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States Resist Urge to Go on Spending Spree as Revenue Pours In.

- **General-obligation bonds of states outperform local debt**
- **Personal income tax revenue grows 11% in first half of 2018**

As a strong economy and federal tax changes boost U.S. state coffers, they've resisted going on spending spree.

Personal income taxes, which make-up about 40 percent of state government revenue, rose 11.2 percent in the first half of the year, as residents prepaid taxes before new limitations on state and local deductions kicked in. In addition, the limit's cap on property-tax deductions means that some will collect more revenue, since states use federally-adjusted income as a base for their taxes.

Yet states haven't ramped-up spending, with budgets growing about 3 percent in the fiscal year that begin July 1, according to the National Association of State Budget Officers. They employ 5.1 million people, same as the beginning of the year, and 30,000 less than last year, according to the U.S. Department of Labor.

"We expect states' top-line revenue to benefit through FY19-20 and are bullish on credit quality of state GO bonds in the near term," Barclays Plc's municipal strategists, led by Mikhail Foux, wrote this week.

State general-obligation bonds have outperformed local ones this year, losing 1.03 percent compared to 1.45 percent for bonds issued by cities, towns and counties, according to Bloomberg Barclays indexes. While a strong economy has increased local sales-tax revenue, the don't benefit directly from federal tax changes.

Almost 95% of state credit ratings are AA or higher, according to Barclays.

Forecasting state revenue has become more challenging because of federal tax policy changes, the volatility of capital gains and online sales, said Fitch Ratings analyst Laura Porter. Pension liabilities, healthcare and education funding continue to grow.

"States in general continue to be conservative," said Porter. "There's lots of uncertainty."

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By Martin Z Braun

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