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Economics

Arizona County Sees Cash in Louisiana Prison Bonds: Muni Credit

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Arizona's La Paz County, whose residents earn about 20 percent less than the state average, is generating cash by lending its name as the issuer of municipal bonds for a Louisiana prison operator.

A La Paz authority that finances industrial development stands to receive \$70,000 annually by selling debt this month for LCS Corrections Services Inc., which has eight prisons in Alabama, Louisiana and Texas at least 1,200 miles (1,931 kilometers) to the east. The county has no obligation for the \$297 million of securities, which LCS is using to pay off bank debt and lower interest costs, said Lori Sullivan, managing director at Raymond James Financial Inc., the lead underwriter.

La Paz joins issuers in states including Colorado and Wisconsin that allow the type of financing, which provides riskier borrowers from charter schools to private prisons access to the \$3.7 trillion municipal market. Forty states prohibit agencies from selling bonds for borrowers from outside their borders, said Toby Rittner, president of the Council of Development Finance Agencies in Columbus, Ohio.

“We are guaranteed an annual fee for 10 years, which will generate a significant amount of money for economic development,” said D.L. Wilson, chairman of the La Paz county board of supervisors and a retired utility manager. “Under Arizona statute, we can finance a project anywhere as long as there is an economic benefit to the state and county.”

Mining Past

About 20,300 people live in the jurisdiction, which borders California and is named after a deserted gold-mining town 280 miles east of Los Angeles. Greenlee, with 8,800 residents in southeast Arizona, is the state’s only county with fewer residents.

Money earned from issuing the bonds will go to the local economic-development agency and chambers of commerce, which promote business to complement farms growing cotton, pistachios, melons and alfalfa, Wilson said. Some will also be used to tout a 16-mile section of the Colorado River, called the Parker Strip, which attracts boaters and water skiers.

County residents make less money than most Arizonans, and have a harder time finding work. The median wage of about \$27,500 in 2012 compared with the state average of \$33,977, Department of Administration data. Its December jobless rate of 9.2 percent exceeded the 7.6 percent Arizona average.

Wisconsin Outlet

The biggest issuer of such debt is the Wisconsin Public Finance Authority, according to Rittner. The agency has arranged more than \$1 billion in bonds for businesses in 36 states, said Mike LaPierre, a program manager. Borrowers have included Northwest University, a Kirkland, Washington, school founded by the Assemblies of God denomination, according to the authority’s website.

In Colorado, the state Educational & Cultural Facilities Authority has sold bonds for borrowers including The Nature Conservancy, which used the funds to refinance debt on its Arlington, Virginia, headquarters.

Rittner said issuance for out-of-state borrowers has prompted more questions from debt managers than any other topic in recent years.

“Many feel that public finance is their state’s prerogative and they get nervous when an outside issuer does work in their state,” he said.

Pushing Back

“There has been some push-back because some states want to have input into these deals,” said James Parks, president of the Louisiana Public Facilities Authority in Baton Rouge. He said his agency could have managed the transaction.

When La Paz sold the bonds, proceeds funded a loan to LCS, which is based in Lafayette, Louisiana, and is using the money to refinance mortgages on its prisons. The facilities house as many as 6,652 inmates, offering documents show.

The documents cite risks to bondholders, including the possibility that demand for the facilities may wane, or that trustees may be unable to sell the assets and generate money to repay the obligations in the event of a default.

Investors on Jan. 16 demanded a 7.5 percent yield for LCS’s 20-year bonds, which are federally taxable, and which Standard & Poor’s rates BBB, two steps above junk. The yield was about 3.9 percentage points more than Treasuries maturing in February 2036. It was also about 2.3 percentage points more than on corporate bonds with a similar rating, Moody’s Investors Service data show.

Default Outlier

About 1.5 percent of jail-related bond issues are in default, the fifth-highest rate among more than 25 types of debt, according to a Jan. 6 report by Matt Fabian, managing director of Concord, Massachusetts research firm Municipal Market Advisors. Less than 0.2 percent of state and local bonds default, Fabian said.

“Private prison bonds are absolutely the red-headed stepchildren in the muni industry,” said David Jaderlund of Jaderlund Investments LLC, which manages \$500 million of bonds in Santa Fe, New Mexico. The bonds are often based on leases with government agencies that may be broken if inmate populations decline or local officials change policies, he said.

Private prisons held 8.7 percent of inmates in 2012, according to a U.S. Department of Justice report issued in December. The facilities are gaining share as more localities decline to build jails

because of budget pressures, Sullivan said.

Issuance Experience

LCS picked La Paz in part because it had experience as the issuer in May for a prison in Holtville, California, owned by a Utah company, she said.

“We wanted to have an issuer with some name recognition,” she said.

The California prison was the authority’s second transaction since it was formed in the 1980s, Wilson said. The unrated bonds, which are tax-exempt and mature in October 2039, traded as recently as Jan. 14 with an average yield of 7.8 percent, data compiled by Bloomberg show.

LCS reported net losses of \$13.1 million in 2012 and \$16.6 million in 2011, as interest expenses exceeded \$17.9 million both years, according to the offering statement for the bonds sold this month. Revenue grew to \$69.9 million in 2012 from \$58.6 million in 2011.

An LCS spokesman, Richard Harbison, declined to comment on the financing, and he said Chairman Jerry Gottlieb also declined to comment.

Development authorities in Arizona have issued bonds for about 20 out-of-state deals over the past six years, said Patrick Ray, a lawyer at Kutak Rock LLP in Scottsdale, who represents La Paz and other counties. While some transactions have required restructurings, none are in default, he said.

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