The revival of bond insurance

Beatrice Mavroleon

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With a number of deals concluded over recent months featuring wrapped bonds, and more expected in the future, bond insurance seems to be enjoying a resurgence, a decade after the industry was all but completely destroyed by the financial crisis.

Most recently, Balfour Beatty and the University of Sussex reached financial close on a student accommodation project that features a £186 million ($240 million) bond issue, wrapped by monoline insurer Assured Guaranty.

Around the same time, Aberdeen Infrastructure Partners and a fund managed by Dalmore Capital reached financial close on a refinancing of the Bexley oncology wing of the St. James's University hospital in Leeds, using bonds and notes also with a wrap provided by Assured Guaranty.

And in February wrapped bonds were used for the refinancing of a student accommodation project for Essex University. Today issuance of more wrapped bonds for a greenfield student accommodation project at Essex University known as Meadows Phase 2A is also imminent.

Monoline history

The history of the monoline insurers goes back to the 1970s, when they were created to guarantee bonds from US municipalities, making it easier for them to raise debt.

Over the years that followed, although some monolines remained focused on their original area of business, others branched out into other areas.

Which is where the trouble started. Because many found their way into exactly the type of asset that came under pressure during the financial crisis—subprime mortgage assets. Which meant that after the crisis, only two monolines were left standing: Assured Guaranty and FSA.

However, although the surviving bond insurers may have remained strong, investors had seen the difficulties elsewhere and were sometimes wary of doing business with them. "Assured Guaranty remained financially strong throughout and since the financial crisis, with positive quarter-on-quarter earnings throughout, but nonetheless we needed to re-establish credibility for our industry and product," explained Dominic Nathan, managing director at Assured Guaranty.

The first European post-crisis success came with the Worcestershire Royal Hospital PFI refinancing of January 2012, for which Assured Guaranty wrapped a bond originally issued in 1999, replacing the original guarantor, Ambac Assurance UK Limited.

Since then, Assured Guaranty acquired the UK subsidiary of its competitor MBIA Insurance Corporation, a deal which followed other acquisitions of bond insurers. And more acquisitions may be in the pipeline. "We have been quite public about our interest in considering the purchase of other legacy monolines that are no longer actively writing new business

– or of their insurance portfolios. Our acquisitions to date have been at a substantial discount to book value, which has been very value accretive for our shareholders," the company said.

Benefits of bond insurance

Part of the appeal of financing infrastructure projects with wrapped bonds stems from the EU Solvency II Directive, which came into effect on 1 January 2016. The directive aims to unify the EU insurance market, while reducing the risk that an insurer would be unable to meet its claims, and reducing losses incurred by policyholders if this occurs. One of the pillars of the directive imposed requirements that ensured insurers' capitalisation was commensurate to the risk they had taken on.

And although an amendment to Solvency II, which was introduced four months later, recognised the key role of the insurance industry in financing infrastructure projects, and lowered the capital requirement for them to do so, the rules around capital allocation are still an important consideration.

Which is where bond insurance comes in. While the capital charge for investing in a BBB-rated 20-year infrastructure bond is 20.1%, for an AA-rated infrastructure bond of similar tenor the charge is 9.7%, according to data from Insurance Europe.

So, with a wrap from a monoline insurer often able to lift the credit rating of a bond issue to AA from the BBB rating of the underlying project, the investment becomes more attractive to insurance companies.

And wrapping bonds also shields investors from risks inherent to the construction period of projects.

Meanwhile, the longer tenors institutional investors can provide compared to banks are an attractive feature to sponsors of infrastructure projects that are typically expected to generate revenue streams spanning 20 years.

Sponsors

And project sponsors seem to believe the cost of the premium for a wrap is worthwhile. "Bank finance remains available, however, the cost, quantum and tenor of funding remain less competitive than institutional debt raised in capital markets," said Jon Wakeford, group director, strategy and corporate communications at University Partnerships Programme (UPP), sponsor of a £104.7 million project to develop and operate student accommodation for the University of London in Stratford, with a wrap from Assured Guaranty, which closed in January.

"UPP made a deliberate strategic decision during the latter part of the last decade to move our projects away from bank lending to bond funding looking to bring together the longevity of university business models, long dated cost-effective borrowing, in long term partnerships for the benefit of all parties," Wakeford explained.