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Demand and Rates High for Chicago's Bond Sales.

(Reuters) – Chicago’s \$1.08 billion of bond sales this week had big investor demand, but still resulted in hefty interest rates due to the city’s festering fiscal woes.

Mayor Rahm Emanuel’s office said Thursday’s sale of \$345 million of tax-exempt, general obligation bonds was 10 times oversubscribed with investor orders.

That allowed underwriters led by Morgan Stanley to reprice the bonds, dropping yields 2 to 8 basis points in several maturities, according to a pricing scale.

The top yield was shaved 8 basis points to 5.69 percent for bonds due in 2039 with a 5.50 percent coupon. That resulted in a 252 basis point spread over Municipal Market Data’s benchmark triple-A scale, signaling the fiscally struggling city continues to pay higher borrowing costs than most issuers in the U.S. municipal bond market.

“There’s a significant penalty,” said Dan Solender, lead portfolio manager at Lord Abbett.

Solender said bonds in tougher sectors of the muni market are able to attract lower yields than Chicago, pointing to \$361 million of revenue bonds for a nonprofit corporation financing student housing at Texas A&M University. Tax-exempt bonds rated triple-B-minus in that deal were priced this week to yield 4.54 percent in 2035 — 113 basis points lower than the 5.67 yield for higher-rated bonds due the same year in Chicago’s deal.

The city, the third largest in the United States by population, is struggling with a projected \$430 million fiscal 2016 budget gap. The deficit is due in part to escalating pension payments that include a looming \$550 million contribution increase to its public safety workers’ retirement funds.

Chicago sold the tax-free bonds a day after nearly \$743 million of taxable GO bonds were priced. Both deals were part of the city’s plan to restructure its short-term debt into longer-term, fixed-rate bonds.

Moody’s Investors Service, which was not asked to rate this week’s Chicago bond sales, in May dropped the city’s credit rating to junk, triggering \$2.2 billion in accelerated debt payments and fees that led the city to undertake the restructuring.

Since then the city converted more than \$900 million of variable-rate debt to fixed rate to end interest rate swaps and bank letters of credit. The deals were also popular with investors but resulted in hefty yields.

Bond sales this week will repay all but about \$140 million of the city’s short-term borrowing program.

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(Reporting By Karen Pierog; Editing by Andrew Hay)

