Written by Bob Adelmann on March 3, 2015

Moody's Downgrades Chicago Again

Within hours of Moody's Investors Service announcing another downgrade to Chicago's general obligation bonds last Friday, Mayor Rahm Emanuel's administration responded, saying that Moody's was out of touch with reality:

> We strongly disagree with Moody's decision to reduce the city's credit rating and would note that Moody's has been consistently and substantially out of step with the other rating agencies [Standard & Poor's and Fitch Ratings], ignoring progress that has been achieved.

At the moment those other two agencies rate Chicago's debt at A-plus or A-minus, with a negative outlook. But in light of an imminent court ruling that could invalidate efforts to cut pension benefits, along with the crushing and increasing burden of those benefits, observers are just waiting for the next two shoes to drop.

As Moody's noted, its downgrade will stand even if the court validates those pension modifications:

> [Our rating] incorporates expected growth in Chicago's already highly-elevated unfunded pension liabilities and continued growth in costs to service those liabilities, even if recent pension reforms proceed and are not overturned.

The downgrade impacts nearly $10 billion of debt the city has incurred over recent years just to stay solvent, including selling off future revenues from sales and gasoline taxes. One more downgrade, and "termination" events in those debts' contracts would be triggered, forcing the city immediately to repay those debts. With an annual budget of just $7 billion, it's clear that they would force the city into bankruptcy.

Illinois itself is in no better shape. At the moment the state is falling way behind in funding promises it has made over the years to its five pension plans: the Teachers' Retirement System, the State Employees Retirement System, the State Universities Retirement System, the Judicial Retirement System, and the General Assembly Retirement System. Altogether the plans owe $183 billion, but only have $72 billion in assets, a shortfall of $111 billion. Put another way, the five plans are *60-percent underfunded*.

Moody's downgraded Chicago by three notches back in July 2013 and another notch in March 2014. Things have gotten worse since then, according to Moody's analyst Rachel Cortez:

> The main thing is that another year has passed and gone by without a solution to the pension issues, both with respect to curbing the growth in the unfunded liabilities and dealing with police and fire pension [payment required by state law] that is getting closer and closer.

None of this pending disaster is being debated by the two big spenders running for mayor. The April 7 runoff between Mayor Emanuel and Chuy Garcia has been punctuated with offers to "investigate" the problem and to "cut waste and inefficiencies," while proposing additional spending on schools. In simple terms, the reality that Moody's sees has yet to be recognized by the candidates, one of whom will be faced with it after the election. In fact, Emanuel's 2015 budget completely ignored the tsunami, failing to offer spending cuts or higher taxes.

Precious little ink has been spilled over the appeal unions have brought against the state's efforts to cut, modestly, some pension benefits and increase contributions to those plans by present workers. On appeal, those unions have claimed that, under the Illinois state constitution, a promise made is one that must be kept, even if there isn't money to fund it. They hold that membership in a public pension plan is "an enforceable contractual relationship, the benefits of which shall not be diminished or impaired." Observers claim that the court is likely to throw out the state's attempt, modest though it may be, to bring sanity back into the conversation. In an earlier case, the Illinois Supreme Court ruled that promised benefits are "absolute" because the clause in the state's constitution is "aimed at protecting the right to receive the promised retirement benefits [and] not the adequacy of the funding to pay for them."

Chicago's corporate counsel, Stephen Patton, prepared a friend-of-the-court brief for the appeal, explaining in candid terms exactly what the city would be faced with if the court enforced the sacrosanct constitutional rule:

> The city will suffer further [bond rating] downgrades that could materially increase the cost of borrowing money essential to funding [the city's] basic operations. And it could make the city immediately liable to pay hundreds of millions of dollars as a result of default and early termination of debt-related obligations.

Patton called such a ruling a "suicide pact" that would doom the city:

> Under the Circuit Court's approach [the one being appealed], pension benefits must be paid, no matter how catastrophic the result for current or future retirees, employees who would [have to] be terminated for lack of funds to pay them, or municipal residents who would not receive adequate levels of basic services….
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> This turns the pension [promises] into a suicide pact.

Reality is finally settling in at the Windy City. It's too bad that the mayoral candidates have so far successfully avoided any serious discussion about it.

A graduate of an Ivy League school and a former investment advisor, Bob is a regular contributor to The New American *magazine and blogs frequently at www.LightFromTheRight.com, primarily on economics and politics.*