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Detroit Settlement A Breakthrough.

WASHINGTON — Market participants said Detroit's settlement with three bond insurers is a breakthrough in the city's bankruptcy proceedings, even though it leaves questions about the city's financial future unanswered and its impact on other locations remains unclear.

The settlement announced Wednesday with Ambac Financial Group, National Public Finance Guarantee Inc., and Assured Guaranty, which together insure $388 million of the city's unlimited-tax general obligation debt, calls for a 74% recovery. That is a large increase from the city's 15% offer on March 31. More importantly, some market participants said, the deal may bring more of the involved parties to the settlement table.

"It's a breakthrough," said Frank Shafroth, director of the State and Local Leadership Center at George Mason University. "If one of them makes a deal, it makes the rest of them sit up and take notice."

All three insurers said they would cover the full payments to their bondholders, making up what isn't covered by the settlement. The deal calls for the Michigan Finance Authority to issue new bonds to refinance the outstanding debt on or before the city's exit from bankruptcy. The new bonds would feature a lien on the city's state aid as additional collateral, ensuring that the bonds are treated as secured in the future. Also on Wednesday, the insurers of the city's pension obligation bonds announced they want the court to review several offers for the assets of the Detroit Art Institute, a controversial move that could provide as much as $2 billion of outside money to the city. Natalie Cohen, a managing director and muni market researcher at Wells Fargo, said Detroit emergency manager Kevyn Orr's decision to recognize the secured status of the ULTGOs could induce others to settle.

"This, plus the newly announced proposals for the Detroit Art Institute potentially will lead to additional settlements on the way to approval of a plan of adjustment," Cohen said.

Susan Collet, senior vice president for government relations with the Bond Dealers of America, said the BDA is pleased with the fact that the deal requires U.S. Bankruptcy Judge Steven Rhodes to find that the ULTGOs are secured.

"In comparison with the original deal, this should be a very welcome development," Collet said.

The settlement requires court approval, and observers noted that the deal with the three bond insurers fails to resolve solve other issues Detroit faces or answer market-wide questions about GO bond disclosure and the role of state governments in assisting distressed municipalities. The settlement doesn't cover any of Detroit's other debts, but would require the ULTGO's to be treated more favorably than unsecured bonds.

"In our view, this underscores the unpredictable nature of the negotiations for bondholders and issuers," wrote Fitch Ratings analyst Amy Laskey.

Others said it could be difficult to discern the effect of this development on the wider market.

“Almost all civil litigation in this country ends with a settlement, without a final resolution of the claims and arguments made by the parties,” said Allen Robertson, president of the National Association of Bond Lawyers. “In light of that fact, the settlement between the City of Detroit and the insurers of its unlimited tax general obligation bonds (contingent upon confirmation of a plan) is unremarkable.

“For the municipal market,” Robertson said, “the lack of a final resolution means that the questions raised by the Detroit bankruptcy almost certainly will continue to be debated and result in some changes in disclosure. Given the facts relating to Detroit and the settlement, however, it seems unclear whether states will feel compelled to make statutory changes to shore up the status of their general obligation bonds.”

Shafroth said Detroit can’t be compared directly with other cities that have faced insolvency or that may face it in the future.

“There are such unique factors here,” Shafroth said.

Genevieve Nolan, the analyst in charge of Detroit for Moody’s Investors Service, said the deal would bring the recovery level up to the level the agency expected. She said Moody’s must now see whether the court upholds the legality of the settlement.

“Obviously, this is a development we’re working on very closely right now,” Nolan said.

Cohen published a commentary which concluded by urging investors to remember that nothing is yet final in these proceedings.

“It’s not over until it’s over,” Cohen wrote. “Investors should keep in mind that the city’s proposals (and state’s) are just that: proposals. Thus far, Judge Steven Rhodes has proceeded quickly but thoughtfully in our view. Many objections to Orr’s March 31 plan were filed this week and Judge Rhodes scheduled a hearing for April 17 on the disclosure statement that the city is expected to send to creditors for approval in May. We would not be surprised if additional news comes out this week ahead of the hearing.”

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