

Bloomberg

Detroit's 86-Cent Water Debt Seen Delivering Profit: Muni Credit

By Brian Chappatta – July 26, 2013
(excerpt)

Detroit's bankruptcy is providing a buying opportunity in the city's \$5.4 billion of water and sewer debt as investors bet that bonds trading at the deepest discount since 2011 will get paid in full. ...

... Detroit securities guaranteed by water and sewer fees would be refinanced and fully repaid under Emergency Financial Manager Kevyn Orr's pre-bankruptcy proposal, unlike some general obligations he deemed unsecured.

Investors still accept less than 100 cents on the dollar to part with the debt. Two series of water bonds backed by units of Assured Guaranty Ltd. (AGO) and MBIA Inc. (MBI) traded July 19 -- the day after Orr filed -- at 86 cents, the lowest since 2011, data compiled by Bloomberg show. Both companies said they would make full and timely payments to bondholders if Detroit doesn't. ...

Confidence Contrast

... Confidence in Detroit's revenue bonds contrasts with views on its general obligations. Orr's plan to avert Chapter 9 included the unprecedented step of classifying more than \$530 million of such securities as unsecured, even though they are backed by the city's taxing power. He offered holders of such borrowings less than 20 cents on the dollar.

Investors holding about \$900 billion of general obligations from issuers nationwide are debating whether Orr's plan will hold up in court. No municipality has used bankruptcy to force such bondholders to take a cut in principal.

While Detroit can stop paying some liabilities under court protection, the water and sewer system will probably continue to pay investors, said David Kudla, chief executive officer of Mainstay Capital Management LLC in Troy, Michigan. Moody's Investors Service said on July 18 it doesn't expect bankruptcy to prevent utility-bond holders from collecting debt service.

Orr Speaks

"Water and sewer, we're going to honor those," Orr said yesterday in an interview at Bloomberg's New York headquarters. "They are unimpaired, they are paid according to their terms, and we are current on all our obligations with our secured debt." ...

... Detroit's filing came after decades of decline left the city of 700,000 too poor to pay billions owed to bondholders, retired police officers and city workers. The municipality this week obtained federal protection from lawsuits while in bankruptcy, setting the stage for a hearing near the end of the year over whether the case belongs in court. ...