No Problem for Houston Munis

Thanks to Texas' high credit quality and federal aid, most municipal bonds issued by areas affected by Harvey aren't in danger.

By
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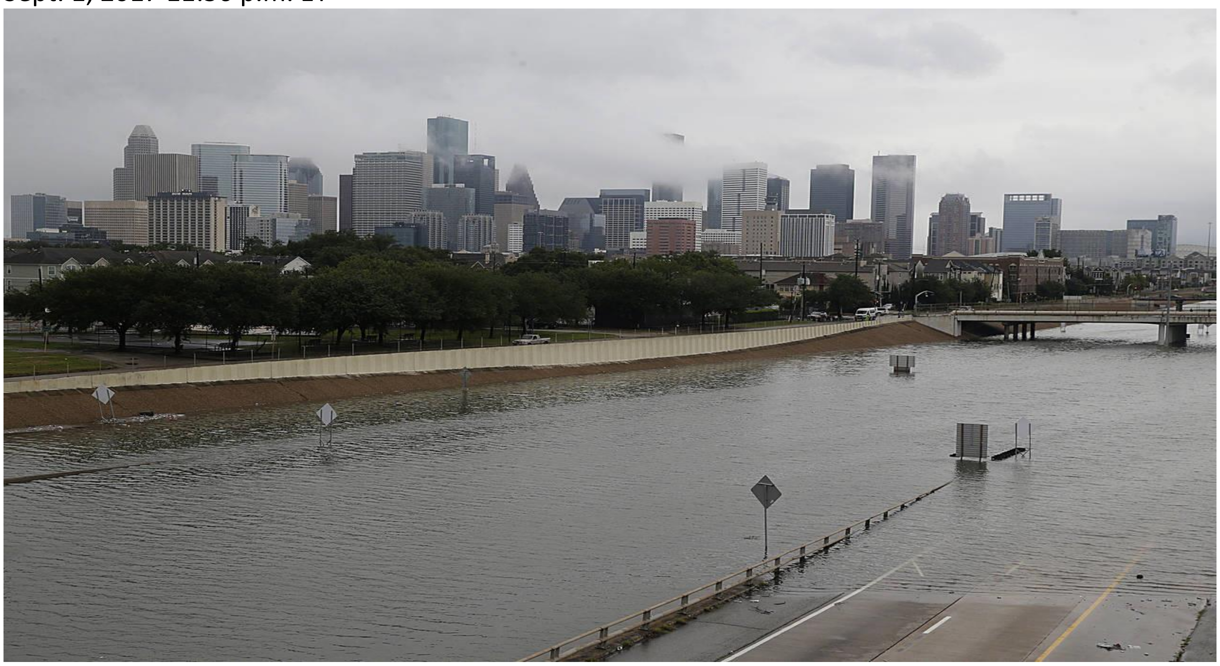

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Massive flooding over a large part of the U.S. Gulf Coast would seem to spell big problems for the finances of affected states and towns—and the investors who hold their municipal bonds.

But as Hurricane Harvey peters out, and Houston residents return home to assess damage, credit analysts, muni strategists, and fund managers aren't too worried about the storm's impact on the muni market.

Peter Block, municipal strategist with Ramirez, described trading last week, even in Houston munis, as "relatively normal." Indeed, the S&P Municipal Bond Texas Index rose slightly in the week following the storm. It's up 4.7% year to date.

Fact is, as devastating as the losses are, local governments will receive federal relief funds, state support, and insurance claims that will allow them to recover. Texas enjoys a top-notch triple-A credit rating, which means it has the reserves to fund operations and make debt payments until additional funds become available or revenues return. Ultimately, spending to rebuild will lead to more tax revenue.

This isn't true of all the areas devastated by Harvey. Some lower-rated issues in areas that experienced major damage may not have cash on hand to fund debt payments during the period of dislocation. Some of them will be downgraded, but analysts say it's too soon to tell which ones. Bonds issued by Muni Utilities Districts, or MUDs, that provide service to large subdivisions are one area of concern, says Jane Ridley, sector lead for local ratings at S&P Global Ratings. Luckily, many MUD bonds held by individuals are insured, says Block.

"Bond insurers can provide an important stopgap for smaller Texas municipalities that may be operationally challenged in this environment, by stepping in and making debt-service payments. This may not even be necessary," notes Cumberland Advisors, which owns some insured munis affected by the storm. The firm also owns school-district bonds guaranteed by the Texas Permanent School Fund, which have triple-A ratings and attractive yields.

In general, ratings agencies are optimistic. "We expect most damaged property in affected communities to be rebuilt, which will maintain tax bases, rather than residents and businesses leaving the areas," Fitch Ratings said last Wednesday. S&P cautioned that it's early to judge. "In the next couple of weeks, we'll have a much better idea," says Ridley. But she emphasizes that Houston's strong economy and double-A credit rating puts it in a much better place than New Orleans after Hurricane Katrina.

Linda Murphy, a credit analyst with T. Rowe Price, which manages $26 billion in muni assets, doesn't expect her firm to be large sellers of munis from affected areas. "There may be some short-term problems," she says, "but we don't see this as anything that can't be overcome."

THERE IS ONE hurricane-related muni concern that lingers: Insurance companies, which are big buyers of municipal bonds, could sell some holdings to fund claims. "You don't need tax-exempt bonds if you report losses or have fewer profits to shield," says Richard Daskin of RSD Advisors.

So far, property and casualty insurers haven't been sellers, says Block. Kevin Woods, chief investment officer at Asset Preservation Advisors, believes firms will sell some muni holdings this year. But because new muni issuance has been low in recent months, strong demand will be able to absorb the extra supply. "Insurance companies selling should have a very minimal impact on the market," he says.

Woods says his firm, which owns $5 million of Houston and $12 million of Harris County bonds, is comfortable holding its positions, most of which are higher credit quality.

Matt Fabian of Municipal Market Analytics goes a step further, asserting in a note last week that if there are dips in muni prices, that would probably be a buying opportunity. He adds, "In this market, any depressed prices probably won't last long."