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[Financial Woes, Federal Probe Drive Up Interest Rate on CPS Bonds.]

Chicago Public Schools was forced to pay top-of-the-market interest rates on nearly $300 million in new bonds issued today amid the uncertainty created by a federal investigation and a looming annual budget deficit of more than $1 billion.

The top yield for investors was 5.63 percent on 25-year bonds, or 2.85 percentage points over benchmark triple-A rated bonds, according to published reports.

The Chicago Board of Education delayed the sale last month after getting hit with downgrades by three ratings agencies.

"While the board's rating remains in investment grade territory, its yields aren't," according to a story published today by Bond Buyer, which tracks the municipal finance market. The yields, or amount that investors are paid, are in the range of bonds with a much lower credit rating, Bond Buyer said.

The relatively high interest rate was likely attractive to investors who discounted the chances that CPS would be unable to repay the bonds. The school district confronts a $1.1 billion budget deficit in fiscal 2016, which starts July 1. About $700 million is due in payments to the school district's woefully underfunded retirement plan.

After this story was published, a CPS spokesman said in a statement that demand for the bonds was 1.7 times the supply, a sign that investors had a strong appetite for the bonds, given the interest rate.

"The strength of today's bond sale is another indicator that investors have confidence in the district and the security of its bonds despite its well-known budget challenges," according to the statement, which did not address the relatively high interest rate needed to attract buyers.

CPS had revenue of $4.94 billion in the fiscal year that ended June 30, 2014, and $6.6 billion in long-term debt, including accrued interest.

The delay in the sale gave investors the comfort of knowing the results of the April 7 runoff election, in which Mayor Rahm Emanuel won a second term. But it also added to the school board's challenges.

TOUGH RATINGS

Reports surfaced on April 14 of a federal investigation into a $20.5 million, no-bid contract awarded to a firm with ties to CEO Barbara Byrd-Bennett. She has taken a leave of absence.

Complicating matters even more was Gov. Bruce Rauner, who talked up the option of bankruptcy for CPS and other governmental agencies. His jawboning likely unsettled investors, even if his comments were aimed at the Chicago Teachers Union, whose retirement plan is the source of much of the schools' financial troubles.

Proceeds of the bond sale will be used to refinance existing debt. Today's bond issue was actually a series of securities with different maturities and lower interest rates.

Even as the school board delayed the bond sale, it went ahead last month with the sale of about $180 million in floating rate debt. The rate on those notes, 4.02 percent, reflected a "steep penalty," according to a Bond Buyer story published April 1.

Moody's Investors Service led off the downgrade parade on March 6, lowering its rating on CPS two levels to Baa3, just above junk bond status. Then Fitch Ratings cut its grade to BBB-minus, just above junk bonds, from A-minus. Standard & Poor's Ratings Services lowered the district's rating by two notches, to A-minus, two notches above junk bond status.

The ratings reduction by Moody's and Fitch triggered a possible $228 million penalty to be paid by CPS on swaps contracts the school district has on $1.1 billion in debt. Swaps are agreements intended to reduce the risk of interest rate changes.

Ahead of the new bond sale, CPS did not seek a rating from Moody's, typically the most skeptical of the ratings agencies. Instead, CPS hired Kroll Bond Rating Agency, a relative newcomer to the field, which assigned a rating of BBB-plus.

Some bond market observers viewed dropping Moody's as "rating shopping," an attempt to obtain a more favorable report, but institutional investors were likely not affected by the change.

CRAIN'S CHICAGO BUSINESS

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