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OppenheimerFunds Chases Distress in Puerto Rico, Long Island.

OppenheimerFunds Inc., which owns more Puerto Rico bonds than any other mutual-fund company, may be among the hardest hit if the island lapses into a record-setting default on some of its \$72 billion of debt.

The New York-based company, which manages \$24 billion in state and local-government debt, also has a stake in another noteworthy, if smaller scale, case of municipal-market distress.

OppenheimerFunds holds about \$21 million, or 46 percent, of the debt sold by Dowling College in Oakdale, New York. The 2,000-student school is the first municipal borrower rated by Moody's Investors Service to default since 2013, ending the longest stretch without such a lapse in almost two decades.

The dual risk illustrates company's long-held strategy of plowing cash into the most precarious corners of the \$3.6 trillion municipal market to capture higher yields. Over the years, its funds have invested in airline-backed debt, tobacco bonds and real-estate development deals roiled by the housing-market crash.

"The basic high-yield strategy is built to survive a handful of defaults," said Matt Fabian, partner at Municipal Market Analytics, a Concord, Massachusetts-based research firm. "In return, they're compensated by a much higher stream of income."

Tactic Succeeds

The tactic has delivered annualized returns of almost 5 percent over the last five years to the firm's AMT-Free New York Municipal Fund, outperforming 96 percent of its peers, Bloomberg data show. It's the fund with the largest stake in Dowling. Ray Pellecchia, an OppenheimerFunds spokesman, declined to comment on the company's investment in the college.

Yet such high-yield bonds, especially those from Puerto Rico, have made the funds prone to short-term swings.

Over the past month, the New York fund has trailed 97 percent of peers, Bloomberg data show. That came after Puerto Rico Governor Alejandro Garcia Padilla said he'd seek to restructure the island's debt, which caused bond prices to tumble. OppenheimerFunds owns more than \$4 billion of uninsured island securities, Bloomberg data show.

The stakes are lower with Dowling College. Like Puerto Rico, its strains are years in the making. Moody's has rated the school below investment grade since 1997. In March 2014, as enrollment fell by almost half in five years, Moody's dropped the college to Ca, the second-worst rank, citing a "higher probability of default."

Default Triggered

Dowling didn't have the money needed to make bond payments due on June 1, according to disclosure filings. Bondholders agreed to give the school until June 30, 2016, to sort out its finances without going after it for the money they're owed. Pellecchia, the OppenheimerFunds spokesman, said the firm is part of the creditors group.

The college doesn't expect to pay bondholders as long as the agreement is in place, according to the filing.

OppenheimerFunds owns municipal debt the school issued in 1996, 2002 and 2006 through agencies of Suffolk County, New York, and Brookhaven, a town within the county.

Some of the 1996 bonds, which are uninsured and mature in five years, changed hands July 16 at 82 cents on the dollar for an 11 percent yield. The 2006 securities are insured against default by ACA Financial Guaranty Corp.

In connection with the agreement with Dowling, some bondholders bought \$6.7 million of taxable debt to provide the college with needed cash, according to the disclosure filings.

The pact may be a good thing for OppenheimerFunds and other investors. Moody's said the odds of recouping losses are now "modestly improved" because the school has breathing room to implement its strategic plan.

Ralph Cerullo, the college's chief financial officer, didn't return a voicemail left at his office seeking comment.

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