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Chicago Mayor Pledges End to Scoop-and-Toss Restructurings.

CHICAGO – Chicago will phase out the use of scoop-and-toss debt restructuring, convert $900 million of floating-rate debt to fixed rate and exit the attached interest rate swaps under measures announced by Mayor Rahm Emanuel Wednesday.

The city also plans over the next four years to reduce its reliance on debt to cover operating expenses like judgments and legal settlements and continue rebuilding reserves partially drained before Emanuel took office four years ago.

“They are the right steps” for the financial well-being of the city, Emanuel said during an address to the Chicago Civic Federation, a government research organization that follows the city’s budgeting and fiscal policies and has chided some of its borrowing practices.

Canceling the interest rate swap agreements attached to the city’s general obligation and sales tax-backed floating-rate debt would result in costly termination payments based on recent negative mark-to-market valuations of about $200 million. The city will use its short-term commercial paper line to cover the costs and eventually fold it into a long-term GO bond sale, said Chicago’s chief financial officer Lois Scott.

The city has three general obligation-backed floating rate deals outstanding from 2003, 2005, and 2007 with swaps attached that are negatively valued at $162 million. Another 2002 sales tax deal has a swap attached that’s negatively valued at $29 million. The city’s most recent downgrade triggered swap termination events on four derivative contracts, adding to the city’s fiscal headaches.

The city’s 24 swaps tied to $2.4 billion of floating-rate general obligation and revenue-backed paper were almost $400 million underwater based on market valuations at the close of 2014, but the mayor did not propose any changes to revenue-backed credits.

In announcing the debt-related measures, Emanuel is taking aim at practices attacked by his critics during the recent mayoral election and criticized by many market participants as shoddy fiscal maneuvers used by distressed issuers for near-term relief that add to the city’s long-term structural budget woes.

Emanuel acknowledged as much, saying the debt maneuvers “mask the true costs of government.”

The time is right, Emanuel said to take a “bigger step forward” on righting the city’s fiscal ship with the debt reforms as the local economy is on the mend following the recession and the budget’s structural deficit has been cut in half.

The plan, dubbed a roadmap for reform, comes three weeks after Emanuel won a second term following a runoff contest during which the city’s deteriorating credit ratings and fiscal hardships took center stage. The city’s massive $19 billion tab of unfunded liabilities and the burden of funding a $550 million increase in its pension contribution for police and firefighters next year have driven

the credit rating dive.

The debt-related policy changes don't solve the city's most daunting challenge, its pension funding shortfalls, and will actually pose a near-term burden as the city uses more operating funds to cover legal costs and phases out the practice of pushing of upcoming debt principal payments off.

Emanuel acknowledged the measures may not stabilize or boost the city's credit standing, but he's hoping analysts and investors will view them "as very good and positive steps."

Moody's Investors Service in late February knocked the city's down one notch to Baa2, only two levels above speculative-grade territory, but assigned a negative outlook.

The downgrade triggered termination events on four swaps with a combined negative valuation of nearly $60 million. BMO Harris Bank agreed to lower the rating threshold on one swap relieving the city from a potential $20 million payment if demanded by the bank. Wells Fargo Bank, the counterparty of the other three, has so far refused.

The city is expected to soon shift the 2003 floating-rate paper attached to one of those swaps to a fixed-rate and cancel out the swap and three others on the transaction that all combined carry a negative valuation of $33 million.

To cover any swap expenses, the city could tap its short-term borrowing program, although that is one of the practices Emanuel is targeting in his reform plan. The city last year drew $36.3 million from its short-term borrowing program to cover termination payments on two of its swaps on a notional principal amount of $206 million from a 2002 issue. The city then planned to convert the paper to a fixed-rate structure.

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BY YVETTE SHIELDS

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