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Hybrid Work Poses Credit Risk to Cities Looking to Issue Debt.

- **Fitch affirms negative outlook for Kansas City on remote work**
- **Hybrid work changing the way cities fill pockets of revenue**

Remote working may be be a boon for many Americans. But it could lead to higher borrowing costs for some cities tapping the municipal-bond market.

Fitch Ratings, earlier this week, affirmed its negative rating of Kansas City, Missouri, flagging remote work as a credit risk. The city anticipates a slow recovery in earnings taxes — which is its largest source of general fund revenue — because of increased remote work, Fitch noted.

While cities have been receiving Federal aid to stay afloat, many could risk a downgrade if they burn through pandemic stimulus money without finding other means to fund deficits, Bloomberg Intelligence strategist Eric Kazatsky said in an interview. And those that face a downgrade may have to issue bonds with higher yields to compensate the increased credit risk. This makes it more expensive to issue bonds and makes refunding less optimal, said Eric Friedland, director of municipal research for Lord Abbett & Co.

Drivers of Downgrades

Remote work can impact a city's revenue in multiple ways, from wage taxes that are levied depending on where workers put in their hours to the sales taxes that commuters pay at a local coffee shop on the way the office. Some states may require you to pay income taxes if you work there for just a day or two and for other states that might be 60 days.

A handful of cities in Ohio, such as Cincinnati, Toledo and Columbus, that rely heavily on income taxes could also see weakness in their revenue streams from remote working and potentially be subject to a downgrade, Kazatsky said.

Cincinnati, for example, derives 73.5% of its general fund revenue from income taxes, a Bloomberg Intelligence report published Thursday said. The average reliance on income taxes for municipal issuers is 8%, according to data from the Metropolitan Policy Program at the Brookings Institute.

Cities that have a greater dependence on commuter taxes are the most sensitive to work-from-home arrangements, Bloomberg Intelligence's report said.

Richmond, Virginia, has the highest share of jobs held by workers commuting from outside the city at 77%, according to data from Pew Charitable Trusts. New York's commuter share is 28% and Philadelphia's is just under 50%.

While remote work won't be the sole credit driver, it is a factor that ratings firms and investors are increasingly considering, said Dora Lee, director of research at Belle Haven Investments. Cities looking to issue debt must not dismiss remote work as a risk, especially as flexible work becomes a longer reality, said Tom Kozlik, head of municipal research and analytics at Hilltop Securities.

“The uncertainty is the most important thing, because this is a once in a generation type shift that we’re seeing and I think there are a lot of people who are down playing it,” he said.

Navigating the Risk

Large cities may be able to preempt a potential downgrade because their economy is often not focused on a single industry, Lee said. Such cities could use their diverse economy to reinvent themselves, she added. And their revenues could be fairly insulated because of the higher cost of living.

S&P Global Ratings revised their outlook for San Francisco to stable from negative on Thursday despite adding remote work as a risk. San Francisco-based firms have been asking for a reassessment of their property taxes as they’re increasingly adopting flexible work, which could put a dent in the city’s revenue. But the city’s “economically sensitive” revenue streams will be able to bounce back in the long term, credit analyst Chris Morgan said in the report.

“Maybe people are not doing full time in the office, but if the sales tax figures and hotel tax revenues are still rising because of some of the other factors like tourism, then it might not be that big of a deal,” Li Yang, a credit analyst with S&P Global Ratings, said in a phone interview. “We don’t necessarily need to see office workers go back 100%.”

Smaller towns outside larger cities could also see economic growth as hybrid work becomes more permanent, Lee said. With people not traveling to large cities for work as frequently as they were pre-pandemic, smaller suburban areas could see a boost to their economy.

President Joe Biden, governors and mayors have been pushing workers to return to their offices to help revive city economies. Local businesses that relied on workers going into the office could see some respite.

Workers who went to the office in 10 of the largest U.S. business districts rose to 42% of pre-Covi--19 levels in the week ended March 30, according to data from Kastle Systems.

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