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Protect Your Muni Bond Portfolio From A Tornado's Ravages.

I haven't written about natural disasters affecting municipal bonds since 2019. The recent Kentucky tornados jolted me to pen this. When disasters happen, the news feeds hit just the highlights. They skip the detail we bond investors need. They rarely list which specific schools, buildings, court houses, city or county facilities were obliterated.

The recent Kentucky tornados are an example of the lack of information. My clients own several Kentucky munis. Many were not in harm's way when the tornados struck. Bowling Green, Kentucky was not so lucky. We owned their Independent School Building Revenue bonds. The good news is that these bonds are backed by the Kentucky Sate Intercept Program. In simple terms, this is a credit enhancement program where the state pledges to pay bond holders in the event of default. This could occur if the municipality supporting the bonds suffered a catastrophe.

The detailed information for Bowling Green Independent School Building Revenue bond holders comes in the Official Statement:

> … the corporation reserves the right, upon 30 days' notice, to call the bonds in whole or in part on any date at par for redemption upon the total destruction by fire, lightning, windstorm, or other hazard of any building constituting the project…

If these bonds are called it would probably be at par. We bond holders would lose the market premium. The premium per bond at that time was around 107.786 or $1077.86 per $1000 face value. We didn't want to lose that premium so we sold our bonds, collected the profits and called it a day.

We weren't worried the State Aid Withholding of Kentucky wouldn't pay. We just didn't want to see our market premiums disappear if the bonds were called.

I've studied the State Intercept Programs, State Aid Withholding and State Guarantees for municipal bonds. The problem (if you can call it that) is, there have been so few investment grade municipal bond defaults I have no idea if the coupon and principal payments in a catastrophe would be prompt or if there would be a lag.

Certainly, if Kentucky or any other state with an Intercept or Aid program failed to honor their pledge of financial assistance, they would be taken to the municipal bond woodshed by the capital market.

As the weather patterns continue to be tumultuous, stay on top of your municipal bonds to ensure they are safe should an unthinkable event occur. Having a secondary source of repayment such as a credit enhancement provides a nice safety net. And knowing the call features in a disaster is imperative.

Forbes

by Marilyn Cohen

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