Michigan Municipal Market Update

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Municipal Commentary

General Obligation (GO) vs Revenue Bonds

Since there are currently ongoing discussions between the City of Detroit and Oakland, Macomb and Wayne Counties regarding Detroit's plan to lease the massive Detroit Water & Sewerage Department (DWSD) to a newly created regional authority, this is a great time to discuss the differences between General Obligation Bonds (GO) and Revenue Bonds.

GO bonds and revenue bonds are two types of bonds issued by municipalities. Both types of bonds promise stated interest rate payments along with a return of principal at maturity. GO bonds are backed by the "full faith and credit" of the municipality or state, meaning the issuer can use its taxing authority to finance the payments on a GO bond. Municipalities sell revenue bonds to raise money for specific projects, such as toll roads, bridges and water and sewer projects. The monies raised from user fees or tolls on that specific project are used to pay off the bonds. Unlike with GO bonds, the proceeds of a revenue bond sale cannot be used for general, unrestricted purpose, only for the specific purpose noted. Both GO and revenue bonds are generally considered safe investments. Traditionally, GO bonds were considered safer than revenue bonds because a municipality can always issue more bonds or raise taxes to pay off a GO issue, while a revenue bond is restricted to a defined revenue stream(s). GO and revenue bonds can be issued on a tax-exempt basis and are typically exempt from taxes in the state of issue. Today some believe revenue bonds provide a more secure source of repayment than general obligation bonds. As in the case with Detroit, debt payments by Detroit's water and sewer system were not affected by the city's financial crisis unlike the city's general obligations.

Detroit Emergency Manager Kevyn Orr would like to lease the entire DWSD system to a newly created regional authority. The plan would call for the counties to pay $1.88 billion, or $47 million annually over 40 years, in return for regional operation of the system. Negotiations are complex, primarily because of billions of dollars in deferred maintenance and EPA compliance costs.

The graph below compares the Bond Buyer 20 year GO index versus the Bond Buyer 25 year Revenue index over the last 20 years.

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