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WSJ: Jefferson County Debt Plan Is Costly.

Escaping the largest U.S. municipal failure could leave Jefferson County, Ala., in an even deeper hole.

The county's plan to emerge from bankruptcy protection hinges in part on the sale of $1.9 billion of new debt this fall to refinance debt tied to its troubled sewer system. But some observers call terms of the new debt onerous.

Jefferson County, Ala., taxpayers stand to repay nearly $6.9 billion over the term of a debt deal.

The proposal for the refinancing, which has been approved by a majority of county commissioners, includes a set of bonds that schedule larger debt payments in the later years of the financing. About $474 million are a type of debt called capital-appreciation bonds. Such bonds have been derided by California's treasurer as "terrible" for their backloaded payments, and Michigan has banned their sale by municipalities.

All told, Jefferson County taxpayers would stand to repay nearly $6.9 billion over the four-decade term of the financing, more than three times the amount the county initially plans to borrow. That is perhaps billions more than they would pay under a plan whose payments would be more evenly distributed, said a potential investor.

Municipal bonds sold to fund water and sewage projects often cost the issuer no more than two times the initial amount borrowed after about 30 years. At current interest rates, a home buyer with good credit can expect to pay less than double the cost of a home over the life of a 30-year mortgage.

But, more-traditional financing for Jefferson County's sewer system "would have required higher initial sewer rate increases," said Jefferson County Commission President David Carrington. "Our rates need to be reasonable."

Jefferson County plans to pay for the new debt with sewer revenues, which will come from rate increases for its sewer-system customers. Sewer bills are expected to increase about 7% annually for the first four years under the deal, according to the county's agreement with debtholders.

Some observers wonder if the county will be able to meet the obligations stacked up in later years. "It's future taxpayers that bear the risk of the higher payments down the road," said Richard Ciccarone of McDonnell Investment Management, whose firm purchases municipal bonds and oversees an $8 billion portfolio of them.

The new debt is needed to complete an agreement signed this spring between Jefferson County officials and investors holding $3.1 billion of debt linked to the sewage-system upgrade. The deal, which helps the Alabama county put behind it the largest municipal bankruptcy in terms of debt outstanding in U.S. history, came after hedge funds and other creditors forgave $1.2 billion of sewer debt. The new bonds would refinance much of the remaining debt. The county filed for Chapter 9 bankruptcy protection in November 2011.

The county's proposal to sell the debt could be formally approved by a judge as early as November. If the plan is allowed to proceed, the debt is likely to be sold to investors as early as then. In addition to the capital-appreciation debt, the $1.9 billion package includes $1.42 billion of bonds that pay interest periodically, according to county documents. Jefferson County has the option to buy back some of the bonds after 10 years.

With capital-appreciation bonds, buyers agree to forgo regular interest payments in favor of receiving accreted payments near the end of the bond's maturity. The bonds were designed to help rapidly growing areas in states such as Texas and Florida where school districts need to borrow money fast to expand their campuses, but they want to make sure future residents share in the cost burden.

Because the bonds push payments to future taxpayers, California Treasurer Bill Lockyer called capital-appreciation bonds "terrible deals" that are the "equivalent of payday loans." He proposed a statewide moratorium this year. Some California school districts using capital-appreciation bonds will repay 10 times or more than the original amount they borrowed, the treasurer said.

The Jefferson County proposed repayment ratio is higher than a typical muni sewer bond. The Detroit water and sewer department sold about $660 million in debt last year but will only pay about two times that amount back to bondholders over the 26-year life of its debt, Mr. Ciccarone said. That ratio was similar for some 30-year debt sold by the Birmingham, Ala., waterworks board earlier this year.

Robert Brooks, a finance professor at University of Alabama, said he found Jefferson County's proposed refinancing deal troubling because the projected sewer revenue growth rate it assumes to pay for the bonds—which for many years is at least 3%—seems ambitious, because the sewer system has only had declining revenue in recent years.

"Those numbers certainly couldn't be based on history," he said. "Three percent seems unreasonably high."

By KELLY NOLAN and KATY STECH