Bond Case Briefs

Municipal Finance Law Since 1971

Fearful Muni Investors Increasingly Embrace Bond Insurance.

- **About $8.8 billion of munis sold in Q1 of 2022 were insured**
- **Increase drives the most-active first quarter in over a decade**

As fears of rising interest rates whipsaw prices in the $4 trillion dollar municipal bond market, more issuers are turning to bond insurance.

State and local governments bought insurance for about $8.8 billion of bonds they issued in the first three months of 2022, representing roughly 8.9% of the total securities sold. Both are the highest levels for a first quarter in more than a decade, according to data compiled by Bloomberg. The volume of insured bonds rose even as year-over-year quarterly sales fell.

The latest figures are still a far cry from the mid-2000's, when at times more than half of bonds issued were sold with insurance. As the financial crisis clobbered bond insurers, and yields broadly fell, demand for bond insurance plunged. But earlier in the pandemic, fears of default spurred increasing demand for coverage, and now higher yields and historic volatility offer an opportunity for insurers to strengthen their pitch.

Build America Mutual, one of two dominant insurers in the muni-bond market, reported its most active first quarter in the company's history, which dates back to 2012. The company insured $4.3 billion of bonds in the primary and secondary markets spread across 27 states, and roughly a third was rated in the AA category.

"There is more demand from investors who are focusing on value preservation and seeking more-liquid securities due to the volatility in rates and uncertainty about fund flows," said Grant Dewey, Build America's head of municipal capital markets.

Assured Guaranty Municipal Corp. insured $5.1 billion in primary and secondary markets in the first quarter, with a 500% year-over-year increase in secondary market insurance. The group insured seven deals with insured par over $100 million, including a $691 million transaction for the Metropolitan Washington Airports Authority.

Demand rose over the past two years, initially due to the pandemic which led to broader credit concerns, said Robert Tucker, Assured's head of investor relations and communications.

Bond insurers guarantee that investors will be paid principal and interest on their securities even if the entity that issues the bonds, such as a local government, defaults. The insurers also perform due diligence for offerings and provide bondholders with ongoing surveillance of insured securities. Their efforts can soothe investor concerns about credit risk and improve liquidity.

"For a long time we've had an improving economy and declining rates, kind of a risk-on market," said Patrick Luby, municipal strategist at CreditSights. "We are now in a more cautious environment, so investors are more wary of credit risk and duration risk."

Luby expects adoption of bond insurance to continue rising because of pricing pressure in the primary market. Adding insurance to a bond can broaden its appeal and increase the comfort level among investors, bolstering demand and potentially improving prices.

Bloomberg Markets

By Nic Querolo

April 12, 2022