

ANCORA

ADVISORS

THE SETTLEMENT OF THE DETROIT BANKRUPTCY AND ITS EFFECT ON THE MUNICIPAL BOND MARKET

By,
Jim Bernard, CFA
Managing Director, Fixed Income
March 2015

In November 2014, the bankruptcy filing by the City of Detroit was approved and finalized only 16 months after it was filed in July 2013. Initially, pensioners were threatened with cuts of at least 34%. Thanks to a “Grand Bargain” by various entities (primarily the Detroit Art Museum), the final settlement included most pensioners having their benefits cut by 4% and most giving up their COLA adjustments. Conversely, bondholders did not fare as well as a result of the settlement, with “haircuts” wiping out between 26% and 66% of their value. Overall, \$7 billion of bondholders’ obligations were wiped out at the stroke of a pen by the bankruptcy judge.

Even with these massive cuts to the pension obligations of Detroit their pension funds remain well underfunded. The City of Detroit is unable to fund the annual contributions needed to maintain a financially viable status for these funds. For instance, the annual pension obligations due pensioners is currently over \$500 million, or nearly twice the total operating budget of the City of Detroit. Unless Detroit accomplishes a significant recovery including new jobs and expanding their population, it is unlikely the remaining pension obligations can be honored. Detroit has already indicated that they plan to only partially fund their pension obligations over the next few decades or longer.

It is interesting to note that even with this recent outcome in Detroit, other pension obligation bonds continue to trade with little adjustment as a result. Certain areas, such as Illinois, have seen some depressed price action for their pension obligation bonds, but most other states and municipalities continue to trade in line with other high grade bonds. Nevertheless, many states and municipalities continue to underfund their pension obligations and/or borrow additional funds in lieu of contributing cash towards these obligations. While better investment returns and some job growth recovery have modestly improved some districts underfunding, most districts continue to be well underfunded.

We continue to advise our clients and our portfolio managers to be very cautious in selecting municipal credits directly or indirectly tied to pension obligations. It is our belief that the major rating agencies have not adjusted their ratings on these bonds adequately enough to factor in the risk of their underfunded obligations. While we realize that many of these General Obligation bonds involve analyzing the legal risks of various entities, we believe it is best for individual bond buyers to avoid these uncertainties whenever possible.

Jim Bernard, CFA, is the Managing Director, Fixed Income at Ancora Advisors LLC a SEC Registered Investment Advisor. He is also a Registered Representative and Registered Principal of Safeguard Securities, Inc. (Member, FINRA/SIPC)

The mention of specific securities, types of securities and/or investment strategies in this newsletter should not be considered as an offer to sell or a solicitation to purchase any specific securities or to implement an investment strategy. Please consult with an Ancora Investment Professional on how the purchase or sale of specific securities can be implemented to meet your particular investment objectives, goals, and risk tolerances. Past performance of these types of investments is not indicative of future results and does not guarantee dividends/interest will be paid or paid at the same rate in the future. The data presented has been obtained from sources that are believed to be accurate and credible. Ancora Advisors makes no guarantee to the complete accuracy of this information. The indexes discussed are market performance indices and are not available for purchase. If you were to purchase the securities that make up these indices, your returns would be lower once fees and/or commissions are deducted. Past performance of these indices is not indicative of future results of the securities contained in these indices.

Ancora Advisors LLC is a registered investment adviser with the Securities and Exchange Commission of the United States. A more detailed description of the company, its management, and practices are contained in its "Firm Brochure" Form ADV, Part 2a. A copy of this form may be received by contacting the company at: 6060 Parkland Blvd, Suite 200, Cleveland, Ohio 44124, Phone: 216-825-4000, or by visiting our website www.ancora.net/adv