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Detroit Disciplined in Return to Bond Market After Bankruptcy.

Detroit found that investors haven't forgotten the largest municipal bankruptcy in U.S. history.

The city sold $245 million of bonds Wednesday, its first offering since emerging from court protection last year. Tax-exempt securities due in 2029, which have the longest maturity, were priced to yield 4.5 percent, according to preliminary data compiled by Bloomberg. That's almost 2 percentage points more than top-rated debt, even though the bonds have a secured claim on the city's income-tax collections.

"They are still, yes, paying the price," said Michael Johnson, managing partner at Gurtin Fixed Income Management, which oversees $9.5 billion of munis in Solana Beach, California, which doesn't own the city's debt and didn't buy on Wednesday. "The forces that have hampered Detroit up until now are still in place."

After decades of population loss, shrinking tax revenue and an economy reeling from the fading automobile industry, Detroit filed for Chapter 9 protection from creditors two years ago. The move allowed the city to lower its obligations by $7 billion by the time it exited bankruptcy in December, though it still has a lower credit rating than any other big U.S. city.

To persuade investors to lend to the city again, Governor Rick Snyder signed legislation in April giving bondholders first claim to the income taxes that will repay the new debt, which was sold through the Michigan Finance Authority. That assurance prompted Standard & Poor's to rate the bonds A, five steps above junk and nine levels higher than its grade on Detroit's general obligations.

Fresh Scrutiny

Detroit's bankruptcy increased scrutiny of legal safeguards on municipal bonds, especially those sold by financially distressed local governments. When Detroit adjusted its debts, some general-obligation bondholders recovered just 41 percent of what they were owed, according to Moody's Investors Service.

S&P still considers Detroit speculative grade and gives the city a B rating, five levels below investment grade, citing its "very weak" economy, management structure and budgetary flexibility.

The city's income tax collections are strong enough to pay for the bonds. The money that will be deposited in a fund earmarked for debt payments will be about 6.5 times what's needed, S&P said last month.

Detroit initially offered 14-year tax-exempt debt for a yield of 4.63 percent, according to three people familiar with the sale who requested anonymity as the pricing wasn't final. Demand allowed underwriters to cut the final yield.

Paying Premium

The federally-taxable portion maturing in 2022 yielded 4.6 percent, according to data compiled by Bloomberg. That's more than twice 10-year U.S. Treasuries.

"Even though I think they are paying a premium, people are comfortable with the analysis and what the city is offering in terms of the security, the pledge, and where they think the city is going financially," said Joseph Rosenblum, director of municipal credit research in New York at AllianceBernstein Holding, which manages $32 billion of municipal bonds. His firm put in an offer for some of the new securities.

The proceeds from the sale will repay a loan from Barclays Plc that helped Detroit emerge from bankruptcy. The funds will also finance city projects, including upgrades for the fire department's fleet.

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Elizabeth Campbell

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