Bond Case Briefs

Municipal Finance Law Since 1971

Detroit Leveraging State Gas Tax Hike to Jump-Start Street Repairs.

- Detroit is borrowing $124.5 million to revitalize two dozen commercial corridors.
- The city is pledging new road funding from the state's 2016 fuel tax and vehicle registration fee increases.
- JPMorgan Chase & Co. was selected from 18 lenders to finance the capital improvements.

Detroit plans to jump-start improvements along commercial corridors by borrowing $124.5 million from JPMorgan Chase & Co. with the city's share of Michigan's new road funding from increases in fuel taxes and vehicle registration fees.

City Council voted Tuesday in favor of a private-placement borrowing arrangement in which JPMorgan Chase buys tax-free municipal bonds through the Michigan Finance Authority that would be dedicated to Detroit.

The bond sale is expected to close by mid-November, pending approval of the Detroit Financial Review Commission and the Michigan Finance Authority.

Detroit's use of new Act 51 transportation revenues is believed to be the first large-scale borrowing by a municipality in recent years to try to accelerate street repairs from the $1.2 billion pool of new road funding that state lawmakers phased in over half a decade.

"Rather than pay as we go and do a little bit through the year 2022, the bond element allows us to accelerate that chunk through three construction seasons," Detroit Finance Director John Naglick said. "I think we're the first, you'll find. It was an innovative idea on our part."

Rare move

Detroit's use of the Michigan Finance Authority as a bonding conduit to pledge road funding dollars through a private placement borrowing is rare.

Marquette was the last city to do it in 1999, borrowing approximately $2.5 million, according to the state Treasury Department.

The bonds are Detroit's first post-bankruptcy borrowing to directly fund street infrastructure improvements. The $245 million in bonds Detroit issued in July 2015 were for funding reinvestment in city services and settling some debts with creditors, Naglick said.

"Obviously a bond with the Michigan Finance Authority's name on it gives the bondholders more comfort than having the city of Detroit's name on it," Naglick said.

Detroit selected JPMorgan Chase after getting 18 solicitations from banks and narrowing it down to JP Morgan, Barclays, Bank of America and Citibank, Naglick said.

Naglick said JPMorgan Chase was selected, in part, because the bank offered to let Detroit draw the $124.5 million over three separate construction seasons at an interest rate of 3.064 percent.

The city's financing plan with JPMorgan Chase calls for withdraws of $41.5 million by October 2018, $48.5 million in the 2019 construction season and $34.5 million in 2020. The bonds will mature by 2032 with a maximum annual debt service of $13.2 million.

"Under a delayed draw term loan, you only start paying interest when you draw the money," he said. "It more matched up with our needs."

The delayed-draw financing locks in interest costs and eliminates additional fees for bond counsel and financial advisers, Naglick said.

Detroit also was able to avoid getting into any kind of interest rate swap arrangement like the kind that led the city into bankruptcy four years ago, Naglick said.

"The city's got a bad history with trying to hedge interest rates, so that was off the table," he said.

Miller Canfield Paddock and Stone PLC served as the city's bond counsel and FirstSouthwest is the city's financial adviser in the deal, Naglick said. JPMorgan is being represented by bond counsel from Dykema Gossett PLLC and the Michigan Finance Authority's bond counsel is Dickinson Wright PLLC.

Transaction costs are expected to be less than $1 million, Naglick said.

$317 million plan

The $124.5 million is part of the Duggan administration's $317 million, five-year plan to revitalize commercial corridors in the city. About 22 miles of commercial corridors are scheduled to get a face-lift.

Closing for the bond sale is scheduled for Nov. 15, pending approval of the FRC and MFA boards.

State Treasurer Nick Khouri, who chairs the FRC and MFA, said he favors Detroit's plan to "front load" road construction and infrastructure improvements that could foster economic development.

"I think this is an appropriate, fine use of bonding," Khouri told Crain's. "The first rule of bonding is never bond for current operations. Bond for roads and sewers over a long period of time."

The state treasurer added: "It makes sense from a public finance view that you're bonding for a public asset and paying off that asset over a number of years."

Crain's Detroit Business

October 24, 2017 2:08 p.m.

By CHAD LIVENGOOD