THE BOND BUYER

Why Arkansas sold tax-exempt junk bonds for a steel mill

By

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The Arkansas Development Finance Authority will close May 31 on $487 million of junk-rated tax-exempt industrial development revenue bonds to expand the Big River Steel plant in Osceola, one of the largest enterprises ever backed by the state.

Goldman Sachs priced the bonds on Tuesday.

“Mississippi County is one of the top steel-producing counties in the country, thanks in large part to Big River Steel,” said Mike Preston, director of the Arkansas Economic Development Commission.

Ro Arrington, director of public finance for ADFA, said that the bond issue was the largest in the agency’s history and one of the state’s largest ever.

“We were very pleased with the results,” Arrington said. “We took a passive approach as the conduit issuer. This was a rather quiet deal. It didn’t get a lot attention in the press.”

With final maturity in 2049, the term bonds bear 4.5% coupons and yields of 4.158% with ratings of B3 from Moody’s Investors Service and B from S&P Global Ratings. Fitch Ratings did not rate the deal.

The non-investment-grade ratings meant that all of the bonds went to institutional investors, Arrington said.

Moody’s applied Big River’s corporate rating of B3 to the deal since the tax-exempt bonds share the same collateral package and will account for almost all of the debt in the company's capital structure. The ratings outlook remains stable.

The new bonds are backed entirely by Big River Steel with no state pledge, though Arkansas previously issued $125 million of general obligation bonds to help finance the $1.2 billion expansion of the plant on the west bank of the Mississippi River. Big River, which touts itself as an advanced-technology steel producer, agreed to build the plant with state incentives in 2013.

The state’s GO bonds included $50 million as a direct loan to the corporation. That drew criticism from some lawmakers who warned that a new state law created loopholes that could be abused in future deals.

Big River eased concerns when it paid off the state loan 17 years ahead of schedule. Although the initial Arkansas bonds carried the state's GO pledge, debt service came from steel mill revenues.

The expansion is expected to double the mill’s capacity to 3.3 million tons and improve its ability to produce higher-value steel products.

“Mississippi County is one of the top steel-producing counties in the country, thanks in large part to Big River Steel,” said Mike Preston, director of the Arkansas Economic Development Commission. “The transportation and industrial infrastructure set on the Mississippi River allows Arkansas products to be sent and used around the world, and we're grateful for the jobs and continued investment of the steel industry in Arkansas and what it provides."

Big River was Arkansas' first project under constitutional Amendment 82 and is the single largest private investment in state history. Amendment 82, approved by voters in 2004 and amended in 2010, allows the state to issue bonds to provide funding for infrastructure and other needs.

Local subsidies of $14 million included $2 million from the city of Osceola and $12 million from Mississippi County. The county was to have received a fixed annual payment in lieu of taxes of $3.5 million over the 20-year term of the GO bonds.

The Advantage Arkansas program allows for a 4% income tax return on total net new payroll for jobs created in Mississippi County. The income tax credit begins the year in which the new employees are hired and is earned each tax year for five years.

Big River invested $10 million with Arkansas Northeastern College for training programs to prepare applicants for the mill's 425 positions with average compensation of $75,000. State officials said average compensation is closer to $90,000.

State officials said the mill has also helped attract to Arkansas an additional $300 million in investments and another 100 jobs from suppliers and support services of Big River.

Big River's reliance on the volatile steel sector tempers the rating, Moody's said, and "also reflects the risk the company is not able to capture share from entrenched competitors when it ramps up its expanded production capacity in 2021, especially considering the substantial amount of other expansion projects announced by its competitors."

Big River's plant is part of major growth in steel production in the South.

Nucor, the largest steelmaker in the U.S., has two plants in Mississippi County and is adding a $230 million cold mill.

Nucor is also expanding a $750 million plant in Louisiana with $160 million of state subsidies. In January 2016, the company temporarily halted production because of market conditions. In 2013, a few days before the plant was set to begin operations a storage dome collapsed.

In 2007, Alabama landed a $5 billion ThyssenKrupp steel mill with $400 million of incentives. ThyssenKrupp AG sold the facility to ArcelorMittal and Nippon Steel and Sumitomo Metal Corp. for $1.55 billion in 2014. The sale required regulatory approvals from three countries along with the state. The plant in Calvert, Alabama, near Mobile, was renamed AM/NS Calvert.

The Big River expansion is expected to double the Arkansas mill's capacity to 3.3 million tons.**BRS**

Big River has an option to lease about 800 acres on the Brownsville, Texas, ship channel for a $1.5 billion plant similar in size to the original in Osceola, which would employ about 500 workers.

In November, Big River chief executive David Stickler said the company had turned aside offers to merge with other firms and would continue with its current expansion plans.

The U.S. mills will face renewed competition from Canada and Mexico this month with the lifting of tariffs imposed by the Trump administration.

The U.S. tariffs on metals from Canada and Mexico have been in effect for nearly a year, with steel imports subject to a 25% tariff and aluminum to a 10% charge. Canada and Mexico responded with retaliatory tariffs.

Trump has called on Congress to ratify the new United States-Mexico-Canada Agreement called the USMCA, an updated version of the North American Free Trade Agreement or NAFTA.

A simmering trade war with China continues to cloud the outlook for steel and products made with the metal.

Credit Suisse cited the removal of Canadian tariffs as bearish for steel prices and will allow foreign firms to become more aggressive in targeting the U.S. market.

Corrected May 24, 2019 at 12:24PM: The names of investment bankers were removed from the original version of the story, because of some uncertainty over which individuals were part of the deal.