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Hurricane Irma: Municipal Finance Update

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Snapshot

- Florida has seen no trading disruptions on the municipal market or cases of potential Irma-driven default.
- The U.S. Virgin Islands are expected to suffer the greatest Irma-related losses.
- Bonds rated by Moody's Investor Service have never defaulted due to a natural disaster.

We were still assessing the damaging effects of Hurricane Harvey on the Houston, Texas, area when the even-stronger Hurricane Irma was ripping through the Caribbean as a Category 5 storm, moving toward Miami, Florida. Fortunately for the highly populated city, Irma ultimately changed paths and weakened to a Category 3 hurricane by the time it made landfall on the far-smaller community of Marco Island.

Market Reaction

Had Irma followed its projected course with sustained strength, Florida's overall economy could have lost as much as $290 billion[1]. While the total impact is still being calculated, initial estimates for Irma-driven economic loss (which includes property damage and lost economic output) ranged from $40 to $60 billion—hundreds of billions of dollars less than expected.

Of course the state's municipalities still suffered significant losses. However, we have yet to witness trading disruptions on the municipal market. Nor have we seen cases of potential Irma-driven default. Before the storm hit, Florida's state general obligation bond spreads were tightening and have since remained unchanged.

Florida's Shining Economic State

With the federal government providing financial assistance in Irma's wake, Florida is expected to maintain its credit rating—which has been AAA due to the state's solid employment and population growth, strong revenues, well-funded pension liabilities and moderate debt burden.

We do not foresee considerable movement in bond prices or spreads within local municipalities affected by the storm—particularly as federal aid is expected to go to the most severely damaged areas. Financial disruption should be minimal, as revenue collections have been historically well-performing and these local issuers have solid reserves.

[1]https://www.usnews.com/news/articles/2017-09-11/irma-harvey-forecast-to-do-290-billion-in-economic-damage

Property & casualty insurance companies are expected to incur limited losses. Most are well-funded and have access to lines of credit, as more than a decade has passed since a major hurricane caused significant property destruction in Florida. Many insurers are also part of the Florida Hurricane Catastrophe Fund (FHCF), which was created after Hurricane Andrew struck in 1993 to help cover their losses. The FHCF currently has about $15 billion in cash, which is also accessible to the insured if needed to reimburse claims made by policy holders.

Virgin Islands' Dimmer State

U.S. Virgin Islands, particularly the islands of St. John and St. Thomas, will likely suffer the greatest Irma-related economic losses. Unlike the Sunshine State, these tropical islands have been struggling financially, recently attempting to issue new bonds in the municipal markets with no success. Credit-rating agencies Standard & Poor's and Fitch both withdrew their credit ratings on the U.S. Virgin Islands due to lack of updated financial information. SEI Fixed Income Portfolio Management does not own bonds related to the U.S Virgin Islands.

Calm Bonds Despite the Storms

With at least a month left of what is expected to be a historically active storm season,[2] there are already two new hurricanes swirling in the Atlantic. Time will tell the degree of physical damage caused by these storms. But as far as the municipal market is concerned (as we said in our Hurricane Harvey update), there is an encouraging precedent: bonds rated by Moody's Investor Service have never defaulted due to a natural disaster.

[2] https://weather.com/storms/hurricane/news/2017-atlantic-hurricane-season-one-of-busiest-september

Important Information

This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice and is intended for educational purposes only.

There are risks involved with investing, including loss of principal. Diversification may not protect against market risk. Bonds and bond funds will decrease in value as interest rates rise.

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