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The Lunacy Of Using City Streets To Collateralize New Municipal Bond Deals.

I felt my hair on fire as I read a *Bond Buyer* article about cities, with underfunded pensions, issuing taxable municipal bonds using city streets as collateral. I mean the *actual physical streets* complete with traffic lights, striping, stop signs. The works. This is no joke.

The two California cities featured in this article are West Covina and Torrance. Torrance happens to be in my own back yard. Who knew they were up to such pension shenanigans? They intend using the bond proceeds to catch up on unfunded pension obligations.

Over the years, I've tried never to skip a chance of sharing my disdain for Pension Obligation Bonds (POBs). Those are taxable municipal bonds issued to investors of which the proceeds go into various public pension funds to improve their funding ratios. The pension investment managers then invest in stocks, bonds, and real estate in order to meet their liabilities as public employees retire.

So, this relatively new twist on things has red flags posted all over it. First, since city streets are pledged as collateral and if a default occurs, what happens? Unclear. Can bondholders order toll booths set up on what just became *their* street to raise the money needed to make them whole? Who knows? Sure, Southern California has Express Lanes and a few toll roads. But tolls on city streets sounds absurd, unworkable and downright stupid.

The city fathers may believe these lease revenue bonds are the cure for underfunded pension incompetency we've witnessed over the last few decades. Paper over and borrow over the unfunded pension obligations is no solution. This is a bad idea that should get no traction from investors.

Apparently, the Torrance deal can be up to $350 million and may come to market in October. West Covina already issued their bonds in July. The Official Statement specifically states, "The Leased Property consists of City streets constituting an estimated 303 miles of streets, with 557 lane miles, and 47,267,942 square feet of pavement." You're probably wondering along with me just how 47 million square feet of pavement could generate cash to repay bondholders. Even more absurd, the Official Statement goes on to say:

"Limited Remedies. The City has not granted any security interest in the Leased Property for the benefit of the owners of the 2020A bonds, and there is no remedy of foreclosure on the Leased Property upon the occurrence of an Event of Default under the Indenture or the lease. If an event of default occurs under the Lease, there is no right for the Authority, the Trustee, or the Owners to terminate the Lease and re-let the Leased Property."

From this, it sounds like West Covina could decide to stop paying bondholders without any available remedy whatsoever. I wouldn't touch these bonds with a 10-foot pole. But investors did. The bonds sold.

My message is simple: If you desire taxable income for your IRA , pension plan or just to supplement your income, then invest in corporate bonds. Do not buy lease revenue pension bonds collateralized by city streets.

With corporates you know where you stand in the pecking order of default. With corporates you can follow quarterly earnings, balance sheets, and news. With municipals, if you're lucky, the issuer will post their financial results just a year later.

This is truly a bad idea and even worse timing with stocks at all-time highs and bond yields at all-time lows.

Forbes

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