Bond Case Briefs

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San Bernardino has Defaulted on $10 Million in Bond Payments.

(Reuters) – The southern California city of San Bernardino has defaulted on nearly $10 million in payments on its privately placed pension bond debt since it declared bankruptcy in 2012, according to documents seen by Reuters.

In addition, the city has not negotiated with its bondholders since September, according to a person familiar with the stalled negotiations.

The missed payments illustrate the trend among cities in bankruptcy to favor payments to pension funds over bondholder obligations, which has increased the hostility between creditors and municipalities.

San Bernardino declared last year that it intends under its bankruptcy exit plan to fully pay Calpers, its biggest creditor and America's largest public pension fund with assets of $300 billion.

The city continues to pay its monthly dues to Calpers in full, but has paid nothing to its bondholders for nearly three years, according to the interest payment schedule on roughly $50 million of pension obligation bonds issued by San Bernardino in 2005.

The non-payment of the bond debt and the city's lack of interest in talks with its pension bondholders just weeks before it must produce a bankruptcy exit plan should serve as a wake-up call to Wall Street issuers of debt to struggling cities, according to Michael Sweet, a bankruptcy attorney with Fox Rothschild in San Francisco.

In January San Bernardino's city attorney, Gary Saenz, told Reuters the city intended to cut its bondholder debt under its bankruptcy plan.

San Bernardino's bankruptcy is being closely watched by the $3.6 trillion U.S. municipal bond market.

In the recent municipal bankruptcies of Detroit – the biggest-ever U.S. municipal bankruptcy – and Stockton, California, bondholders were forced to accept big cuts to their debt while pensioners emerged relatively unscathed.

"Bondholders should be realizing that in Chapter 9 cases those who will invariably get better treatment by the cities are former and current employers, who are part of the community, and not the faceless bankers holding commercial paper," Sweet said.

But Sweet said San Bernardino's treatment of its bondholders could come back to haunt it. "Down the road, the city may find that the capital market is unavailable to it or that it will be penalized at a very high rate when it seeks to borrow," he said.

San Bernardino, a city of 205,000 located 65 miles east of Los Angeles, declared bankruptcy in July

2012 with a $45 million deficit.

Bondholders and public employees want to understand how distressed cities handle their debts to Wall Street compared with other creditors such as pension funds.

San Bernardino's roughly $50 million pension bond debt was used in 2005 to pay off a portion of the city's obligation to Calpers.

In an unprecedented legal argument for a Chapter 9 municipal bankruptcy, EEPK, the Luxembourg-based bank and holder of the pension bonds, and Ambac Assurance Corp, which insures a portion of the bonds, assert in a January lawsuit against San Bernardino that those bonds are part of a single pension obligation, so that any payment to Calpers by San Bernardino requires equivalent payment to the bondholders.

Next week EEPK attorneys will ask the judge overseeing the bankruptcy to set a schedule to adjudicate the lawsuit. Wells Fargo Bank, the flagship bank of Wells Fargo & Co., is the bond trustee but is not a party to the lawsuit.

On Friday, the city filed court papers to dismiss EEPK and Ambac's lawsuit. The city said the bondholder argument "transcends novelty."

Rosanna Westmoreland, a Calpers spokeswoman, said EEPK's argument was "wrong."

San Bernardino's city attorney was not immediately available for comment.

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