Bond Case Briefs

Municipal Finance Law Since 1971

Nobody Traded When JPMorgan Put Chicago School Debt Up for Sale.

- Offered notes at yield corresponding to even lower rating
- It may have been way to gauge value amid selloff, analyst says

JPMorgan Chase & Co. offered a crucial lifeline to the ailing Chicago Public Schools by purchasing almost $1 billion of short-term notes from the junk-rated system in the last four months. When the New York-based bank put some of its holdings up for sale, nobody made the trade.

On Nov. 22, JPMorgan offered $50 million to $100 million of the notes maturing Dec. 2017 with potential for more depending on demand, according to people familiar with the matter. The notes had a coupon of 70 percent of the three-month London interbank offered rate plus 400 basis points, which, according to the notes' official statement, would apply if the rating was between CCC+ and CCC, only a few notches above debt that's already in default. The school system's general-obligation bonds are currently rated B3 by Moody's Investors Service and B by Standard & Poor's.

It's unclear whether JPMorgan was trying to sell the securities, or just gauge their value during the market rout that followed Donald Trump's election. Brian Marchiony, a spokesman for the bank, declined to comment.

"It could have been price discovery to get a sense of how much those notes are worth," said Matt Fabian, a partner with Municipal Market Analytics Inc. "In the middle of a market-wide selloff, I think they were hard to value."

The yields quoted by JPMorgan underscore the riskiness of the loans and suggest the district may pay a high price if it follows through with a planned $600 million note sale in January, a month before it must deposit more than $400 million for debt service. If Chicago's schools can't issue the debt, it faces some difficult decisions, said Naomi Richman, a managing director at Moody's.

"They could try to cut expenses, although that's certainly a very high magnitude of expenses to have to cut," said Richman. "They could ask the state of Illinois for assistance, which they have been doing, but the state has budget issues of its own."

Expenses at the third-largest U.S. school system consistently exceed operating revenue and the district is counting on more than $200 million in state aid — and a $250 million credit from the its pension board — to cover a $720 million retirement-fund payment due in June.

JPMorgan has close ties to Chicago, where it's the third-largest private sector employer, and the bank has been the biggest lender to the school system. Chief Executive Officer Jamie Dimon was head of Bank One Corp. when JPMorgan bought the Chicago-based bank in 2004. William Daley, son and brother of Chicago mayors Richard J. Daley and Richard M. Daley, served as vice chairman at JPMorgan. JPMorgan loaned $500 million to Chicago's schools in 2015, according to data compiled by Bloomberg.

Chicago’s schools, whose enrollment has declined 5.6 percent over the last five years, began the fiscal year July 1 with a $1.1 billion deficit. The district’s cash position declined to $83 million at the end of fiscal 2016 from about $1.3 billion at the beginning of fiscal 2012, according to a recent bond offering statement, and the district’s reliance on short-term borrowing has grown by $850 million in two years.
Illinois Governor Bruce Rauner has said bankruptcy for the school system might be the best option, though the Democrat-controlled legislature has bucked his suggestion that state law be changed to allow it.

“The big risk here is bankruptcy between now and 2017 when they come due,” said Paul Mansour, head of municipal research at Conning, referring to the district’s notes. “Investors are more nervous about that than anything else.”

Last week, the district had little trouble finding buyers for its more highly rated securities. It sold about $730 million of bonds secured by a dedicated share of the city’s property tax, which won the debt investment grade ranks of A from Fitch Ratings and BBB from Kroll Bond Rating Agency. Debt maturing in 30-years were priced to yield 6.25 percent, almost 2 percentage points more than generic bonds with the same rating, according to data compiled by Bloomberg.

Bloomberg Markets

by Martin Z Braun

December 22, 2016, 2:00 AM PST