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Detroit's Orr: Investors in Bonds Headed for Haircut Should Have Known.

If you bought Detroit debt without making sure it came with support from credit enhancement or a revenue lien, you will now pay the price, Detroit emergency manager Kevyn Orr says.

"If you lent money to an insolvent city that has been going insolvent as openly and notoriously as possible since 2000, and you don't have a security interest, then you are an unsecured creditor," Orr told The Bond Buyer in a telephone interview Tuesday. "This has been building for decades and decades. They understood the risk."

Orr's comments come days after he unveiled a comprehensive but controversial restructuring plan that relies on slashing the city's unsecured debt. Orr wants to issue $2 billion of notes to pay off holders of $11.4 billion of unsecured debt on a pro rata basis.

He said he should know within 30 days whether he will file a Chapter 9 bankruptcy.

The plan puts $650 million of the city's unlimited- and limited-tax general obligation bonds on par with $5.7 billion of retiree health care, $1.5 billion of pension certificates, and a newly assessed $3.5 billion unfunded pension liability. Orr, a corporate bankruptcy attorney who worked on the Chrysler restructuring, said his decision to lump GO bonds in with debt like unfunded retirement liabilities and POCs reflects "traditional categories."

"For those that were apparently unsecured, they were all treated equally," he said. "We've been saying since the beginning that our thinking, our methodology, is to treat all claimants equally within their class."

The restructuring plan was not vetted by the state and came solely from his office, said Orr. It does not reflect a formal position by the state on the classifications of a local government's debt.

"We have not talked to the state about this, and the state has no obligation to us on this proposal. This is our proposal," he said.

The treatment of $650 million of the city's GOs — out of a total of $1.1 billion of GOs — as unsecured surprised many in the municipal market, who note that unlimited-tax GOs are typically considered among the safest products in the market.

Orr countered that assessment, saying UTGOs are no more than "the safest unsecured debt" in reality.

"I know the whole moral argument," he said. "But unsecured claimants always say, 'It's not me'."

The banks that are counterparties on the city's eight interest-rate swaps hedging $1.4 billion of pension certificates, for example, were savvy enough to demand a lien on casino revenues in 2009 when it became clear Detroit would have a hard time making the payments, he said.

“The factors that have gone into underwriting since 2000 reflect the acute deterioration,” said Orr.

As part of the restructuring plan, Orr announced an immediate moratorium on repayment of all unsecured debt, starting with a $39.7 million payment due Friday on the pension COPs.

Holders of the COPs have the ability to sue the city in state court over the default. If they win, the court would order a judgment levy forcing the city to raise taxes to generate new money to cover the debt payments.

But Orr cautioned that a lawsuit could push the city closer to a Chapter 9 filing.

“We expect to have intense negotiations that would forestall any lawsuit,” he said. “Any lawsuit would cause us to reassess our plan to try to pursue an out-of-court settlement. If I were the parties, I would not run to the courthouse.”

Detroit will continue to default on unsecured debt, including its GOs, that comes due during negotiations, Orr said. It will also continue to make payments on the debt it considers secured, while negotiating with creditors on a restructuring or refinancing aimed at providing the city relief on its annual debt service burden.

Secured debt totals about $7 billion, including $5.9 billion of water and sewer revenue bonds and $480 million of GOs. Nearly all the debt carries bond insurance.

Orr said he expects to meet with bondholders later this week and next, with some meetings in person and some on the telephone. It should become clear within the next 30 days whether the city will file for Chapter 9 bankruptcy.

“That doesn’t necessarily mean we’re going to file in 30 days,” he said. “If we’re making progress, we’ll continue to negotiate.”

The emergency manager said he’s not focused on the impact the default or proposed haircut may have on other Michigan issuers or the broader municipal market.

“Frankly, my focus is on the obligation I have for the city of Detroit,” he said. “I cannot really take into account the potential impact it may have [on the municipal market].”

He added that he doubts the city’s default or a bankruptcy would stain other local governments or the state itself.

“Detroit is such a unique situation,” he said. “Detroit is so clearly insolvent that for anybody to impute anything on another municipality because of Detroit is wrong.”

Orr said he’s not worried about future access to the markets when the city may badly need borrowed money.

“My experience is once you get a debtor in a position with better cash flows and lower debt, that they’re more credit worthy,” he said.

The restructuring plan included a new assessment of the city’s pension liability that boosts the unfunded figure to $3.5 billion from about $640 million. Orr has a meeting set with labor to discuss cuts on Thursday, and would not go into detail ahead of the meeting on the new pension figures, which are based on more conservative investment and amortization assumptions.

“There’s no mysteries here,” he said, “It’s straightforward math.”

He also declined to comment on the notion that the restructuring plan favors unions and employees over bondholders, saying only that labor feels as strongly as bondholders that they are facing unfair sacrifices.

“If you ask unions, this is yet another Wall Street bailout,” Orr said.

“I can’t be governed by perception — only by the reality of where we are,” he added. “I understand different people are going to be upset, but at the end of the day we tried to adhere to the benefits of the bargain they cut.”

Orr said he is negotiating with creditors on a class-by-class basis. The city may enter into separate — confidential — agreements with creditors of the same class, he noted.

“There may be times when different people want to cull themselves from the herd, and we may enter into confidential settlements with those folks,” he said. “We reserve that right.”

As to whether the city can expect help from the state or the federal government, directly or indirectly, Orr said it’s unlikely.

“Let me put it this way: It’s been made clear to me that we are on our own,” he said. “The cavalry is not coming.”

by: CAITLIN DEVITT