Bond Case Briefs

Municipal Finance Law Since 1971

Chicago School Bond Sale May Attract Unusual Investors.

Chicago's struggling public school district could lure hedge funds and other investors with an unusual opportunity to buy high-yield municipal assets while pivoting attention away from Puerto Rico's distressed debts.

The Chicago Board of Education's $875 million bond issue next week comes as the nation's third-largest public school system struggles with a structural budget deficit of at least $1 billion.

Rated below investment-grade, the Chicago Board of Education is likely to attract a new class of investors not typical to the municipal bond market. The new deal may see interest from hedge funds and private equity funds, taxable investors who do not necessarily benefit from tax-exempt paper, said Michael Comes, portfolio manager and vice president research at Cumberland Advisors.

"This is similar to what happened in Puerto Rico, where it shut itself out of the muni market," said Comes. "I think we're at the cusp of that with the Chicago Board of Education deal."

This week, Republican legislators pushed the idea of a state takeover and potential bankruptcy plan, a proposal favored by Illinois Governor Bruce Rauner but quickly shot down by Democrats who control the legislature.

Such distress signs also caught the attention of municipal bond insurers such as Assured Guaranty, MBIA, and Ambac Financial Group, which have until now been focusing intently on developments in Puerto Rico. But news from Illinois served "as a reminder that there are multiple drivers of the insurers' share prices," BTIG Research Group said on Friday.

The district's so-called credit spread widened over Municipal Market Data's benchmark triple-A scale in secondary market trading on Thursday to 464 basis points for bonds due in 19 years from 412 basis points two weeks ago. That signals investors will demand hefty yields for the junk-rated general obligation bonds. Financially stressed Illinois and the city of Chicago were able to sell bonds this month at spreads much narrower than the school district's.

Still, demand for muni bonds is high among investors, as cash saturates the market and supply remains low. Recent trouble in the equity market has intensified investors' interest, as the idea of municipal bonds as a safe haven asset takes hold.

"There is a lot of interest in muni high yield, and there's not much out there," said Alan Schankel, municipal strategist at Janney Fixed Income Strategy. "Munis outperformed other fixed income asset classes last year, and I think they are likely to do the same thing this year."

Chicago Board of Education's issue includes a refunding and restructuring of outstanding debt to convert variable-rate bonds to fixed rate and to push out maturities on other bonds to free up money for the school system's sagging budget. The issue will also raise money to cover fees to terminate interest rate swaps related to the variable-rate debt.

Tax-exempt bonds totaling $795.5 million will be offered in term maturities in 2035, 2040, and 2044, according to the preliminary official statement. Another $79.5 million of taxable bonds are due in 2033.

Reuters

Jan 22, 2016

(Reporting by Robin Respaut in San Francisco and Karen Pierog in Chicago; Editing by Tom Brown)