Bond Case Briefs

Municipal Finance Law Since 1971

How Marijuana Munis Could Save the States.

Bonds backed by billions of dollars in pot sales taxes could shore up hard-hit state budgets — that is, if the feds would get out of the way.

FORTUNE — Thomas Doe, an analyst in the municipal bond market, was in Denver to give a speech last September when an unmistakable scent caught his attention. He'd been walking down the 16th Street Mall, the city's main retail drag, "and I'm smelling it in the air," says Doe, who goes by Tom. Then, completing the tableau, Doe popped into a hotel lobby and spotted three dudes wearing tie-dye and snacking on chips — this just a few months before marijuana for recreational use went on sale in Colorado.

That's when things really started to click for the 55-year-old founder and CEO of Municipal Market Advisors, a research firm with subscribers including some 300 institutional investors, along with government regulators. Earlier last year Doe and his colleagues had joked about whether a market for medical marijuana tourism could revive the flagging finances of a place like Puerto Rico, whose bond rating has dropped in recent years.

After Doe's trip to Denver, though, his thoughts on the matter of cannabis and credit ratings turned serious, particularly in light of certain revenue projections. The Colorado Legislative Council Staff estimated additional revenues from legalization, for example, at $100 million over two years. In Washington State, where recreational sales will begin later this year, a fiscal impact study said tax revenue could reach up to $1.9 billion over five years, averaging nearly $400 million annually. Indeed, legalizing marijuana nationwide, to believe a 2010 report by the Cato Institute, would generate some $8.7 billion in tax revenue, in addition to billions in cost savings related to law enforcement.

Doe believes that's enough money to help cash-strapped municipalities meet pension obligations, undertake construction projects, and lower their borrowing costs in the bond market — and, therefore, enough to inspire other states to legalize marijuana, too. "It would be a real positive for states that are struggling right now," he tells Fortune. "They've got such an infrastructure funding gap — and they have challenges with funding their pensions — that this is significant revenue."

Gregory Whiteley, portfolio manager for government securities at Jeffrey Gundlach's DoubleLine Capital, agrees about the potential upside. "By all accounts the legal recreational marijuana market is potentially quite large, so the impact on state and local finances could be significant," he says.

It's not a totally new idea. Back in 2010, hundreds of attendees surveyed at a Bond Buyer conference in California agreed that bonds backed by marijuana taxes would materialize were the state to legalize the recreational use. (That measure, Proposition 19, failed the same year.) A state estimate, from 2009, had put revenue potential at $1.4 billion a year.

Though solid data is still lacking, Whiteley says that for now the subject is "definitely on my radar."

Doe, meanwhile, has been busy putting the issue on the radar of analysts and investors. He began to

speak publicly last fall about the future of marijuana and public finances — first to attendees at a bond market industry conference in Chicago in October, then to institutional investors at the Massachusetts Investor Conference in December. This month he told clients in a research note that "a successful experience in Colorado" could result in a domino effect of legalization across the country.

"Colorado's legalization of marijuana on Jan. 1 will provide hard data as to the potential revenue source from the cannabis product directly as well as ancillary products and services," according to the note provided to Fortune. "Should tax revenue match projections then other states and cities are apt to follow the lead of Colorado."

State budget planners aren't convinced by marijuana's potential just yet. "Budget office folks are going to be very cautious until they see money coming in," says Scott Pattison, executive director of the National Association of State Budget Officers. NASBO's membership would also want to see whether any revenue gains are offset by expenditures resulting from legalization — say, additional costs related to law enforcement or public health. In other words, Pattison notes, "Are there extra expenses, or do we spend less in certain areas?"

Budget officers would certainly "take notice," however, of revenue figures that exceed 2% of a state's budget. "Then I think they'll start to say, Yeah, wow," Pattison says.

By Doe's reckoning, $400 million is enough to fund, hypothetically, 10 social service programs that cost $40 million each, or to finance major construction. "$400 million of new tax revenue would be material," he says, adding, "I've seen states borrow $400 million to help fund infrastructure projects."

That said, skeptics list a host of reasons why marijuana sales won't ultimately make a dent in state finances, or the bond market for that matter. Craig Mauermann is managing director and senior portfolio manager at BMO Global Asset Management U.S. He does think that other states will be enticed to follow the lead of Colorado and Washington — but that doing so will only dilute the revenue stream in the end. "The so-called boon is pretty much going to be spread out," he says.

Mauermann questions, too, whether marijuana sales will end up eating into consumers' "disposable vice income" for products like cigarettes and alcohol, which also generate sales tax revenue for states.

Then there's the illegal competition. Mark Tenenhaus, director of municipal research at RSW Investments, doubts that high-priced legal pot could steal substantial market share from the underground economy. In Colorado, retailers have been peddling marijuana at around $400 an ounce, according to media reports. "I don't think you're ever going to get rid of the black market," says Tenenhaus.

Like their lawbreaker competitors, legal purveyors of recreational and medical marijuana (permitted in 20 states and in Washington, D.C.) have another challenge to confront: the feds. Marijuana remains an illegal substance under federal law. If a municipality wanted to back a bond offering, in part, with revenue from marijuana sales, bondholders would have to be advised of the risk that sales could be shut down. "In this environment, it's a pretty strong risk," says attorney Robert Christmas, a partner at Nixon Peabody who specializes in bankruptcy and government insolvencies.

Tom Doe agrees that federal prohibitions, particularly banking restrictions, pose a big impediment to the growth of a legal marketplace. Right now banks won't touch the transactions or proceeds from sales, forcing merchants to deal in cash, including when they pay taxes. "The banking laws will

have to be adjusted," Doe says.

But Doe also believes the political sentiment is already shifting. Polls by Pew Research Center and Gallup have found that a majority of Americans favor legalizing marijuana. Just this month, states including New York, New Hampshire, and Florida have made moves in favor of some form of legalization.

Even President Obama appeared to have softened his tone on pot, when he told The New Yorker that he thinks the drug is less dangerous than alcohol "in terms of its impact on the individual consumer."

His administration is working on guidance so that marijuana businesses can make better use of the banking system and not have to deal solely in cash, Attorney General Eric Holder said at an event at the University of Virginia last week.

"If the electorate is supportive then I think the politicians go with it," Doe says.

Similarly, long-time advocates of marijuana reform say interest in "cannabis commerce" is having an effect on the political climate, too. Allen St. Pierre has worked at the National Organization for the Reform of Marijuana Laws (NORML) since 1991. Two decades later, St. Pierre, now executive director, is suddenly hearing from people like Doe, along with reps from "hedge funds, angel investors … and big, big law firms that are wondering whether or not to put a toe in the water."

"Those folks have the ear and the sway of those politicians far more than we do," he says.

Aging Baby Boomers may prove another pressure point on pols. "They want health care options," says Doe. He envisions a future in which Boomers become strong advocates for medical marijuana because it "may be a less expensive and a more desired therapy for diseases" that are impacting them.

But the money may talk soon enough. Colorado's new pot businesses will report their first round of sales tax revenue on Feb. 20, and the state's Department of Revenue will post the numbers. "Bottom line," says Doe, "you've got a state that's going to provide real data, and we'll see where all of this ends up."

By Catherine Dunn

Copyright © 2026 Bond Case Briefs | bondcasebriefs.com