



# Have hurricanes changed our outlook?

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*Recent hurricanes have caused unprecedented devastation. In this article, we consider the consequences for bondholders.*

The 2017 hurricane season brought widespread disruption and utter devastation to parts of the mainland U.S., Puerto Rico and the Caribbean. In many areas, the rescue process is still unfolding, and rebuilding may take years.

With any event of this magnitude, our research team considers the potential impact on the municipal bond market. Our view is that Texas and Florida municipal debt poses no new concerns, but Puerto Rico bondholder recovery prospects have likely dwindled.

Please visit [FEMA.gov](http://FEMA.gov) for information on recovery efforts, including how you can help those in need, or how you can apply for assistance if you've suffered hurricane damage.



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## Diverging scenarios in the mainland U.S. and Puerto Rico

Most issuers in the path of Hurricane Harvey and Hurricane Irma maintain adequate reserves to meet their obligations and begin the rebuilding process. Federal and state aid, as well as private property insurance, will most likely mitigate a large portion of the recovery spending and likely result in short-term boosts to local economic activity. Longer term, assessed values usually improve as older homes are replaced with new ones, and infrastructure improvements will help limit damage from future storms.

In the wake of Hurricane Maria, Puerto Rico is facing a humanitarian crisis and is in dire need of supplies and support. Given that recovery and rebuilding are the clear spending priorities, bondholders should lower expectations for their own

recovery. Since Puerto Rico has defaulted on most of its debt, revenues diverted for rebuilding efforts *not* covered by federal assistance are likely to further reduce bondholder recovery — especially since federal funding has historically been less than 100% of rebuilding costs.

Affected regions	Short-term impact on municipalities	Long-term impact on municipalities
<b>Harvey</b> 	<ul style="list-style-type: none"> <li>■ Issuers should have adequate cash reserves to continue to pay current bondholders.</li> </ul>	Assessed values should improve as older homes and infrastructure are replaced, creating higher tax revenues.
<b>Irma</b> 	<ul style="list-style-type: none"> <li>■ Federal and state aid, plus private property insurance should drive short-term boosts to local economic activity.</li> </ul>	
<b>Maria</b> 	<ul style="list-style-type: none"> <li>■ Money could be diverted away from paying bondholders to rebuilding efforts.</li> <li>■ Any economic boost from recovery spending may be offset by a loss of tourism.</li> </ul>	Long-term economic strength could be weakened because educated and skilled workers may continue to leave the island for better opportunities.

While unlikely, we can't rule out the possibility that funding will actually exceed costs. This happened with Hurricane Katrina in 2005, but it was largely the result of federal funding for levee improvements. Infrastructure improvements that will prevent catastrophic flooding are doubtful in Puerto Rico. Even if federal support and other outside funding cover the recovery costs from this hurricane, the overall effect for bondholders is probably neutral at best; the sales tax boost from recovery spending will likely be more than offset by lost tourism revenue.

### A weakened outlook for Puerto Rico's economy

The bigger issue for Puerto Rico bondholders (beyond the short-term cash needed for rebuilding) is the longer term impact on the economy. Our municipal credit research team has been concerned about the level of risk in Puerto Rico for years. Long before Hurricane Maria, we believed that [Puerto Rico bondholders should expect significant losses](#). Now, the economic outlook is further weakened by the effects of the hurricane.

Outmigration from Puerto Rico has been significant in recent years, and it's one of the reasons the local economy has been in a recession for a decade. If rebuilding

critical infrastructure like electricity takes longer than expected, the trend may accelerate, especially when you consider many of the homes on island don't have wind damage insurance. The decision to move to the mainland U.S. may be even more economically appealing when faced with the prospect of starting over.

History argues for a favorable outcome in the aftermath of Hurricane Maria, as outside money continues to help rebuild and make Puerto Rico stronger than it was before the storm. But long-term economic prospects, which are the basis of the outlook for bondholders, are likely weaker now. It will be some time before we know the full extent of damage and cost estimates of the losses on Puerto Rico, but the best outcome we can hope for in the upcoming weeks, months and even years is the swiftest recovery possible.

#### **The bottom line**

There isn't significant concern with Texas and Florida municipal debt being affected by the recent hurricanes. However, Puerto Rico bondholder recovery prospects have likely been reduced due to the devastation of the storm. Federal assistance will help in the near term, but further population declines are likely to hinder long-term economic growth.

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