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Sanctuary Cities Order Foreshadows Turbulence for City Credits

By Bond Buyer Staff

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Cities, counties and states are gearing up for a costly battle over billions of dollars in federal funding after President Trump threatened to halt support for those that defy his ban on so-called "sanctuary cities."

While municipal market observers don't expect the executive order itself to have significant credit impacts for the many large cities Trump targeted, it is expected to foreshadow more long-term turbulence for urban-federal relations.

"The new administration's other policy decisions could have a more meaningful impact on local government finances," Fitch Ratings wrote in a commentary Monday.

"Sanctuary jurisdictions across the United States willfully violate Federal law in an attempt to shield aliens from removal from the United States," Trump's Jan. 25 [directive says](#). "These jurisdictions have caused immeasurable harm to the American people and to the very fabric of our Republic."

The term "sanctuary city" has no precise legal meaning. It is generally understood to mean any local government that does not require police to or forbids police from inquiring about a person's immigration status in the course of their duties.

Such cities do not want to bear the cost of holding inmates for federal immigration investigations and/or believe that it discourages residents from reporting crime. Some think the practice weakens a sense of community.

The directive empowers the U.S. Attorney General and the Secretary of Homeland Security to withhold federal funding "except as deemed necessary for law enforcement purposes" to jurisdictions that do not allow local law officers to enforce federal immigration law.

"We are taking the approach it is more headline risk than actual credit risk," said Tom Schuette, partner and co-head of portfolio management at Gurtin Fixed Income Management. "We believe that ultimately through litigation such as the lawsuit just filed by San Francisco there won't be material dollar amount impacts to the sanctuary cities."

In that [Jan. 31 lawsuit](#), the first to challenge the directive, San Francisco called the order a "severe invasion" of the city's sovereignty.

"San Francisco faces the imminent loss of federal funds and impending action if it does not capitulate to the president's demand that it help enforce federal immigration law," the city said in the complaint filed in San Francisco U.S. District Court. "The Executive Branch may not commandeer state and local officials to enforce federal law."

The more than \$1.2 billion in federal funds San Francisco receives annually accounts for 13% of the city's budget, city officials say. Trump's threat prevents the city from approving a budget for the new fiscal year, according to the lawsuit.

A San Francisco municipal bond attorney who asked not to be named does not expect the litigation to interfere with the city's ability to issue bonds. However, the litigation would need to be included in disclosure, the attorney said.

The lawsuit could impact the city if it wanted to finance an infrastructure improvement through its general fund because of the hit to federal funding, according to the attorney.

Investors don't like uncertainty, the attorney noted, and there is some uncertainty in the executive order about what funds exactly would be withheld, which he said is always bad for investors or people looking at the credit quality of the city.

According to the Urban Institute, Trump's sanctuary order could affect as many as 500 counties, 40 cities and seven states.

A Reuters analysis of federal grants found that the 10 largest U.S. cities could lose \$2.27 billion in annual funds if Trump's directive were carried out. That does not include law enforcement grants excluded by the directive.

While S&P Global Ratings analysts do not expect any immediate credit impact from the directive, "enforcement of the executive order by the federal government could result in legal, law enforcement, and criminal justice costs that could impact the financial position of sanctuary jurisdictions. At this stage, the size of such costs and other expenses is unknown."

Among the largest cities considered "sanctuary cities" are New York, Los Angeles, Chicago, Philadelphia, Boston, Denver, Washington and Seattle. Most of those cities have taken a defiant response to Trump's action.

"We're going to stay a sanctuary city," said Chicago Mayor Rahm Emanuel, whose city received about \$1.5 billion of federal grant money last year. "We are not going to stop being a welcoming city." To reinforce the point, the Chicago City Council reaffirmed its status shortly before Trump signed the order.

New York Mayor Bill De Blasio, whose city receives about \$7 billion in federal funding – more than 8% of its \$84 billion budget -- and must guarantee security for Trump Tower on Fifth Avenue, questioned the logic of cutting funds in the name of fighting terrorism.

"We are going to fight this, and cities and states around the country are going to fight this," said De Blasio, who called the directive "vague" and "illogical."

"I will use all of my power within lawful means to protect all Boston residents," said Mayor Marty Walsh. "Even if that means using City Hall as a last resort."

"If being a sanctuary city means that we value taking care of one another, and welcoming refugees and immigrants, then I welcome the title," said Denver Mayor Michael Hancock, who previously denied the title. The Mile High City received \$175 million in federal money in 2015.

Los Angeles Mayor Eric Garcetti said his city, which Homeland Security identified as the second most vulnerable to terrorist activity, regularly cooperates with federal law enforcement.

"What we don't do is ask local police officers to enforce federal immigration laws," he said. "And that's an official LAPD policy that's been enforced for nearly 40 years."

Cities such as Los Angeles and San Francisco that enjoy support from state government may fare better than those in more confrontational relationships with their state capitols, according to Adam Stern, an attorney and municipal bond analyst with Breckinridge Capital Advisors in Boston.

While California's Democratic Gov. Jerry Brown is defending local governments that refuse to use local police as immigration enforcement, Texas' Republican Gov. Greg Abbott is playing tag-team with Trump in threatening the Lone Star State's Democratic-controlled cities and counties, including those on the border.

"Unlike the federal government, states have broad authority to cut aid to local governments that choose not to cooperate with federal immigration officials," Stern wrote in a commentary Tuesday.

Beyond the funding threat, Stern said, cities will face a weekly "shaming" under Trump's Jan. 25 directive that calls for a public listing of crimes by undocumented immigrants. In his campaign for president, Trump made listing the victims of undocumented immigrants a major feature.

The 2015 slaying of 32-year-old Kate Steinle on a San Francisco pier by a repeat felon deported five times to Mexico became Trump's starkest and most often cited example of a threat from undocumented immigrants.

While Trump's posture on sanctuary cities will likely have "only a modest impact" on such cities' near-term credit fundamentals because of the "legally problematic" status of curtailing such federal grant support, Stern wrote, a shaming policy contains more worrisome long-term implications for sanctuary communities.

The more intense the shaming, the greater the damage, Stern said.

"Over the long term, shaming sanctuary cities may prove to be a larger credit issue than merely withholding federal aid," Stern said. "Shaming could upset state and local relationships, inhibit social cohesion and reduce economic vitality in certain communities."

That kind of hostility is bad for municipal credit, Stern said.

"A growing body of research positively correlates social trust with economic growth," Stern said. "We believe that prolonged shaming of sanctuary cities may diminish credit quality over time."

San Francisco's suit came as a California Assembly committee advanced a bill to prohibit state and local law enforcement from cooperating with federal immigration authorities.

If targeted by Trump, the big cities of Texas cannot count on a friendly legislature or governor to back them up.

In Austin, [Abbott cut off](#) funding to Travis County, the county of 1.1 million with its seat in Austin, after newly elected Sheriff Sally Hernandez affirmed her sanctuary policy on federal detainees

A group of Texas lawmakers known as the Texas Conservative Coalition are seeking to pass a law that imposes criminal penalties on public officials defending people who came here illegally.

Under Trump's directive, the federal government is the only authority on what constitutes a "sanctuary city." Cities that do not claim the status could still be found in violation.

Last year, the Department of Justice [identified Miami-Dade County](#) as a sanctuary jurisdiction based on a 2013 resolution passed by county commissioners.

The 2013 resolution allowed the county's corrections department to honor Immigration and Customs Enforcement detainee requests only if the county is reimbursed for all costs, and the detainee either was previously convicted of a forcible felony or was charged with a non-bondable offense.

Miami-Dade County received \$10.77 million of grants from federal programs between fiscal 2015 and March 17, 2016 that may violate the federal law requiring local governments to cooperate with ICE, according to the DOJ report.

The grants would have been about 15% of the county's \$7.15 billion fiscal 2017 total budget, for which 68% goes to the general fund. The county provides services to 2.7 million residents who live in unincorporated areas.

The day after Trump signed the executive order threatening to pull federal funds from sanctuary jurisdictions, Miami-Dade Mayor Carlos Gimenez reversed the 2013 resolution and ordered the county's corrections department to "honor all immigration detainer requests."

Gimenez, a Republican, wrote that Florida's largest county "complies with federal law and intends to fully cooperate with the federal government,"

"Miami-Dade Mayor drops sanctuary policy. Right decision. Strong!" [Trump tweeted](#) in response.

The new policy drew large protests to county offices, and questions from one commissioner who wanted to know how it would affect individuals detained on the basis of immigration status alone.

The county's previous policy had worked effectively "to reduce fears in the immigrant community about the possibility of unwarranted detention, and has contributed to more positive policy-community relations than that experienced in some other jurisdictions," Commissioner Daniella Levine Cava wrote in a letter to Gimenez Jan. 30.

Cava requested that the County Commission receive a briefing on the matter, and that the mayor consider joining pending lawsuits challenging the president's executive order.

Fitch Ratings analyst Amy Laskey agrees that Trump's directive is not likely to hold up in court but that even if it does, the credit impact will be negligible.

"Even if a jurisdiction's status as a 'sanctuary city' were clear, the amount and method of implementation of proposed federal cuts is not," she wrote Monday.

Of greater concern for local finances are Trump's plans to end the Affordable Care Act, turn Medicaid into a block grant and curtail funding for social programs, Laskey wrote.

"The impact on state and local governments of tax and fiscal policy changes is difficult to predict at this point," she wrote.

Trump's anti-immigrant agenda is likely to spur more turbulence, and several states have joined the legal actions challenging Trump's order barring travel from seven predominantly Muslim Middle Eastern countries, an action that brought hordes of protesters to major airports the last weekend in January.

For the big cities, many still in recovery mode from the last recession and staggered by pension accounting rules that have brought numerous credit downgrades, the threatened loss of federal funding was not a hopeful sign.

In Ohio, Cincinnati Mayor John Cranley announced Monday he won't support the deportation of undocumented residents and officially declared the city a sanctuary. That prompted Ohio Treasurer Josh Mandel to travel to Cincinnati to condemn Cranley's statement.

At a victory celebration for Trump in Cincinnati on Dec. 1, Mandel vowed: "Over my dead body will Cincinnati or Columbus or Cleveland or any of these become sanctuary cities."

This story is based on reporting by Keeley Webster, Kyle Glazier, Yvette Shields, Nora Colomer, Paul Burton, Andrew Coen, Shelly Sigo, and Richard Williamson, and was written by Williamson.



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