**Council Office of Financial Analysis**

To: Interested Parties

From: Ben Winick

Date: January 8, 2016

Re: Proposed Bond Offerings

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Mayor Emanuel has asked for the City Council to approve six bond offerings. Some information about those proposals is outlined below (and broken up by source).

$1.25 billion of General Obligation bonds. This authorization can be broken out into three different parts. (The figures below are approximate)

- $50-$250 million of refunding bonds for savings
- $400-$450 million for "scoop and toss"
- $600-$750 million for new capital improvements

*Refunding for savings*
It is currently the policy of the City to seek savings of 3% of present value or more per refunded bond as part of its refinancing deals. Precise savings that would be achieved from the deals cannot be known until the time that the bonds are issued, though a deal is likely to yield both short-term and long-term savings.

*Scoop and toss*
As opposed to the refunding for savings, the practice of "scoop and toss" increases the City's interest costs over time by paying down short term maturities with the issuance of longer term debt obligations. This practice of essentially extending the terms of existing debt should be avoided whenever possible. The Mayor has proposed a phase out of this practice so that it is ended by Fiscal Year 2019. Any plan to end this practice is positive for the fiscal future of the City of Chicago.

The proposed ordinance differs from the concept that had initially been envisioned for the phase out of this practice. Previously, it was believed that the city would continue to issue "scoop and toss" bonds each year over the next three years. In total, around $400 million was anticipated to be issued for this purpose. The phase out has been altered to refund the maturities now that were going to be refunded in 2016 as well as 2017 and 2018. There are a number of merits to this amended proposed phase out.

First of all, on December 16, the Federal Reserve unanimously voted to increase its benchmark interest rate by 25 basis points, and has signaled that it is likely to increase rates further in the future. This and future increases indicates that the City may benefit from issuing bonds sooner rather than later, especially for those issuances that the City is near certain to sell, such as the phase out of "scoop and toss" bonds. While it is true that improved fiscal stability will be rewarded with improved credit quality, this process will take time, and given the number of outstanding issues that still exist, will likely take years. Simply put, the certainty of increasing interest rates is greater than the uncertainty of the City receiving a ratings increase in the short term.

Additionally, there is potential that some savings can be achieved by restructuring all needed bonds now instead of paying interest over the next one and two years on those to be restructured bonds and then approximately 15 years once they are refunded. By restructuring now, the City would only be paying interest over a 15 year period for the refunding bonds, instead of 16 or 17 years under the prior strategy. It should be noted that this is only a possibility, and will likely not be determined until the City of Chicago takes these bonds to market.

Lastly, there is a benefit in providing greater certainty to the phase out of this practice. No one can predict what may happen between now and 2019, and unforeseen events could put greater pressure on the City's budget in the future. If the practice of "scoop and toss" is phased out each year over the next couple of years, an argument could potentially be made to continue the practice as a result of increased and unforeseen budgetary pressures. However, if it is phased out today, and there is greater clarity and certainty over what the city's debt service schedule will look like in the near future, it will make it more difficult for the city to fall back on poor fiscal practices if the practice has already been phased out. In addition, the City Council may want to consider a proposed ordinance to codify the termination of the practice of "scoop and toss".

*New capital money*

Similarly, the proposed issuance of approximately $600 million of new general obligation debt is for the purpose of anticipated capital expenditures and equipment purchases in 2016, 2017 and 2018. As stated previously, it is anticipated that increasing interest rates will be greater than any reduction in spreads on City of Chicago debt.

Not including anticipated expenses from the Aldermanic Menu, the amounts that are being proposed are largely in line with the annual amounts of bond funds that have been utilized for capital projects in the recent past, though it does appear to differ from what had previously been outlined in the capital improvement plan. It should be noted that the CIP includes projects that may not have funding source immediately available, such as sources from the State of Illinois.

<u>$200 million Sales tax revenue bonds</u>

The administration has additionally proposed authorization for the issuance of $200 million of sales tax revenue bonds. That proposal can be broken up into two parts in the approximate amounts.

- $70 million for new capital
- $130 million for refunding for savings

*<u>New capital</u>*

The administration is proposing to issue sales tax revenue bonds to cover the costs of the Aldermanic Menu program. The projects that are completed with these sources provide important neighborhood improvements throughout our communities and can improve the quality of life for a community's residents.

While important, many of the projects are smaller in nature, and could be funded with a pay-as-you-go capital program. However, scarce operational resources are much better targeted towards the ongoing phase out of "scoop and toss", terminating the practice of issuing debt to cover operational expenditures, and increasing the annual contribution to the City's pension systems to improve the funded ratios and provide greater fiscal solvency of the systems.

The Mayor's office is proposing to fund these projects with sales tax revenue bonds as opposed to general obligation bonds on a theory that the currently higher credit quality of sales tax debt may allow for the City to receive improved spreads compared to what would be received in the market from GO debt. This appears to be borne out by a sales tax backed issuance that was done last summer, and the fact that sales tax revenue bonds are currently trading at around 100 basis points lower on the secondary market than GO bonds.

Additional attention needs to be given to the fact that sales tax resources are primarily deposited into the corporate fund, as opposed to property taxes used to back GO debt. It could be argued that this places an additional strain on the corporate fund budget. In response, it should first be noted that given the timing of a sales tax bond issuance, the first payments are not likely to have any impact on the already adopted 2016 budget. Second, a number of expenses, most notable pension contributions, are primarily funded through the property tax levy, though in 2016, $114 million from the corporate fund is being utilized to make the required pension contribution. In future years, these payments can be moved to property tax funds as sales taxes are used to cover debt service that otherwise would have required property tax backing.

*Refunding for savings*

As previously mentioned, it is currently the policy of the City to seek savings of 3% of present value or more per bond as part of its refinancing deals. Precise savings that would be achieved from the deals cannot be known until the time that the bonds are issued, though a deal is likely to yield both short-term and long-term savings.

$900 million Water Revenue bonds

This proposed authorization can be broken down into three parts.

- $200 million for swap terminations
- $500 million for variable rate terminations
- $200 million for new capital, which is authorized under a separate proposed ordinance

*Swap termination ($700 million ordinance authorization)*

The interest rate swaps are one of the few remaining swap deals that are still outstanding as part of the City's debt portfolio. By paying for the termination of these swaps now, the penalties for termination will likely be significantly less than if there were to be a further downgrade of the City's bond rating. In addition to that risk, it is also likely that rates will continue to be low enough so that the City does not benefit from the terms of the interest rate swap.

*Variable rate conversions ($700 million ordinance authorization)*

The proposal to convert existing variable rate debt to fixed rate debt will permit the city to mitigate the risk related to its existing debt and provide greater certainty for rate-payers going forward. While it is near certain that interest rates will be rising, now seems to be an appropriate time to convert those bonds.

*New capital ($200 million ordinance authorization)*

The $200 million for new capital is in line with what has been previously outlined in the capital improvement plan for 2016 and 2017. The debt service for these bonds will be covered by revenues generated for the Water Fund.

$400 million Wastewater bonds

The proposed issuance of wastewater bonds consists of two components.

- $300 million for new sewer improvements
- $100 million for refunding for savings

*New capital*

The $300 million for new capital is in line with what has been previously outlined in the capital improvement plan for 2016 and 2017. The debt service for these bonds will be covered by revenues generated for the Sewer Fund.

*Refunding for savings*

As previously mentioned, it is currently the policy of the City to seek savings of 3% of present value or more per bond as part of its refinancing deals. Precise savings that would be achieved from the deals cannot be known until the time that the bonds are issued, though a deal is likely to yield both short-term and long-term savings.

$900 million Midway revenue bonds

As with the other proposals, the Midway proposal is also in three components.

- $500 million for capital improvements
- $200 million for refunding for savings
- $200 million for conversions to Customer Facility Charge bonds.

*New capital*

The capital improvements can largely be compartmentalized into two parts. The first is the previously announced upgrades for parking, security and concessions at the airport. It is anticipated that the cost of this modernization will cost approximately $250 million and be completed by 2020.

In addition to those improvements, regular and ongoing capital needs are also going to be funded with this proposal. Included in those expenses are residential noise insulation projects, runway maintenance and lighting projects.

While the $500 million amount does differ from what was presented in the capital improvement plan, it does not appear that the plan had yet been able to account for all of the component aspects of the proposed modernization.

*Refunding for savings*

As previously mentioned, it is currently the policy of the City to seek savings of 3% of present value or more per bond as part of its refinancing deals. Precise savings that would be achieved from the deals cannot be known until the time that the bonds are issued, though a deal is likely to yield both short-term and long-term savings.

*Conversion to Customer Facility Charge Bonds*

This proposal is being done largely at the request of Southwest Airlines and the car rental companies that are operating at Midway. Similar bonds have been offered at O'Hare at the behest of the major carriers there. By restructuring these bonds, it will allow excess Customer Facility Charge revenues to be used for operational expenses with is not currently possible due to restrictions that are in place under the current structure, and will help ensure that debt liability is more clearly lined up with the entities generating the revenue.

Inducement language for proposed Franklin Point development

Federal regulation limits the ability of municipal issuers to use tax exempt bonds to reimburse costs that have already been expended. By approving the inducement ordinance, and establishing that the costs of this project may be covered by tax exempt debt in the future, it keeps the possibility open that a developer could incur costs and have improvements to the public way reimbursed with tax exempt debt. The inducement by itself does not provide a City subsidy to the developer for these improvements. Any future bond issuance for this project would still require City Council approval.