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Puerto Rico to Detroit Buoyed by Insurance Comeback: Muni Credit.

Buyers of debt issued by bankrupt [Detroit](#) or junk-rated Puerto Rico are finding it pays to have bond insurance. The backing is even more valuable after upgrades of units of Assured Guaranty Ltd. and MBIA Inc.

Insured local debt beat the \$3.7 trillion municipal market last year for the first time since 2007, before the companies lost their top credit grades during the financial crisis. Standard & Poor's last week raised subsidiaries of Assured to AA, the third-highest level, and MBIA's National Public Finance Guarantee Corp. to AA-, one step lower.

The National increase alone lifted ratings on about \$300 billion of bonds, according to research firm Municipal Market Advisors. The upgrades have an amplified effect on distressed issuers. Some uninsured Puerto Rico bonds fell over the past year at more than five times the pace of those backed by Assured. Detroit general obligations with insurance trade at 99 cents on the dollar, while those without it have fallen to about 20 cents, data compiled by Bloomberg show.

"The insurance protects you from all the downside risk from an impending restructuring that may or may not happen" in Puerto Rico, said Robert DiMella, who oversees about \$7.5 billion of local debt as co-head of MacKay Municipal Managers in Princeton, New Jersey. "It's a very good way for investors to invest in Puerto Rico, and that's what we're doing."

Double Up

The rating boost may help the insurers double their market share to 8 percent of issuance this year, S&P said in a report last week. The higher credit standing will make it easier for them to win business should borrowing costs rise and make the backstop more valuable to issuers, according to S&P. Muni yields remain near [generational lows](#) as bond sales have slumped.

The consensus on Wall Street is that interest rates are poised to rise. Ten-year Treasury yields will climb to 3.34 percent in the fourth quarter from about 2.7 percent now, according to the median forecast of 70 analysts surveyed by Bloomberg.

Insurers were largely stripped of their top ratings in 2008 amid losses on guarantees of subprime-mortgage-backed debt. Build America Mutual Assurance Co. entered the market in 2012 with S&P's AA rating, becoming the first new insurer for local bonds since 2007. This year, about 4.8 percent of the debt had the protection, up from 3.2 percent in 2013, Bloomberg data show. Insurers once covered more than half the market.

Credit Equalizer

The backing had appeal for individual investors, who own about 60 percent of munis, because it gave AAA ratings regardless of the underlying credit. The focus has shifted in part to the insurers' role in protecting investors in bankruptcy court after Chapter 9 filings by municipalities including Detroit,

the [California](#) city of Stockton, and Jefferson County, [Alabama](#).

“Bond insurance represents a great value for the investor when you’re talking about the very stressed credits like Puerto Rico, or the uncertainty associated with Detroit,” said Patrick Early, chief muni analyst at Wells Fargo Advisors LLC in St. Louis. “Essentially you’re getting a AA at BBB levels.”

Debt backed by units of Assured Guaranty probably trade with yields as much as 0.75 percentage point higher than uninsured securities from a AA municipality, DiMella said. Heading into this year, MacKay boosted holdings of insured bonds above the amount in the benchmark the firm tracks, he said. MacKay added insured Puerto Rico bonds, he said.

Value Maintained

Uninsured 10-year general obligations from the U.S. territory have declined over the past year at more than five times the pace of securities backed by [Assured Guaranty \(AGO\)](#) Municipal Corp.

Puerto Rico general obligations with Assured’s protection and maturing in July 2024 traded March 24 at 98 cents on the dollar, the highest since August, data compiled by Bloomberg show. At this time last year it traded at about 102 cents on the dollar.

By comparison, debt with the same maturity that doesn’t have insurance traded yesterday at an average of about 74 cents, a one-month low. A year ago, it changed hands at 99 cents.

In Detroit, uninsured limited-tax general obligations due in April 2016 traded last week at 22 cents, while debt with identical maturities backed by Assured and National went for about 99 cents and 95 cents, respectively.

Competitive Strength

[MBIA \(MBI\)](#)’s new rating “will significantly enhance its financial flexibility,” Chief Executive Officer Jay Brown said in a March 18 statement. Dominic Frederico, CEO of Hamilton, Bermuda-based Assured, said in a separate statement the company was pleased S&P “recognized the strength of our competitive position.”

A probable target for insured volume is 5 percent, according to a report this week from Municipal Market Advisors, based in Concord, [Massachusetts](#). Business is limited by the fact that about 70 percent of insured bonds in 2013 came from five states: California, [Texas](#), [Pennsylvania](#), New York and [Illinois](#).

Issuers using the protection this year include Oyster Bay, New York, with an A- rating from S&P, and Henry Mayo Newhall Memorial Hospital in [Valencia](#), California, with a BBB- grade.

“There was definite value,” Bob Hudson, the hospital’s chief financial officer, said in an interview. “With Assured, we were able to issue without a debt-service reserve fund, and that, in combination with the interest reduction between BBB-and AA-, made it very favorable.”

The \$70 million tax-exempt deal in January included a portion maturing in October 2043 that yielded 5.3 percent. By comparison, the interest rate on benchmark 30-year hospital bonds rated BBB was [5.85 percent](#).

“You certainly have to sacrifice some yield, but the sacrifice you’re making today is going to be well worth it down the road” as yield spreads on the bond decline, DiMella said.

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