Bond Case Briefs

Municipal Finance Law Since 1971

How a Corporate `War' Over Covenants May Affect Munis.

PHOENIX – New language designed to protect investors appeared last month in the offering documents of a taxable hospital deal, as the ripple effect of a battle in the corporate bond arena spread to the municipal market.

The language, which appeared in offering documents for a $350 million taxable Children's Hospital Corporation (Mass.) issuance, makes clear that investors are due a premium in the event of a default. It specifies that investors are due an amount "equal to the make-whole redemption price." Municipal finance pros said the language appears to have crossed over as a result of a dust-up over corporate bond covenants in late 2016 – though some expressed skepticism that such covenants would take hold in the municipal market.

Adam Cohen, a corporate finance attorney who founded and writes for a research firm called Covenant Review, said the issue arouse in October when corporate borrowers started including provisions in their offering documents that prevented buyers from collecting any kind of premium if the bonds were redeemed early. They started doing so as an effort to "opt out" of court rulings that ordered some corporate borrowers to pay make-whole redemptions after covenant breaches, a move that investors quickly began railing against.

That meant that issuers could voluntarily breach their covenants and only pay out par. An ugly "war" played out over this in the corporate market late last year, Cohen said, leading borrowers to drop their insistence on that provision. The language in the Children's Hospital Corporation deal is the "reverse" of what the corporate borrowers tried to do, Cohen said.

"It's a big deal because this war from corporate bonds leapt over to munis," Cohen said, adding that had personally spoken to some fund managers that said they would want this protective language in future muni deals they bought, but that the majority of the market appears unaware of the issue.

But despite the uproar the deal caused in the corporate world, muni market professionals seem skeptical that the issue is as big in the tax-exempt market. The hospital deal that included the make-whole provision was taxable, and so not representative of the most common type of muni bond issuances.

A bond lawyer who reviewed the offering documents at The Bond Buyer's request but requested anonymity to comment on the deal said he didn't believe that the provision would become commonplace in the muni market, and probably wasn't necessary. The attorney said that taxable deals are generally sold to corporate buyers, and as such reflect the expectations of the corporate market.

"Our clients don't have the same incentives to game the system like corporate players do," the lawyer said. "I'm surprised they had this whole kabuki dance."

Triet Nguyen, managing director and head of public finance credit at NewOak said that he had not seen the provision in a muni deal, and didn't see much utility in including it in a tax-exempt

issuance.

“I think it will be hard to enforce in bankruptcy and does not have any direct impact on recovery,” said Nguyen. “In a sense, all it does is inflate the bondholders’ potential claim.”

The Bond Buyer

By Kyle Glazier

February 7, 2017

Copyright © 2026 Bond Case Briefs | bondcasebriefs.com