# Bond Case Briefs

*Municipal Finance Law Since 1971*

---

## Municipal Prison Bonds Turn to Junk as Inmate Population Falls.

The privately run prison in Walnut Grove, Mississippi, was besieged for years by violence and legal fights over deplorable conditions. Then last month, with local sentencing reforms keeping fewer behind bars, officials shut it down, leaving the state on the hook for $121 million of debt left behind.

“The taxpayers are paying for that building and it’s just sitting there,” said Chip Jones, an alderman for the 1,600-person town about 63 miles (101 kilometers) east of Jackson, the state capital.

The closing is part of a shift taking place nationwide among states and local governments that have sold $30 billion of bonds to build prisons and jails, some of which were leased to for-profit operators. With officials re-evaluating tough-on-crime laws that caused inmate populations to soar and the federal government moving to jettison its use of private prisons, the reduced need for such facilities is rippling through a niche of the $3.8 trillion municipal-securities market.

On Friday, a Texas prison that serves as a U.S. detention center had its credit rating cut to junk by S&P Global Ratings, joining half a dozen others that were downgraded below investment grade by the company since federal officials in August announced plans to phase out for-profit facilities. About $300 million of tax-exempt debt issued for almost two dozen prisons has already defaulted, and investors are demanding higher yields on other securities amid speculation the distress will spread.

“At any point there are only so many prisoners out there to fill the private prison beds,” said Matt Fabian, managing director for Municipal Market Analytics Inc. “It creates unequal distribution and you have prisons competing against one another.”

The number of Americans behind bars has been on a steady decline. After peaking at 1.62 million in 2009, the state and federal prison population dropped over the next five years, reducing it by 54,000, or 3 percent, by 2014, the most recent year for which figures are available, according to the U.S. Bureau of Justice Statistics.

It’s not certain that such reductions will continue, said Daniel Hanson, an analyst who follows the municipal-bond market for Height Securities in Washington. Even with the decrease, some federal prisons are still over capacity and states may already have done much of what they can to keep non-violent offenders out of their penal systems, he said.

“The low hanging fruit of criminal-justice reform is already done,” said Hanson.

At the federal level, the impact is poised to trickle down. The Department of Justice on Aug. 18 said it will cancel or scale back the scope of private prison contracts after the number of federal inmates fell by about 25,000 over the past three years. About two weeks later, the U.S. Department of Homeland Security, which houses immigration detainees in privately run facilities, said it will review whether to curb their use too.

Such a step would jeopardize the repayment of local-government bonds issued for prisons, which are typically repaid with revenue from leasing them instead of with taxpayer money. Since August, S&P has lowered to junk debt issued by, among others, the Washington Economic Development Financing Authority, the Garza County Public Facility Corp. in Texas, and the La Paz County Industrial Development Authority in Arizona.

The prices of some securities have tumbled, pushing up the yields as investors demand higher compensation for the risk. The yield on bonds issued for the Reeves County detention center in Pecos, Texas, which mature in 2021 and were among those downgraded, rose to as much as 6.4 percent last month from 4.6 percent in early August.

Additional closures could spread the impact. In Florence, Arizona, a 31,000-resident town southeast of Phoenix, the seven prisons — four of which are privately-run — are a major employer, said Jess Knudson, town spokesman. One of them is an immigration facility that could be hit if Homeland Security follows Justice's lead.

"Our ability to influence that decision doesn't exist," Knudson said.

The Mississippi Department of Corrections closed the Walnut Grove prison because of budget constraints and the number of inmates, with the annual average population dropping by about 10.5 percent between fiscal 2011 and 2016, bond documents show.

The decline was driven in part by the passage of criminal-justice reform that gave judges more discretion over sentencing, according to the Pew Charitable Trusts, which partnered with a state task force to push the 2014 law. The measure is projected to save the state $266 million over 10 years while also "safely reducing" the number of inmates, the group said.

With less need for prison beds, Mississippi chose to shut down a facility that had a troubled history under former operator Geo Group. After it was sued by inmates, the Justice Department faulted it in 2012 for widespread staff misconduct and deliberate indifference to the welfare of the young offenders housed there.

A federal judge said the description of life inside painted "a picture of such horror as should be unrealized anywhere in the civilized world."

Mississippi said it has been pleased with Management and Training Corp., the for profit company that took over Geo Group after the Justice Department investigation.

The prison was closed last month and its 900 inmates were moved to other facilities. Mississippi still owes $121 million of debt for Walnut Grove, which the department of corrections has an "absolute and unconditional" obligation to pay off, according to bond documents. There state is considering using the emptied prison for another purpose.

"Anything's better than nothing," said Jones, the local alderman. "The taxpayers are paying for that building, and it's just sitting there."

**Bloomberg Markets**

Amanda Albright and Darrell Preston

October 3, 2016 — 2:00 AM PDT Updated on October 3, 2016 — 7:45 AM PDT