Detroit Sells Muni Bonds at a Price

By KELLY NOLAN WSJ 12 15 11

Detroit didn't have any trouble selling $484 million in water and sewer debt in the municipal-bond market on Wednesday, but the deal came at a price, given the city's fiscal woes.

Detroit sold its debt with yields ranging from about 0.60 to 1.80 percentage point more than the muni market's triple-A benchmark scale, depending on maturity, a term sheet showed. A $225 million tranche maturing in 2041 offered a top yield of 5.35%.

Moody's placed some of Detroit's bonds on review for downgrade last week. Here, Detroit's downtown.

However, compared with an earlier pricing, yields were 0.01 to 0.05 percentage points lower on some maturities, an indication of good demand. Bond prices and yields move inversely.

With interest rates low broadly and a relative lack of supply in the muni-bond market so far this month, "there seems to be a fair amount of buyers looking for yield," said Kathy Bramlage, director at Treasury Partners, a unit of financial advisory firm HighTower Advisors in New York, which has $5 billion of fixed income assets under management. Ms. Bramlage declined to comment on whether her firm participated in the deal.

The yields weren't high enough to entice some investors to participate, though. Matt Dalton, chief executive of Belle Haven Investments in White Plains, N.Y., said he passed on the offering, based on its pricing. Dalton owns some of Detroit Water's other outstanding debt.

"To us, there is not enough of a discount to where the debt has been trading recently," given negative headlines about Detroit's finances and the fact there's some uncertainty about whether sewer debt continues to be paid off during bankruptcy, a matter currently being debated in Jefferson County, Ala.'s case, said Mr. Dalton, whose firm has $950 million of fixed-income assets under management.

Last week, Moody's Investors Service put some of Detroit's bonds on review for downgrade last week, saying the possible appointment of an "emergency financial manager" over the city would increase the risk that it could file for bankruptcy. The ratings firm added that since Detroit's water and sewer utility is city-owned, it may not be "completely immune" to the risks associated with a bankruptcy filing, if one were to happen.

"Appointment of an emergency manager is a requisite step in the path toward state approval for bankruptcy filing, although is not necessarily a strong predictor of bankruptcy," Moody's said.

Michigan started a preliminary review of Detroit's finances on Dec. 6, and that review could last up to 30 days, said Terry Stanton, a spokesman for the state Treasury. If the review finds "probable financial stress" in Detroit, the governor would name a team to further review its financial condition. If that team finds a "financial emergency" exists, an emergency manager would be appointed, he said.

The Detroit water deal received mid-level investment-grade ratings of A1 from Moody's and A-plus from S&P. Proceeds of the deal will be used for capital improvements and to terminate all of the water system's outstanding swaps. Net termination value of the swaps is currently about $210 million, according to S&P.

Rodney Johnson, a spokesman for Detroit's water and sewer department, said the bond sale was a routine offering, which the city does at least every other year. He said Detroit's financial problems weren't too much of a concern, because of a recent court ruling in November that gave the water department's director increased authority and therefore, less reliance on the city.

The bond sale "was already in our plan," he said. The court ruling "should bring some clarity."

Bryan Bailey, senior vice president and portfolio manager for Waddell & Reed Advisors Municipal Bond Fund and the Ivy Municipal Bond Fund, said his firm, which oversees $2.35 billion in muni assets, put in a small order for the deal.

"We're comfortable enough with the structure, and we think the bonds can withstand negative headlines," he said.

No Michigan municipality has ever filed for bankruptcy, according to the Michigan Treasury, although four cities and Detroit Public Schools are under the supervision of an emergency financial manager.

It may also comfort investors that in the event that an emergency manager is appointed over Detroit, he or she will be required to come up with a plan that ensures debt payments for the city's water and sewer are provided for, said Lisa Greer Quateman, a bond attorney at Polsinelli Shugart in Los Angeles, referring to disclosures in the deal's preliminary official statement.

In the event of bankruptcy, revenue bond debt payments generally should continue to be paid, though this matter is under debate in Jefferson County, Ala.'s bankruptcy case, she said. Ms. Quateman isn't providing bond counsel for the Detroit deal.

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