THE BOND BUYER

Ohio Buckeye tobacco refunding took debt off default track

By

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This article is part of a series spotlighting The Bond Buyer's ten 2020 Deal of the Year award winners, running from December 9 through 15. One of these honorees will be chosen as our national Deal of the Year at a virtual event taking place December 16. For more information on the Deal of the Year winners and how to obtain a complimentary pass for the virtual event, click here.

Dark clouds loomed for Ohio's more than $5 billion of tobacco bonds as dwindling settlement payments tied to falling cigarette consumption put default on the horizon as soon as 2024.

The Buckeye Tobacco Settlement Financing Authority's $5.35 billion refinancing on Feb. 25 bumped a portion of the bonds back into investment-grade territory and eliminated default risk.

"The refunding of the Buckeye Tobacco Settlement bonds certainly achieved all its objectives," said Ohio Office of Budget and Management Director Kimberly Murnieks.

Jefferies and Citi were joint lead managers on the transaction, which is being recognized by The Bond Buyer as Midwest Deal of the Year.

While declining cigarette use may be good news from a public health perspective, it wasn’t for investors. A default on the 2007 bonds wouldn’t impact the state’s fiscal health but it would have negatively impacted investors holding those bonds, state officials said.

“The authority was a conscientious steward of those interests, and this transaction prevented [default]. A default would also have made it difficult for the tobacco settlement revenues that are to be paid to the state in perpetuity to return to the state in the future,” Ohio Office of Budget and Management Director Kimberly Murnieks said recently as she reflected on the deal’s goals.

The authority began considering a refunding in the fall of 2019 when market conditions became more conducive to refinancing, she said. The budget director sits on the Buckeye authority along with Gov. Mike DeWine and State Treasurer Robert Sprague. The state established the authority to securitize its share of annual payments under the 1998 Tobacco Master Settlement Agreement.

“The refunding of the Buckeye Tobacco Settlement bonds certainly achieved all its objectives of increasing bond resiliency while also optimizing potential residual revenue back to the state,” Murnieks said. Under the new structure, tobacco settlement revenues could return as early as 2052 and the deal generated an estimated residual TSR savings of $1.34 billion or 24% of the refunded par.

The transaction, offered in five series, drew more than 150 investors and $50 billion in orders as strong interest prompted the team to move the pricing up a day.

“We had a diverse structure with a variety of taxable and tax-exempt product including taxable fixed amortization serials, taxable turbos, tax-exempt turbos, senior capital appreciation bonds, etc.,” Kym Arnone, managing director and joint head of municipal finance at Jefferies, said after the pricing.

“In addition to navigating the complex structured finance criteria required to rate a portion of the bonds, successful execution required a significant marketing effort," she said. "The linchpin of the distribution strategy was generating significant replacement demand from existing holders” of the non-rated bonds.

Tobacco refundings are more complex to structure than typical refinancings due to the evolution of rating agency criteria for investment-grade ratings on various classes of bonds, and tobacco transactions must satisfy the federal tax debt/equity test.

The structure is designed to withstand significant future declines in tobacco consumption. The state did not contribute funds or provide credit support for the newly issued bonds, so no risk was transferred to taxpayers.

S&P Global Ratings assigned various investment-grade ratings to some of the new bonds, ranging from BBB-plus to A, depending on the seniority and maturity. The outstanding bonds were rated B-minus and CCC-plus. The transaction also included about $3.3 billion of non-rated bonds maturing in 2055.

The original Buckeyes priced with low investment-grade ratings in 2007 but the bonds fell well into junk-bond territory as domestic cigarette sales volume declined.

Proceeds of the original deal provided a one-time upfront payment that financed the cost of improving facilities of Ohio’s K-12 schools and universities.

Orrick, Herrington & Sutcliffe LLP was transaction counsel and Squire Patton Boggs LLP was co-transaction counsel. PFM Financial Advisors LLC was the municipal advisor. Another 16 underwriters rounded out the syndicate as co-managers.

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