

Bond Case Briefs

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Fitch: Michigan's Statutory Lien Bill Would Raise Recoveries.

Fitch Ratings-New York-21 October 2015: If enacted, Michigan's statutory lien bill will significantly improve recovery value if a municipality defaults, compared to other general creditors, including employees, Fitch Ratings says. However, it will not reduce the risk of default.

The legislation would also help improve investor views on the state's local credits, which were damaged as a result of the losses bondholders suffered in the Detroit bankruptcy. Detroit's unlimited tax general obligation bondholders recovered 74 cents on the dollar. Had this bill been in place, recoveries could have been higher.

The bill would place a statutory first lien on taxes that are subject to an unlimited tax pledge and require them to be held in trust for the bondholders. The state's Senate is currently considering the legislation. Polls suggest it is favored by the legislature. However, some state officials, including Governor Rick Snyder, have voiced opposition to it.

In our view, failure to enact this law would be a credit negative for Michigan local issuers, as it indicates lawmakers desire to place bondholders on equal footing with ordinary creditors rather than providing additional security for bondholders. This would suggest that bondholders' claims should be subject to full re-evaluation in a bankruptcy proceeding.

Similar legislation has been approved in California and New Jersey. In most cases, a statutory lien is a lien arising by force of a statute on specified circumstances or conditions. This lien is in contrast to a consensual lien, which is created by agreement, where both parties to a financing agree to a certain security structure and document that agreement in an indenture or loan document. Debt secured by special revenues is exempt from the automatic stay provisions in this code, protecting such debt from payment interruption in the event of a bankruptcy filing. This protection does not extend to bonds secured by a statutory lien, so timely payment is not guaranteed in a bankruptcy.