue withholding, including at the Illinois Supreme Court, the state comptroller's office announced its intention to send \$2.3 million of withheld revenue to Harvey's police pension fund to begin satisfying that judgment.

We estimate that at least 25%, or roughly \$5.4 million, of the city's \$21.9 million of budgeted general fund revenue in fiscal 2017 was eligible for withholding under the comptroller's announced framework. Since the city's two pension judgments amount to nearly \$20 million, it will likely take several years of revenue withholding to retire the obligations unless a court intervenes, a settlement is reached or state law is changed.

Moody's declaration of "credit positive" or "credit negative" does not connote a rating or outlook change. It is indicative of the impact of a distinct event or development as one of many credit factors affecting the issuer.

Capitol Fax

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