
Emanuel Says He Didn't Do Risky Interest-Rate Swaps, But He's Done Four.

Mayor Rahm Emanuel this week distanced himself from the risky derivatives that are draining funds from the city's school system, declaring: "Under my tenure, there have been no swaps."

But records show the city of Chicago has entered into at least four interest-rate swaps under the Emanuel administration.

The deals brought the city nearly $20 million upfront but will require regular payments for up to 30 years, much like the derivative deals sapping Chicago Public Schools.

The Tribune series "Borrowing Trouble" this month found that CPS' decision to issue $1 billion in auction-rate debt paired with interest-rate swaps will likely cost $100 million more than what the school district would have paid for traditional fixed-rate debt. One draw of those risky deals was the hefty upfront payments that accompanied some swaps.

The Tribune analysis sparked questions from reporters after the City Council meeting Wednesday, and Emanuel was quick to point out that his administration has canceled derivatives the city entered under Mayor Richard M. Daley.

"Under my tenure, there have been no swaps, and we actually terminated nearly about a billion dollars in value of swaps," he said. "So I've been clear about righting the ship going forward."

Records show that the four swaps entered by the Emanuel administration are linked to existing debt — floating-rate bonds issued in 2003, 2005 and 2007, under Daley. The records obtained by the Tribune show new contracts with new banks, layered on top of existing swaps, in effect creating double swaps on the old debt.

When the Tribune contacted City Hall on Thursday, the mayor's office described what the Emanuel administration has done as modifications of existing swap deals.

The four swaps entered in December 2011 and February 2012 under Emanuel "are not new swaps," the mayor's office said in a statement. "They are modifications to the original underlying swaps, all of which were inherited by this administration." A spokeswoman for the mayor's office said the Tribune is "parsing words" by reporting that the Emanuel administration has entered into new swaps.

A letter the city provided to the Tribune in September offers a nuanced assessment of the Emanuel administration's record. That month, the city's chief financial officer wrote to union representatives, who have been critical of city and school swaps, that the city has not entered swaps on "additional debt."

CFO Lois Scott wrote to union representatives that the mayor "halt(ed) the city from entering into any new swaps on additional debt."

She also wrote: “Mayor Emanuel shares your concerns about the substantial risk and potential cost of these transactions.”

A document showing that the Emanuel administration entered into the four swaps is a listing of the city’s swap deals, titled “City of Chicago Swap Portfolio,” from December 2012. The document was provided to the Tribune months ago in response to a public records request. The city also provided the signed agreement with PNC Bank for one of the February 2012 deals.

Three of the four new swaps increase the unpredictability of the city’s interest payments, experts said. One expert called the new derivatives “speculative.”

“Basically what they wound up doing is speculating on interest rates,” said Matt Fabian, a managing partner at Concord, Mass.-based Municipal Market Advisors. “It might work out well.”

Governments typically use swaps to protect against unpredictable payments — not as a way of betting on interest rates. Under a typical interest-rate swap contract, a bank agrees to pay a government based on a floating rate and the government agrees to pay the bank based on a fixed interest rate.

The government pairs these swaps with floating-rate bonds in hopes that the floating rate coming from the bank will cover the payments owed on the bonds and the only money coming out of the government’s pocket will be the fixed payments on the swap. The 2003, 2005 and 2007 bonds were paired with that type of swap at the time they were issued.

The Emanuel administration layered new swap contracts with different banks on top of the existing swaps, records show. Under the new swaps, the city agreed to pay a second set of banks a floating rate — the same floating rate the city is receiving from the first set of banks — and receive a different floating rate.

But in three of the four cases, the Emanuel administration was trading a more predictable arrangement for a less predictable one, Fabian said.

On those three swaps, the rate the city had received under Daley was linked to a composite variable-rate municipal bond index published by the Securities Industry and Financial Markets Association, a trade group. The SIFMA rate is based on actual government bonds and was a fairly reliable match, experts say, for the interest the city could expect to pay on its debt.

Under the new double-deck swaps created by the Emanuel administration, however, the city is receiving a rate linked to the London Interbank Offered Rate, or Libor, the rate banks charge one another for short-term loans, which can diverge from municipal bond rates, creating a mismatch — called “basis risk” — between what the city gets from banks and what it owes bondholders.

If the Libor-based swap payments exceed what the city owes, the city makes money; if not, the city loses money.

Switching from SIFMA-based swaps to Libor-based swaps increases the possibility of that mismatch, said Andrew Kalotay, whose New York debt management advisory firm advised the city on separate deals.

“Before (the swaps) there’s very little basis risk if any,” Kalotay said. “After, there’s definitely basis risk.”

The mayor’s office said it took steps to protect against any risk created by the switch from SIFMA to

Libor by, for example, negotiating a higher upfront payment. The double-deck swaps Emanuel entered into also typically cost less to get out of than other kinds of swaps, which can be prohibitively expensive to terminate.

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