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Birmingham Water Offers Muni Deal at Punitive Rates

By Kelly Nolan

Birmingham's Water Works Board offered about \$106 million of municipal debt at punitive rates Tuesday, given its ties to Jefferson County, Ala., which filed for the largest municipal bankruptcy in U.S. history in 2011.

For instance, on a 30-year bond in the deal, the water system offered a preliminary yield of 3.67% to individual investors. A similarly rated bond with a comparable maturity yields about 3.18%, according to Thomson Reuters Municipal Market Data.

The bond sale is expected to wrap up Wednesday, when orders are taken from institutions. Although the water system is a completely separate entity from the county, it collects revenue for Jefferson County's sewer system in the areas that overlap its service area, in exchange for a collection fee.

According to bond documents, Jefferson County sewer users account for about 59% of the board's customers. But the water system also serves parts of four other counties, with a customer base that has remained "stable," increasing by an average of 0.5% annually over the past five years, according to Standard & Poor's.

In March, S&P upgraded the water system one notch to double-A, citing its "strong financial profile," with its ample reserves and revenues projected to be more than enough to cover debt service payments.

Moody's Investors Service gives the water system an equivalent rating of Aa2, the third-highest investment-grade rating. Proceeds of this week's deal were being used to refund some older debt with higher interest rates and to finance various improvement projects and system upgrades.

The size of this week's deal, at about \$106 million, was smaller than the roughly \$154 million the water system originally planned; the refunding portion was shrunk.

Michael Johnson, Birmingham Water's assistant general manager for finance and administration, said that part of the sale was cut back due to market conditions and the system's desire to achieve certain savings targets.

He added that Birmingham Water had "high hopes" that the bond sale would go well, and it had done some outreach to make sure market participants understood the water system was a separate entity from Jefferson County.

"We've gotten that message out," he said.

Kevin Woods, principal at Asset Preservation Advisors in Atlanta, said his firm placed an order for some of the Birmingham Water debt. He said the water system had "very good diversification," providing service to many people outside of Jefferson County, and a very low delinquency rate.

He also said the amount of revenues Birmingham Water collected was more than adequate to cover its debt service payments. "This is priced way too cheap for what it is," said Mr. Woods, whose firm oversees about \$2 billion in munis.

But others stayed away. Jim Gilliland, senior vice president at Diversified Trust in Memphis, said his firm had no issue with Birmingham Water's financial profile, but he was worried about the so-called liquidity of the bonds, given the overhang of Jefferson County's bankruptcy case.

The county filed for the largest municipal bankruptcy ever in November 2011, in part due to exotic financing taken out on its sewer system that soured.

"If there's a curve ball from the bankruptcy case, it will be harder to sell the bonds at the market price," said Mr. Gilliland, whose firm oversees about \$650 million in munis, of the Birmingham water bonds. "I do think the credit is good, but it has the problem of perception."

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