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Chicago Turns to Scoop and Toss, Tax Hikes, and Job Cuts to Manage Coronavirus Wounds.

Chicago's fix for a record $1.2 billion 2021 budget shortfall and remaining 2020 COVID-19 pandemic tax wounds count on $948 million of relief through a $1.7 billion refinancing and restructuring of general obligation and Sales Tax Securitization Corporation debt.

Chicago Mayor Lori Lightfoot's proposed 2021 budget totals $12.76B when counting all funds, including a $4 billion corporate fund.

Heading into 2021, the city was still working to close an $800 million revenue hole caused by the pandemic's economic blows while the 2021 gap was estimated at $1.2 billion due to roughly $800 million of pandemic-related tax losses and $400 million of rising structural costs.

The $1.2 billion shortage is wiped out through a mix of structural measures like tax increases and efficiencies as well as non-recurring, one-shots like debt restructuring and furloughs. The city will take $501 million of debt savings and relief, bank $184.9 million of new revenue, and cut $537.2 million in costs through savings and efficiencies. It mostly leaves the city's healthy reserves alone.

The city attributes 35% of its 2021 hole to structural demands and 65% to COVID-19 blows with 47% of the measures tackling the $1.2 billion shortfall structural in nature.

"We believe that these structural reforms will set us up well to continue along our path toward structural balance, we which are targeting for 2023. And I hope you will agree and ultimately vote to support this budget," Lightfoot told the City Council in her budget address Wednesday.

Staying on course with the goal to structurally balance the city's books by 2023 will prove more difficult given a post-debt restructuring spike in 2022 of about $600 million in debt service and a $300 million price tag to cover an actuarial pension contribution for the municipal and laborers funds. Those factors are likely to weigh heavily in what rating agencies have to say on the proposed plan.

The city's general obligation credit is rated junk-level by Moody?s Investors Service, at Ba1, it's rated BBB-minus by Fitch Ratings, BBB-plus by S&P Global Ratings, and A by Kroll Bond Rating Service. S&P moved the outlook to negative in April over mounting pandemic pressures that make structural balance targets a tougher task. The others assign a stable outlook.

Chicago's GO paper is thinly traded but recent trades put spreads at about 325 basis points to the Municipal Market Data's top benchmark, said Daniel Berger, senior market strategist at MMD-Refinitiv.

"Ratings agencies have demonstrated unusual patience, due to the unusual circumstances" said Brian Battle, director of trading at Chicago-based Performance Trust Capital Partners, who added, at first glance the budget proposal and debt restructuring appears "reasonable as this voluntary quarantine is unprecedented."

Market participants will welcome that spending cuts and tax increases are part of the equation and may be willing to swallow the return to scoop-and-toss debt restructuring. “The mayor’s office is being responsible by talking about tax increases and spending cuts,” Battle said, adding that on debt restructuring the city “did it way before there were circumstances” like the pandemic.

Bigger questions loom large over the city’s post-pandemic fiscal picture. “The more salient question for the city is what is the long-term revenue and spending plan. What is the one, three, and five projections for revenue increases and spending cuts and how does the city attain fiscal stability,” he said.

The package now heads to the council with hearings beginning Monday and a vote expected next month. While Lightfoot labeled the tax hikes and layoffs modest, they may prove a hard sell for some council members who prefer other tax proposals, want police spending cut and more spending on human services, and may look skeptically at the debt refinancing.

“I think it is a fair division and reasonable approach to structural change during this pandemic with little federal help,” said Alderman Scott Waguespack, Lightfoot’s Finance Committee chair, who was a frequent critic of the former mayor’s budgets. “They have a balance in here where we cannot do all structural changes at once. We don’t want to hit personnel too hard, or raise property taxes too high but I believe rating agencies are looking for a good balance.”

The $537.2 million of savings and efficiencies include $106.3 million in personnel reductions from measures like five furlough days and the elimination of 1,900 positions, including 350 layoffs. The budget cuts about 600 police department positions, but Lightfoot said she has no plans to cut other police spending, especially given demands associated with reforms under a consent decree.

The city will sweep old accounts, moving $59 million to the corporate fund and will require Chicago Public Schools to reimburse it for $40 million of pension contributions for CPS employees who participate in the city’s pension funds and $54 million will come from improved rates in healthcare contracts.

The $184.9 million of new revenue comes from a $33.5 million increase in an expected tax-increment financing surplus declaration, a $30 million draw on city fund balances, new tax revenue, including a $93.9 million property tax hike, including $16 million for new property and a $42.5 million hike due loss of collections. The city lost litigation filed by the pension funds and now must make up the difference between what’s levied to cover pension contributions and what’s collected. Future annual property tax hikes will be tied to inflation, a shift from existing practices. The city will also raise $25 million from a hike on cloud computing and motor fuel taxes.

Council members have pressed the administration to dip deeply into reserves. The city’s fiscal chief Jennie Huang Bennett has pushed back, warning that preservation of the reserves that total $900 million between an unassigned fund balance, a cash reserve, and long term reserves are central to maintaining the city’s ratings and weathering a prolonged pandemic hit.

“To be clear, folks, we are not experiencing a rainy day. It is truly a rainy season, and we must continue to be prudent and cautious,” Lightfoot said.

The city will declare a $300 million TIF surplus, pocketing $76 million or $33.5 million more than previously anticipated. Chicago Public Schools receives half of any surplus and the city’s sister agencies and Cook County receive the remainder.

Pension appropriations rise to $1.815 billion in 2021 from $1.68 billion. The city is carrying $31.8

billion of net pension liabilities, and funded ratios for the funds are at 18% for firefighters, 21% for police, 24% for municipal, and 43% for laborers. The contributions shoot up in 2022 to $2.245 billion due to a roughly $300 million spike when the laborers and municipal fund payments move to an actuarial level and due to modest growth in contributions to police and firefighters which moved to an ARC this year.

Debt

A cornerstone of the 2021 package that will also cover half of the 2020 hole will come from a $1.7 billion debt refinancing and restructuring. If approved by the council, the city would issue the first piece of the refinancing in December, according to budget documents.

Lightfoot refinanced GO and other debt with $1.5 billion of borrowing under the GO and STSC credits in January generating a total of $300 million in savings that were mostly taken upfront. Bennett has stressed the upfront savings may mark a one-time maneuver but did not constitute scoop-and-toss, as maturities were not extended and savings were achieved in all maturities.

“Unlike the refinancing in 2020, the city will be increasing the debt service on the bonds in future years and extending the debt,” reads a city description of the proposed transaction. “Overall, the city will use the refinancing savings to help pay for the cost of the debt restructuring and overall the transaction will still generate positive savings on a net present value basis.”

The city says the debt will be layered into STSC debt structure to create a level debt service schedule that meets projected of sales tax collections, which are pledged to payoff the bonds. A chart included in the budget presentation shows a reduction in combined GO and STSC debt service to about $200 million in both 2020 and 2021 from existing levels of $600 million in 2020 and $700 million in 2021.

The expected $800 million of debt service owed in 2022 is held steady and continues with modest increases through 2029, holds mostly steady through 2032 with higher payments owed through 2047 with new debt piled on in 2048-2050.

The STSC bonds are sold through a bankruptcy-remote entity that garners higher ratings in the double-A to triple-A category, depending on whether they are senior or second lien.

Pushing off 2020 and 2021 debt service and extending debt will mark a return to the past fiscal tactic of scooping and tossing debt first used by former Mayor Richard M. Daley as he sought to hold the line on property taxes while financing infrastructure projects. Mayor Rahm Emanuel inherited the practice when he took office in 2011 and then phased it out in his second term.

Some market participants considered the city’s first issues under the STSC, which was established in 2017, as “scoop-and-toss lite” as the maturities of some general obligation bonds being refunded were pushed a few years out and interest was capitalized. The city’s last deal also capitalized interest.

By Yvette Shields

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