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Chicago Mulls Borrowing That Puerto Rico Rejected as Risky.

Chicago may allow the use of a type of debt that's fallen out of favor in other municipalities because it saddles taxpayers with higher costs by delaying payments.

Mayor Rahm Emanuel proposed issuing \$500 million of bonds this week in an ordinance that would permit the use of capital appreciation bonds, where borrowers postpone interest and principal payments into one sum at the end of the term. Emanuel's pitch also allows for the more common current interest bonds, which the city said it expects to use.

"We have no intention of issuing CABs," said Chicago Chief Financial Officer Carole Brown, who noted that language has been included in past ordinances. "We do that so we have maximum flexibility. If there is some off chance that there is an investor that wants us to issue bonds with a certain structure, we have flexibility."

Chicago is struggling to plug its deficit and \$20 billion of unfunded pension liabilities. The proposal would give the third-most-populous city a means of borrowing without having to face the costs right away.

"Given where Chicago is at, it does seem like it's a way to kind of push off debt payments out longer, which from a credit standpoint is not favorable," said Michael Johnson, managing partner at Gurtin Fixed Income Management, which oversees \$9.5 billion of munis in Solana Beach, California. "It's probably not the best idea for them right now."

Texas restricted the use of CABs in June and California has limited them since 2013. The Puerto Rico Electric Power Authority dismissed a bondholder plan last week to restructure its debt using capital appreciation bonds, citing the disproportionate risks.

Abusive Debt

Chicago hasn't issued capital appreciation bonds since 2009, Molly Poppe, a city spokeswoman, said in an e-mail.

Use of capital appreciation bonds have come under fire in Texas and California, where lawmakers have passed legislation to limit their use. Former California Treasurer William Lockyer called the debt "abusive" because it passes on large payments to future generations.

"They increase the total cost and lower flexibility going into the future," said Steve Murray, a senior director at Fitch Ratings. "They can limit future borrowing ability."

Emanuel also proposed selling \$125 million of wastewater revenue bonds to fund swap termination payments, Poppe said. A separate ordinance would authorize \$2 billion in bonds for O'Hare International Airport, including \$1.7 billion of refunding for savings, and about \$300 million of new money for capital projects and interest, according to Poppe.

Bloomberg

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July 31, 2015 — 10:26 AM PDT Updated on July 31, 2015 — 12:25 PM PDT

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