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Bondholders Burned in Denver Show Rare Risk From Bull Market,

- **Denver project highlights risks to buyers of premium bonds**
- **Par buyback clause means some investors may lose over 10%**

Denver International Airport's decision to terminate a contract with private developers to build a "Great Hall" at one of its terminals is proving costly to investors who bought about $190 million municipal bonds to help finance the project.

The securities were sold at a premium and borrowing provisions allow Great Hall Partners LLC to redeem the debt at par plus accrued interest upon cancellation of the development agreement. Because the debt was trading for 115 cents on the dollar, the prices swiftly dropped by more than 10% after the airport announced last month that it was terminating a $1.8 billion contract with the consortium to renovate the main terminal and operate retail concessions for three decades.

It follows an instance last year when for-profit health system HCA Healthcare Inc. bought Mission Health System, an Asheville, North Carolina-based non-profit, triggering a par call on Mission's premium bonds. The losses imposed by Denver Great Hall and Mission could cause buyers to shun new deals with similar provisions.

"This should be a wake-up call for the industry," said Fred Cohen, former director of municipal bond trading at AllianceBernstein Holding LP. "Buyers haven't focused on it because it hasn't happened that often, but it happens every once in a while and investors pay the price."

The steep price drop illustrates a rarely seen risk in the $3.8 trillion municipal-bond market that's grown as tumbling interest rates push prices of many securities well above face value. Since many investors still want debt that carry 5% coupons because it's the easiest to resell, more than 70% of the $232 billion of municipal bonds issued this year have been sold at a premium, according to data compiled by Bloomberg.

Investors should demand that borrowers issuing new premium bonds agree to pay the amortized cost of the debt, reflecting how much money they've lent to the issuer, rather than par in the event of an extraordinary redemption, Cohen said.

Disappointed

Denver officials in August notified the partnership that includes Ferrovial Airports International Ltd, Saunders Construction Inc. and JLC Infrastructure, that it was terminating the development agreement for the Great Hall Project in the airport's Jeppesen Terminal, which had been beset by delays and cost overruns.

Nuveen LLC held about $20 million of the Great Hall bonds as of July 31. John Miller, who oversees more than $150 billion state and local government bonds as head of municipal investments, said the firm was disappointed at Denver International Airport's decision to terminate the agreement.

The action “will result in bondholders being damaged and the equity participant possibly benefiting from a make whole equity call. It is unknown how much the developer will be paid to go away as a result of the termination payment, meanwhile, bondholders may be offered par,” Miller said in an email. “DIA believes the best course of action is to take over as developer because the project has experienced significant delays and cost overruns. While the majority of bondholders have supported DIA deals in the past, its purported course of action is not a viable solution for bondholders as this action would hurt long-term investors in the airport.”

Adam Banker, a spokesman for Fidelity Investments, which owned about $20 million of the bonds at the end of July, said the company doesn’t comment on specific holdings.

The decision to terminate the contract was in the best interest of the airport, passengers and the airport’s investors, said Stacey Stegman, an airport spokeswoman.

“The bottom line is that these are not the city’s or airport’s bonds,” Stegman wrote in an email. “In the case of termination, a ‘termination for convenience’ placed Great Hall Partners’ bondholders/accredited investors in the best position.”

The city will make a termination payment to Great Hall Partners and the Public Finance Authority which issued the debt and it will be their responsibility to pay bondholders, she said.

Prices on the biggest maturity of the bonds, a $132 million block maturing in 2049, dropped to 104 cents on the dollar from 115 cents the day before. The partnership issued the maturity in December 2017 at 113 cents on the dollar. As of mid August the amortized cost of $132 million Denver Great Hall bonds maturing in 2049 was about 111 cents on the dollar or $147 million.

Redemption Provisions

Buyers have accepted “extraordinary” redemption provisions at par not only because they’re triggered infrequently, but because of a bull market for tax exempt debt where demand far exceeds supply, Cohen said. Investors have poured $43 billion into municipal bond funds through August, an almost five-fold increase compared to the same period last year. State and local debt issuance has increased about 9%.

Premium bonds are desirable for institutional investors because they outperform discount bonds when rates rise and are less costly to trade. In general, revenue bonds issued for specific projects such as hospitals, have extraordinary redemption provisions, while general obligation bonds don’t, Cohen said.

Bloomberg Markets

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September 5, 2019, 10:43 AM PDT

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