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Cities, states back off bonds amid budget concerns

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Uncertainty about where their next dollar is coming from has chilled the municipal bond market, meaning cities and states will be breaking ground on fewer public works projects, canceling or delaying projects worth tens of billions of dollars and providing yet another blow to economic-recovery efforts.

Through mid-August, the total value of municipal bonds issued nationwide was down about 40 percent over the same period a year ago, the largest decline in about two decades. The means fewer bonds issued for water and sewer systems, education, transportation, health care, electric utilities and general government purposes.

That leaves Kansas City, for example, without the money to prevent water from bubbling to the surface of streets and lawns because of aging water pipes that are bursting under pressure. The city can only afford to fix a fraction of the plumbing on its repair list, a problem that may only marginally improve if it is able to issue more bonds later this year.

"Obviously, I think Kansas City, Mo., has some improvements that are needed," said Kansas City resident Erik Ankrom, but he added that taxes already seem high and he's not sure if the water problems are worthy of plunging the city further into debt. "For the minor inconvenience it is, those funds may be better directed toward other infrastructure projects."

Market analysts attribute the municipal bond drop-off to a variety of factors, including a natural slowdown after last year's rush to issue bonds before a federal stimulus act program expired. But another reason, say local government officials, is the fact that their budgets are stretched so thin, they're not willing - or able - to siphon scarce tax dollars toward debt repayment.

"There's no question that this year some of the decline is simply budget problems that people have," said John White, chief executive officer of the Public Financial Management Group, a Philadelphia-based investment advisory firm. "There is an atmosphere now where taxpayers are asking more questions about anything that's debt-related than they have in the past."

- In Georgia, Gov. Nathan Deal slashed bonding to $563 million from about $1 billion in previous fiscal years, delaying a number of state university projects.

- Instead of issuing $10 million to $12 million in bonds, Concord, N.H., has trimmed its plans to between $7 million and $8 million this year, largely because taxpayers are unwilling to pay the larger debt service, said Brian LeBrun, the deputy city manager for finance.

- In Ohio, where the value of municipal bond sales is down more than 55 percent so far this year, the Elyria City School District recently decided against placing a $50 million bond issue on the November ballot after a survey showed it had a poor chance of passing.

- In Connecticut, local school districts also are cutting back on their construction and renovation projects. "A lot of local officials are understandably concerned about putting bonding referendums in front of voters right now because there is such a widespread feeling that there needs to be budget-cutting going on," said Democratic state Rep. Andrew Fleischmann.

Unlike the federal government, which borrows to finance its daily operations, most local governments issue bonds to pay for specific public works projects. Without additional bond revenue, many of those infrastructure projects simply don't get done. That means roads may remain bumpy, classrooms may remain crowded and - as Kansas City has demonstrated - old water mains may burst before they can be replaced.

"Just about everybody every day either rides on a street or a subway car, or gets on an airplane, or sends their kids to school, or turns on the water faucet or flushes the toilet, or engages in some kind of activity that involves a bond-financed piece of infrastructure," said Michael Decker, the managing director and co-head of municipal securities division for the Securities Industry and Financial Markets Association.

And it may be a while before annual bond issuances crack the $400 billion mark as they did in each of the past two years. That bubble was aided partly by Build America Bonds, a stimulus act creation that expired at the end of 2010. The special bonds paid taxable interest to investors - unlike the tax-free bonds municipalities usually use - but were popular with local governments because the U.S. Treasury Department subsidized their borrowing costs.

Build America Bonds accounted for $51 billion of the $204 billion of municipal bonds that had been issued in the first half of 2010, White said. Through June this year, municipal bonds totaled less than $115 billion nationwide, and their dollar value was down in every state except Utah, Maine and Alaska, according to figures from Thomson Reuters. Bond sales have picked up since then in some states, but not nearly enough to close the gap.

Although interest rates generally remain low - theoretically making it a good time for governments to take on more debt - some governmental entities with lower credit ratings or small bond issuances have found it difficult to find willing buyers, said Chris Hoene, the research director for National League of Cities.

He said that's partly because of the collapse of municipal bond insurers, which provided a safety net for bond buyers by guaranteeing an issuance that might have otherwise had a lower credit rating. The problem is so serious that the National League of Cities is exploring how to create its own municipal bond insurance agency, Hoene said.

In Kansas City, the Water Services Department issued nearly $200 million in bonds in 2009 to refund previous bonds issued over the past 13 years and generate $69 million in new revenues. It also has raised customer rates by at least 10 percent in each of the past four years. Yet its $24 million annual expenditure for new water pipes still falls far short of its annual $55 million in repair needs.

In July, when heat indexes over 100 degrees caused soil to shift and consumers to use more water, the city logged 211 work orders for busted water mains - setting a 13-year high mark, said water department spokeswoman Colleen Doctorian.

For some office workers, the water main breaks meant they had to trudge across streets and parking lots to find buildings with workable restrooms. Ankrom said he was washing laundry one Sunday when city crews, without warning, shut off his water to repair a broken water main that buckled the street near his loft condominium.

In Royse City, Texas, just east of Dallas, city council members engaged in a tense debate earlier this year about how much - if any - additional debt they should incur.

They ultimately opted not to issue $1.5 million in bonds to buy property for downtown parking and renovate city hall and an animal shelter. Instead, they chose the smallest option with the greatest likelihood of an economic benefit - a $500,000 bond issuance to finance the city's share of a $19 million Interstate 30 overpass at a location where a new Walmart store is to be built.

A similar debate occurred in Michigan's Upper Peninsula city of Marquette. That city's $3 million bond issuance this year will be barely one-third of what it was last year and an even smaller fraction of the $20 million issued in 2008, when it launched a renovation of its wastewater treatment plant, said Marquette's chief financial officer, Gary Simpson.

Reluctant to raise property taxes in order to pay off an increased debt load, Marquette officials are instead content to gradually chip away at an estimated $125 million repair list with a short-term goal of reducing the average age of its water pipes to 100 years old.

"We're doing the projects that absolutely have to be done, but those that can wait a year or two, that's what we're going to do," Simpson said.

Associated Press writers Susan Haigh in Hartford, Conn.; Norma Love in Concord, N.H.; and Shannon McCaffrey in Atlanta contributed to this report.