Bond Case Briefs

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What Gets You 6.5% Yield: 40-Yr Munis From A Bankrupt Issuer.

If you're looking to check off both interest-rate risk and credit risk from your holiday shopping list, look no further than Jefferson County's new municipal bonds. To recap: the county collapsed into bankruptcy in 2011 under the weight of $3.1 billion in debt related to its sewer system. This week it's attempting the extremely rare maneuver of selling new bonds, both short-term and long-term, while still under Chapter 9 bankruptcy protection, with the proceeds paying off holders of the county's old debt at well below face value.

Among the $1.8 billion in new bonds the county plans to sell this week is a tranche of subordinated debt that matures in 2053 and is expected to yield 6.5%. This is an uncommonly potent blend of interest-rate risk and credit risk. The long duration of the 40-year munis makes them particularly vulnerable to rising longer-term interest rates, while the bonds, being sold by an issuer that's still in bankruptcy, managed a BBB- rating from Standard & Poor's and a junk rating from Fitch.

At least that 6.5% yield is tax-free, but such is the state of the bond market these days that you have to load up on multiple risks to achieve anything approaching a double-digit after-tax yield. Hence hedge funds, not your average muni buyer, are among the investors being targeted by the underwriters of the new bonds.

For those looking for a little less credit risk, there's another tranche of 40-year bonds within the deal that's being insured by Assured Guaranty, which carries investment-grade ratings thanks to the insurance. That cuts the yield to around 5.75%. Even that arrangement, of course, isn't risk-free: Assured is one of the few remaining monoline insurance companies after most of its onetime competitors were felled by the credit crisis because they strayed from their core muni business and started wrapping riskier types of bonds. And you still get all the interest-rate risk of a 40-year muni bond.

By Michael Aneiro