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Detroit School Bonds Would Fully Pay in Split Plan, Snyder Says.

Investors holding $1.5 billion of bonds from Detroit's distressed schools would be fully repaid under a plan by the state to split the system in two, Michigan Governor Rick Snyder said.

The proposal, which passed the state Senate last month, establishes a new district responsible for educating students and running the schools, while the existing district's only task is to collect taxes and repay all obligations except pensions. Moody's Investors Service said in a report Thursday that while the plan could be "a significantly positive event for bondholders," the split doesn't mean a default or bankruptcy is off the table.

"We've done nothing to suggest or say anything other than bondholders are going to get paid through this entire process," Snyder said during an interview at Bloomberg's New York headquarters. He answered "yes" when asked if bondholders would be repaid in full under the plan, referred to as Newco-Oldco in corporate finance.

"I don't know how they'd have a default or bankruptcy if you did Newco-Oldco," he said. "That is the financial solution."

Detroit's school district is reeling from the same population decline that pushed the city into the largest U.S. municipal bankruptcy. The system, which has seen enrollment drop by nearly 100,000 students in the past decade, is overseen by Emergency Manager Steven Rhodes, the judge in Detroit's Chapter 9 proceedings.

Moody's gives it an issuer rating of Caa1, the fifth-lowest rank.

Snyder this week signed an emergency funding measure for the schools, which would send $48.7 million to the district to keep doors open through the end of the school year. The Senate passed a $720 million bill that would break the system into two last month.

Getting the proposal through the House "will be more challenging than it was in the Senate, but that's not to say it's not doable," Snyder said. "The real issue is not necessarily about the money as much anymore. Much of it now is more about what level of oversight."

The split-district plan would allow Rhodes to vacate his emergency-manager post, Snyder said. One of the reasons he was chosen for the position was that he'd have to step down before the school system could declare bankruptcy, since he'd have a conflict of interest, the governor said.

Much of the Detroit school debt is backed by state aid, bond insurers, or both.

The largest tax-exempt bond outstanding, due in May 2029, has protection from Assured Guaranty Municipal Corp. and trades at a premium. Franklin Advisers and Nuveen Asset Management are the largest holders of the $183.7 million obligation, owning about $25.9 million and $20.5 million, respectively, data compiled by Bloomberg show.

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