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Rhode Island Refunds Tobacco Bonds as Rally Sputters: Muni Deal.

Rhode Island is selling \$594 million in debt backed by tobacco-company payments as the segment is losing some luster while it beats the \$3.7 trillion municipal market this year.

The state's Tobacco Settlement Financing Corp. is refunding securities this week that are backed by funds from a 1998 settlement between U.S. states and cigarette companies to cover health-care costs related to smoking, bond documents show.

The revenue behind the bonds relies on cigarette sales. Rising taxes and increased regulation may curb payments made by cigarette companies to states, according to bond documents. Domestic cigarette shipments fell 4.9 percent last year, the steepest drop since 2010, according to data from the National Association of Attorneys General.

There is less risk associated with falling sales in this deal given its "ability to withstand an approximately 8.3 percent year-over-year decline in cigarette shipments," Standard & Poor's said in a report.

S&P ranks \$335 million of the bonds maturing from 2015 through 2024 with an A mark, the sixth-highest grade, and those due from 2025 through 2034 get A-, one level lower. The securities maturing after 2034 are rated BBB+, the third-lowest investment grade.

Risk Horizon

The longer-dated bonds have lower grades because the increased duration means greater risk to the industry, S&P said in its July 25 report.

Phillip Morris USA, Reynolds American Inc. (RAI) and Lorillard Inc. (LO) struck an agreement with 46 states in 1998 that mandated the companies pay more than \$200 billion to resolve their liability in litigation over health-care costs resulting from smoking. About \$94 billion of municipal debt is backed by these payments, which are based on cigarette shipments.

While tobacco bonds have outpaced the rest of munis this year, they trailed the broader market the past two months. Since the end of May, tobacco bonds have lost 1.7 percent, while munis added 0.1 percent. For all of 2014, tobacco bonds are still up 11 percent through July 31, compared with 6.3 percent for the market.

Thomas Mullaney, the state's budget officer, didn't immediately respond to messages left at his office in Providence requesting comment on the sale.

By Elizabeth Campbell Aug 3, 2014 5:30 PM PT

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