
Illinois' threats to choke Chicago Board of Education bonds probe muddy legal territory

by Gunjan Banerji

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Illinois Governor Bruce Rauner's (R) recent statements to knock **Chicago Board of Education** (CBOE) out of the bond markets may not mesh with current Illinois laws, said two public finance attorneys.

The statements refer to Illinois' current powers over distressed districts, which CBOE may be carved out from. However, the governor has repeatedly stated that the district needs a state takeover or municipal bankruptcy. Republicans introduced such legislation, some of which is specifically crafted for **Chicago** and CBOE, in January, which the governor supports.

This week, a public back-and-forth between the governor and CBOE CEO Forrest Claypool came to the forefront, as Rauner stated that the Illinois State Board of Education (ISBE) could prevent the district from issuing more bonds. A few weeks ago when the district came to market with almost USD 900m in debt, the governor called for bankruptcy for the district, and it wasn't his first time doing so.

CBOE is not currently allowed to file for bankruptcy under state statute, and the state powers that Rauner alluded to this week are not cut and dry in Illinois statute, according to the two public finance attorneys.

And while Illinois state takeover laws appear somewhat muddled, CBOE's financial crisis remains crystal clear. The district entered FY16 (fiscal year started 1 July) pegging its USD 5.7bn budget to USD 500m in help from Illinois that has not yet come. The district's cash flow projections indicate that it will make a USD 676m pension payment in June 2016, after which the state's largest school system will be left with USD 24m in operating cash to educate almost 400,000 students, according to latest offering documents.

The district has been hanging by a thread, and its liquidity entering FY17 grows even murkier, noted a municipal credit analyst.

Rauner threatened to block the distressed district's market access, but investors almost did that even without legal statute, forcing CBOE to downsize and cheapen its debt to top yields of 8.5%.

Archaic Illinois laws become relevant

East St. Louis School District 189 and North Chicago School District in Illinois are already under oversight by the ISBE. However, Chicago is Illinois' biggest city, and has certain laws tailored specifically for it. The School Finance Authority Act, or Article 34A, for example, is designed for boards of education of cities with over 500,000 people—Chicago is the only city in the state that fits the bill.

At issue is whether or not CBOE is subject to the ISBE fiscal oversight laws that districts throughout the state are, because of a particular statute initially designed to exclude CBOE from it, said Clark Hill's John Schomberg.

The governor's office stated that CBOE is no longer subject to Article 34A. This would allow the ISBE to require school districts certified in "financial difficulty" to develop and submit a fiscal plan and report to the ISBE regarding compliance with such a plan. Section 1A-8 of Illinois law states that a district under such a plan can't issue bonds, notes or tax anticipation warrants.

The matter is not so cut and dry, said Schomberg and a second Illinois-based public finance attorney. There are legal arguments supporting CBOE's case as well as the governor's public statements.

Recognizing Article 34A, which allowed an independent board to manage CBOE's finances during its last crisis in 1980, would mean that ISBE doesn't have the powers Rauner claims it has. The Chicago School Finance Authority was officially dissolved in 2010, after issuing over USD 1.1bn in bonds.

"[Article 34A] applied only when the reform board existed, which it no longer does. CPS [CBOE] is not governed by Article 34, which means CPS can be required to develop a financial plan and would be prohibited from issuing bonds during that period," said Catherine Kelly, a spokesperson for the governor.

But despite the dissolution, CBOE could make an argument that although the board currently doesn't exist, it still has some residual power and could be resurrected, said the second public finance attorney. CBOE could challenge ISBE's power over the district and its future debt issuances, added the attorney.

If ISBE finds "financial difficulty" and requests that CBOE go through the various steps of coming up with a financial plan and then adhering to it under the ISBE's watch, CBOE management could fight back and argue that under current statute, the ISBE is not allowed to do so, Schomberg said.

Then, it would be on the ISBE to force them to put together a financial plan under the state's courts.

Investigation persists

Regardless of the ambiguous legal territory, nothing stopped the ISBE from starting an investigation last week to determine if CBOE qualifies as being in "financial difficulty," said Laine Evans of the ISBE.

Tony Smith, state superintendent of education, sent a letter to Claypool and CBOE President Frank Clark last week initiating a "proper investigation of the financial integrity of [CBOE]," according to documents seen by *Debtwire Municipals*.

The district must send ISBE audits, cash flows, monthly payroll amounts, a three-year financial plain, and labor contracts, according to the documents. CBOE must also send alternate revenue bond amortization schedules to determine increases of general state aid or other revenue that needs to go to debt service instead of operations, according to the documents.

CBOE did not respond to a request for comment.