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Chicago Credits Outreach for Strong Showing on GO Issue.

CHICAGO – Chicago drew dozens of new investors to a general obligation bond sale this week that was more than doubled after it sized up the market's demand.

That strong demand pared the expected interest rate penalty Chicago faced on its $880 million GO sale, but it still paid a steep price for its blemished credit.

Wednesday's pricing marked the city's first GO outing since two, rare, triple-notch downgrades last year. Moody's Investors Service stung the city anew last week when it dropped the GO rating one more level to Baa1 citing the city's pension funding strains. Fitch Ratings rates Chicago GOs A-minus and Standard & Poor's rates them A-plus. All three assign a negative outlook.

Buoyed by strong early indications from investors who have faced a paltry muni primary all year, the city bolstered its sale from an original $400 million to $655 million last week and then $790 million earlier this week. Wells Fargo Securities ran the books.

In addition to strong investor interest, the belief that rates are headed up amid positive economic news and concerns that world events could fuel a flight to quality contributed to the city's sizing decisions in recent days, Chicago Chief Financial Officer Lois Scott said Thursday.

The city originally planned to issue mostly refunding bonds this week, to be followed by a new-money deal in the spring with a separate team, and then possibly another late in the year.

In the end, the city to opted to fold all of its GO borrowing needs for the year into the one deal and the size settled at $883 million on Wednesday. The deal included a $432.6 million tax-exempt series and a $450.8 million taxable coupon. The taxable pricing was moved up by a day.

"We saw several other issuers accelerate their deals and their size and it seemed the opportune time to get in. The conditions seemed prime," Scott said.

The city reached out to investors individually and through a "roadshow" presentation in recent weeks highlighting its economic strengths and fiscal strides, in contrast to a pension funding mess Scott acknowledged is severe.

"The city and its financial team did a tremendous amount of work to make sure that investors understood our disclosure information and responded to questions," said Scott, who was hired by Mayor Rahm Emanuel after his 2011 election. "It really showed to us how much credit work institutional investors are doing on their own."

The city expected from indications this week good demand but was surprised by the $3.6 billion of orders it received. The tax-exempt series was five times oversubscribed and the taxable four times. Orders came from at least 80 institutions of which 50 were new. The new investors were money managers and other institutions and not hedge funds, Scott added.

The city also saw the return of some investor names that have shunned city debt in both the primary and secondary.

“It shows how hard Wells Fargo and the syndicate worked to not only reach out to their primary accounts but others,” Scott said.

During course of the pricing Wednesday, the city said spreads narrowed by five to 10 basis points across the pricing scale. The 10-year maturity in the city’s tax-exempt series paid a yield of 3.95%, a spread of about 145 basis points to the Municipal Market Data’s benchmark on top-rated municipals.

The city’s tax-exempt long bond maturing in 2036 paid a yield of 5.18%, 161 basis points over MMD. The city’s 30-year taxable coupon ended at 265 basis points over Treasuries. Earlier indications suggested the city could see a spread of 280 basis points on the taxable piece, according to market participants.

Matt Posner, a managing director at Municipal Market Advisors, said the deal was surprising in that it did not initially come at the concession some had expected given the roughly 25 basis point penalty seen in secondary trades after the latest Moody’s downgrade.

“I think institutional participants understand why Moody’s had to downgrade the city after it changed its criteria to give more weight to pensions but they recognize the strong fundamentals of the city’s GO credit,” Posner said. “It also still offers a pretty high yield.”

The yields clearly displayed the sharp toll of the downgrades. In the city’s last deal in May 2012 its 10-year maturity priced at 84 basis points over MMD and a 22-year maturity comparable to the 2036 bond in the new deal priced at 89 basis points over MMD. Its 30-year taxable bond priced 252.6 basis points over Treasuries, according to Thomson Reuters data.

“Our spreads are higher than they were but we were able to narrow them” in the deal, Scott said. “But we think the strength of the orders certainly sends a significant message that the investment community thinks we are on the right path.”

The city carved out three maturities for retail buyers but saw just limited interest as most Illinois paper does not offer an exemption from state income taxes. The city received bids from Build America Mutual Assurance Co. and Assured Guaranty Municipal Corp. and Assured coverage was provided on one maturity. A total of $15.2 million in orders went to retail.

Under the structure, principal repayment does not begin until 2018 in keeping with past city GO sales. The delayed principal repayment contributes to a slow debt amortization schedule that’s considered a negative credit factor.

The deal included $237 million of new money proceeds to fund the city’s 2014 capital needs. It took out $295 million of commercial paper including a portion that financed the city’s 2013 needs. Proceeds also will cover legal judgments against Chicago last year, refund debt for savings, and support an ongoing deferral of the city’s debt service schedule by pushing some maturities out, another negative noted by analysts.

The city opted to tap the CP program -which provides liquidity and serves as a short term financing vehicle – instead of a long-term bond sale last year as rates headed upward in the latter half of the year and it faced a stream of negative credit action. Scott estimated the use of CP in the near-term saved the city about $10 million on interest costs. The city recently doubled its CP authorization to $1 billion.

In the city’s roadshow, Scott declared: “The city of Chicago credit is strong and getting stronger.” The city’s ratings, which all carry a negative outlook, arguably belie that statement.

Scott said Thursday the statement was meant to reflect the city's positive economic news, and not necessarily a rating agency assessment.

The roadshow highlights the city's structural budget improvement through cost savings and ending the use of reserves seen under the prior Richard Daley administration. The city has put $30 million back into its long term reserve pot that holds $635 million.

It also highlights the city's overhaul of retiree healthcare subsidies, its home rule status and flexibility on taxes to "address of financial challenges" and momentum in the General Assembly to tackle local pension reforms after overhauling the state system in December.

Scott also stresses that the city leadership has a strong command of its fiscal issues and a "plan to address our legacy liabilities" which includes its $19 billion of unfunded pension obligations and an $8 billion debt load.

But the city has been taken to task by the rating agencies and public policy groups for not offering an independent plan to address its liabilities or the looming $600 million spike in its contributions to its police and fire funds that will be required next year absent state action. The city has floated plans to overhaul pension benefits and contributions and phase in the payment spike, but has no backup plan should state lawmakers fail to act.

"Overall we have a strong economy and a strong credit and pensions are the outlier in an otherwise favorable credit environment," Scott said at the close of the roadshow.

Moody's warned in its most recent downgrade report that the sheer size of the city's pension obligations threatens Chicago's "fiscal solvency" absent action on reforms and a long term infusion of funding.

Loop Capital Markets LLC which was slated to be bookrunner on the now cancelled second city GO sale, was added as a co-senior manager on the Wednesday sale. William Blair & Co. Inc., BMO Capital Markets, and Cabrera Capital Markets LLC also served as co-senior managers. The city will give the firms on the cancelled second deal consideration for other transactions anticipated this year such as its water and sewer revenue bond sales, Scott said.

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