# Bond Case Briefs

*Municipal Finance Law Since 1971*

---

## Risk Creeps Into Municipal Bond Market, Yet Prices Stay High.

**Rock-bottom yields leave risk-averse investors with few options**

Add the municipal market to the long list of American institutions reshaped by Covid-19.

The pandemic is threatening the creditworthiness of many municipal securities long seen as safe investments—bonds for higher education, health care, tourism and travel.

Prices across much of the market remain at or near pre-pandemic highs even as borrowers' finances have become more precarious.

Moody's Investors Service has lowered its outlook to negative on all municipal bond sectors except for housing-finance agencies and water, sewer and public power.

Analysts predict downgrades.

"It's amazing that we've sustained six months of being shut down to some degree with very minimal rating actions," said Lisa Washburn, a managing director at Municipal Market Analytics.

Municipal bond defaults have reached their highest rate since 2011, the aftermath of the last recession, according to Municipal Market Analytics data.

Still, Americans continue to pour money into municipal bond mutual funds, which are clocking 17 straight weeks of inflows since mid-May.

After prices cratered in March, they rebounded to pre-pandemic highs as investors flocked to the tax-exempt investments.

Rock-bottom yields across the fixed-income market have left risk-averse investors with few other appealing options. Municipal bonds default far less often than corporate debt. Moves by the Federal Reserve to backstop the municipal market have stoked investor confidence.

Some fund managers see big-name borrowers who have good relationships with creditors as a good long-term buy even if their bonds are at risk of a short-term downgrade.

"We're modestly more comfortable with those guys because there is a possibility that we're entering a terrain where sophistication and access to markets is a big credit differentiator," said Adam Stern, co-head of research at Breckinridge Capital Advisors.

Such buyers have helped bolster prices in the thinly traded $4 trillion market. Many high-net-worth households buy municipal securities for retirement income and hesitate to erode the value of their portfolios by trading.

Prices are rising on bonds backed by essential services. Water system improvement bonds issued by

the San Francisco Public Utilities Commission that mature in 2029 are trading at 108 cents on the dollar compared to 104 cents in January.

Debt manager Richard Morales is expecting strong investor demand for a September water-syste--improvement bond issue and planning a money-saving refinancing in October.

“Everybody needs to flush the toilet,” Mr. Morales said. “And the water that comes out of their sink has to go down a drain.”

Tourism-linked borrowers, however, face more uncertainty and sometimes wary investors.

At the Greater Columbus Convention Center in Ohio, hotel tax revenues are falling from about $26 million a year to a roughly projected $10 million, said Executive Director Don Brown.

“Hotel occupancy has plummeted,” Mr. Brown said.

Over the past five months, the Franklin County Convention Facilities Authority has withdrawn about $4.9 million from a reserve fund to cover debt payments on bonds issued to renovate the center. The authority plans to restructure about $200 million to bring annual debt payments below $10 million until 2025 to avoid drawing on a revenue pledge by Columbus and Franklin County, Mr. Brown said.

Convention center bonds due in 2025 are trading at highs of 118 cents on the dollar versus 119 cents before the pandemic.

Bonds for communal-living developments such as senior housing and student dormitories are defaulting at greater rates than during the last downturn, according to Municipal Market Analytics data.

The pandemic has drained revenue from universities as Covid-19 outbreaks prompted schools to cancel sports and forgo housing fees. Public universities get a median 13% of their revenue from those types of sources and private universities get a median 16%, according to an analysis by Merritt Research Services.

Moody’s downgraded 10 health-care borrowers and 17 higher-education and nonprofit borrowers in the second quarter of this year. Both S&P and Fitch Ratings have lowered Northwestern University to AA+ as a result of pandemic-related pressures.

A stress test by Merritt found that if universities lost a quarter of their revenues, 44% of public schools and 39% of private schools would exhaust any available financial cushion unless they made cuts.

“I would expect that some are vulnerable to that kind of loss,” said Richard Ciccarone, Merritt’s president and chief executive.

In the same scenario, about a fifth of hospitals would run out of cash, the firm found.

Some health-care facilities are already running into trouble. Petaluma Health Center, a nonprofit network of clinics in Sonoma County, Calif., that serves students and the homeless, last month disclosed to bondholders it had recorded a $3.7 million deficit for the second quarter. The group said it expects forgiveness on a federal loan to plug the shortfall.

In many cases, investors are continuing to pay pre-pandemic prices despite added risk.

Ten-year tax-exempt bonds New York City issued last month paid out yields of 1.45%—nearly the same as bonds priced Feb. 13, about a month before the city shut down in response to Covid-19.

Jonathan Kahn, a New York state resident and a buy-and-hold individual investor in New York municipal debt, said he hasn't bought muni bonds since March because prices are too high to justify exposing himself to the uncertain environment for state and local government finance.

"There's no clarity as to revenues and expenses for the duration of the bonds that they are selling," Mr. Kahn said. "Therefore it is impossible to gauge the risk, and interest rates are so low there is no offsetting reward."

Copyright © 2020 Bond Case Briefs | bondcasebriefs.com