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Wayne County Warns Investors of Bankruptcy Risks

By CAITLIN DEVITT

CHICAGO - Wayne County, Mich., home to Detroit with some 1.8 million residents, introduced discussion of how its debt might fare in a bankruptcy as it prepared to come to market with $187 million of notes.

The county hired Orrick, Herrington & Sutcliffe LLP as special bankruptcy counsel on the deal, expected to price June 18. Bond documents and an online investor road show on the deal both feature discussions on bankruptcy in the sections about investor risks.

Clark Hill attorney **Robert D. Gordon**

The revised and expanded disclosure comes as issuers face heightened regulatory scrutiny on their communications with investors.

"If an issuer of bonds is seen as being in significant financial distress, where the possibility even of bankruptcy is a consideration, then there is naturally a greater interest and focus on these disclosures in the risk section of the prospectus that relate to the possibility of the issuer filing a Chapter 9 bankruptcy," said Robert Gordon, an attorney and member of the corporate restructuring practice at Clark Hill, who represented the two Detroit retirement systems in that city's bankruptcy.

County Executive Warren Evans publicly warned of the risks earlier this year in several high-profile press conferences. A February audit showed that the county's finances are so weak that it could run out of money by this summer and be in a negative liquidity position by next summer.

The offering documents for the deal mark the first time the county, which carries junk ratings from all three rating agencies, has formally warned investors of the possibility of bankruptcy.

The county has tried to assuage potential investor concerns with various enhancements, deputy treasurer Christa McLellan said in an email.

"These enhancements include creation of both a trust and a note reserve account and receipt of an opinion from nationally recognized bankruptcy counsel," McLellan said. "The reason for the added enhancements to the credit is to display the strengths of the program to investors and to give them a better perspective on how the program performs regardless of external adverse conditions."

Standard & Poor's assigned a rating of SP-1 to the notes, denoting a "strong capacity to pay principal and interest."

Wayne County faces a $74 million negative general fund balance as of September 2014 and is expecting a negative balance of $64 million by September 2015, according to bond documents.

The documents note that Evans has proposed a plan to deal with the county's financial condition.

"Without these or similar measures, the county executive indicated that the

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state of Michigan would likely appoint an emergency manager," the documents say, adding that the emergency manager has the power to recommend a Chapter 9 bankruptcy filing.

Next week's deal features $186.7 million of taxable limited-tax general obligation notes with a Dec. 1, 2017 final maturity and an optional redemption in December 2016 at 100.50%. The notes are secured by a pledge of the county's full faith and credit, and expected to be paid from 2014 delinquent property taxes, plus interest and fees, that were unpaid as of June 1, 2015. The county will use proceeds from the note deal to pay its local units. Detroit accounts for 61% of the county's net receivable tax revenues.

Prior to the final maturity of the notes, the county will charge back to the local units any 2014 delinquent taxes which still remain unpaid.

There was a total of $192.1 million in unpaid taxes, according to the county.

The notes are also secured by a note reserve fund with an initial balance of $18.7 million, 10% of the par amount. The county treasurer is required to deposit all pledged tax revenues into a debt retirement trust on a weekly basis, according to the investor presentation.

The offering documents feature Orrick's legal opinion that the revenue backing the notes would likely be exempt from the automatic stay in the event that the county filed for Chapter 9.

"Although there is no case law directly on point and, thus, the issue is not free from doubt," Michigan law should treat the local units' delinquent taxes as not being the county's property, that opinion says. That would likely make them exempt from any automatic stay in a bankruptcy. The documents emphasize that tax collections are placed in a segregated fund and not used for general fund purposes. Also under Michigan law, the bond trustee has a "valid and enforceable" lien on the pledged tax revenues, according to the online road show.

"Should the court disagree and find that the trustee does not have a valid and enforceable lien on the pledged tax revenues or that collections on the delinquent taxes are not enterprise funds and therefore are available for the county's general fund purposes, then there could be substantial delays or reductions in payments on the notes," bond documents say.

Detroit, which filed for bankruptcy in July 2014, did not have any debt with a similar note pledge, although the city treated all its limited-tax GO bonds as unsecured. LTGO holders eventually took a 66% haircut on their investment.

The note borrowing is one the county makes regularly to cover late property tax collections owed to its local units.

Bank of America Merrill Lynch is the underwriter. Axe & Ecklund PC is note counsel. Public Financial Management Inc. is municipal advisor.

The delinquent tax fund was the focus of the county board of commissioners last week as the board voted to transfer $74 million from the fund to the county's general fund to cover a $49 million court-ordered payment into the retirement system. Evans later vetoed the move and said he would impose a one-time property tax to raise the money.

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