

# **Bond Case Briefs**

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## **Nuveen, Goldman Buy Chicago School Debt.**

Chicago's public schools are poised to shut down on Friday as the teachers' union stages a one-day strike, the latest sign of escalating financial pressure on a junk-rated district that's veering toward insolvency.

The distress hasn't deterred Nuveen Asset Management, Goldman Sachs Asset Management and OppenheimerFunds Inc. According to data compiled by Bloomberg, the three were some of the biggest buyers of the \$725 million of bonds the school system sold last month, when it was forced to pay yields as high as 8.5 percent — three times more than benchmark debt, even though it doesn't have the power to go bankrupt.

"Investors are betting that the 8.5 percent yield will be a sufficient cushion to offset the bumpy ride ahead for the CPS bonds," said Richard Ciccarone, president of Merritt Research Services LLC, which analyzes municipal finances. "Time will tell whether it will be enough."

Chicago's school system, the nation's third largest, has been pushed to the brink after years of skipping pension payments and borrowing to cover operating costs, which has led credit-rating companies to downgrade its bonds to as low as five steps below investment grade. Facing projected deficits of \$1 billion a year through 2020, the school system is lobbying for more aid from Illinois, while Republican Governor Bruce Rauner is pushing for a state takeover and changing the law to let it file for bankruptcy to reduce its debt.

The district's borrowing last month provided needed cash and showed that investment firms anticipate it will find a way to turn around its finances. The purchases have so far paid off: Bonds due in 2044 traded Wednesday for 91 cents on the dollar, up from the initial price of 84 cents.

The deal "came at a time of heightened controversy around state takeover threats and bankruptcy threats," said John Miller, co-head of fixed income at Nuveen, which oversees about \$110 billion of municipal debt, including \$279 million of last month's issue, according to data compiled by Bloomberg. "Those were maybe overdone, if you will, because there isn't a legal path or a legal mechanism to do those things."

Rauner has had no success in the Democrat-controlled legislature with his Chapter 9 proposal, which Democrats and unions oppose because it would let the schools seek to alter labor contracts as well as other debts. Such a change is unlikely and wouldn't happen for years, according to Miller, who said that the state aid and property-tax revenue that the school district has pledged to bondholders should be sufficient to keep it from defaulting.

"It's 390,000 students, and it's one of the largest employers at 27,000 employees," he said. "They're not going to shut down."

Goldman Sachs funds holds about \$87 million of the 29-year debt the district sold last month, data compiled by Bloomberg show, while OppenheimerFunds has \$9 million. That makes them the second- and third-largest holders after Nuveen, based on the most recent data available. Goldman

spokesman Andrew Williams declined to comment. OppenheimerFunds spokeswoman Meredith Richard declined to comment. Emily Bittner, a spokeswoman for the district, didn't return e-mail and phone messages requesting comment.

The bond sale refinanced debt and provided cash to help the district cover its operating expenses. After it closed, the board deposited \$268 million with bond trustees, which covers all general-obligation debt payments through March 1, 2017, according to Moody's Investors Service.

Nuveen's participation in the deal as a local firm with a strong track record is a "vote of confidence," said Ciccarone, the Chicago-based analyst with Merritt. Their involvement is reminiscent of the consortium of local banks in the late 1970s that put together interim financing when the district couldn't pay teachers, he said.

The district still faces serious challenges. The state hasn't come through with \$480 million in aid that school officials have pleaded for to close this year's budget gap, which was brought on by rising retirement-benefit expenses. Chicago's is the only Illinois district that pays the vast majority of its own pension costs, and it owes another \$679 million to the retirement fund by June 30.

With no sign of help from the state, the district announced three furlough days this year to save an estimated \$30 million and cut school budgets by \$85 million. Rauner, who is locked in a record-long budget impasse with Democratic lawmakers, has said he will only help Chicago's schools if Mayor Rahm Emanuel, a Democrat, helps push his agenda. Rauner wants limits on collective bargaining, property tax curbs and term limits, none of which are winning favor from Democrats.

Tensions with teachers are also rising. The union authorized Friday's strike to pressure the state and highlight stalled contract talks. It may save money initially as teachers who don't come to school won't get paid, saving about \$10 million, according to district estimates if all educators don't report to work.

Longer term, it complicates the ongoing negotiations for the contract that expired June 30. If an unfavorable labor pact is reached without corresponding cuts, the district's "very weak" liquidity will be even more strained, according to Moody's.

"This is a case where their finances are bad, and it would be a tough situation to dig out of even if you had everyone rowing in the same direction," said Tom Schuette, co-head of credit research and portfolio management at Solana Beach, California-based Gurtin Fixed Income Management LLC, which holds about \$10.3 billion of munis. "It's really hard to see how they manage through this when you have the labor union and the state seemingly pushing in opposite direction of management."

## **Bloomberg Business**

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