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Chicago Faces Test in Muni Market Next Week.

Chicago will get its first taste of selling debt in the U.S. municipal bond market after its credit rating was dropped to "junk" by Moody's Investors Service when it converts $805.7 million of variable-rate bonds to fixed-rate next week.

Competitive and negotiated sales, including notes, will reach $6.34 billion in a holiday-shortened week, according to data compiled by Thomson Reuters. U.S. markets are shut on Monday for the Memorial Day holiday.

Moody's downgraded Chicago's general obligation rating to Ba1 on May 12, triggering $2.2 billion in accelerated debt and fee payments by Chicago to banks.

The bond conversion is aimed at terminating bank letters of credit and swaps used to hedge interest-rate risk on the variable-rate debt. New forbearance agreements with the banks give Chicago until June 8 to complete the conversion.

The bonds, which will be priced on Wednesday through lead underwriter Bank of America Merrill Lynch, are likely to come cheap with fat yields.

The city's bonds have been trading at yields about 300 basis points over the U.S. municipal bond market's benchmark triple-A scale, according to Municipal Market Data, a unit of Thomson Reuters. Still, city officials are optimistic.

"Recent trading in Chicago bonds show interest rates normalizing as investors learn more about the ability of Mayor (Rahm) Emanuel and his finance team to adapt and manage through the effects of the Moody's downgrade," a Chicago official said on Thursday.

The Chicago Board of Education, which has also had its credit ratings downgraded, was socked with high interest rates in recent bond sales. Yields in a nearly $300 million GO bond issue priced in April topped out at 5.63 percent for bonds due in 2039. That yield was 283 basis points over the benchmark scale.

Offering documents for the upcoming Chicago debt conversion indicate the bonds will be rated by Standard & Poor's, Fitch Ratings and Kroll Bond Rating Agency, all of which still have investment grade ratings for the city's GO debt, but not Moody's.

REUTERS

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(Reporting by Karen Pierog in Chicago and Edward Krudy in New York; Editing by Matthew Lewis)