

Bond Case Briefs

Municipal Finance Law Since 1971

Junk-Muni Boom Sets Up Historic Distress for Billions of Debt.

- **Pandemic hitting Elvis's Graceland, luxury hotel in Washington**
- **The stress emerging is 'really just starting,' analyst says**

Businesses that flooded the municipal-bond market with debt sold through government agencies are helping drag the industry into its biggest wave of financial distress in nearly a decade.

The risky corporate ventures aren't what one typically associates with the \$3.9 trillion haven backed largely by states and cities, which are at little risk of defaulting even during economic calamities like the one that's gripped the nation for the past five months.

But companies eligible for federal subsidies issued tens of billions of dollars of tax-exempt debt in recent years, seizing on a surge of cash into the junk-bond market as investors chased bigger returns.

Now, with the economy rocked by the biggest collapse since World War II, a small but growing number are struggling to repay what they borrowed, threatening to roil that corner of the muni market and add to the corporate bankruptcies piling up across America. Among those in trouble, there's a biofuel factory in Maine, the Mandarin Oriental hotel near the banks of the Potomac River in Washington, D.C., and Graceland, the Elvis Presley shrine hit by less tourists due to the coronavirus.

This year, more than 50 municipal-bond issues worth \$5 billion have defaulted, the most since 2011, according to Municipal Market Analytics, an independent research firm. Nearly two dozen more have drawn on reserve funds since the start of the year to cover debt payments when revenue fell short, a potential sign of more stress to come, according to data compiled by Bloomberg.

"They're really just starting," said Lisa Washburn, chief credit officer at Municipal Market Analytics, which tracks municipal-bond defaults. "It was just more than the deals could handle."

The increased distress belies the relative calm in even the riskiest segment of the municipal market, where investors have continued to pile in despite the downturn set off by the coronavirus. While the first waves of shutdowns set off a steep selloff in March, high-yield municipal bonds have since fully rebounded, tracking the rally across markets as the Federal Reserve eased monetary policy aggressively.

That has caused yields in the state and local debt market to slide to the lowest since the early 1950s, maintaining the low borrowing costs that fueled a record wave of junk-bond deals — many of which are now facing their first major test.

Sales of high-yield debt by state and local government agencies — for projects like nursing homes, charter schools and real estate development — surged by 31% in 2019 to nearly \$17 billion, the most since at least 2012, according to Bank of America Corp. More than \$10 billion was sold only to big

institutional buyers able to handle the risk, according to data compiled by Bloomberg.

The flood of easy money bankrolling speculative projects already meant that some distress was inevitable, but the pandemic is presenting an added challenge, said Bill Black, a senior portfolio manager at City National Rochdale.

"There's certainly more to come," he said, though he added that he expects it to be contained enough that the performance of the broader high-yield market won't be imperiled.

Much of the distress tracked by Bloomberg since the pandemic's spread to the U.S. has come from assisted-living centers and continuing-care retirement communities, both of which are dealing with both the public health and financial challenges of Covid-19.

But the stress has expanded to other sectors, too. A novel sector of the health-care industry focused on cancer has struggled from patients putting off treatments because of the pandemic. So-called proton-therapy centers have sold about \$1.5 billion of municipal debt since 2014, about \$900 million of which is now considered distressed, according to data compiled by Bloomberg. Among them is one in Maryland that sold debt in 2018 and last month had to draw down a reserve fund to pay bondholders.

The pandemic has stung some speculative projects already struggling to get up and running. Columbia Pulp I, which has borrowed about \$200 million since 2017 for a waste-to-pulp plant that has struggled with delays, suspended operations in March due to Covid-19 and is negotiating on a forbearance plan as pulp prices decline.

The hit to tourism and shutdowns of mass gatherings have also taken a toll. In Memphis, Tennessee, there's been fewer tourists showing up at Graceland, the museum in Elvis Presley's former home that borrowed in 2017 for an expansion. The agency that sold the debt had to tap reserves when debt payments were due in July and the securities were cut to junk this month by S&P Global Ratings.

In Riverside County, California, a horse and soccer complex called SilverLakes that raised money in the municipal market three times since 2015 was already struggling before the pandemic, with revenue just 30% of projections when it sold securities in 2018.

Balboa Management Group, the developer of the complex, in July skipped a debt payment, and future payments to investors will be deferred under an agreement with creditors lasting until 2021, according to a securities filing. Richard J. Brandes, who formed Balboa and provided a personal guaranty on the bonds, did not respond to requests for comment.

Other big projects are being closely watched by investors. The still-closed American Dream mall and entertainment complex in New Jersey, financed with \$1.1 billion in debt, has seen bond prices sink to about 87 cents on the dollar in early July amid doubts about whether it will draw crowds in the wake of the pandemic.

Washburn, the analyst with Municipal Market Analytics, said she's expecting the stress to continue to pile up.

"Going into 2021, you'll probably see even more pressure on more safe sector credits," she said.

Bloomberg Markets

By Amanda Albright

August 17, 2020, 7:00 AM PDT

— *With assistance by Natalia Lenkiewicz, Trevor Rowe, Olivia Whalen, and Danielle Moran*

Copyright © 2024 Bond Case Briefs | bondcasebriefs.com