

THE BOND BUYER

First bond market test for Jefferson County since Chapter 9 exit

By Shelly Sigo

July 12, 2017

BRADENTON, Fla. – Hoping they've regained the trust of bondholders, Jefferson County, Ala., officials are turning to the credit markets for the first time since emerging from bankruptcy nearly four years ago.

The county is set to price \$344 million of 25-year limited obligation refunding warrants Thursday.



"We've done everything we can do to restore the confidence investors have in Jefferson County," said County Commission President Jimmie Stephens.

Raymond James is the book-runner.

The deal will refund outstanding education revenue warrants with a new 1% local sales tax that will support debt service. A portion of the sales tax collections will provide the county with its first new source of general fund revenue since a local occupational tax was struck down by state courts in 2011.

The refunding warrants are rated AA with a stable outlook by S&P Global Ratings. Fitch Ratings assigned an A rating to the deal, and placed that rating on negative watch to reflect what it said is a potential legal challenge to the sales tax revenue pledged to bondholders.

The county exited bankruptcy in December 2013.

"We've done everything we can do to restore the confidence investors have in Jefferson County," Commission President Jimmie Stephens said.

As part of its bankruptcy exit, the county simultaneously sold \$1.8 billion in sewer warrants to write down \$1.4 billion of the sewer system's debt.

"The county is in good shape moving forward," Stephens said Tuesday. "The sewer crisis and the bankruptcy are in the rear view mirror."

But the legal challenges are not. Attorney Calvin Grigsby, who is representing a group of local residents, says his clients are continuing to pursue a reversal of the state law authorizing the new local sales tax underpinning the refunding deal.

If the sales tax is struck down, Jefferson County has covenanted in the indenture to enact a replacement tax and ensure that debt service is paid, according to lengthy disclosures on the sales tax and the county's bankruptcy case in the preliminary official statement.

Jefferson County is also waiting for the 11th Circuit Court of Appeals in Atlanta to rule on its plan of adjustment, which has been under appeal since 2013. The appellate court decision could validate the plan or sent it back to the bankruptcy court for revision.

The divergent ratings, ongoing legal challenges, and contentious history with past sewer bondholders over the bankruptcy case could lead some investors to demand a penalty for the new refunding warrants.

“We would expect the issue to price at a concession to its ratings, which are split anyway, given the county’s controversial past and ongoing legal challenges,” said Triet Nguyen, managing director at NewOak Fundamental Credit. “At the right spread, there should be sufficient investor interest to get the deal placed.”

Nguyen also said the special revenue pledge backing the refunding warrants – the new sales tax as opposed to a general obligation pledge - may also entice some buyers.

“There’s definitely plenty of hair on this bond issue,” said Richard Ciccarone, president of Merritt Research Services.

“At this point in time, I’m sure they are working to rebuild trust with bondholders,” he said. “The question is at what price?”

In the past, Ciccarone said, issuers paid a price for having a default or a bankruptcy when they returned to the bond market. He still thinks Jefferson County is vulnerable to a penalty reflecting its history and dealings with past sewer bondholders.



“At the right spread, there should be sufficient investor interest to get the deal placed,” said NewOak Managing Director Triet Nguyen.

“It was complex to begin with and there are still unresolved issues,” he said.

Ciccarone said the markets are different today with more niche and crossover players with mandates to buy more speculative deals in order to find yield opportunities. He also said that Jefferson County has developed a more positive outlook post-bankruptcy, and pointed to cash-on-hand in the general fund and a favorable assigned/unassigned fund balance.

According to the preliminary official statement for the refunding, the county’s unassigned fund balance was \$76.2 million as of Sept. 30, 2016, which was approximately 49.4% of general fund operating expenses in fiscal 2016. The fiscal year ended with a general fund balance of \$121.8 million.

The sanitary sewer operations fund reported a net position of \$844.3 million. Annual revenues increased to \$199.8 million in fiscal 2016, from \$193.7 million in 2016.

Some \$1.9 billion of sewer warrants are outstanding.

Jefferson County's improved financial position led Moody's Investors Service on June 27 to upgrade the county's issuer rating to A3 from Baa3; it also raised the county's general obligation limited tax debt rating and the rating on the outstanding limited obligation school warrants to A3 from Baa3.

Moody's was not asked to rate this week's refunding issue.

Stephens said the current County Commission has released audits on schedule and structurally balanced the budget, as well as strengthened reserves and fiscal policies.

On a recent roadshow to Chicago, New York, and Boston, Stephens said county officials received "positive feedback" and were questioned about the sewer debt. Sewer system revenues have come in above projections, he said, while expenses have been below projections.

"We've done everything we said we would do," Stephen said. "I think that will be reflected in this offering, and moving forward."

The county still faces unknowns about the special sales tax authorized by the Alabama Legislature in 2015. Grigsby initially said he filed for a writ of certiorari by the U.S. Supreme Court on June 15, which was the last day to request that the high court review the bill authorizing the refunding.

Grigsby filed for the high court review on behalf of his clients, Jefferson County State Reps. Mary Moore and John Rogers, Birmingham Water Works Board member William Muhammad, and Andrew Bennett, a former assistant county tax assessor.

They lost an appeal of the refunding case before the Alabama Supreme Court in April, and want the Supreme Court to review constitutional provisions that they argue were violated, according to a copy of the petition provided to The Bond Buyer by Grigsby.

The county said in its POS that its attorneys have not been able to verify that the petition was filed or placed on the court docket.

“There are some technical adjustments we have to make to the filing within the next 60 days,” Grigsby said in an email Monday. “These adjustments will be made and the writ will be before the court within statutory [Supreme Court] jurisdictional requirements.”

Grigsby, who is a former broker-dealer, said the county’s underwriters will price the refunding warrants to the litigation risk of whether the Supreme Court will grant the writ petition.

“As long as this risk is fully disclosed, the bond counsel, disclosure counsel and underwriters’ counsel and underwriters should have no liability and the risk is fully shifted to the bondholder looking for yield,” he said.

Grigsby is also representing many of the same local residents in an appeal of the county’s bankruptcy plan of adjustment.

The plan gives bondholders the right to go back to the bankruptcy court if the county fails to enact sewer system rate increases that service the debt. Commissioners have followed the plan faithfully, according to Stephens.

Still, the overhanging legal issues and the lower A rating from Fitch will probably influence Thursday’s pricing, said Chris Doucet, chief executive officer of Doucet Asset Management in Birmingham.

“My sense is the bonds are going to price 10 to 20 basis points cheap to the A-rated municipal revenue bond curve on the short end, and 25 to 40 basis points cheap to the scale on the long end,” said Doucet, who lives in Jefferson County.

“The combination of the lingering taint of the 2013 bankruptcy filing and the challenge to the new tax that backs the bonds will translate into slightly higher interest on the bonds than would be otherwise merited based on the financials of the county alone,” he said.

Given the historic stability of the pledged local sales tax, and the expected debt service coverage of around 3.7 times on the bonds, Doucet said he expects the refunding issue will be well received by institutional and retail buyers.

Doucet said that the current county commissioners have had “the unenviable task of guiding Jefferson County through the bankruptcy process and nursing it back to health.”

Without access to capital markets, he said, commissioners were forced to be more frugal with their cash and other resources than most municipalities.

“Despite these limited resources and challenges, the results have been significant,” Doucet said. “Both the reserved and unreserved fund balances are healthy, the pensions are fully funded which is a rarity among municipalities these days, and there been a general business and development renaissance that has occurred in many parts of the county.”

Stephens has said the refunding will provide commissioners with new revenue to address backlogged needs and new projects.

In Alabama, counties do not have home rule, and new revenue sources must be authorized by state lawmakers. The act that authorizes this week’s refunding and the new local 1% sales tax is expected to provide about \$36.3 million in new annual revenue to the county’s general fund – in addition to paying debt service on the refunding warrants. Some of the revenue will go toward schools, local transit and other purposes.

The county said in an electronic roadshow program that expects to use \$25 million of the new funding on transportation projects, \$10 million on economic development projects, and the remainder on expenses in accordance with fiscal policies such as funding other post-employment benefits.

Collections from the new local sales tax will replace part of the general fund money the county lost when state courts struck down the occupational tax, according to Stephens.

“When we went to the Legislature and asked for help, and they determined that this is the vehicle we would use,” he said, referring to the refunding and new sales tax. “It’s going to be a game changer for Jefferson County. We’re looking to move forward.”

Raymond James and Associates Inc. and Stifel, Nicolaus & Co., are co-senior managers for the refunding.

Citi, Drexel Hamilton, Piper Jaffray, and Securities Capital Corp. are also in the selling group.

Public Resources Advisory Group and Terminus Municipal Advisors are co-financial advisors for the county.

Balch & Bingham is bond counsel. Waldrep, Stewart & Kendrick is disclosure counsel.

Bradley Arant Boult Cummings is underwriters’ counsel.



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