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New Jersey to Refund Junk Tobacco Bonds for $3.2 billion of High-Grade Paper.

NEW YORK (Reuters) – New Jersey will sell $3.2 billion of tobacco refunding bonds on April 4 in a deal that effectively strips the debt of its junk rating and elevates it to investment grade.

The deal, the largest of next week's $8 billion of U.S. municipal bond and note sales, will refinance what remains of $3.6 billion of bonds issued in 2007 by the state's Tobacco Settlement Financing Corporation.

S&P Global Ratings currently rates those bonds a B, in speculative territory. But the credit agency expects to assign various investment-grade ratings to the new bonds – from BBB to A depending on the seniority and maturity, according to bond documents.

In 1998, big tobacco companies agreed to make annual payments to most U.S. states to cover medical costs for sick smokers.

Many states opted to securitize that stream of money by selling municipal bonds backed by the expected payments from tobacco companies.

However, the payments are tied to smoking rates. Fewer shipments of cigarettes means less money to back the bonds, and smoking rates have been falling.

The New Jersey deal is part of a new generation of refinanced tobacco bonds and takes into account that more smokers are quitting, according to Alan Schankel, managing director at Janney Montgomery Scott.

Like most other tobacco bonds of an earlier era, New Jersey's 2007 bonds "were based on assumptions that cigarette smoking declines would not exceed 4 percent annually."

The new bonds being issued next week are designed around different expectations – that consumption will continue to decline as much as 8.72 percent by the time the 2046 senior term bonds mature.

The deal is "reflective of lower smoking rates and more realistic assumptions," Schankel said.

The state expects to save $250 million immediately on the refinancing.

Ahead of New Jersey's offering, debt from Ohio's Buckeye Tobacco Settlement Financing Authority traded higher at $98.75, according to analyzed price data from Markit.

There were more than $30 million of trades this week in the 2046 maturity of Ohio's 2007 tobacco bonds with a 5.875 percent coupon, according to trade data from the Municipal Securities Rulemaking Board.

Also in New Jersey next week, the fiscally stressed seaside resort Atlantic City plans to price $49.37

million of taxable bonds rated ‘BBB+’ through sole manager Morgan Stanley & Co. Inc.

Proceeds from the bonds, which are backed by a state program, will be used to pay pension and healthcare contribution with interest that the city deferred in 2015.

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