# Municipal Credit Update

## Difficult Decisions Ahead for St. Louis as a Result of Rams' Departure

January 2016

On January 12th, the National Football League (NFL) owners voted to approve the Rams' move from St. Louis ("the City") to Los Angeles, leaving the City, St. Louis County and the State of Missouri with approximately $144 million in debt and maintenance costs for what will now be an empty stadium.1 While we never held any of the City's stadium-related debt in our clients' portfolios, we did hold a small amount of the City's other debt, which we exited promptly after the vote, eliminating any exposure to the City. We chose to act swiftly on the breaking news without penalty to our clients given what we believed to be a degree of uncertainty on how the City will treat the remaining stadium debt following the team's departure. The City is currently facing difficult financial headwinds and continuing to appropriate increasingly scarce resources to pay bondholders for a stadium with no tenant may become a contentious decision at a time when other essential city services are being reduced. We decided that the downside risk that may occur should City leaders publicly question paying for a now mothballed stadium, potential spillover effects on unrelated securities, and whether or not the headline risk could impair liquidity in the City's debt was sufficient to sell any positions tied to the City.

[1] Respaut, Robin. "With NFL Rams Gone, St. Louis Still Stuck with Stadium Debt." Reuters. February 3rd, 2016. Retrieved from www.reuters.com on February 8, 2016.

### What is annual appropriation debt?

Many local units of government and states issue annual appropriation debt (often called lease revenue bonds or certificates of participation) as it does not require voter approval, and debt repayments are simply a budget obligation without a dedicated tax pledged to debt service and subject to annual approval by the governing body. This type of debt is common in states, such as Missouri, that have strict constitutional or statutory debt limits or require significant voter approval thresholds. Debt repayments are contingent on an obligor's willingness to appropriate, on an annual basis, for the debt service tied to the bonds. As extra incentive for appropriation, these debt structures often grant the Trustee a leasehold interest in a specific property that the government will forfeit should the issuer fail to appropriate during any given year. The leased property typically has varying degrees of essentiality to the issuing local government. For instance, a police headquarters, an administration building or a school would be much more essential to a city or a school than would a golf course or a baseball stadium. The impact that the loss of the property would have on the local government's ability to maintain essential services to taxpayers may dictate how committed the issuer is to repaying the bonds, especially during times of fiscal distress. For this reason, when conducting our credit analysis of this type of debt, we typically avoid projects that we judge to be highly non-essential to core government operations.

Rating agencies often apply blind notching methodologies to these bonds relative to an issuer's general obligation rating – often only one notch for the appropriation risk. For example, Standard & Poor's maintains an A+ issuer rating on the City of St. Louis, and an A rating on its stadium bonds as of April 2, 2015. We do not follow this same methodology as it does not fully capture the risk bondholders assume, especially when an issuer is confronting a challenging fiscal landscape or a potentially politically indefensible decision. When cities use taxpayer dollars to finance or provide back-end support to projects that are not essential, especially sports facilities, there is always the possibility that newly elected officials, or those that are subject to re-election, fail to support the project in the tough times and hence non-appropriation risk is heightened.

In the case of St. Louis' Edward Jones Dome, the bonds were structured in a manner that afforded the NFL and the City, County and State enormous flexibility. The NFL is not required to make any payment toward the bonds nor were they required to commit to staying in the City until the bonds were repaid. On top of that, sponsoring local governments and the State provided no leasehold interest in the property, so should the City choose not to pay the debt, the stadium would not be lost nor would any other governmental property.

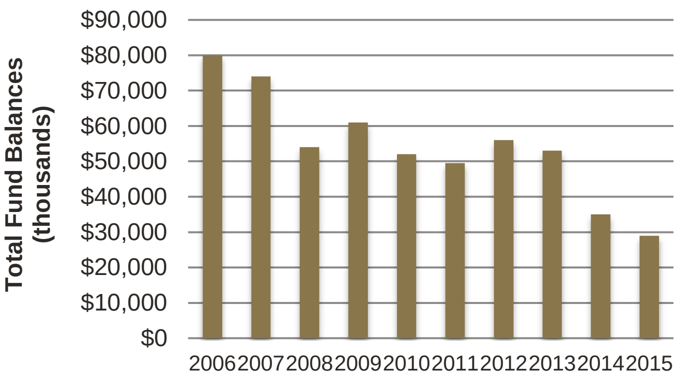
The municipal market has a variety of examples of obligors failing to appropriate for debt tied to non-essential assets. As just one illustration of this risk, in December 2011 the Village of Lombard ("the Village"), Illinois Board of Trustees refused to appropriate funds under a tax rebate agreement for a hotel-conference center that failed to perform as expected, ultimately resulting in a default of the hotel-related bonds. Standard & Poor's dropped the Village's rating from AA to BBB after the initial refusal to appropriate, and then to B after the bonds defaulted. To this date, the Village has refused to appropriate any funds towards the project[2] and its finance director has stated that they were "going to do what's in the best interest of the taxpayers of the Village of Lombard."[3]

### Why is St. Louis' risk profile heightened?

The City of St. Louis is already poorly positioned and the loss of the Rams will only exacerbate its operating pressures. The loss of the team is sure to have some impact on economic activity in the City, but the loss of the player's reportable income is likely to have a more immediate effect on the City's earnings tax collections. The earnings tax comprises nearly 50% of the City's General Fund revenues and, as seen in Figure 1, the City's inability to maintain balanced operations has reduced its financial flexibility significantly over the last decade closing fiscal 2015 with only a modest financial cushion that could easily be exhausted in the near future should current trends continue or worsen.[4]

[2] Shields, Yvette. "Chicago Suburb Takes Second Stab at Hotel Debt Relief." The Bond Buyer. December 29th, 2015. Retrieved from www.bondbuyer.com on February 7, 2016.
[3] Merrion, Paul. "Lombard in junk bond territory over hotel dispute." *Crain's Chicago Business*. February 12th, 2014. Retrieved from www.chicagobusiness.com on February 7, 2016.
[4] City of St. Louis 2015 Comprehensive Annual Financial Report.

**Figure 1. City General Fund Balances Decline to Decade Lows in 2015**




The possible contentious nature of the stadium financing in light of the City's declining financial position begs a number of questions: Can and will the City continue to support the debt at a time when their finances are deteriorating? Will there be public sentiment or political pressure on the City to divert resources that would go to stadium bondholders towards City services? These questions are no longer distant concerns; they are current considerations the City is likely going to face, on an annual basis. If the negative trajectory of its financial profile persists, justifying a $6 million payment toward the operations and debt service of a vacant stadium may become an increasingly contentious feat. To add some perspective, the City reduced its overall budget by nearly $20 million in fiscal 2015 and still closed with a $7 million deficit in the General Fund; net of the payments for the stadium, they may have actually come close to maintaining fiscal balance. Clearly, the City is aware of the financial burden they will continue to carry in supporting not only the debt, but the operations and maintenance costs of the facility. The City has taken a page out of the football playbook and thrown a Hail Mary pass requesting a supplemental allocation from the NFL for the outstanding stadium debt.[5] In this case, the NFL is not legally obligated to do so and we believe it is unlikely any assistance is provided.

Should the trajectory of the City's fiscal profile continue its negative path we believe local leaders may be hard-pressed to make politically unpalatable cuts to essential services while at the same time appropriating operating dollars to an unoccupied football stadium. As a result, there is a heightened risk to bondholders exposed to any of the City's security classes which may be impacted by the spillover effect of a non-appropriation event. While many cities may be initially enthused by the promise of economic expansion that a new stadium may bring, the risks of failed cash flows or loss of the occupying team are critical considerations, not only for taxpayers, but for bondholders as well.

Please feel free to contact us at research@gurtin.com for additional information.

Check out our Twitter @followGurtin and LinkedIn for news, information, and market updates.

**Share the report:**

[5] Pistor, Nicholas J.C. "St. Louis aldermanic president asks NFL to pay for Edward Jones dome debt." St. Louis Post. January 22nd, 2016. Retrieved from www.stltoday.com on January 25, 2016.

## Analysts:

**Iliana Perez**
Vice President
iperez@gurtin.com

**Thomas Schuette**
Partner, Co-Head of Credit Research, Co-Head of Portfolio Management
tschuette@gurtin.com

**Important Disclosures**

The contents of the report are for informational and educational purposes only. Each investor should make his or her own investigation and evaluation of the investments including the merits and risks thereof, and this report should not be construed as investment, tax, financial, accounting or legal advice. Gurtin Fixed Income Management, LLC, doing business as Gurtin Municipal Bond Management ("Gurtin") is a registered investment adviser with the U.S. Securities and Exchange Commission (the "SEC").

The analysis contained herein is based on the data available at the time of publication, certain assumptions, that if different could result in different outcomes, and the opinions of Gurtin. The opinions and information stated and relied upon herein may become outdated, change, or otherwise be superseded at any time without notice. Certain information contained in this report is based upon third party sources, which Gurtin believes to be reliable, but are not guaranteed for accuracy or completeness. Neither the SEC nor any other federal or state agency or non-U.S. commission has confirmed the accuracy or determined the adequacy of this document. Any report to the contrary is unlawful.

Each investor should inform himself or herself as to the tax consequences of the investments and services described herein. Clients should have the financial ability and willingness to accept the risks associated with the investments made by Gurtin. Gurtin reserves the right to modify any of the terms described herein.

No assurance can be given that the investment objectives will be achieved or that investors will receive a return of any capital. In considering any prior performance information, historical or hypothetical, contained herein, clients should bear in mind that prior performance does not guarantee nor is it indicative of future results. Performance includes the reinvestment of all income. Therefore, no current or prospective client should assume that the future performance of any specific investment or investment strategy (including those undertaken or recommended by Gurtin) will be profitable or equal to corresponding indicated performance levels.

Each recipient of this report acknowledges and agrees that the contents hereof constitute proprietary information that Gurtin derives independent economic value from. The recipient further agrees that the contents of this report are a trade secret, any reproduction or distribution of this report, in whole or in part, or the disclosure of its contents, without the prior written consent of Gurtin, is prohibited, and the disclosure of this report or its contents is likely to cause substantial and irreparable competitive harm to Gurtin. By accepting this report, each recipient agrees to the foregoing.