
Chicago Schools Selling First Bonds Since 2013 as Finances Teeter.

(Bloomberg) — For all the financial challenges confronting Chicago, its schools are in even more precarious shape as the Board of Education sells debt for the first time since 2013.

The nation's third-largest system is grappling with pension and budget deficits that spurred the closing of 50 schools almost two years ago. This month, Moody's Investors Service and Fitch Ratings cut its credit to one level above junk, potentially triggering a $228 million payment to end interest-rate swaps. The Moody's move left the district grade one step weaker than the city.

The struggles of the system and its 400,000 students have become a rallying point for opponents to Mayor Rahm Emanuel. As Chicago heads for an unprecedented mayoral runoff, Emanuel is dealing with voter backlash after the school board he appointed carried out the closings. The system projects a $1.1 billion shortfall next fiscal year because climbing retirement costs are consuming a growing share of resources.

"It's very difficult to see how they get out of this pickle," said Paul Mansour, the Hartford, Connecticut-based head of municipal research at Conning, which oversees about $11 billion in municipal debt. "We've been trimming our position."

Cooler Schools

The district sold about $178 million of floating-rate debt Tuesday, and plans to price an additional $372 million of securities March 31, according to data compiled by Bloomberg. Next week's issue will include about $77 million of fixed-rate bonds for refinancing as well as debt to reimburse the system for capital work, according to officials and Bloomberg data. The projects include installing air conditioning and upgrading classrooms, said Ginger Ostro, chief financial officer for the system.

"As those projects occur, we pay for them using a line of credit, which is less expensive for us," Ostro said. "When that's fully used, then we would issue the bonds that we're issuing now to replace that line of credit."

The district hasn't sold debt since issuing floating-rate securities in May 2013, according to Bill McCaffrey, a spokesman. It joins governments nationwide refunding with municipal yields hovering above five-decade lows.

Bond Support

Moody's grades the board's debt Baa3, while Fitch gives it an equivalent BBB-. S&P assesses it at A-, three steps higher. All three have a negative outlook.

Kroll Bond Rating Agency marks the borrowings BBB+, three levels above junk, with a stable outlook, noting that the bonds have protection as state aid is the main source of repayment.

Yet the looming crisis is evident in bond documents, which say that operating revenue may tally $4.8 billion in fiscal 2016, short of expenditures of $5.9 billion.

"We have exhausted all short-term solutions to our budget crisis," Barbara Byrd-Bennett, chief executive officer of the system, said at a Feb. 25 board meeting. Given the outlook for fiscal 2016, "it is impossible for us to cut our way to a balanced budget."

The travails have become a central issue in the leadup to the April 7 runoff pitting Emanuel, 55, against Jesus "Chuy" Garcia, a 58-year-old Cook County commissioner. While the election is nonpartisan, both are Democrats.

Emanuel's Lead

Emanuel held a 51 percent to 37 percent lead in a poll of 712 registered voters that was taken March 6-11 and published in the Chicago Tribune. The survey had an error margin of 3.7 percentage points.

The winner will take over as the city of 2.7 million approaches a fiscal cliff. Chicago has $20 billion in unfunded pension liabilities, with a $600 million payment due next year.

Chicago's mayor effectively runs the school system, appointing the seven-member board. Garcia has said he supports shifting to an elected board, a move voters approved in a nonbinding referendum Feb. 24.

In a TV commercial, Garcia stands in front of a shuttered school and blames Emanuel for the district's financial strain. Garcia has called the decision to close the schools a disaster, while not promising to reopen any of them. He's backed by the Chicago Teachers Union and its president, Karen Lewis, who's publicly clashed with the mayor, most notably during a 2012 teachers' strike.

Annual Savings

Emanuel, who has said the closed schools were underperforming and underused, repeatedly highlights his extension of the school day, enactment of full-day kindergarten and free community college for public-school students with a grade-point average of at least 3.0. Closings have saved an estimated $40 million a year, according to bond documents.

Since 2011, the district has reduced non-classroom spending by more than $740 million, eliminated hundreds of administrative positions and renegotiated contracts, according to officials.

In December 2012, it sold 21-year bonds to yield 3.57 percent, about 1.4 percentage points above benchmark munis, Bloomberg data show.

"We would anticipate that our credit spreads have widened slightly given the changes in our ratings, but again, that's something that we're evaluating day to day," said Walter Stock, the system's debt manager.

The district hasn't done enough to ease its fiscal woes, said Richard Ciccarone, Chicago-based chief executive officer of Merritt Research Services LLC, which analyzes municipal finance.

"The cost of procrastination is coming home to roost," Ciccarone said. "They're going to have to pay the price for that."

Mar 23, 2015 5:00 PM PDT

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