Moody's Lowers Chicago's Debt Rating to Junk Status

Moody's cut its rating on another $4 billion of Chicago's debt to just above junk status, for a total of $13 billion that was downgraded on Tuesday. This is approaching two times the city's total annual revenues, and fails to take into account the $550 million payment the city must make in December to keep the police and firemen's pension plan solvent. Nor does it take into account the $230 million penalty the city must pay for terminating previous "swap" agreements that allowed it to continue to borrow at competitive rates.

With this two-level drop, $2 billion in additional penalties may come due, according to Moody's: "[Our] current rating actions give the counterparties of these [swap] transactions the option to immediately demand up to $2.2 billion in accelerated principal and accrued interest [payments] and associated termination fees."

Doing the math is frightening. But Chicago's Budget Director Alex Holt seems unconcerned:

> There will be termination payments we'll need to make. But we were going to take out $200 million in variable rate debt anyway over the course of the year … we think the capital markets will continue to be available to us. We think investors still have confidence in the city.

Mayor Rahm Emanuel claimed the two-level drop by Moody's was unfair and irresponsible:

> While Chicago's financial crisis is very real and at our doorsteps, today's decision by Moody's to downgrade the city's credit by two steps goes far beyond … reality. Their decision was driven solely by the overturning of a state pension bill that did not include Chicago's pension reform [bill], yet they did not downgrade the State of Illinois.

The other two credit rating agencies, Standard & Poor's and Fitch, kept their ratings on Chicago's various debts at investment grade. Emanuel said Moody's refused "to acknowledge Chicago's growing economy, the progress we have made … balancing our budget without raising property taxes while adding to our reserves, securing pension reforms for two of the City's four [pension] funds … and the progress we are making … at the other two city funds."

Moody's was unimpressed with this "progress," noting that the decision by the Illinois State Supreme Court to toss the state's pension reform remedies limited Chicago's options at fixing their own:

> Based on [that decision], we believe the city's options for curbing growth in its own unfunded pension liabilities have narrowed considerably. [Even if the mayor's proposed plan to raise employee contributions by 29 percent] stands, we expect the costs of servicing Chicago's unfunded liabilities will grow, placing significant strain on the city's financial operations.

It gets worse. Moody's predicted that Chicago's four pension plans will shortly run out of money, at which time the city itself will likely have to pay retirees directly from its own treasury. Said Moody's,

> As the plans move toward insolvency, the city's credit standing will continue to deteriorate, given our view that the state may eventually implement legislation forcing Chicago to pay annuitants directly. [Those] annuitant payments would materially exceed current employer contribution levels. In our view, Chicago's ability and willingness to fund annuitant payments [directly], should they be required, is uncertain.

Moody's also provided a warning to anyone living in Chicago and paying taxes on either their income or their property: Rahm is coming your way. The agency warned, "Balanced against the city's many credit challenges are several [positive] attributes, the greatest of which is the city's broad legal authority to tap into its large and diverse tax bases [to obtain] increased revenue.

The Civic Federation, an independent and non-partisan research group, published a "plain-English" guide to understanding how the state of Illinois got itself into the same mess facing Chicago. In plain English, politicians refused to fund the liabilities they created when making promises to special-interest groups such as the unions. In the past 10 years the annual contributions to pay for those future promises never came close to the contributions actually needed. As the Federation explained: "To fund the pension plans at a level that would cover the normal cost and pay down the unfunded liabilities over 30 years, the employers [the state and municipalities like Chicago] would have needed to contribute an additional 29 percent of payroll, or $2.2 billion, in Fiscal Year 2013."

This is dreamland. With the perfect storm of unfunded pension plan liabilities, demands to keep the police and firemen's plan fully funded by the end of the year, the cost of terminating various "swaps," and the new costs triggered by Moody's downgrade of the bulk of Chicago's debt to junk status, there is simply no way that Mayor Emanuel is going to talk his way out of this. Annuitants will take substantial haircuts, taxpayers will be forced to ante up, and current employees will have to pay significantly more for benefits that may not even be there when they retire.

The mass exodus that began in 2014 is more than likely to continue as taxpayers get out of the Windy City ahead of the storm. This will hasten the moment when the mayor is finally forced to admit that his beloved city is just flat broke.

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