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Summary:

Chicago; General Obligation; Joint Criteria

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Summary:

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Credit Profile		
US$127.0 mil GO bnds taxable rfdg ser 2014D due 01/01/2044		
Long Term Rating	A+/Negative	New
US$109.0 mil GO bnds project ser 2014A due 01/01/2039		
Long Term Rating	A+/Negative	New
US$108.0 mil GO bnds rfdg ser 2014B due 01/01/2033		
Long Term Rating	A+/Negative	New
US$44.0 mil GO bnds taxable proj ser 2014C due 01/01/2044		
Long Term Rating	A+/Negative	New
Chicago GO		
Long Term Rating	A+/Negative	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'A+' rating to Chicago's series 2014A, 2014B, 2014C, and 2014D general obligation (GO) bonds and affirmed its 'A+' rating on Chicago's (GO) bonds outstanding under our local GO criteria, released Sept. 12, 2013. The negative outlook reflects our view of the risks involved in how the city will address its upcoming, large pension payments.

A pledge of the city's full faith credit and resources, as well as ad valorem property taxes without limitation as to rate or amount, secures its GO bonds.

The rating reflects our assessment of the following factors for the city, specifically its:

- Strong, broad, and diverse economy given its status as a major regional economic center;
- Adequate budgetary flexibility, which indicates that, although the city has home rule status, which provides increased taxing and borrowing capacity, its flexibility is limited by the city's historical reluctance to adjust property taxes;
- Very weak budgetary performance, reflecting recent deficits and reliance on reserves to balance operations and an outlook of continued budget challenges; however, we note that the city has no plans to utilize its long-term reserves in the service concession reserve fund;
- Very strong liquidity providing very strong cash levels to cover both debt service and expenditures;
- Strong management conditions with good financial practices and policies in place;
- Very weak debt and contingent liabilities position, driven mostly by the city's high net direct debt; and
- Weak Institutional Framework score.

Strong economy

We consider Chicago's economy to be strong, broad, and diverse, with employment opportunities spanning all the major industries. Furthermore, the city is home to the headquarters of several large corporations, has a large tourism

base, and is a transportation hub. Cook County's unemployment rate historically tracks higher than the state and peaked at 10.8% in 2010, but has since fallen to 9.3% in 2012. Chicago's per capita effective buying income (EBI) was 96% of the national average in 2012, which we consider adequate. The city's per capita EBI as a percent of the U.S. is projected to remain the same, at 96% by 2017. Per capita market value for the city was adequate at $82,088 in fiscal 2013. Equalized assessed value peaked at $84.7 billion in levy year 2009, and has fallen since then to $65 billion for levy year 2012, reflecting a decline in city home prices and the impact of a recent revaluation. However, the trend in equalized assessed value does not affect the city's year-over-year property tax revenues since the city extends taxes based on amount, rather than on rate.

Adequate budget flexibility

In our opinion, the city's budgetary flexibility is helped by its reserves in the service concessions and reserve funds. At the close of fiscal 2012 (Dec. 31), the general fund unassigned balance was thin at $33.4 million, or 1.1% of expenditures. With respect to revenues, fiscal 2013 ended on a positive note due to an estimated $75 million positive revenue variance although we expect the overall total general fund balance will likely decline due to the planned use of the $177 million assigned fund balance. The fiscal 2014 general fund budget calls for a $53.4 million use of reserves, reflecting the appropriation of $30 million of the unassigned fiscal 2012 general fund balance and $20 million of 2013 positive revenue budget variance. The long-term Skyway and parking meter reserves stood at $624.8 million, or 20% of expenditures. The city has adopted ordinances that discourage spending down the reserves in the service concessions and reserve funds, indicating to us that those reserves, specifically, will not be drawn down going forward. The city budgeted to add $15 million to the service concession and reserve funds in budget year 2013 and $5 million in 2014; this would follow $20 million deposited during fiscal 2012.

Although the city has taxing flexibility owing to its home-rule status, it has not historically availed itself of that flexibility. Hindering budget flexibility is a political unwillingness historically to raise property taxes to meet budgetary challenges, particularly with respect to looming pension payment increases. In our view, the city also has a limited capacity to cut spending given that nearly two-thirds of 2012 general fund expenses were in the area of public safety.

Very weak budgetary performance

The city's budgetary performance, in our view, has been very weak overall for the past four fiscal years and it continues to faces significant challenges. In fiscal years 2009 through 2011, the general fund ended with surpluses but relied heavily on one-shot budget balancing maneuvers, including large transfers in from the service concession reserve fund. The service concession reserve fund had been pumped up with cash from the sale of leased assets, including the Skyway and parking meters. The service concession reserve fund now holds $625 million, and city ordinances only allow interest generated in the fund to be transferred out. In fiscal 2012, the city balanced its budget with minimal transfers in from other funds but ended the year with a $101 million general fund shortfall. The city's $2.9 billion of general fund revenue consists of a diverse array of revenues, the largest being sales taxes ($572 million, or 20%). Although the general fund revenue stream is diverse, expenditures are strongly concentrated in public safety, which accounted for 63% of expenses in 2012. The city is taking steps to manage these costs, and year-over-year they rose only 1.3% in 2012. In 2013, the city budgeted to use its $177 million assigned general fund balance, which represents carryover of unbudgeted revenue growth from fiscal 2012. Fiscal 2013 positive budget variances in property, sales, and income taxes contributed to actual but unaudited overall revenues exceeding budgeted revenues

by $75 million (about 2.5% of the budget). Fiscal 2013 actual expenditures were on track with the $3 billion budget. The $3.2 billion 2014 budget was balanced with the use of $53 million of general fund reserves. The budget increases 4% year-over-year, assumes tax revenue growth, and relies upon $97.1 million in nonrecurring revenue sources. The economic recovery suggests that revenues could improve in the near term. However, the city faces significant challenges with respect to managing its costs, most notably with respect to its pensions. Should the city fail to obtain state legislative relief to phase in the contributions or to reduce the liabilities, it will face more than a $600 million increase in annual pension contributions to its police and fire plans in fiscal 2016. However, decisions about how to fund the increased contributions must be made in late calendar 2014 if the revenues are to be realized in time to make the payments in 2016. At this time, the city's position is that it will continue to seek legislative support and labor concessions. Even if the city is able to smooth out the contributions, the increased costs will likely be an impediment to significant future budget surpluses.

Very strong liquidity

Supporting the city's finances is liquidity we consider to be very strong, with total government available cash of more than 100% of debt service. We believe the city has exceptional access to external liquidity. The city has issued bonds frequently during the past 15 years, including GO bonds, enterprise fund revenue bonds, and sales tax bonds.

Strong management

We view the city's management conditions as strong, supported by "good" financial management practices under our financial management assessment (FMA). The city produces long-term financial and capital plans, which officials update annually. The city has a formal debt management policy and has adopted ordinances that limit the use of nongeneral fund reserves for budget-balancing purposes.

Very weak debt and contingent liability profile

In our opinion, the city's debt and contingent liabilities profile is very weak, with pension funding levels and upcoming pension payments posing a significant challenge. The city has a combination of fixed-rate and variable-rate debt, and swaps are utilized to hedge risk. We do not view the city's debt portfolio as being vulnerable to interest rate risk or speculative contingent liabilities. Direct debt is manageable in our view, with total governmental fund debt service at 13% of total governmental fund expenditures in 2012. The city has a roughly $3 billion, five-year bond program, most of it focused on water and sewer projects. We do not expect debt issuance within the next two years to lead to significant increases in the GO debt burden. The city has used bonds to improve and modernize its infrastructure.

The city's debt profile is challenged by its pension obligations. The city contributes to four different pension plans. The city's budgets include pension payments for the four defined benefit plans that fully meet the statutorily required amounts. However, current state statutes in effect base contributions on a multiple of payroll and do not address unfunded liabilities. The budgeted pension payment amount for 2013 is $479.5 million, based on the statutory formula. This stops short of the $1.47 billion actuarially required contribution (ARC) determined in the Dec. 31, 2012 actuarial report. If it was included in the 2013 corporate fund budget, the ARC payment of $1.5 billion would represent roughly 35% of the corporate fund budget, an amount we consider very high.

The overall unfunded liability of the four plans is $19.5 billion as of 2012, up from $11.9 billion in 2009, and the plans altogether are 35% funded. Funding levels for each of the plans are as follows:

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- The municipal employees plan: 38% funded, with an $8.4 billion unfunded liability;
- The laborers' plan: 56% funded, with a $1.02 billion unfunded liability;
- The police officers' plan: 31% funded, with a $6.9 billion unfunded liability; and
- The fire fighters' plan: 25% funded, with a $3.03 billion unfunded liability.

Legislation was enacted by the state in 2010 to reduce benefits in the four defined-benefit pension plans, which in the long-term could ease budgetary pressure. However, the city's budget faces the more immediate pressure from legislation that changed the statutory formula guiding the police and fire pension contributions, bringing those more in line with an actuarial funding methodology and a 90% funding goal by 2040. The effect of the legislation causes contributions to rise from the current $480 million to roughly $1.1 billion in 2016. We feel the legislation has positive implications for the future health of the police and fire plans, but in the meantime it has the potential to become a source of budget stress given that the city has indicated an unwillingness to rely on property tax increases to fund this cost. The city's home rule status provides the city with the ability to raise virtually any tax without voter approval, but if the city is to go this route, it will have to make a decision to adopt a tax increase in enough time to then set the rate and begin collecting the revenue for the 2016 payment. If the city were to raise its property tax rate to fund the pension payments, it would have to set the rate by the end of calendar 2014 in order for the tax to be on the fall 2015 tax bills. A sales tax increase would need a similar implementation date in order to ensure timely collections. These examples serve to illustrate that the pension payment in 2016 is a more immediate priority than the payment date suggests. The statutory formula guiding the city's other two pension systems -- municipal employees and laborers -- has not changed, and those contributions are based on a multiple of payroll. So while those contributions are not expected to materially increase in the future, and thus are not a source of budget stress, the city does estimate that the assets in those plans could be depleted at some point after 2020.

Thus, in our opinion, the status of the city's pension plans has significant rating implications both from a near-term and long-term perspective. In our view, the city's lack of progress in making structural changes in pension funding is a negative credit factor.

The city is currently party to an other postemployment benefit (OPEB) settlement agreement that capped its liability until the agreement expired June 30, 2013. The city has obligated itself to provide OPEB benefits through the end of its fiscal year, Dec. 31, 2013. As of Jan. 1, 2014, the city continues to contribute 55% of the cost to eligible employees who retired prior to Aug. 23, 1989. For all other employees, the plan will be phased out entirely by Jan. 1, 2017, when the Patient Protection and Affordable Care Act will take its place. Under the current plan, the city's OPEB benefits extend to police, municipal, fire, and laborer's pension fund retirees and eligible dependents. The city's net OPEB expenses under the plan were $97.5 million in 2012. The city reported a $415.8 million unfunded actuarial accrued liability (UAAL) on its police, municipal, fire, and laborer's plans as of the Dec. 31, 2012 valuation. The UAAL on other city employees not covered under the aforementioned plans was $471 million as of the most recent valuation (Dec. 31, 2011).

Weak institutional framework

The institutional framework score for Chicago is weak, reflecting the lack of rigorous statutory requirements for financial reporting and a large unfunded mandate with respect to pension contributions. See the Institutional Framework score for Illinois.

Outlook

The negative outlook reflects our view of the city's upcoming spike in pension costs, which could potentially become a source of budget stress. We could lower the rating by the end of 2015 if the city substantially draws down its reserves in an effort to increase its pension payments in line with state mandates, regardless of whatever relief the state legislature may provide. In order for us to affirm the rating and return the outlook to stable, we would need to see the city successfully absorb its higher pension costs while maintaining balanced budgetary performance and reserves at or near their current level.

Related Criteria And Research

Related Criteria

USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Institutional Framework Overview: Illinois Local Governments

Ratings Detail (As Of February 24, 2014)		
Chicago GO bnds proj		
Long Term Rating	A+/Negative	Affirmed
Chicago GO bnds var rate demand bnds rfdg ser 2007G		
Long Term Rating	AAA/A-1	Affirmed
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Chicago GO pre-rfd ser 2007C (wrap of insured) (MBIA & National) (AGM) (SEC MKT)		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Chicago GO variable rate dem bnds rfdg ser 2007F		
Long Term Rating	AAA/A-1	Affirmed
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Chicago GO VRDBs (Neighborhoods Alive 21 Prog) ser 2002B- 5		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Chicago GO VRDBs (Neighborhoods Alive 21 Prog) ser 2002B-3		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Chicago GO VRDBs (Neighborhoods Alive 21 Prog) ser 2002 B-4		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Chicago GO VRDO ser 2005D-1		
Long Term Rating	AAA/A-1	Affirmed
Unenhanced Rating	A+(SPUR)/Negative	Affirmed

Ratings Detail (As Of February 24, 2014) (cont.)		
Chicago GO VRDO ser 2005D-2		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Chicago GO (wrap of insured) (AMBAC & AGM)		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Chicago GO (wrap of insured) (AMBAC & AGM) (SEC MKT)		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Chicago GO (wrap of insured) (AMBAC & BHAC) (SEC MKT)		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Chicago GO (wrap of insured) (FGIC & BHAC) (SEC MKT)		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Chicago GO (AGM)		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Chicago GO (AGM) (SEC MKT)		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Chicago GO (ASSURED GTY)		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Chicago GO (BAM)		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Chicago GO (FGIC)		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Chicago GO (FGIC) (MBIA) (National)		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Chicago GO (MBIA) (National)		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Chicago GO		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Chicago GO VRDB ser 2003B-1		
Long Term Rating	A+/A-1/Negative	Affirmed
Chicago GO VRDB ser 2007EFG		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed
Long Term Rating	AAA/A-1	Affirmed
Chicago GO (CIFG)		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed

Many issues are enhanced by bond insurance.

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