Jefferson County Agony Means Higher Borrowing Costs for Alabama Taxpayers

By Sarah Frier - Aug 22, 2011

Local governments in Alabama, where thousands of highways and bridges are overdue for repairs, face higher borrowing costs for public projects as Jefferson County debates filing the nation's biggest municipal bankruptcy.

A town that wants to borrow for road improvements or building renovations will pay about 0.2 percentage point more than one with the same credit rating in another state, even if the debt has nothing to do with Jefferson County, said Jonathan Nordstrom, a managing director at Morgan Keegan & Co., which he said is the top Alabama underwriter. If the issuer is in Jefferson County, it might be stuck with 0.8 percentage point more in regular interest rates, he said.

"In the municipal marketplace, people see the initials AL for Alabama by it and they say, 'I need higher yield,'" said Tom Dalpiaz, who oversees $280 million in municipal bonds as senior vice president at Monument, Colorado-based Advisors Asset Management Inc. "If bond market participants don't see the state stepping in to help Jefferson County in some way, the reasoning becomes, 'If other entities in the state come into trouble, maybe the state isn't going to help them either.'"

That means that residents of the state the U.S. Census Bureau ranks 47th in median household income have comparatively less access to capital to improve infrastructure, schools and public institutions.

Three-Year Agony

Jefferson County, home to Birmingham and more than 658,000 people, has spent three years dealing with the collapse of a sewer-bond refinancing. The county was poised last week to file the largest municipal bankruptcy in U.S. history, and delayed the decision to try again to settle with creditors including JPMorgan Chase & Co. (JPM)

The state Legislature has not agreed to help ease the county's debt burden. The state has fiscal problems of its own: One in seven Alabamians lived below the poverty line in 2009 and in July, 10 percent of its workers were unemployed.

The state has failed to meet revenue projections, leading to three consecutive midyear budget cuts, and it slashed hundreds of jobs last week, said Chris Sanders, fiscal policy analyst at the

Arise Citizens' Policy Project. The Montgomery- based nonprofit advocates policies to help the poor.

Higher relative borrowing costs are "just another bad thing piled on top of a lot of other bad things that are happening for the state and the localities," Sanders said.

Declining Issuance

Issuers in the state sold $1.1 billion in municipal debt this year through last week, according to data compiled by Bloomberg. That compares with $1.7 billion in the same period last year and $2.7 billion in 2007, before the market crash.

A Birmingham general-obligation bond that matures in 2032 traded to yield 4.61 percent on Aug. 15, according to data compiled by Bloomberg. Standard & Poor's rates the bond AA, third highest.

A bond for Memphis, Tennessee, which has the same credit rating and maturity, traded the same day with a 4.25 percent yield.

Even Huntsville, a city two hours north of Birmingham with a AAA credit rating, has debt trading with yields slightly higher than those of average top-rated debt. A bond issued in September and maturing in 2020 traded on Aug. 17 to yield 2.42 percent. That compares with the 2.07 percent yield for most top- rated nine-year debt that day, according to data compiled by Bloomberg.

That's Not Us

Huntsville Mayor Tommy Battle said linking his city's debt to anything going on in Jefferson County is short-sighted. If the city finds bond sale costs too high, it will take out a private loan, he said.

"If we find the yields are pushed up artificially because of this, we'll go to plan B in our borrowing until the artificial bubble has popped," he said.

The ability of Alabama's local governments to act is hobbled by a constitution that requires many economic development or infrastructure changes to pass through the Legislature, according to Arise. More than 70 percent of constitutional amendments apply to a single city or county, and almost 90 percent of state revenue is earmarked for specific purposes.

Meanwhile, municipal governments face deteriorating infrastructure. School buses each day must detour 1,722 miles around weight-restricted county-maintained bridges, at an annual cost of $2.5 million, according to a February report from the Association of County Engineers of Alabama. Counties maintain 2,675 bridges that are more than 50 years old, and replacing them all would cost an estimated $1.3 billion, according to the report.

The Need Remains

The elevated borrowing costs add up. A $10 million 30-year maturity serial bond issue with par bonds and level debt service would cost $6.4 million in debt service interest costs over the life of the bond issue, said Chris Mier, a managing director at Loop Capital Markets LLC in Chicago. A bond paying 0.2 percentage point more in yield would require an additional $430,000 in debt service costs over that period, he said.

That could buy 71 ambulances on GovDeals.com, an online store for surplus government equipment.

Alabama's local governments may be paying less to borrow than in the past even as they pay more than those in other states. Municipal yields overall have fallen, with top-rated tax-exempt 10-year debt trading at 2.174 percent Aug. 19, its lowest since September 2010, according to data compiled by Bloomberg.

When Jefferson County resolves its debt crisis, investors may judge the state's issuers more like their peers, Nordstrom said. Governments -- and residents -- will put the money to work.

"There are a lot of unmet needs and there will be more," Sanders said.

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