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CREDIT MARKETS

Some Muni Bonds Are Left Behind in Rush to Safer Investments

Investors shy away from debt likely to be affected by coronavirus epidemic, such as travel and hospitality bonds

Bonds that financed passenger-terminal construction at Houston's George Bush Intercontinental Airport, which last traded around 107 cents on the dollar in late 2018, sold for 103 cents on the dollar on Friday.

PHOTO: SCOTT HEINS/GETTY IMAGES

By Heather Gillers Follow

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Municipal-bond prices have surged as the potential impact of the novel coronavirus has driven investors into safer assets. But not all bonds have enjoyed the rally, with investors shying away from riskier debt and from securities likely to be affected by the virus, namely travel and hospitality bonds.

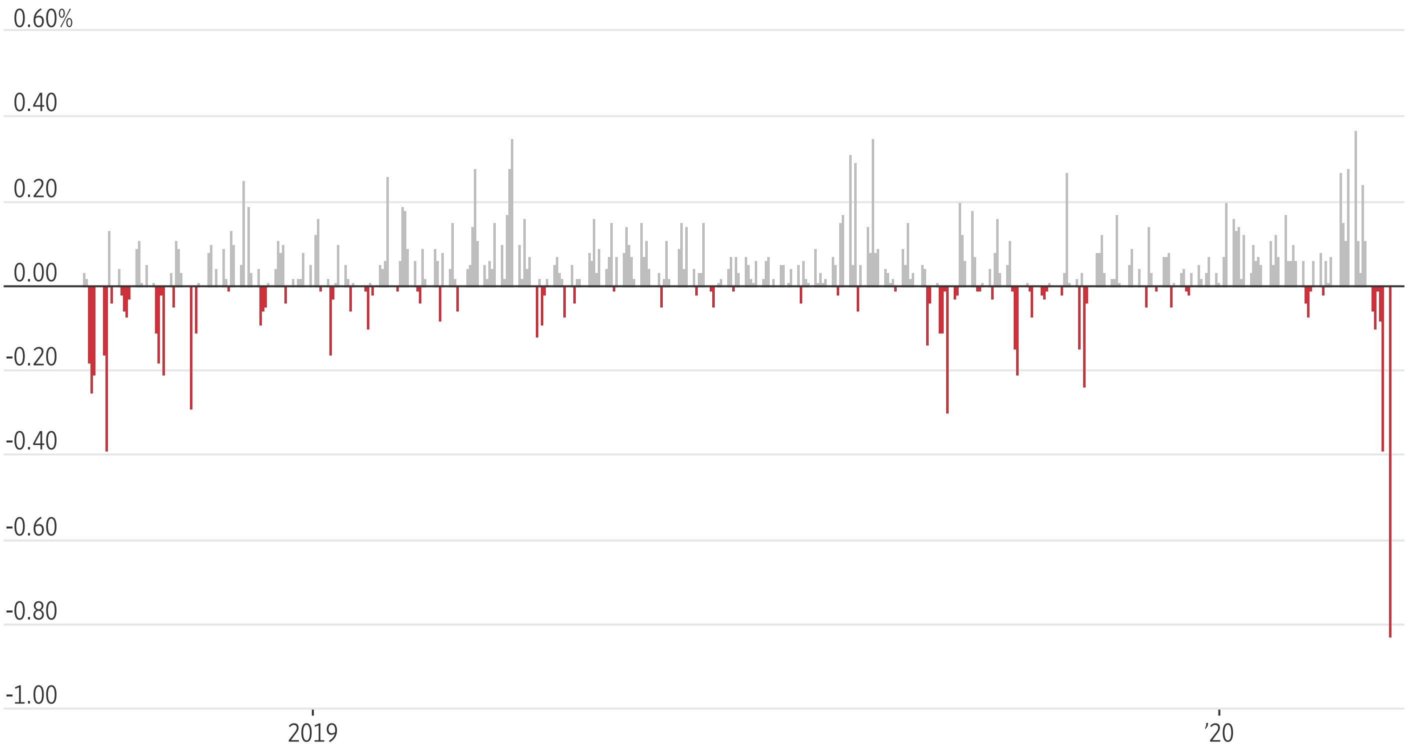
Investors are paying less for debt from convention-center hotels and airports as the potential economic reach of the coronavirus becomes clearer. Overall prices on riskier bonds have fallen as well, with investors pulling money from high-yield funds and the S&P Municipal Bond High Yield Index experiencing its biggest one-day drop in more than three years Monday.

Some investors have become increasingly concerned that amid signs of a global slowdown, these less creditworthy bonds carry more risk than they are worth, analysts said.

Rejecting Risk

Prices on riskier municipal bonds experienced their biggest drop in more than a year Friday.

Daily change in S&P Muni High-Yield Index



Source: S&P Municipal Bond High Yield Index

“A whole bunch of municipal-bond credits are reliant on a well-functioning economy, are reliant on a well-functioning transportation industry,” said Nicholos Venditti, a portfolio manager at Thornburg Investment Management. “That’s a little scary.”

Overall, municipal-bond prices have continued to climb in the roughly $4 trillion muni market as investors seek out safe-haven investments, driving yields to a nearly 40-year low Friday, according to Refinitiv.

Muni bonds have been a sought-after investment over the past several years as falling supply and the increasing value of the tax exemption on municipal-bond interest have stoked demand. That leaves plenty of room for prices to fall as the market reacts to risks associated with the virus.

Yields rose between 12% and 35% from Feb. 28 to March 5 on a sampling of a dozen bonds backed by airports, airlines, a convention-center hotel and an amusement park, according to an analysis by Jon Barasch, director of municipal evaluations at financial analytics company ICE Data Services. The comparison is based on trade data and the firm's valuations of those bonds.

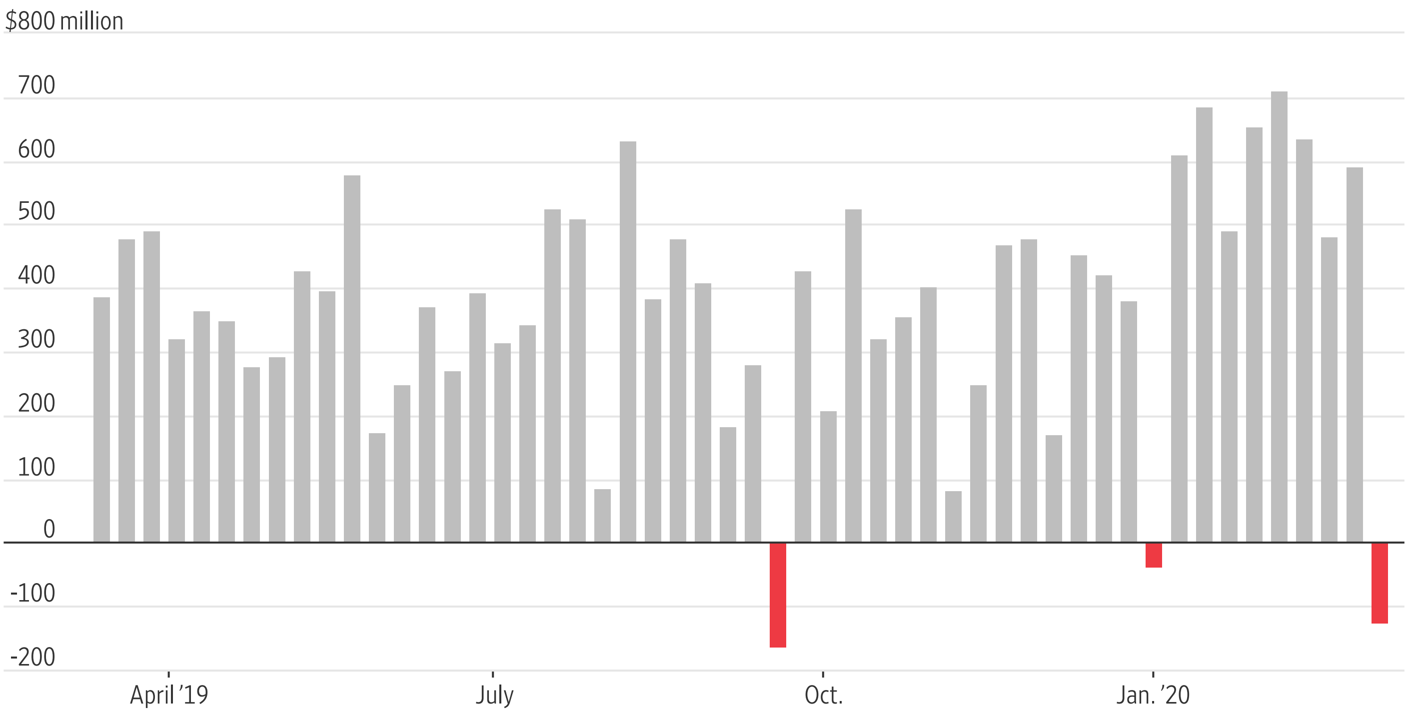
That contrasts with the broader municipal market, where yields fell 10% for five-year bonds over the same period and rose by a maximum of 3% for longer-maturity debt, according to ICE Data Services' Muni Yield Curve.

Beginning March 2, "the weakness became more prevalent," Mr. Barasch said. Yields rise as prices fall.

Getting Out

Investors withdrew more money from high-yield muni funds in the week ending last Wednesday than during almost any other week in the past year.

Net high-yield muni bond fund flows



Source: Refinitiv

While municipal bonds are most often the liabilities of state and local governments with the power to collect taxes and fees, about $784.5 billion is issued on behalf of nonprofit or for-profit businesses, according to Federal Reserve data, typically for projects thought to have some public benefit, such as economic development.

Prices dropped on some bonds backed by airline payments last week, Municipal Securities Rulemaking Board data show. Bonds issued in October to build an aircraft-maintenance facility at Los Angeles International Airport traded at 115 cents on the dollar Thursday, down from nearly 119 cents on the dollar in mid-February. Bonds that financed a passenger terminal construction project at Houston's George Bush Intercontinental Airport, which last traded around 107 cents on the dollar in late 2018 and which analysts had valued at about 106, sold for 103 cents on the dollar on Friday.

Meanwhile, the S&P Municipal Bond High Yield Index dropped every trading day last week and fell more than three-quarters of a percent Monday, the biggest one-day drop since November 2016. The VanEck Vectors High-Yield Municipal Index ETF had its biggest price drop in at least five years Monday, a decline of more than 5%, as investors continued to pull money from high-yield munis.

SHARE YOUR THOUGHTS

Do you expect muni bonds to regain stability in the coming months? Why or why not? Join the conversation below.

Mr. Venditti said that the municipal market tends to react more slowly than the corporate-bond market, where bond prices have already fallen for many companies whose fates are linked to travel or economic growth. "Ultimately that lag may cost investors," he said.

For example, tax-exempt municipal bonds backed by United States Steel Corp. could fetch a yield of 2.394%, or an estimated 3.8% after taxes if sold today, according to an analysis of Bloomberg data by Mr. Venditti. That compares with an expected yield of 10.801% on the company's corporate debt.

It isn't just the infrastructure and transportation sectors that are vulnerable. High-yield muni-bond funds often contain the debt of senior-living facilities and financially distressed local governments, two borrowers looking particularly susceptible to the impact of the coronavirus. Long-term-care facilities around the country are bracing themselves after a facility in Kirkland, Wash., emerged as the site of some of the earliest U.S. cases. Meanwhile, stock selloffs and record-low bond yields are putting dents in public pension funds, threatening to drive up yearly retirement costs for local governments.

Investors pulled $128.5 million from high-yield municipal bond funds for the week ended last Wednesday, contributing to the first week of outflows from all muni funds in more than a year. Investors also pulled money out of high-grade muni funds, reflecting what Refinitiv senior market strategist Daniel Berger said may be an emerging preference for more liquid safe-haven investments such as Treasurys.

Write to Heather Gillers at heather.gillers@wsj.com

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