Hospitals, Cities Hit by Surging Interest Rates in 2008 Echo.

- **As cash yanked from market, yields on variable-rate bonds jump**
- **The rates on tens of billions of dollars of debt surge**

On Wednesday, as a hospital system in Memphis, Tennessee, was preparing for how to combat the spreading coronavirus, the havoc the pandemic was causing on Wall Street rippled down with its own financial hit.

Investors were rapidly hoarding cash as the economy grinds to a near halt, creating an exodus from the corner of the municipal-bond market where the health-care provider had raised cash.

With short-term yields surging, U.S. Bank more than doubled the interest rate on $124 million of variable-rate bonds issued by Methodist Le Bonheur Healthcare to 5% — threatening to add almost $4 million a year to its annual debt payments.

The liquidity crisis that's racing through financial markets is delivering similar blows to local governments, hospitals and non-profits nationwide. At least $34.6 billion of municipal bonds with yields that reset daily have seen their interest rates surge by 2 percentage points or more in the last two days, according to data compiled by Bloomberg. And an index of tax-exempt debt with variable interest rates reset to yield 5.2% on Wednesday, the most since 2008.

"There's a tremendous amount of fear and concern in the market right now, and I think that when you see that panic signal going off, it's not a surprise that clients are rushing to cash," said Kristian Lind, a senior portfolio manager for Neuberger Berman.

The interest-rate hikes come as Wall Street's municipal-bond desks are dealt blow after blow, with state and local debt headed for the worst monthly rout since 1987, according to Bloomberg Barclays indexes. With investors pulling money out of mutual funds, managers are being forced to dump securities to raise cash.

Variable-rate municipal bond are one of the easiest investments to unload because they can always be sold for 100 cents on the dollar as frequently as every day. Banks are required to buy the securities if there aren't enough buyers, giving them a strong incentive to raise the rates so they don't have to take unwanted debt into their inventories.

Kristin Kelly, a spokesperson for U.S. Bank, which serves as what's known as the remarketing agent on the Methodist Le Bonheur's debt, declined to comment. Sarah Farley, a spokeswoman for the health-care provider, did not have an immediate comment.

The rising rates echo what happened in 2008, when much of the variable-rate municipal market unraveled after the real estate bubble burst. The market for so-called auction-rate securities collapsed completely as investors dumped them en masse, while the yields on other bonds surged to 8%.

An index of variable-rate munis spiked higher as investors hit exits

Brian Mayhew, the chief financial officer of the Metropolitan Transportation Commission in San Francisco, watched that debacle foist spiraling bills on his agency and is now seeing it unfold again.

He said he's been told to expect a "shock" when the rate resets on his agency's bonds, whose interest payments are about $4 million a year. A 1 percentage point increase in its interest rate would increase costs by about $350,000 a month, he said.

The higher rates are "real money," said Mayhew.

The sell-off is coming just as banks' inventories of the securities usually swell around this time of the year as Americans sell them in order to pay their tax bills. Lind, the Neuberger Berman portfolio manager, said the financial market havoc has created a "perfect storm" that's giving banks a strong incentive to increase the interest rates to lure buyers back.

"Whoever can set their rates the cheapest is most likely going to be sitting on less inventory between now and tax time," he said.

Abrupt Shift

The Memphis health care system is among the dozens that have been affected. Bonds issued by the state of Oregon issued for veterans' projects were reset to yield 5% on Wednesday, up from 1.92% on Monday. Bonds issued for an art museum in Kansas City, Missouri, which had to shut its doors until April due to the coronavirus, also saw its bonds reset to 5%, up from 1.92% on Monday.

The tax-time uptick in yields is usually a short-lived phenomenon, and this time may be no different. But it's an abrupt shift for borrowers that had been paying near zero interest rates for years.

Mayhew joked that he would consider buying his tolling agency's debt because the shift higher in yields is likely to be short lived.

"I don't think we're going to hate the whole market if we get a couple of bad months," Mayhew said.

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