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Chicago Schools Fast Running Out of Cash as Standoff With Illinois Governor Worsens.

CHICAGO — Chicago's cash-starved public schools' district may be choked off from more loans and find itself unable to meet a $676 million pension payment in June because of a deepening legal dispute with Illinois' governor.

The state's school board, stocked with Republican Governor Bruce Rauner's appointees, is expected to declare Chicago's school system in "financial difficulty" as early as April under an Illinois law authorizing state takeovers of financially distressed school systems. Rauner, who is seeking to take over the schools' district, contends that finding would bar the nation's third-largest public school system from further borrowing.

Chicago Public Schools (CPS), which only just borrowed $725 million through a bond sale, says it is exempt from the law, thus keeping Rauner and his State Board of Education from dictating financial decisions involving the system, including its ability to borrow additional funds.

CPS plans to tap an existing $370 million credit line with Barclays Bank to help pay its June 30 pension obligation, according to Moody's Investors Service analyst Mark Lazarus. But that could also be in jeopardy because of Rauner's stance.

The district has indicated a need to sell more debt, but that seems unlikely now. "I'd say it's dangerous to issue it, and it would be more dangerous to buy it," said Richard Ciccerone, who heads Merritt Research Services, a Chicago-based municipal credit data company.

CPS already carries a $6.2 billion debt load, and its finances remain precarious after February's borrowing. In that bond offering, the system disclosed it expected to have only $24 million in operating revenue when its fiscal year ends June 30. Budget cuts announced by CPS CEO Forrest Claypool since then could grow that balance to as much as $118 million, according to Moody's.

Still, that wouldn't represent much of a cash cushion given that more than 40 percent of the cuts are not guaranteed and this is a schools' district with a $5.7 billion annual budget. CPS aims to save $65 million by reducing its contribution to teachers' pension payments by 7 percent but teachers have threatened to strike over the issue in April, likely leaving a state labor panel or the courts to decide the legality of that cut.

Since January, Rauner has staged a running attack on CPS and Chicago's Democratic Mayor Rahm Emanuel, who controls the school district. "They've misspent hundreds of millions of dollars, and they hurt their students and their teachers as a result," Rauner told reporters at a news conference in Chicago last month.

As justification for a state takeover, Rauner's office cited Illinois law permitting the State Board of Education to seize control of financially troubled school systems and to block new borrowing. Claypool insists CPS is exempt, but Rauner's office claims the exemption no longer exists because it is based on an obsolete part of the law.

“If it determined that any school district was in financial duress, the state board has the right, the legal authority, to block any debt offerings,” Rauner said.

The dispute itself could prevent CPS from selling bonds, according to legal experts. That is because lawyers representing the system likely cannot issue a clean opinion on the district’s debt offering as legal, valid and enforceable, a necessary assurance for investors.

Any plausible question about the validity of the debt would probably prevent attorneys from giving such an unqualified opinion, said Clayton Gillette, a professor of local government law at the NYU School of Law.

Without that, the bonds probably will not be marketable, he said. Even if the offering could be sold, investors would demand very high rates as compensation for the risk, Gillette added.

“So at the very least (CPS) is going to end up paying more,” Gillette said.

Already, CPS has struggled in the bond market. The district pulled back an $875 million long-term junk-rated bond issue in January, ultimately selling only $725 million of bonds on Feb. 3. To attract investors, CPS needed to offer an 8.50 percent rate on most of the bonds, up from the 7.75 percent they were aiming for in January. The total cost to retire the bonds through maturity in 2044 is about $1.9 billion.

Nearly 80 percent of proceeds from February’s bond issue was earmarked to boost operating cash – a troubling sign for bond investors.

“If an entity depends on market access to pay bills, that to us is effectively insolvent,” said Triet Nguyen, who tracks distressed municipal bond credits at financial services company NewOak Capital in New York.

Nguyen said that happened with Puerto Rico, which like CPS relied on bond sales for liquidity. The U.S. territory, which has not been able to sell municipal bonds since 2014, has defaulted on some debt and is seeking restructuring help from the U.S. Congress.

“There’s a high probability this could happen [in Chicago], particularly under the backdrop of such vocal criticism from the governor,” Nguyen said.

The district’s lack of market access could make banks wary of extending any new credit too, he said.

With uncertainty about its prospects rising, CPS also could hit a ceiling on the interest rate it can pay for its long-term borrowing. A state law forbids long-term public borrowing at a rate over 9 percent — just half a percentage point above the top rate in February’s bond sale.

“They don’t have much room for any future borrowing,” said Laurence Msall, president of the Civic Federation, a nonpartisan Chicago-based financial watchdog group that tracks CPS finances.

By REUTERS

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