Hedge funds eye Detroit for “hostile takeover”

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Detroit’s $8.6 billion in junk bond debt is being eyed by hedge funds eager to play their part in the looting of the city, as debt restructuring negotiations between Emergency Manager Kevyn Orr and the city’s creditors loom. Detroit is the largest and most indebted municipality in US history to undergo emergency debt restructuring, through bankruptcy or otherwise.

The modus operandi of the hedge funds has been established over decades of “hostile takeovers” of corporations, whereby typically a majority of the target company’s shares are purchased by the fund, giving it control of the company. Wages and pensions are then gutted, profitable assets sold off and big investors walk off with vast sums, leaving only wreckage behind. Though Detroit is not a corporation, the terms of its emergency management—outlined in Michigan’s Public Act 436—amount to a bankers’ dictatorship and the situation is almost completely analogous.

Historically, the municipal bond market has been the domain of those seeking a stable investment with modest long-term returns. Municipalities, unlike corporations, rarely enter into bankruptcy and, so far, have been free from the threat of outright liquidation. This permanence and stability of municipalities has until recently made bonds a relatively safe bet for investors.

However, the devastation of Detroit over decades—an acute manifestation of the global crisis of capitalism—the drying up of federal and state aid, and the impact of the 2008 crash in particular have destroyed the city’s credit rating, calling into question its ability to pay up and sending bond prices on the secondary market plummeting. Many investors who thought they were avoiding risk by purchasing bonds years ago are now more eager to simply cash out and cut their losses. Hedge funds, which seek high-risk investments with big profit potential, plan to purchase huge swaths of distressed bonds at a discount on the secondary market. Their plan is to re-sell them for a handsome profit after the sweeping attacks on the working class in the city boost the value of their holdings.

Last week, Emergency Manager Orr revealed a broad “restructuring plan” and is now set to negotiate the particulars with the city’s creditors and union officials in closed-door meetings over the next six weeks.

Upon issuing the report, Orr emphasized that he sought to avoid bankruptcy, but this is largely a technical matter. Whether negotiations are mediated by Orr himself—who legally rules as a dictator over the city, free from any interference from the people or even elected officials—or a judge in bankruptcy court, a drastic restructuring of the city in favor of finance capital is impending. “We’ll have an assessment of whether or not we can do this consensually or if we’ll have to go to court,” Orr said.

Orr’s report, though merely an outline, underscores the fact that his task is to collect for the city’s biggest bondholders and creditors, and that it will be the working masses of Detroit who are to suffer the brunt of the attack that emerges from negotiations. Health care for both active and retired workers, as well as pensions, face possible theft. Privatization of city services such as recreation centers, trash collection, transportation, street lighting, water and sewage processing, are all “on the table.” Union contracts may be ripped up and layoffs or concessions imposed on city workers. The number of streetlights is to be nearly halved.

Still, the uncertainty is causing the value of Detroit’s debt to fall further. Following the release of Orr’s report, Moody’s downgraded the city’s bond debt deeper into junk status. This can only further entice hedge funds. Though the buyer is unknown to the public (as are all bondholders), earlier this year a $25 million block of Detroit's pension certificates—which are similar to bonds—were sold at about 66 cents on the dollar. The size of the investment suggests a hedge fund.

Since 2005, the US municipal bond market has virtually doubled—from $1.9 trillion to $3.7 trillion in bonds issued. Because of the cutbacks in federal and state aid and lower tax collections, municipalities have been compelled to borrow more and more to cover the budget gap. They borrow by issuing bonds—which are a form of debt—selling them to investors looking for tax-free earnings.

Though the scale of Detroit's financial collapse is unprecedented in US history, recent municipal bankruptcies throughout the country have resulted in both massive cuts to jobs and services and massive payoffs for hedge funds.

In April of this year, Stockton, California, population 291,707 as of the 2010 census, became the largest US city to be approved for bankruptcy. Stockton City Manager Bob Deis boasted, "Over the next two years, city-paid retiree health benefits [amounting to $540 million] will be completely eliminated."

In November 2011, Jefferson County, Alabama filed the most expensive US municipal bankruptcy to date, with more than $4 billion in debt. Hedge fund Monarch Alternative Capital acquired more than $600 million of it. Another hedge fund called Stone Lion Capital scooped up more than $10 million. More than 700 county workers were fired.

Hedge funds are making similar moves in Greece, where they have poured money into the banking sector of the severely indebted country, where a strike ban is being enforced under virtual martial law. As in America, the hedge fund managers are essentially betting on the ability of the unelected bankers of the troika (European Union, International Monetary Fund and European Central Bank) to extract wealth from the workers of Greece by lowering wages and scrapping infrastructure.

Achilles Risvas, a manager of a Greek-focused hedge fund, called Greece "the mother of all recovery trades. The situation is hugely attractive because of the asymmetry of the pay-off." Emphasizing his confidence in the ability of finance capital and its representatives to quash working class resistance, he said of the deal, "It's free leverage with limited downside."

A recent article in Reuters noted, "This sudden interest in the staid world of municipal debt comes as these so-called distressed funds are looking for new places to put their money. Lucrative corporate bankruptcies have dried up, thanks in part to the Federal Reserve's policy of low interest rates."

"Of course," the article continued, "these hedge funds may be deterred by the financial and political constraints of local governments, which must pay police and collect trash and cannot be forced into liquidation. But despite the risks, some are already betting hundreds of millions of dollars that there are big returns in cash-strapped governments."

In fact, the restructuring plan outlined by Orr does call for the "liquidation" of large parts of the city of Detroit deemed too poor or under-populated to continue to pay for services, including public lighting. The rest of the city is to be reorganized based on the profit interests of wealthy real estate developers, corporate executives and the billionaire hedge fund managers.

The fact that Detroit is now the target of the same vultures who have dismantled industry after industry for their personal gain poses the sharpest threat to the working class. The defense and expansion of jobs, living standards and essential services and the rebuilding of the city to meet the needs of working people are possible only by building a political movement, independent of the Democrats and Republicans, to break the grip of the financial oligarchy.