

THE WALL STREET JOURNAL.

SANCTUARY CITIES MAY NOT SEE BORROWING HIT FROM TRUMP ORDER

Threat to cut municipalities' federal funds won't hurt their credit in short term, say bond-market analysts

By Jon Kamp, Scott Calvert and Aaron Kuriloff
February 15, 2017

The municipal-bond market has an early read on President Donald Trump's executive order threatening sanctuary cities: more bark than bite.

The Jan. 25 order's threat to cut federal funds to cities and counties that decline to cooperate with federal authorities enforcing policies on illegal immigrants is unlikely to hurt the municipalities' credit, at least in the short term, according to credit-ratings firms, analysts and investors.

Two such cities – New York and Philadelphia – are out selling more than \$1 billion of bonds but only made brief references to the order in marketing documents.

Officials from cities like Philadelphia and Los Angeles are still trying to figure out how much of their budgets could be on the line. The order directs the Office of Management and Budget to provide details on the federal grant money cities receive, but the White House hasn't yet identified the funds it can shut off.

Matt Szabo, deputy mayor of budget and innovation in Los Angeles, called the presidential order "sufficiently vague," but said he is operating under the assumption the city's roughly \$500 million in federal grant money could be at risk. Excluding the city's utility department, airport and seaport, which control their own operating budgets, the city's current budget is about \$8.7 billion.

"Any reduction in funding would result in a real cut in service," he said, noting that federal grants help pay for things like housing and economic-development programs administered by hundreds of city workers.

Most federal dollars that go to cities are based on statutory grants that follow a formula and can only be stopped if the funds aren't being spent on the intended purpose, said Linda Bilmes, a senior lecturer in public policy at Harvard University's Kennedy School of government. For example, ignoring federal immigration policy wouldn't justify halting a Head Start grant for early childhood education, said Ms. Bilmes, who has held senior roles in the U.S. Department of Commerce under President Bill Clinton.

Ratings firms said they don't see a major threat in the near future to municipal borrowers' ability to repay their debts.

According to Standard & Poor's, the executive order most likely will jeopardize grants from the Department of Homeland Security and Justice Department that account for less than 1% of municipal budgets that S&P had analyzed.

Grants from all federal agencies and departments comprise 10% of the average municipal budgets in sanctuary jurisdictions, but reach as high as 41%, said the ratings firm, which didn't name the specific cities. S&P said the executive branch has limited power to withhold or defer funds appropriated by Congress.

"The muni market's view on this is it's not good, but it's not necessarily a credit risk," said Guy Davidson, director of municipal investments at AllianceBernstein Holding LP. Lower credit ratings could lead to higher borrowing costs.

Some credit analysts raised concerns the White House order will open gaps in city and county budgets.

Howard Cure, director of municipal-bond research at Evercore Wealth Management, said cutting off federal money flowing to New York City programs such as housing or health care, for example, could pressure finances. "The city would either have to back down on this or find other money, and if they don't, it would put a real strain on their budget," he said.

On Jan. 26, Miami-Dade County Mayor Carlos Gimenez directed jails to comply with federal requests to detain immigrants. The county estimated it will receive \$355 million in federal funding in the current fiscal year, including support for affordable housing, transit and battling beach erosion. Some immigration advocacy groups, including the American Civil Liberties Union of Florida, disagreed with the county's analysis of the order and don't believe its prior jail policy put the county at risk.

A Miami-Dade spokesman said, "Faced with the possibility of losing hundreds of millions of dollars in federal funding, much of which is discretionary, the mayor made the responsible decision to protect county government."

Philadelphia City Council President Darrell Clarke said the city should take Mr. Trump's threat seriously, even though he said he believes the order is unconstitutional.

"If there is still room for reasonable compromise with the federal government that preserves our ability to protect residents, including undocumented immigrants, and preserves critical funding for local policing and programs that help low-income people, then that to me is worth exploring," Mr. Clarke said this month.

In its recent bond offering, New York City indicated it sees modest risks saying it believes reductions to federal funding are legally limited and that such grants "comprise a small percentage of the city's total budget."

The city also said it believes most or all of those federal grants would qualify for the exemption in the executive order that said funds "deemed necessary for law enforcement purposes" wouldn't be cut. The city added that there is no guarantee the order won't cause

a “significant reduction or delay” in receiving the grant funds, but said it would mount “a vigorous legal challenge” if that happened.

Los Angeles also will head to court if necessary, and the city is “confident that the Constitution and courts will be on our side,” a spokesman said.

At least four jurisdictions, including San Francisco, have filed lawsuits alleging the order is unconstitutional. Legal experts say prior Supreme Court rulings could limit the executive order’s reach.