DEBT MANAGEMENT

Summary

CPS maintains its school buildings through an annual capital program, described in the Capital chapter. For the most part, the capital program is funded through the issuance of bonds, similar to a loan with annual principal and interest payments. Most of these bonds are backed by General State Aid payments. Since General State Aid is also a major revenue source to support core classroom activities, we face a continuing challenge to balance the day-to-day classroom needs with the need for quality education facilities.

Debt Overview

The Board of Education currently has $5.6 billion of outstanding debt. The FY2012 budget includes appropriations from the Debt Service Funds of $409.9 million for payments on existing debt as well as $400 million in new bonds. CPS continually reviews the affordability of its capital program, minimizes debt issuance costs and monitors existing debt for any cost-saving opportunities as part of its efforts to meet budget challenges.

Debt Profile

CPS has established the following debt management goals to balance costs, risks and liquidity needs:

- to borrow at the lowest cost of funds balanced against the risk of sizeable increases in interest rates;
- to maintain an appropriate allocation of debt products and to manage/refinance when advantageous to current market conditions;
- to maintain strong credit ratings, which keeps interest rates lower;
- to fund a capital plan that balances the need for new construction with the affordability of additional debt issuance.

Types of Obligations

The Board is authorized by state law to issue notes and bonds and to enter into lease agreements for capital improvement projects. General Obligation Bonds are a type of financing tool frequently used by local governments and school districts, which usually means that property taxes are levied specifically to repay those bonds. CPS bonds have two revenue sources: both property taxes and specific revenue. Practically, however, CPS uses only non-property tax revenues to repay its bonds. Thus CPS bonds are a special kind of general obligation bonds: Alternate Revenue General Obligation Bonds. The Board is authorized to issue Alternate Revenue Bonds after adopting a resolution and satisfying public notice publication and petition period requirements in lieu of a voter referendum.

CPS bonds are backed by General State Aid, Personal Property Replacement Taxes, or revenues derived from Intergovernmental Agreements with the City of Chicago. No property taxes have been used to pay CPS-issued bonds.

CPS has benefitted from issuing certain types of bonds in which much of the interest costs are paid by the U.S. Government, resulting in a very low cost of borrowing for CPS. These include Qualified Zone Academy Bonds, which provide capital funding for schools in high-poverty areas at reduced interest rates for CPS, Qualified School Construction Bonds (QSCBs) and Build America Bonds (BABs). The American Recovery and Reinvestment Act of 2009 created QSCBs, which were bonds which only school districts could sell and provided some of the lowest interest cost financing CPS has ever achieved, and BABs, which were available to school districts and other governments with a substantial subsidy. In total, CPS has paid less than one-third of total typical interest costs on these specialized bonds due to the subsidized nature of the instruments.

Another CPS obligation relates to the Public Building Commission (PBC), a government entity that sold bonds to fund schools secured by CPS payments. These are the only CPS bonds that rely solely on property tax levies. The FY2012 budget includes $52 million in payments for principal and interest on these bonds. In addition to property tax revenue, CPS receives state revenue for capital through the state's Capital Development Board.

FY2012 Debt Service Costs for all Obligations

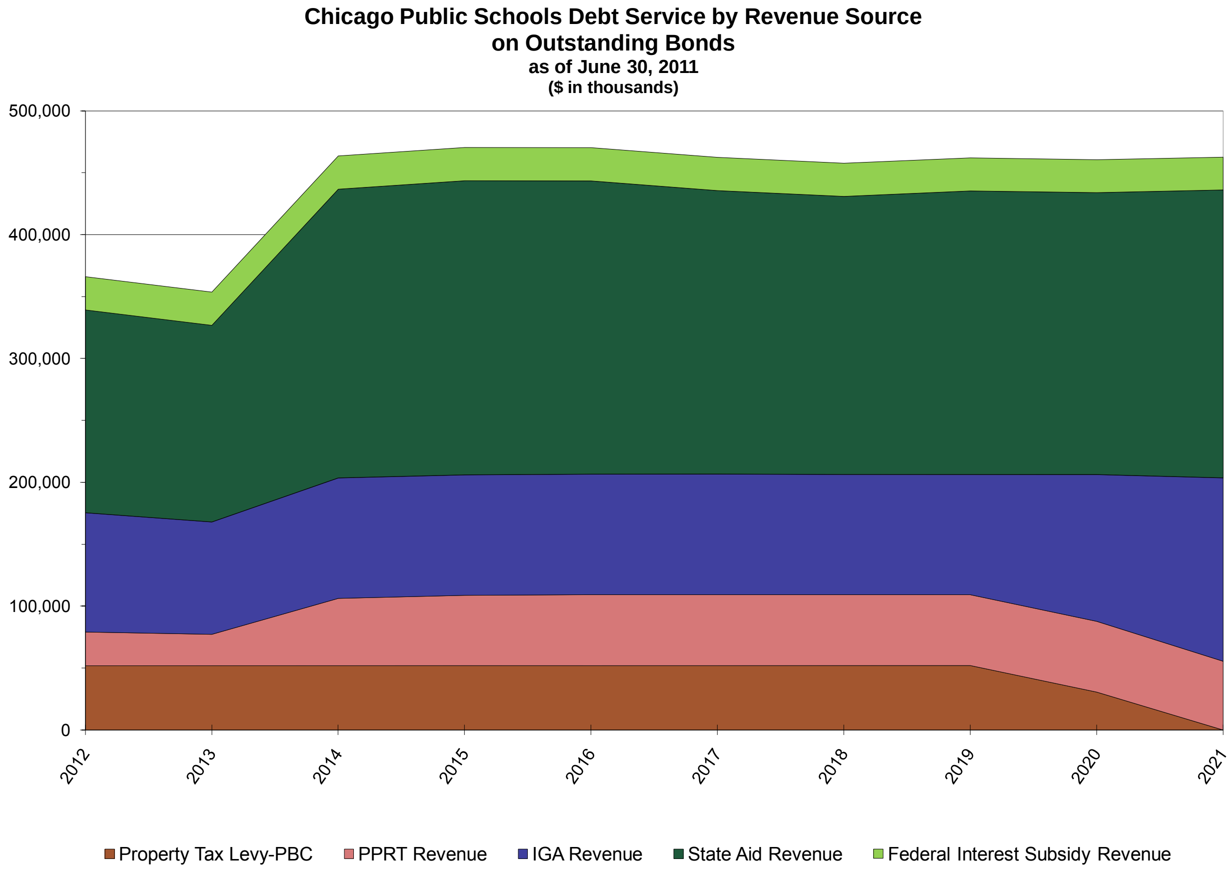
As shown in the table below, FY2012 includes appropriations for existing alternate bonds, PBC payments (included with existing bonds), and the issuance of $400 million of new bonds, for a total of $409.9 million for debt service. While this represents an increase compared to FY2011 estimated actual payments, actual costs for FY2011 were far below the original FY2011 budget due to the restructuring of debt service. CPS refinanced its existing debt in FY2011 to gain budget relief in FY2011 and FY2012.

FY2010 - FY2012 Summary of Debt Service Funds
(In Millions)

	FY2010 Actual	FY2011 Estimated Actual	FY2012 Budget
Beginning Year Fund Balance	$426.9	$499.8	$480.9
Restricted Fund Balance	(272.3)	(278.0)	(261.1)
Assigned Fund Balance	(154.6)	(169.8)	(219.8)
Fund balance to be appropriated	0.0	52.0	0.0
Revenues:			
Property taxes	11.2	32.5	51.9
PPRT	55.7	25.4	55.2
General State Aid	184.3	222.5	162.8
State capital reimbursement	0.0	29.7	54.1
Other local (City IGA)	171.9	109.0	96.7
Federal interest subsidy	7.5	19.1	26.8
Total Revenue	430.6	438.2	447.5
Expenditures:			
Existing Bond Principal payment	80.3	70.9	88.5
Existing Bond Interest payment	213.0	267.6	278.5
Total Existing Bond Debt Service	293.3	338.5	367.0
FY2012 New Bond Debt Service			32.0
Fees	7.9	8.6	10.9
Total Appropriation	383.9	347.1	409.9
Other Financing Sources/(Uses)	26.1	(110.0)	0.0
Restricted Fund Balance	330.0	261.1	298.7
Assigned Fund Balance	169.8	219.8	219.8
End-of-Year Fund Balance	$499.8	$480.9	$518.5

Long-Term Fiscal Challenges

The graph below illustrates CPS's fiscal challenge. After a dip in debt service payments as a result of the FY2011 restructuring, debt service increases to nearly $475 million in FY2014. Because we are required to set aside the debt service one year in advance, the impact of this jump will be felt in FY2013. Significantly, the amount of debt service paid from General State Aid ("State Aid Revenue") will jump from $162.8 million in the current year to over $250 million in FY2013. The graph below shows the debt service payments for the outstanding bonds only: this graph does not show the impact of the $400 million in new bonds proposed in the FY2012 budget nor any future bonds required to support future capital budgets. Resources needed to pay bondholders are in direct competition with resources needed for the classroom. Our challenge could not be more stark.



Measuring Debt Burden

In addition to evaluating the total amount of debt outstanding and the annual debt service payments, those evaluating our financial picture also look at "debt burden." The purpose is to gauge how much taxpayers bear in debt costs, and to understand CPS's debt capacity: to determine how much debt is affordable for residents and for CPS's financial position. Several methods of measuring debt burden are commonly employed for school districts. These include comparing existing debt to legal debt limits, measuring debt per capita, and measuring debt as a percentage of operating expenditures.

Legal Debt Limit

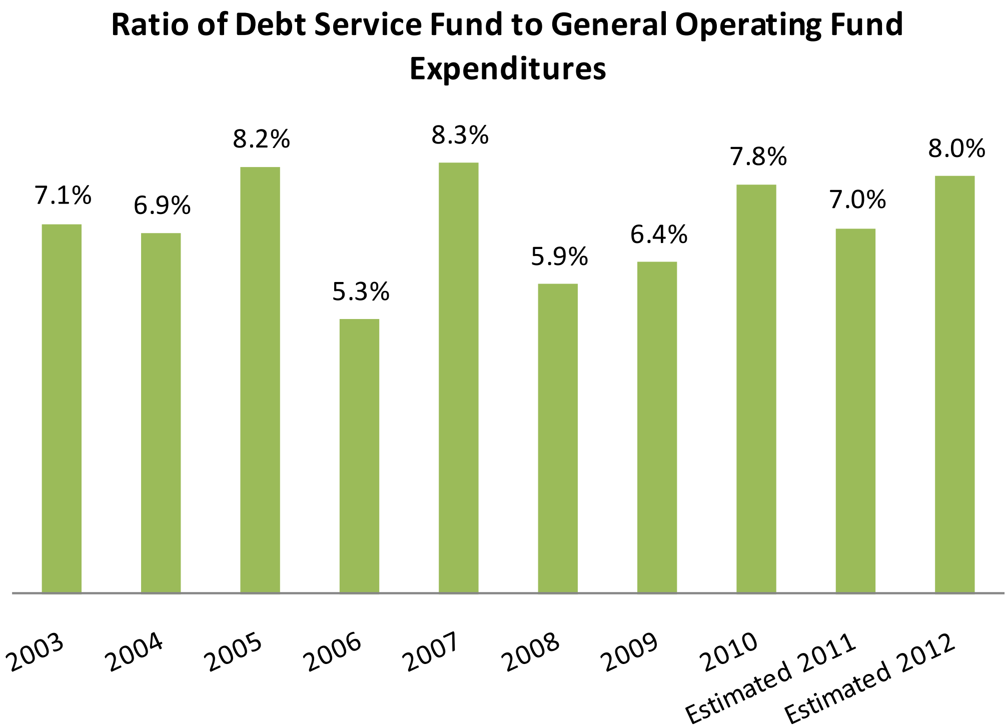
The Illinois School Code imposes a statutory limit of 13.8% on the ratio of the total outstanding property tax-supported debt that a school district may borrow compared with a school district's equalized assessed value, which generally represents a fraction of total property value in the district. Because the Board has issued alternate revenue bonds for which property tax levies are not extended, these bonds do not count against the legal debt limit imposed by the Illinois School Code. Total property tax supported debt was less than 1% of the legal debt limit.

Debt Per Capita

The Board's per capita debt burden, or total debt divided by the City of Chicago's population, has increased in the last decade. As reported in the FY2010 Comprehensive Annual Financial Report, debt per capita in FY2001 was $854; by FY2010, debt per capita reached $1,720. This is within the moderate range relative to other comparable school districts, but the rate of increase is significant.

Debt as a Percent of Operating Expenditures

Another way of measuring the total debt burden is by dividing annual debt service expenditures by operating fund expenditures. Based on this method, the debt burden for FY2010 was a moderate 7.8% of operating expenditures. For FY2011, actual debt service payments are estimated at 7% of total operating expenditures due to the FY2011 debt restructuring. With the proposed bond issue, the debt burden is anticipated to increase to 8% of operating appropriations in FY2012.



Credit Ratings and Debt Management Policy

The Debt Management Policy of CPS provides guidance for debt management and capital planning and supports the Board's ability to manage its debt in a conservative and prudent manner. One of the goals of the policy is to ensure that CPS maintains the highest possible credit rating among the three credit agencies. These agencies exist as independent entities and their purpose is to give investors, or bondholders, an indication of the creditworthiness of a government entity. A high credit score can lower the cost of debt issuance, much the same way a strong personal credit score can reduce the interest costs of loans and credit cards.

CPS meets frequently with the credit rating agencies about its budget, audited financial results, debt plan, and management initiatives to ensure the agencies have the most updated information possible. The primary rating factors for CPS concern management, debt profile, financial results and economic and demographic factors, including student enrollment.

In FY2011, the credit ratings for CPS remained at AA- by Standard & Poor's and Aa2 by Moody's Investors Service. Fitch Ratings lowered its rating to A+ from AA- in October 2010. Although Standard & Poor's and Moody's Investors Service credit ratings did not change, CPS's ratings carry a "negative outlook" from both rating agencies. These outlooks can indicate the trajectory of a rating: a negative outlook can mean that the agencies believe the credit rating is deteriorating and a possible candidate for downgrade. These negative outlooks persist primarily due to CPS's strained financial condition, inability

to meet Fund Balance Policy goal in fiscal 2010 through the use of rainy day reserves, the size of out-year deficits (which exceed $1 billion per year), and the state's continual delay in certain payments. Like a high credit rating can mean lower borrowing costs, deterioration in credit rating will increase interest fees.

As part of the Debt Management Policy, CPS is authorized to use a number of tools to manage its portfolio of debt. Some of the tools and techniques employed are: refunding of existing debt, using derivative instruments, issuing fixed or variable-rate bonds, and issuing short-term or long-term debt. These tools are used to manage various types of risks, to generate cost savings, and to assist capital asset planning.

Typically, CPS issues fixed rate bonds which pay a set, agreed-upon interest rate according to a schedule set at the time of debt issuance. However, about 20% of CPS debt is variable rate, which means that the interest rate can fluctuate. The interest rate on variable rate debt is often lower than what can be achieved in a fixed rate market, but the rate can be highly volatile: CPS uses interest rate swaps to reduce the volatility inherent in variable rate debt, yet still achieve cost savings when compared to traditional fixed rate debt. An interest rate swap is an agreement between two parties (known as counterparties) where one stream of future interest payments is exchanged for another based on a specified principal amount. The Board generally pays a fixed rate to a counterparty and receives a variable rate from the counterparty which is intended to offset the amount paid to its variable rate bondholders. CPS only enters into transactions with a highly rated, credible and diverse group of counterparties.

A copy of the Debt Management Policy is available at the Board's website at
http://policy.cps.k12.us/documents/404.1.pdf.

Outstanding debt
as of June 30, 2011

Debt Outstanding at 6/30/11 Chicago Public Schools	**Closing Date**	**Maturity Date**	**Principal Outstanding At 6/30/11**	**Pledged Funding Source for Debt Service**
PBC Series A of 1992	1/1/92	1/1/2020	$205,025 ,000	Property Tax
PBC Series A of 1993	4/1/93	12/1/2011	11,660 ,000	Property Tax
PBC Series B of 1999	3/1/99	7/1/2018	113,690 ,000	Property Tax
Unlimited Tax G.O. Series 1997A*	12/3/97	12/1/2030	37,985,204	IGA / PPRT
Qualified Zone Academy Bond	9/24/98	9/23/2011	14,000,000	IGA
Unlimited Tax G.O. Series 1998B-1*	10/28/98	12/1/2031	294,045,851	IGA / PPRT
Unlimited Tax G.O. Series 1999A*	2/25/99	12/1/2031	481,667,762	IGA / PPRT
QZAB IDFA 1999A	12/22/99	12/21/2011	12,000,000	State Aid
Unlimited Tax G.O. Series 2000BC D	9/7/00	3/1/2032	285,200,000	State Aid
QZAB Series 2000E	12/19/00	12/18/2013	13,390,000	State Aid
QZAB Series 2001B	10/24/01	10/23/2015	9,440,000	State Aid
Unlimited Tax G.O. Series 2002A	9/24/02	12/1/2022	42,540,000	IGA
Unlimited Tax G.O. Series 2003A	2/13/03	12/1/2016	6,795,000	State Aid
QZAB Series 2003C	10/28/03	10/27/2017	4,585,000	State Aid
Unlimited Tax G.O. Refunding, Series 2004A	4/6/04	12/1/2020	202,420,000	PPRT / State Aid
Unlimited Tax G.O. Series 2004G	12/1/04	12/1/2022	12,500,000	IGA
Unlimited Tax G.O. Series 2005AB	6/27/05	12/1/2032	246,180,000	PPRT / State Aid
QZAB Series 2006A	6/7/06	6/1/2021	6,852,800	State Aid
Unlimited Tax G.O. Series 2006B	9/27/06	12/1/2036	320,775,000	State Aid
Unlimited Tax G.O. Series 2007BC	9/4/07	12/1/2024	203,715,000	IGA / PPRT
Unlimited Tax G.O. Series 2007D	12/13/07	12/1/2029	203,865,000	State Aid
Unlimited Tax G.O. Series 2008A	5/13/08	12/1/2030	262,785,000	IGA / PPRT
Unlimited Tax G.O. Series 2008B	5/13/08	3/1/2034	214,175,000	State Aid
Unlimited Tax G.O. Series 2008C	5/1/08	12/1/2032	464,655,000	State Aid
Unlimited Tax G.O. Series 2009A	3/18/09	3/1/2026	130,000,000	State Aid
Unlimited Tax G.O. Series 2009BC	6/25/09	3/1/2031	75,410,000	State Aid
Unlimited Tax G.O. Series 2009D	7/29/09	12/1/2022	63,210,000	State Aid
Unlimited Tax G.O. BAB Series 2009E	9/24/09	12/1/2039	518,210,000	State Aid / Federal Subsidy
Unlimited Tax G.O. Series 2009F	9/24/09	12/1/2016	23,750,000	State Aid / Federal Subsidy
Unlimited Tax G.O. QSCB Series 2009G	12/17/09	12/15/2025	254,240,000	State Aid
Unlimited Tax G.O. Series 2010A	2/17/10	3/1/2035	48,910,000	State Aid
Unlimited Tax G.O. Series 2010B	2/17/10	3/1/2036	157,055,000	State Aid
Unlimited Tax G.O. QSCB Series 2010C	11/2/10	11/1/2029	257,125,000	State Aid

Debt Outstanding at 6/30/11 Chicago Public Schools	**Closing Date**	**Maturity Date**	**Principal Outstanding At 6/30/11**	**Pledged Funding Source for Debt Service**
Unlimited Tax G.O. BAB Series 2010D	11/2/10	12/1/2040	125,000,000	State Aid
Unlimited Tax G.O. Refunding Series 2010F	11/2/10	12/1/2031	183,750,000	State Aid
Taxable Unlimited Tax G.O. Refunding Series 2010G	11/2/10	12/1/2017	72,915,000	State Aid
Total Principal Outstanding			**$5,579,521,617**	

*Excludes accreted interest accrued on 0% coupon capital appreciation bonds.

Schedule of Debt Service Requirements to Maturity*					
($ in thousands)					
Fiscal Year Ending June 30	Total Existing General Obligation Bond Principal	Total Existing General Obligation Bond Interest	Total Existing G.O. Bond Debt Service	PBC Leases	TOTAL
2012	$57,871	$257,186	$315,057	$51,926	$366,983
2013	40,973	260,815	301,788	51,963	353,751
2014	147,632	264,015	411,647	51,982	463,629
2015	157,542	260,883	418,425	52,029	470,454
2016	161,191	257,122	418,313	51,997	470,310
2017	157,518	252,951	410,469	52,020	462,489
2018	172,767	244,170	416,937	52,069	469,006
2019	178,875	237,970	416,845	52,099	468,944
2020	191,621	245,416	437,037	30,636	467,673
2021	216,950	253,420	470,370		470,370
2022	203,398	246,495	449,893		449,893
2023	212,098	239,302	451,400		451,400
2024	216,997	228,117	445,114		445,114
2025	225,483	219,871	445,354		445,354
2026	502,773	223,247	726,020		726,020
2027	258,915	210,891	469,806		469,806
2028	268,245	200,371	468,616		468,616
2029	227,667	243,508	471,175		471,175
2030	491,232	227,911	719,143		719,143
2031	270,124	211,373	481,497		481,497
2032	235,916	244,084	480,000		480,000
2033	106,205	64,542	170,747		170,747
2034	94,275	60,776	155,051		155,051
2035	82,920	57,275	140,195		140,195
2036	72,890	54,392	127,282		127,282
2037	57,305	52,071	109,376		109,376
2038	55,225	50,198	105,423		105,423
2039	58,260	48,142	106,402		106,402
2040	61,460	45,948	107,408		107,408
2041	64,820	2,113	66,933		66,933
2042	0	0	0		0
	$5,249,150	**$5,464,576**	**$10,713,726**	**$446,719**	**$11,160,445**

The Board anticipates issuing about $400 million of bonds in fiscal year 2012, resulting in additional annual debt service of $32 million.