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Muni Tobacco Bonds Rally Most Since January on N.Y. Settlement.

High-yield municipal tobacco bonds rallied by the most since January after New York reached a settlement with cigarette companies that freed up \$550 million of funds, fueling speculation that other states will follow suit.

Junk-rated tobacco bonds returned 2.1 percent on Tuesday, boosting 2015 gains to 13.4 percent, Barclays Plc index data show. The broad municipal market is up 2 percent for the year. Some bonds from Ohio's Buckeye Tobacco Settlement Financing Authority touched the lowest yield in more than two years.

New York Attorney General Eric T. Schneiderman announced a settlement Tuesday that releases money from an escrow account to the state, counties and New York City. The funds had been withheld since 2003 because of a dispute surrounding the 1998 settlement among states and tobacco companies. Now 90 percent of previously trapped funds will be released and the state has no risk of losing future annual payments as the result of arbitration proceedings.

That's positive for tobacco bonds, which allowed states and cities to borrow against their settlements. The payments from cigarette companies are used to cover interest and principal bills on the securities.

"Tobacco companies are talking to New York — how could they not be talking to Ohio?" John Miller, co-head of fixed income at Nuveen Asset Management, said in an interview at Bloomberg's New York headquarters. Ohio is the largest issuer of tobacco bonds after New York among the nine states that won decisions in 2013 over disputed payments.

"If Ohio settled, it would release a huge amount of money," said Miller, whose company oversees about \$100 billion in munis.

Buckeye tobacco bonds maturing in June 2047 traded Wednesday at an average 86 cents on the dollar to yield 6.98 percent, the lowest rate since June 2013, data compiled by Bloomberg show. The debt has ratings six steps below investment grade by Standard & Poor's and Moody's Investors Service because sharper-than-expected declines in smoking threaten timely payments to investors.

New York tobacco bonds due in June 2021 traded the most since February on the settlement. Unlike the majority of the securities, which carry junk ratings, the Empire State's debt has the third-highest investment grade rank.

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