

# **Bond Case Briefs**

*Municipal Finance Law Since 1971*

---

## **Sewage-to-Fertilizer Plan Shows No Junk Bonds Stink.**

A central Florida facility that would convert sewage into fertilizer is the latest project to tap relentless demand for the riskiest municipal bonds.

The Orange County Industrial Development Authority plans to offer \$62 million of unrated debt next week on behalf of a unit of VitAG Corp., which plans facilities that combine biosolids with sulfuric acid and ammonia to produce fertilizer. The federally tax-free securities will finance a plant on a site in Zellwood, Florida, near tourist center Orlando.

The malodorous initiative may still come up roses for high-yield investors who have been inundated with cash for 23 straight weeks, Lipper US Fund Flows data show. The wave has buoyed bonds for industrial-development projects. They're the riskiest subset of junk-rated munis, accounting for the most defaults in part because of the dependence on a single project.

"This is like the worst of the worst," yet investors will probably buy it, said Tom Metzold, co-director of munis in Boston at Eaton Vance Management, which oversees about \$24 billion in local debt. "When too much money chases too few bonds, deals come to market that have no right coming to market. The risk-reward profile is so out of balance, it's nuts."

### Outsize Return

Local agencies can issue debt in the \$3.7 trillion municipal market on behalf of private companies, whose credit backs the securities.

Speculative-grade industrial-development debt has gained about 14 percent this year, more than double the return for all munis, Barclays Plc data show. The bonds, which carry an average tax-free yield of 6.4 percent, are luring investors as interest rates remain near generational lows.

"We're aware that municipal-bond investors are looking for yield and the high-yield market has performed well," said Ed Zughaft, senior vice president of finance for VitAG, which is based in Beech Island, South Carolina. "We're hopeful that we can take advantage of the timing here. We've already received a lot of interest from investors."

Biosolids, organic materials derived from treating sewage sludge, contain nitrogen nutrients, which are used in fertilizer to replenish soil. The company would follow other commodity-based ventures that have turned to the tax-exempt market in the past 14 months for financing.

### Private Equity

The Iowa Finance Authority sold \$1.2 billion of junk-rated debt in April 2013 to fund the building of a nitrogen fertilizer plant by Egypt's Orascom Construction Industries. At the time, it was a record speculative muni offering. In November, a Louisiana public authority issued \$140 million of unrated bonds for a German wood-pellet producer. The deal's tax-exempt portion yielded 10.5 percent.

Private-equity firm KKR & Co. (KKR:US) bought \$95 million of taxable debt in the wood-pellet offer.

In this month's Orange County deal, an affiliate of TPG Capital, a Fort Worth, Texas-based private-equity firm with \$54.5 billion in assets, will contribute at least \$20 million in equity, according to offering documents.

An affiliate of Denham Capital Management LP, a \$7.3 billion U.S. private-equity fund focused on energy and mining, will get \$1 million from the financing proceeds, offering documents show. Denham owned part of VitAG until last year.

#### 7.5% Yield

Bond documents cited an estimated annual interest rate of 7.5 percent on the debt, which has portions due in 2024 and 2036. For top earners, that equals a 12.4 percent rate on taxable securities. Benchmark 10-year Treasuries yield about 2.6 percent.

"There are some big investors in it," said Justin Land, who helps manage \$3 billion of munis at Naples, Florida-based Wasmer, Schroeder & Co. The company will look at the deal for its high-yield fund. "It can work, though like anything else in project finance, there are a lot of ways it can fail."

Projects funded with unrated bonds are ramping up to meet the demand for speculative securities, which have grades at least 10 steps below AAA. Unrated bonds fall into the high-yield camp.

Investors next week can also buy debt for a senior-living facility called Rose Villa near Portland, Oregon, Bloomberg data show. The securities don't have a rating.

By Brian Chappatta and Toluse Olorunnipa June 17, 2014