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Fear Revives Muni-Bond Insurance Business From Decade-Long Slump.

- **Since Early May about 10% of new bonds sold with insurance**
- **Insurance seen as hedge against feared rating downgrades**

As the coronavirus pandemic rips through the finances of state and local governments, municipal-bond insurers are busier than they've been in years.

Since early May, about 10% of new bond sales have been offered with insurance, nearly double the average since 2012, according to data compiled by Bloomberg. The last time the market saw back-to back-months of double digit insurance rates was in July and August of 2009.

State and local government bonds sold with insurance was once a mainstay in the $3.9 trillion market. But the industry nearly collapsed in the financial crisis, when the companies had their credit ratings slashed because of losses tied to toxic mortgage securities, leaving only about 5% of new sales carrying insurance since then.

"Covid-19 has had tectonic shifts in the market psychology and fear of further credit deterioration," said Grant Dewey, head of municipal capital markets at Build America Mutual, a municipal bond insurer.

He said that his group has been seeing higher demand from larger issuers and higher quality names as investors seek to hedge against feared rating downgrades. BAM has seen an increase in borrowers looking to insure their new debt issues and "record" volume from investment firms looking to guarantee the bonds they've already purchased.

Bond insurance allows an issuer to borrow at lower rates than their credit ratings might allow by giving assurance to investors that they get paid no matter what. The insurer guarantees repayment of principal and interest over the life of the debt in return for a one-time premium.

Jamie Doffermyre, municipal sales manager at Citigroup Inc., said that investors have been placing more value on insurance over the last couple of years and the shift has "accelerated" during the coronavirus pandemic.

"Insurance has performed well over the last few years and people are realizing that the absolute rating on the bond will be more stable if its wrapped and it will keep the spread more intact if there is a credit event," Doffermyre said. "More customers are willing to place value on wraps that haven't before."

The insurers' rising market share has come amid a steady increase in the volume of new bonds being offered, suggesting demand is both "real and distributed," wrote Matt Fabian and Lisa Washburn of Municipal Market Analytics in a note to clients. MMA says that any new issue penetration above 6% represents a "material change" in investor behavior.

When Inglewood, California sold $102 million of taxable pension bonds in early June, it bought insurance from Assured Guaranty Ltd. to offset some of the market's uncertainty, said Bill Reynolds, a director at Urban Futures Inc., the financial adviser on the sale.

"People want a little bit of security that the deal won't fall flat on its face when it sells," he said. "The market is just so weird right now."

The municipal market sold off in March when fears about the economic impacts of the coronavirus pandemic thew financial markets into chaos. News sales of bonds largely froze up after investors pulled record amounts out of mutual funds. The market rebounded after the Federal Reserve stepped in to support the market though various liquidity programs.

Dewey, the manager at Build America Mutual, said business inquires "exploded" in March, April and May and the company was fielding requests from investors looking to insure bonds already in their portfolio when the market seized up.

"For investors it's not necessarily about a fear of default but more of a fear of downgrades," Dewey said.

Moody's Investors Service has most of corners of the municipal market on a negative outlook, signaling the finances for airports, colleges and universities, toll roads plus states and local governments face upcoming headwinds because of the economic fallout of the pandemic.

"Because of the market uncertainty, no one wants to get stuck issuing bonds and then the market collapses" Reynolds, the financial adviser said.

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