

Chicago Social Justice Bonds

City of Chicago

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City of Chicago
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CHICAGO'S SOCIAL JUSTICE BONDS

An aggressive marketing campaign was released to sell bonds to residents of the City of Chicago before they are offered to large banks and institutional investors. The bonds were introduced for a limited time for only a week and coined “Social Justice Bonds”. The offer will be \$97.7 million in nontaxable municipal bonds, plus an additional \$60 million in taxable bonds.¹ The bonds are structured to sell through the Sales Tax Securitization Corporation (STSC)². Ownership of current and future sales tax revenue is in the hands of the Sales Tax Securitization Corporation, which was formed in 2017. Although they have ownership rights, the earnings will go to the City of Chicago. Why did the City sell its current and future sales tax revenue to an outside entity, the administration indicated it was done to lower the city’s interest cost.

Sales Tax Securitization Corporation (STSC)

According to the City of Chicago the STSC was created to secure lower interest rates and save money for taxpayers, however due to the lack of credit worthiness and lack of investor confidence, the City needed to utilize a third party for a bond offering to ensure timely payments and for protection in the event of an economic downturn. The STSC does indeed lower the city’s interest cost. The Sales Tax Securitization Corporation allows bankruptcy remote status which is a form of protection. The structure of the social bonds mitigates the impact of economic downturns; therefore, debt obligations are expected to be met with sales tax revenue (current and future). The downside of such a structured deal is that it allows municipalities to receive an infusion at the expense of citizens while they ‘kick the can down the road’ by borrowing more and allowing first rights to municipal bondholders on future public assets. Unlike typical municipal bonds the city’s social justice bonds are marketing the social benefit, the chance to invest in Chicago and support social justice initiatives.

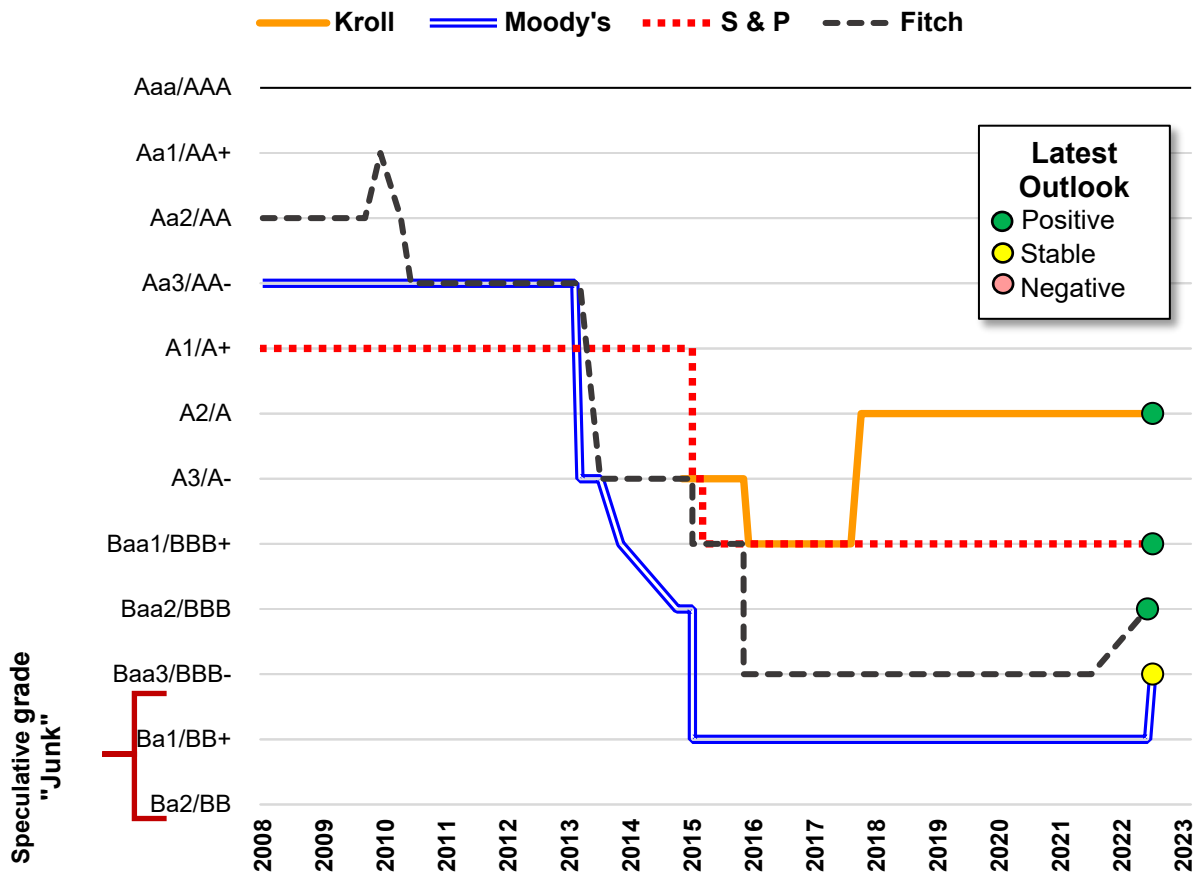
The city introduced its first “social justice” bonds that will target seven trackable Chicago Recovery Plan projects. Use of the funds include electrification of the city’s light fleet by 2035, tree canopy expansion, supportive housing, community housing development, mixed-use housing development, vacant lot clearance and community development grants.³ The STSC will offer \$155 million in new cash bonds.⁴ Funding for the \$1.2 billion CRP projects relies on a mix of borrowing and state COVID-19 relief from the American Rescue Plan.⁵ The social bonds have a voluntary reporting agreement that will detail expenditures of the proceeds on an annual basis and plan to include social outcomes and impacts.⁶

Benefits Of Chicago Recovery Plan Projects (Social Justice Bond)

The city expects benefits of a cost savings of \$2.5 million annually and reduction of greenhouse gas emissions.⁷ The city also plans to plant 75,000 trees over the next five years and will prioritize tree planting in underserved and marginalized communities to equitably convey ecosystem benefits.⁸ The city also plans to acquire or develop housing and sell / redevelop 10,000 vacant lots. Research shows a reduction in gun violence, vandalism, burglaries, and other crimes near vacant lots that have been repurposed.⁹ Any reduction in violence will be welcome and a benefit for the city. Taxpayers will have an interest rate between 5.765% and 7.781% and have the option of purchasing 2-, 3-, 10-, and 30-year government bonds.¹⁰ The final prices will be based on Treasury quotes on January 19, 2023.

Chicagoans have a priority in securing the bonds, therefore Chicagoans can purchase bonds, realize a return on investment, and enhance their communities. The bonds can be purchased in increments as low as \$1,000 – the bonds are accessible. Rating agencies has increased bond ratings in Chicago, and according to Jennie Huan Bennett, chief financial officer for the City of Chicago the city’s bonds is now investment grade, investment grade indicates a minimum risk to investors. Below is a historical bond chart created by COFA (November 14, 2022) that displays our bond rating history. Chicago bond ratings have improved and are stable with a positive outlook.

City of Chicago - General Obligation Bond Rating History



SOURCE: Fitch Ratings; Kroll Bond Rating Agency; Moody's Corporation; S&P Global Ratings
 NOTES: S&P and Kroll gave Chicago's GO Bonds an outlook of **Positive** in their latest issued reports. Fitch also gave Chicago's GO Bonds an outlook of *Positive* in their latest report, while Moody's gave an outlook of *Stable*. Ratings and outlooks as of November 14, 2022.

Implications

COFA believes that the city proceeds with caution with the released social justice bonds and focus on securing Chicago's fiscal future by focusing on pension funding, education, violence, and the City's infrastructure. The City has serious pension issues, 400,000 lead pipes that must be replaced, a broken school system, and continued violence that plaques the City. The social justice bonds had a unique marketing plan. Where will the proceeds from the bonds go, is there a risk the funds will be commingled and used at the City's discretion.

Chicago's Environmental, social or governance bond refers to a bond with a set environmental, social or governance objective (ESG bonds).¹¹ Chicago's social justice bonds will be sold under the higher-rated Sales Tax Securitization Corporation. Structuring the bond with STSC remote status reduces the impact of an economic downturn, but is borrowing from future sales tax the best solution? Is borrowing from future sales tax revenue advantageous in the long run? Does the sale of future sales tax seem reminiscent of the sale of the Skyway or the sale of City Parking meters?

The sales tax securitization bonds are secured by a first lien on the state-collected portion of the city's home rule sales and use taxes.¹² The security of the STSC is to reduce uncertainty if the city goes bankrupt, if the city foresees hard times, after the COVID funding is exhausted the STSC deal is at least rational. Proceeds from the sale of Bonds will go to the City, however RBC Capital Markets, Siebert Williams Shank & Co. LLC and UBS Financial Services Inc. are tender managers and leading the STSC transaction, will also receive compensation.¹³

An alternative to the STSC structure is to utilize the current structure in the generation of GO (General Obligation) bonds while strengthening Chicago's fiscal outlook, by addressing pension cost / debt and to consider pension reform. If Chicago's fiscal outlook was in an upward trajectory toward a real balanced budget it would not need to look for creative solutions to hedge from economic downturns. Sooner or later Chicago must live within its means. The graph from historical bond ratings show positivity, can Chicago continue this trend?

Chicago's social justice bonds will carry a social label to increase the appeal for investors, of the seven initiatives mentioned they are being pushed as being transformative social investments. What makes the investments equitable and transformative – is it the 75,000 trees that will be prioritized in marginalized and underserved communities for equitable ecosystem benefits or perhaps the vacant lots that will be cleaned up. These initiatives are nothing new and the city is currently funding affordable housing, vacant lot programs, and the tree program.

Money is fungible, and we must ensure that the proceeds do not go into one pot, the use of proceeds from the social justice bonds must be intentional and earmarked for the intended purpose. The social justice bonds have a voluntary agreement for reporting that must be adhered to. The social equity point

is at the center of the administrations talking points. The 2023 budget was in large part based on equity and inclusion, the seven initiatives were included, to therefore promote the use of bond proceeds for social justice initiatives ring redundant or suspect. The social justice bonds may be a good investment for investors, but COFA believes that the focus should be on securing our fiscal health by addressing fundamental issues that are prevalent such as violence, education, pension funding and the City's infrastructure (pipe replacement). The social justice bonds are already on the market, the City must proceed with caution and ensure the standards are high, measurements are transparent, and outcomes are independently determined.

ENDNOTES

¹Roeder, D., 2023. High-minded high finance: City cells bonds to the masses. Retrieved from: <https://chicago.suntimes.com/2023/1/16/23552880/chicago-social-bond-program-neighborhood-improvement-money>

²Glennon, M. Chicago's New "Social Bonds": Limited Time Special Offer! Wirepoints. Retrieved from: <https://wirepoints.org/chicagos-new-social-bonds-limited-time-special-offer-wirepoints/>

^{3,4,5,6,7}Parker, L. 2023. Chicago launches bid, prepares debut for social bonds. Retrieved from: <https://localtoday.news/il/chicago-launches-bid-prepares-debut-for-social-bonds-140805.html>

^{8,9,10}Parker, L. 2023. Chicago launches bid, prepares debut for social bonds. Retrieved from: <https://localtoday.news/il/chicago-launches-bid-prepares-debut-for-social-bonds-140805.html>

¹¹Price, D. 2022. Managing social risk and addressing racial inequities in the Muni bond market. Retrieved from: <https://impactalpha.com/managing-social-risks-and-addressing-racial-inequities-in-the-muni-bond-market/>

¹²Fitch Rates Chicago Sales Tax Securitization Corp., IL's First Lien Rev 'AA'; Second Lien Revs 'AA-' <https://www.fitchratings.com/research/us-public-finance/fitch-rates-chicago-sales-tax-securitization-corp-il-first-lien-rev-aa-second-lien-revs-aa-06-12-2022>

¹³Parker, L. Chicago launches bid, prepares debut for social bonds. <https://localtoday.news/il/chicago-launches-bid-prepares-debut-for-social-bonds-140805.html>