## Municipal Market Comments



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## Despite Its Historic Impact, Sandy Not Expected to Trigger Rating Downgrades

Hurricane Sandy left unprecedented damage across a large swath of the Northeast last week. Although the heaviest damage appears to be in New York and New Jersey, the effects of the storm are being felt from North Carolina to Maine, and as far west as Lake Michigan. Initial estimates of the economic impacts of Sandy range as high as \$50 billion to \$70 billion, including not only property damage but also economic impacts from cancelled flights, transportation interruptions and other factors.

Investors are right to question whether Sandy's damage will negatively impact the credit quality of affected municipal issuers. From cities and towns on the Jersey Shore to the Long Island Power Authority and the Port Authority of New York and New Jersey, countless municipal bond issuers have sustained significant property damage and interruption of service that might extend for days or weeks. Should investors sell holdings in these issuers' bonds?

As we have noted in the past, although the damage from hurricanes, tornadoes, flooding, earthquakes and other natural disasters can be substantial, the impacts on municipal bond ratings from natural disasters have historically been extremely limited. In our 20 years in the municipal market, we have not seen any payment defaults on municipal bonds due to natural disaster impacts. While there were a very limited number of payment delays due to Hurricane Katrina, these were due to business interruptions that delayed electronic payments, not to municipalities failing to make payments as scheduled and lasted no longer than a few days. The very few modest rating downgrades that we have seen were all related to Hurricane Katrina's unprecedented impact on the New Orleans area and were secured by issuers that were generally of low single-A to triple-B credit quality.

Hurricane Irene presents a useful case study, having affected many of the same areas only last year. While that storm was far less damaging, it still produced more than \$6 billion of damage across parts of the Northeast. Even so, we have not seen any rating agency actions that noted Irene damages as a significant factor in degrading a municipality's credit quality.



Short-term budget and cash flow pressures on municipalities' finances are a common outcome following a disaster. Clean-up of storm damage can be a long and expensive process that could strain the financial resources of many municipalities. For this reason, FEMA makes available short-term funding for storm recovery that typically mitigates most or all of the clean-up costs. Over the intermediate term, state assistance and FEMA disaster aid typically reimburse between 80% and 100% of disaster-related expenses. Given President Obama's quick declaration of major disaster areas in the affected states, FEMA will be able to move quickly to get funds flowing to state and local governments.

Unlike the corporate market, where companies may be exposed to uninsured disaster-related costs and other direct business impacts, municipalities have an insurer-of-last-resort in FEMA that provides both short-term help to mitigate disaster cleanup and recovery and also long-term aid to support reconstruction. In fact, the most common outcome from natural disaster is a regeneration of the local infrastructure and economy due to rebuilding and reconstruction activity.

In general, we do not recommend that investors sell municipal bonds that may be in disaster-prone areas or subject to weather related headline risk. By carefully selecting bonds secured by issuers that have strong inherent credit quality and adequate liquidity, investors can take comfort in the extremely strong performance of high-quality municipal bonds to literally "weather the storm."

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