



**House
Legislative
Analysis
Section**

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FOREIGN CURRENCY BONDS

**House Bill 5056 as introduced
First Analysis (10-24-95)**

**Sponsor: Rep. Greg Kaza
Committee: Urban Policy**

THE APPARENT PROBLEM:

Written testimony presented to the House Urban Policy Committee by an associate professor of finance at Oakland University explains international bonds and notes as instruments that "are sold initially to an investor outside the country of the borrower." Each country's international bond market has two components. The first, foreign bonds, are issues sold primarily in one country and currency by a borrower of a different nationality, as for example, when U.S. dollar bonds are sold by a British firm in the United States. "The second component, *Eurobonds*, are underwritten by international syndicates and sold simultaneously in a number of national markets." An example would be a U.S. dollar bond issued by General Motors in Europe and sold in London.

Eurobonds, according to the testimony, are issued by multinational corporations, large domestic corporations, sovereign governments, and international institutions, and pay interest annually. The advantages to the issuer are, first, that their rates are typically lower than those of comparable domestic bonds. This allows a foreign government to borrow at lower rates in the *Eurobond* markets than at home. Second, *Eurobonds* are subject to less stringent regulations in the country of origin than securities denominated in a local currency and sold in that country. Third, disclosure requirements are also much less stringent than those of the Securities and Exchange Commission on U.S. sales. Consequently, the registration costs of a Eurobond offering are less than those of a domestic issue and less time is needed to bring a new issue to market. Finally, interest paid on *Eurobonds* is usually not subject to an income withholding tax, and the interest is not always reported to tax authorities.

The City of Detroit has proposed that cities with empowerment zone or enterprise community designations be allowed to issue bonds denominated in a foreign currency. The city's budget director maintains

that such bonds would give these cities greater flexibility in their investment options and would reduce interest costs. Legislation has been proposed to allow these communities to take advantage of this means of acquiring funds.

THE CONTENT OF THE BILL:

House Bill 5056 would amend the Municipal Finance Act to permit a "distressed urban area" to issue bonds denominated in a foreign currency, unless prohibited by law. Under the bill, a "distressed urban area" is defined to mean a city that has been designated an empowerment zone or enterprise community by the U. S. Department of Housing and Urban Development (HUD). The bill would place the following restrictions on the issuance of these bonds:

- ** The issuance would be subject to favorable market conditions.
- ** If the foreign denomination was not disclosed by the underwriter to a prospective purchaser in writing before a sale, the sale could be voided by the purchaser.
- ** The distressed urban area would be required to file notice of each issuance with the Department of Treasury, specifying the principal and the currency, no later than ten calendar days after delivery to a purchaser.

MCL 131.16

BACKGROUND INFORMATION:

On December 21, 1994, the federal Department of Housing and Urban Development designated a portion of the city of Detroit as an empowerment zone, and designated Muskegon/Muskegon Heights, Flint, and Lake County as enterprise communities. For further information, see the House Legislative Analysis Section's analysis of enrolled House Bill 4730 and Senate Bill 539, dated 8-8-95.

House Bill 5056 (10-24-95)

FISCAL IMPLICATIONS:

The House Fiscal Agency estimates that the provisions of the bill would have no impact on state funds. (10-16-95)

ARGUMENTS:

For:

Allowing cities designated as enterprise communities or empowerment zones by the U.S. Department of Housing and Development (HUD) to issue bonds denominated in foreign currencies would give them the flexibility to take advantage of an efficient means of acquiring capital funds, primarily by allowing them to enter the *Eurobond* market, and thus widening their borrowing powers. The concept has been pursued with success in other states. Kentucky, for example, has issued "Samurai" bonds to entice Japanese investors. Considerable savings can be realized by issuing bonds in a foreign currency, and, as pointed out in written testimony presented to the committee by the City of Detroit's budget director, the savings can be significant when the amount borrowed is large. For example, even a .05 percent savings on the proposed refinancing of the city's Resource Recovery Bond would save the city one quarter of a million dollars in interest costs. Although the City of Detroit has no immediate plans to take advantage of this proposal, it is important that legislation be in place so that the city would have the option of taking advantage of favorable market situations when they arise.

Against:

There are three reasons why Michigan cities should not speculate in foreign currencies. First, foreign investors will not be interested in the bonds, since the interest rates are generally low. The bonds might be purchased by U.S. residents, since they are eligible for the federal tax break. U.S. investors, however, generally choose to invest in regular tax exempt municipal bonds that are not denominated in a foreign currency. Second, having a municipality's obligations in a foreign currency exposes the municipality to "currency risk." For example, if a municipality has a \$100 million bond issue in marks, and the value of the mark rises by 20 percent, then the municipality's obligation will also rise, in this case to \$120 million. Third, the provisions of the bill are restricted to cities that have been designated as empowerment zones or enterprise communities by HUD, and experience has shown that financially distressed municipalities are more likely than others to become involved in speculative ventures.

Against:

It is not clear why the provisions of the bill would restrict permission to issue bonds denominated in a foreign currency to a city that has been designated an empowerment zone or enterprise community by HUD. Why not allow all municipalities to have this additional borrowing option?

Response:

Few municipalities would qualify to enter the Eurobond market, as provided under the bill, since bonds in foreign denominations are normally issued in very large amounts (e.g., \$100 million or more). Generally, the only cities that could enter the market are those with large distressed urban areas, such as Detroit, which often have need of large amounts of funds to finance urban development projects.

POSITIONS:

The City of Detroit's budget director testified before the Urban Policy Committee in support of the bill. (10-18-95)

The Michigan Jobs Commission has no position on the bill. (10-23-95)