Muni Bond Watch by Will Swarts Published August 11, 2010

Museum Exhibits Muni Debt Woes

Although the cultural arts are deeply woven into in the fabric of New York City, they aren't immune to financing troubles in the wake of the subprime debt collapse.

In 2000, the American Folk Art Museum issued $32 million in municipal bonds to finance its new building, just a few doors from the Metropolitan Museum of Art on West 53rd Street in Manhattan. Six months ago, the museum notified bond holders that it had defaulted on payments for a portion of its debt. It is renegotiating its debt, but declined to discuss its current status.

The museum’s default put a high-profile twist on an increasingly familiar situation.

An organization uses tax-free debt issued through a quasi-governmental authority to embark on a project, and plans to pay off the bond with future revenues. In a brutal economic climate, the projected revenues don't arrive, and eventually the debt falls into default, and bondholders must line up for repayment. Recent data from Municipal Market Advisors, which tracks tax-free debt, shows 591 bond issues in some form of default, 227 of which have missed actual payments.

About $15 million in 30-year Museum of American Folk Art bonds, issued in 2000 at a price of 98.7 cents on the dollar and a yield of 6.125%, are apparently the only museum related bonds in trouble.

"The museum is not going to discuss specifics relating to the bond issue at this time but we are working constructively with our trustees, creditors and partners to ensure the museum’s financial stability for the future," Maria Ann Conelli, the executive director, said in an email message.

The New York City Trust for Cultural Resources, a public corporation that helps museums and other cultural institutions issue debt, declined to discuss the 2009 default but indicated no other New York organizations are in similar straits.

Unlike many of the higher risk municipal bonds that are in trouble, either defaulting on payments or entering technical default, this debt is backed by a bond insurer, ACA Financial Guaranty. Despite its own considerable financial woes, related to losses in the subprime mortgage market, ACA will back the bond payments, but it's not doing any new bond insurance.

“ACA’s financial guaranty insurance policy guarantees the payment of principal and interest due the museum’s bondholders and we anticipate honoring any claim that may be made on this and our other policies," said Whit Clay, a spokesperson for ACA Financial Guaranty. "We are working with the museum to resolve this issue in keeping with the best interests of ACA and all of its policyholders, including those who hold the museum’s bonds.”

Robert Kane, chief executive officer of BondView, a New York municipal bond data tracking company, says ACA's safety net was once a typical feature of the muni bond landscape, but that many bond insurers bet big on subprime mortgage debt at the behest of ratings agencies, and were battered by the collapse of that debt.

“The bad news is that this bond is defaulted; the good news is it's insured," he says. "But the other bad news is that the insurer ACA is like all the others and is having lots of problems. Pretty much all of these insurers have gone belly up, and the insurance that was underlying a lot of these bonds now doesn't really exist."

Privately held insurer FGIC, the parent of Financial Guaranty Insurance, last week filed for bankruptcy.

Shares of **Ambac** (*ABK*[1]) and **MBIA** (*MBI*[2]), formerly among the largest muni bond, or monocline, insurers, are worth a fraction of their value in October 2007, when the first tremors of the subprime crash started to rattle the financial system's foundations.

Thomas Doe, chief executive of Municipal Market Advisors, says bond insurance has disappeared since the crash.

If there's a benefit, he says it's that investors and advisors pay much closer attention to the underlying risks of a municipal debt, now that there's effectively no safety net.

The market thinks the Folk Art Museum bonds are a high-risk bet, even with the ACA guarantee. An Aug. 6 trade recorded by the Municipal Securities Rulemaking Board showed the bond trading at 61.7 cents on the dollar, with a yield of 10.86%.

1 http://www.smartmoney.com/quote/ABK/
2 http://www.smartmoney.com/quote/MBI/
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