Stressed Muni Credits: Illinois, Chicago, and Puerto Rico
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Some high profile Municipal credits continued to grab headlines throughout the year as low-funded pension levels and Puerto Rico's fiscal and economic woes were heightened. Below we offer commentary on some of the credits that received much of the media attention in 2015.

Illinois & Chicago Under Pressure

- The State of Illinois, who has the lowest funded pension system in the country, as well as political gridlock, and lacks a 2016 budget six months into the fiscal year, suffered one notch downgrades from both Moody's and Fitch in the fourth quarter.
- A 2011 tax increase was allowed to expire at the start of 2015, reducing tax revenues, while fixed expenditures are growing and day-to-day liquidity and spending priorities are managed due to the lack of a budget.
- Pension contributions are considered flexible and a November payment into the system was not made due to liquidity pressures, further exacerbating the pension issue.
- Unpaid bills accumulate as cash flow management and the need to maintain liquidity remains paramount.
- Chicago, its largest city, has fared even worse than the state throughout 2015, as low pension funding levels, large operating deficits, lack of political will, and limited flexibility overhang the City and its related credits.
- The City, and the Chicago School District in particular, suffered multi-notch downgrades with Moody's leading the way with a much harsher stance, finally dropping them into the junk category.
- Illinois has been penalized in the market all year with widening credit spreads due to their fiscal, pension, and political situation.
- Chicago experienced a much more significant market penalty because of the greater rating deterioration and the move into junk. The city and some of its related credits now trade at distressed levels.

Puerto Rico's Struggles Continue

- Puerto Rico captured the majority of the credit headlines this year as the island continued to suffer from economic and demographic deterioration, as well as revenue and liquidity erosion.
- The Governor announced the islands inability to pay the $70 billion in aggregate debt that the Commonwealth and its public corporations have accumulated.
- Representatives from the Commonwealth have been petitioning the federal government to allow restructuring under Chapter 9 of the US bankruptcy code, while there has also been discussion of a federal oversight agency to step in and manage the islands finances.
- What is clear is that economic conditions continue to erode, with limited job opportunities, high unemployment, no known economic driver and dependence on a large government sector.
- While the island has defaulted on a small amount of its debt payments, the defaults have been limited to public corporations where revenue streams are not tightly secured. The Commonwealth has diverted certain revenues dedicated to other bonds, which has allowed continued payment of the islands General Obligation debt.
- At this time it is uncertain to know what the outcomes ultimately hold for bondholders, although trading levels are clear that an impairment in recovery of principal is inevitable for most, if not all, bondholders.
- We continue to not see a broad based, wide market reaction to the events unfolding in Puerto Rico at this time.

Appleton does not currently buy or own State of Illinois GO, Chicago GO, or Puerto Rico bonds. We will continue to monitor any credit developments and watch for potential investing opportunities should conditions warrant.

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