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Detroit Schools Paying Penalty in Bond Market Post Bankruptcy.

Detroit's schools are paying a hefty penalty for persistent financial woes as the district taps the tax-exempt debt market in the wake of the city's record bankruptcy.

The \$121 million in notes maturing in August being sold through the Michigan Finance Authority were priced to yield 5.75 percent, according to preliminary data compiled by Bloomberg. That's about 5.5 percentage points more than one-year benchmark municipal bonds.

"The market pricing is just reflective of many buyers' uncertainty regarding the legal standing of this type of security package for a name that has suffered so much fundamentally in recent decades," said Gabe Diederich, a Menomonee Falls, Wisconsin-based money manager at Wells Capital, which manages about \$39 billion of municipals, including some Michigan school holdings.

The proceeds of the deal will refinance debt to help cover the district's budget deficit, according to bond documents. The district, which has been run by a state-appointed manager since 2009, is in Wayne County, which entered into a consent pact with the state last month to try to mend its own spiraling finances.

Michelle Zdrodowski, a spokeswoman for the schools, said in an e-mail that the district was not going to make any comment during the pricing period.

Detroit Public Schools' financial problems mirror a shrinking population, a trend that has contributed to slumping enrollment. The "severe declines" in the number of students enrolled at Detroit schools has limited state aid available for debt payments, according to Standard & Poor's, which rates the notes SP-3, its lowest short-term grade. The schools saw average annual enrollment declines of more than 12 percent from 2007 to 2012, according to S&P.

In May, the Michigan Finance Authority sold \$82.8 million of notes maturing in June 2016 at a yield of 4.75 percent.

The district is behind on its pension payments by about \$92 million, bond documents show. The state's office of retirement systems can ask the Michigan treasurer to intercept state aid to the schools to get the funds. While the director of the pension system has said that he doesn't plan to do that as long as the district sticks to its plan to make payments in October, the pension costs remain a drag on school finances.

The state is working to ease the district's fiscal woes. In April, Gov. Rick Snyder proposed a restructuring of the school system into two parts. One district would be charged with paying off the \$483 million of operating debt using an existing property tax, and the other would be tasked with educating students and collecting state aid funds, according to bond documents. Legislation on the plan is expected to be introduced in the coming months, according to bond documents dated Sept. 4.

"Ultimately there just doesn't appear to be a near-term catalyst for boosting enrollment and

changing the trajectory of the trends of Detroit public schools itself,” said Diederich, who passed on the note sale Thursday.

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