

Bond Case Briefs

Municipal Finance Law Since 1971

Detroit's Paying a Penalty on First Bond Sale Since Bankruptcy.

Detroit is paying a high price in its return to the \$3.6 trillion municipal-bond market for the first time since emerging from a record bankruptcy.

The \$245 million of bonds, to be sold Wednesday through the Michigan Finance Authority, have the top claim on city income taxes to ensure investors are repaid. Even so, 14-year debt is being offered at an initial yield of 4.75 percent, according to three people familiar with the sale who requested anonymity because it isn't final. That's 2.1 percentage points more than top-rated securities.

"It's still Detroit," said Dennis Derby, a portfolio manager in Menomonee Falls, Wisconsin, for Wells Capital Management, which holds the city's water bonds among its \$39 billion of munis. "There's still concerns of whether or not they can have positive momentum."

Detroit filed for bankruptcy protection two years ago to escape from debts it couldn't afford after the population tumbled, tax collections slid and the automobile-industry's decline left the economy reeling.

That allowed the city to cut \$7 billion from its obligations by the time it emerged from bankruptcy in December, an effort to steady the government's finances and hasten its revival.

Investor Losses

The plan left some general-obligation bondholders recovering as little as 41 percent of what they were owed, according to Moody's Investors Service. Those losses called into question the long-held assumption that cities would do everything possible to repay securities backed by their full faith and credit.

To persuade investors to lend to the city again, Michigan Governor Rick Snyder signed legislation giving bondholders first claim to the income taxes that will repay the debt sold this week. That led Standard & Poor's to award the deal an A rating, five steps above junk and nine levels higher than its grade on Detroit's general obligations.

John Naglick, Detroit's deputy chief financial officer, marketed the securities during a presentation in New York and in phone calls with investors. He declined to comment on the expected yields ahead of the sale.

"We feel that investors really took the time to understand the security provisions that came with this bond," said Naglick. "People looked even beyond the bond at the recovery of the city of Detroit."

Detroit Rebound

Detroit's leaders have been seeking to revive the city, whose population of about 680,000 as of July 2014 was less than half the peak after the Second World War. There are signs of progress:

employment has risen 3 percent over the last four years and income-tax revenue grew 18 percent from 2010 to 2015, according to Moody's.

The proceeds from this week's sale will repay a loan from Barclays Plc that helped Detroit emerge from bankruptcy, Naglick said. They will also finance city projects, including upgrades for the fire department's fleet.

The city's income-tax collections are strong enough to cover the bonds, S&P said in a statement last month.

While Moody's wasn't hired to rate the deal, it said it may have assigned the securities an investment-grade rank even though the city is five levels below that threshold.

Skeptical Investors

The deal isn't the first for Detroit since it filed for bankruptcy. Michigan's finance agency sold \$185 million of bonds in June 2014 for Detroit's lighting authority. With investor protections similar to those being offering this week, the 30-year securities sold for a yield of 4.6 percent, in line with an index of revenue bonds with the lowest investment grades, according to data compiled by Bloomberg.

The bankruptcy may deter some would-be buyers, said Dan Solender, who helps manage \$17 billion as head of munis at Lord Abbett & Co. in Jersey City, New Jersey. The firm owns some of Detroit's water and sewer debt.

"The history there is pretty weak considering how they dealt with bondholders with their bankruptcy," Solender said. "They'll have market access. It's just at a cost."

Bloomberg

Elizabeth Campbell

August 17, 2015 — 9:01 PM PDT