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[Atlantic City Bond Offering Attracts Hedge Funds as Buyers.]

The City of Atlantic City, N.J., attracted a contingent of hedge fund investors to its latest bond offering as it works to restructure its obligations and operations in an effort to avoid filing for bankruptcy, a city official said in an interview.

Atlantic City's revenue and finance director, Michael Stinson, said Friday by phone that the city has completed a $40.56 million bond offering through a negotiated sale with six or seven investors, including some hedge funds that he declined to name.

The city sold taxable general obligation term bonds, one set of which matures in 2040 and has a 7.5% coupon, and another which matures in 2028 and has a 7% coupon. The bonds are priced at a discount to yield higher than their coupon amount. According to Stinson, the 2040 bonds will yield 7.75%.

The bonds were issued under New Jersey's Municipal Qualified Bond Act, a program that provides additional security for investors since the money for bond payments comes from the state and will never enter Atlantic City's general fund. New Jersey's treasurer will set aside a portion of state aid that was allotted for the city and give it directly to the paying agent for the bonds.

"I'm thankful that the deal went through," Stinson said. "I'm obviously disappointed at the rate of interest that the city has to pay."

Stinson hopes the next bond offering will be priced lower.

"I'm certainly hoping that it's not that high," he said. "It's a slightly shorter term and a [lesser] amount, so I'm hoping that it'll be a significantly [lower] interest rate."

Stinson revealed that the city is planning a competitive sale of $12 million in term bonds with maturities up to 15 years next week, also under the Municipal Qualified Bond Act.

Proceeds from the $40.56 million offering will be used to repay a $40 million bridge loan from New Jersey that comes due next month, while funds from the $12 million bond offering will go toward repaying $12 million in bond anticipation notes that mature in August.

Stinson said he hopes Atlantic City will be able to use the Qualified Bond Act for further debt issuance beyond the $12 million offering. There are no concrete plans for bond offerings beyond that one, and the question of further debt issuance "will play out based on the tax appeals for this year," Stinson said, referring to negotiations surrounding tax refunds to casinos.

Thanks to the Municipal Qualified Bond Act, the $40.56 million bond issuance scored an A- rating from Standard & Poor's.

Lisa Washburn, a managing director of Municipal Market Analytics Inc., a Concord, Mass., municipal credit research firm, commented by phone that the yield on the new bonds is "high, but it sure would have been a lot higher had New Jersey not provided its [Qualified Bond Act] program."

She said it is interesting that New Jersey is using funds from its municipal aid program to repay a loan to itself.

It's fortunate for Atlantic City that New Jersey has agreed to support the same structure for the upcoming $12 million issuance, since Washburn believes it would be much more difficult to get a bond deal done otherwise.

Even with that program, however, there is some uncertainty over whether the bonds would be safe if Atlantic City were to file for Chapter 9 bankruptcy.

Preliminary bond offering documents included a legal opinion from Woodbridge, N.J.-based bond counsel Wilentz, Goldman & Spitzer PA, asserting that Municipal Qualified Bond Act debt would be unimpaired in a Chapter 9 scenario.

Investors may have taken comfort in how similarly structured bonds were unimpaired during Detroit's Chapter 9 restructuring.

Washburn was quick to point out, however, that Detroit doesn't provide a precedent for the treatment of these bonds in a New Jersey bankruptcy court.

"Michigan has no bearing on New Jersey laws," she explained. "This is based on state laws."

Having studied the legal opinion, Washburn came to the conclusion that the question of whether the bonds would be impaired in bankruptcy "doesn't seem clear cut."

Ultimately, that issue would be decided by a judge. As for the analysis in the bond documents, "that's an opinion, and there's faith being placed that that's actually going to hold up," Washburn said. "Given what we've seen in other bankruptcies, I think the best you can say is that you don't know what you don't know until you get into bankruptcy."

Another open question is the amount of aid that New Jersey will be willing–and able–to provide.

Atlantic City's emergency manager, Kevin Lavin, urged New Jersey to provide financial support to the gaming town in a March 23 preliminary report.

However, the state's own credit strength has some observers worried, particularly in light of a case pending in the New Jersey Supreme Court that will determine whether the state can uphold Gov. Chris Christie's cut to its pension funding.

"If [New Jersey] loses their pension case and they have to fund up for the 2016 budget, there could be some concerns around the amount of municipal aid that will be available," Washburn warned. "If the ruling goes against them, they're going to have to look everywhere for money, under every seat cushion."

That search may even have to include programs that provide financial aid to distressed cities, she added.

Washburn said she expects a ruling on the pension case to come soon. The state's fiscal year ends on June 30, and the court could order New Jersey to put up more money before then, or for the 2016 budget.

Christie appointed an emergency manager for Atlantic City in January as the city's revenues have shrunk because of rapidly declining property taxes from casinos. Of Atlantic City's 12 casinos, four have closed in the past two years.

The Deal

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