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Muni Issuance $9.3 bln Next Week, Chicago Schools Face Test.

(Reuters) – A planned $300 million sale by the Chicago Board of Education next week will test the municipal bond market's appetite for the board's debt in the wake of recent rating downgrades, a federal probe and unresolved financial problems.

The sale comes as issuance in the market is slated to reach $9.3 billion next week, including notes, its highest since the end of March as the amount of new bonds coming to market this year continues to exceed previous years.

The Chicago Board of Education is planning to sell $296.6 million of general obligation bonds on Tuesday through PNC Capital Markets. The board has been beset by problems in recent weeks, pushing out the spreads on the bond.

Illinois Governor Bruce Rauner reportedly said earlier this week that the nation's third-largest public school system could be headed to bankruptcy, although such a move is not currently allowed under state law.

Some of the board's bonds traded on Thursday at as much as 254 basis points over Municipal Market Data's benchmark triple-A yield scale.

Last month both Moody's Investors Service and Fitch Ratings dropped their ratings to one notch above the junk level, citing the Chicago Public Schools' $1.1 billion projected budget deficit and big unfunded pension liability. The downgrades triggered the termination of interest-rate hedges on variable-rate debt that unless renegotiated could cost the district about $228 million in payments to banks.

A recent sale by the board of $178.1 million of variable-rate general obligation refunding bonds due in 2032 resulted in an eye-popping, two-year initial rate of 4 percent over the SIFMA Index. Just two years ago, the board's bonds were priced at only 75 basis points and 83 basis points over the index.

Next week will see a plethora of small deals. The largest negotiated deal is a $887.9 million sale by Energy Northwest, which is refunding taxable revenue bonds through JP Morgan Chase for its nuclear power plant, the Columbia Generating Station, in Richland, Washington.

The state of California will sell a total of $1.1 billion of taxable and tax exempt general obligations bonds in three competitive deals next week.

Next weeks sales will bring the year-to-date issuance to over $136 billion, 70 percent higher than the same period last year. New issuance in the first quarter of the year represented the strongest start to the year since the first quarter of 2010.

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