Chicago Board of Education bonds dip into 70's; global market meltdown impacts municipals
By Gunjan Banerji
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Chicago Board of Education (CBOE) bonds dipped into the 70's, and could trade at even more distressed levels, two municipal bond traders said.

A USD 469m tranche of Series 2012A tax exempt general obligation bonds issued by the district last traded yesterday at 77.9 yielding 6.78%, according to Electronic Municipal Market Access.

"It's difficult to say how low it will go," the first trader said, adding that the district is essentially out of cash and may rely on the market for short-term funding needs.

The district recently announced a budget that relied on USD 480m in aid from Springfield, USD 250m in scoop and toss borrowing, and USD 200m in cuts, as reported.

Questionable solutions

If the state does not provide financial help to the district, the board may engage in further "unsustainable borrowing," as reported. CBOE authorized USD 1.1bn of general obligation debt at a 22 July school board meeting.

However, increasing the debt load could precipitate further price deterioration on the bonds, the two traders said.

More debt is not the solution for CBOE, said the first trader. Borrowing could temper a short-term liquidity crisis, but would be a clear detriment to the district in the long-term.

Issuing general obligation debt would not be wise right now given the credit's secondary market activity, a third trader said. "They should wait until they can get their act together to issue GO debt," the trader said of the board. "Short-term paper could be a better option so as to not lock in towering rates."

Global market headwinds could also harm the district's market access. The spread between investment grade debt and junk debt tends to widen in periods of market volatility, said Lamont Black, an assistant professor of finance at DePaul University in Chicago. Black was formerly an economist at the Federal Reserve Board of Governors in Washington DC.

While volatility in equities can set off a "flight to safety" to bonded debt, investors flock to investment grade debt, not junk debt, Black said.

"People tend to charge more to hold risk when they're worried about a global market meltdown," Black said.

Weak credit, strong security

While the credit quality is a "nightmare," the bonds should be money good, a municipal credit analyst said, noting that the school district's bonds have strong security features.

The district’s bonds have a double-barrel pledge, relying on state aid revenues as well as a property tax levy, the analyst said. Moody’s and Fitch rate them at the junk levels of Ba3 and BB+, respectively, while S&P knocked it to BB as well, after the budget announcement on 10 August. Kroll Bond Rating Agency pegs it at BBB+. All agencies have negative outlooks on the credit.

The nature of politics in Illinois and Chicago highlights a marked risk with Chicago Board of Education bonds that doesn’t exist to the same degree in other municipals, said Brian Lockhart of Peak Capital Management.

“Illinois has a tradition of waiting until the 11th hour or later to get things done,” the municipal credit analyst added. The district is reliant on the state and the city, both of which have discrete but interrelated financial problems.

However, CBOE’s position in the third largest city in the country could also be buoying bond prices above where they would trade otherwise, the first trader said.

“It’s hard to imagine a major school district in a major metropolitan city filing for Chapter 9,” said the trader.

Governor Bruce Rauner has made access to Chapter 9 for municipalities a pillar of his turnaround agenda; a bill is set for hearings in the state legislature.

The board meets tomorrow to approve or deny the budget. CBOE did not respond to a request for comment.