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Revenue Bonds Gain Favor Over General Obligations: Muni Credit

By Brendan A. McGrail and Matt Robinson

March 29 (Bloomberg) -- Municipal bonds tied to dedicated revenue such as water and sewer fees are gaining favor with investors as budget deficits and dwindling federal aid dims demand for debt backed by states' creditworthiness.

The extra yield investors demand to hold 10-year AAA rated utility revenue bonds rather than general obligations was 22 basis points yesterday compared with 51 basis points on Dec. 31, according to data compiled by Bloomberg. The 12-month average is 36 basis points. A basis point is 0.01 percentage point.

"It's taken years for the perception to shift that essential-purpose revenue bonds can be just as safe and effective as general obligations," said Neil Klein, who oversees $900 million in fixed-income assets at New York-based Carret Asset Management.

While general-obligation securities were often viewed as an easier credit to understand than revenue bonds, declining home prices and dwindling tax receipts in some areas have made it harder to predict municipalities' future income, sending investors toward more specific revenue streams, Klein said in a phone interview.

The extra yield investors demand for an 11-year AA- California water bond has dropped by more than half to 46 basis points on March 18 from 109 points on Jan. 24, according to a Bloomberg Valuation index of top-rated debt. The so-called spread on an 11-year A- rated state general obligation fell just 23 basis points to 118 points in the same period.

Coming Deficits

States face budget deficits of $112 billion in the coming fiscal year, according to the Washington-based Center on Budget and Policy Priorities, a nonprofit that focuses on issues that affect lower-income Americans. While tax collections have improved with the economy, they have yet to return to pre-financial-crisis levels or rebound enough to make up for the loss of federal help. President Barack Obama hasn't proposed new aid and House Republicans have said they wouldn't support it.

Since 2009, the federal government has cushioned the recession's blow to states by providing aid to help close budget shortfalls and cover the increased cost of Medicaid, the health- care program for the poor whose rolls have swelled as residents are thrown out of work. Some $151 billion of such help will have been provided by the end of June, when the assistance is to run out, according to the National Governors Association.

San Jose

Among this week's revenue-backed offerings, San Jose, California, whose general-obligation AAA rating was cut by one level this month, is selling $109 million in debt tied to hotel taxes. The issue, rated A- by Standard & Poor's, fourth-lowest of 10 investment grades, and A2 by Moody's Investors Service, one level higher, will finance the renovation and expansion of the convention center in the 10th-largest U.S. city, according to preliminary offering documents.

The convention center is a "key driver" in the city's hotel business, with about 10 percent of visitors staying in San Jose's 77 hotels as part of a convention, Moody's said in a March 15 report. Also, the city will establish a rate stabilization fund designed to support the bonds in the event that tax receipts are insufficient to pay debt service, Moody's said.

While the underlying credit is lower than the city's, the backing of the bonds may help draw investors, said Bud Byrnes, chief executive officer of RH Investment Corp., an Encino, California-based broker-dealer which specializes in the state's securities.

"It's not a great credit, but it'll have the ability to get paid," Byrnes said. "It'll be interesting to see where it gets priced."

Following are descriptions of pending sales of U.S. municipal debt:

SUNSHINE STATE GOVERNMENTAL FINANCING COMMISSION, created in 1985 to provide common financing to a limited number of qualified cities and counties in Florida, plans to sell about $290 million in tax-exempt debt today. The securities, which are backed by Miami-Dade County, are rated fourth-highest at Aa3 by Moody's and one level lower by S&P at A+. Banks led by JPMorgan Chase & Co. will underwrite the issue. (Updated March 29)

NEW YORK CITY TRANSITIONAL FINANCE AUTHORITY, which helps fund capital projects in the most-populous U.S. city, plans to sell $500 million in tax-exempt debt as soon as next week to refinance debt. The bonds, backed by personal-income taxes, are top-rated from S&P and Fitch Ratings, and second-highest rated by Moody's. Banks led by Barclays Plc will underwrite the offering. (Added March 29)

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--With assistance from William Selway in Washington. Editors:
Walid El-Gabry, Jerry Hart

To contact the reporters on this story:
Brendan McGrail in New York at +1-212-617-6818 or bmcgrail@bloomberg.net; Matthew Robinson in New York at +1-212-617-5409 or mrobinson55@bloomberg.net

To contact the editor responsible for this story:
Mark Tannenbaum at +1-212-617-1962 or
mtannen@bloomberg.net