Chicago Board of Education's labor strife left at standstill
By Gunjan Banerji
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Chicago Board of Education is in a bind with both the teachers' union and the Illinois legislature.

The teachers' contract has been the "elephant in the room that no one's talking about because there are bigger things to worry about," said John Schomberg, a senior counsel at law firm Clark Hill. Schomberg was general counsel to former Illinois Governor Pat Quinn from 2010 to 2015.

Meanwhile, the distressed school district's deadline to fork over USD 634m to the Chicago Teachers Pension Fund is today. As of yesterday, the district did not have a feasible plan for making the payment. The district faces a USD 1bn deficit.

It's one of the largest school districts in the country, so how lawmakers deal with it is important in understanding overarching support for the City of Chicago, said Adam Stern, director of municipal research at Breckinridge Capital Advisors.

The junk-rated city is dealing with its own financial problems, as previously reported. However, the Board of Education is a major political subdivision that bears on the Chicago area's long-term fiscal and economic health, Stern said. It also has implications regarding how other states might deal with their school districts, Stern said.

Negotiations between the Board of Education and the unions broke off last week, according to a mass email from Karen Lewis of the Chicago Teachers Union. The union's contracts expire today.

Appetite for a strike or lockout is greatly reduced in light of the 2012 strikes, Schomberg said. The strikes led to closed schools for eight days.

However, unions were aware of the district's financial situation when they struck in 2012, said Ted Dabrowski of the Illinois Policy Institute. The district's finances have eroded over time; given that the district is already in fiscal trouble, the fact that Mayor Rahm Emanuel agreed to a salary increase after the last strike was very telling, Dabrowski said.

The union's requests this year included getting rid of extraneous paperwork and testing and excessive testing, according to the mass email. Chicago Teachers Union claimed that the board threatened to terminate 3,000 teachers, increase class size, eliminate their pension pick-up, and enforce USD 200m of cuts.

In terms of a ratings transition perspective continued labor strife is an issue for the district, Stern said. If you don't have stable labor relations, it can be a problem that tends to be correlated with an inability to balance revenues and expenditures.

Moody's Investors Service pegs the district at the junk rating of Ba3 with a negative outlook while Fitch Ratings has it at BBB- with a negative outlook. Standard & Poor's pegs it at A- with a negative outlook, and Kroll Bond Ratings Agency grades it at BBB+ with a stable outlook.

High stakes and deadlocked labor negotiations can lead to market nervousness and price swings—even if bondholders' securities are safe – they may have to deal with some volatility, said Donald Boyd, senior fellow at the Rockefeller Institute of Government, a public policy research arm of the State University of New York. The drama between the municipality and labor unions is better than personnel compensation that is so high that it could put their eventual securities at risk, Boyd said.

A tranche of USD 165m Series 2015C general obligation bonds maturing in 2039 last traded today at 91.5 yielding 5.9%, according to Electronic Municipal Market Access (EMMA). The same tranche traded in May 2015 at 98 yielding 5.6%, according to EMMA.

Unions want what they consider to be fair compensation, and they want the government to be able to pay it for a sustained period, Boyd said. Holding out for huge salary increases that lead to layoffs or cuts in other benefits is not necessarily a winning strategy, although it does depend on which interests the union has closest to heart, Boyd said.

There is not a strong history in the municipal market of labor unions demanding contract provisions that lead to a bond default. In the end, labor unions typically realize that bond default doesn't solve their purpose, Stern said. It is not in the union's interests to jeopardize the district's finances, and certainly not to the point of default, Boyd said.

"Thus, there is a point at which they would feel they're going too far," Boyd said.

We may be approaching a slightly different era in which there will be an uptick in situations in which people decide that they have to burn the village in order to save it—but the examples will be few and far between, Stern said.

The district has a policy of not discussing negotiations. Calls to the Chicago Teachers Union were not returned.