
Warning Signs Flash For Muni Bondbuyers Chasing Riskiest Debt.

- Firm says key measure of distress rises 30% to most since 2015
- Figures reflect results of 'incredible appetite for risk'

There's an alarm bell sounding for investors who've been plowing into the riskiest state and local government bonds.

So far this year, 108 borrowers who raised cash in the $3.8 trillion municipal market have run into troubles grave enough that they skipped debt payments or violated other financial terms of their bond contracts, like drawing down their cash reserves, according to data compiled by Municipal Market Analytics. That's a 30% jump from the same period in 2018 and the most since 2015.

The figures underscore concern in pockets of Wall Street that the influx of cash from yield-chasing investors is increasing the risk in the municipal market, where real estate developers, nursing home operators and even factory owners can raise money by issuing debt through local government agencies. The demand has pushed junk-bond yields to about 2.4 percentage points more than what top-rated borrowers pay, the smallest penalty since before the financial crisis more than a decade ago.

MMA analyst Matt Fabian said about 41% of the borrowers that ran into distress sold the debt within the last three years. That marks an increase from the historical average of about 20% to 25% encountering strain so soon.

The number of payment defaults rose at a slower pace than so-called impairments — such as drawing on credit lines to cover interest bills — with 37 this year, an increase of 19%, Fabian and analyst Lisa Washburn said in a report to clients Tuesday. But the jump in impairments may foretell a rise in defaults, since about half of the borrowers that experience impairments eventually wind up reneging on the debt payments, according to Fabian.

"That impairments are rising faster than defaults means that defaults will continue to rise into next year as troubled credit begins to transition to defaults," Fabian said in a telephone interview.

One contributing factor is the "incredible appetite for risk," he said, adding that it is more about that than any shifts in the economy.

"Investors are permitting riskier bonds to come to market," Fabian said. "That's what driving the trend of recent issues getting into trouble faster than normal."

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