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Where Amazon and Municipal Bond Finance Collide.

Amazon.com, Inc is looking for a new headquarters, but the biggest cities vying for the privilege are drowning in debt, and having a new HQ in a high debt city won't be good for Amazon going forward.

On January 18, the company released its short list of the top 20 candidates that remain in the running to land the retail giant's second home base. Many cities across the US made bold pitches to Amazon to lure the behemoth to their respective cities. The details of each city's proposal remain closely guarded secrets, with lucrative tax incentives and infrastructure components offered to hopefully convince the company to bring a reported potential $5 billion additional investment and 50,000 new jobs to the lucky winner.

When deciding on a final location, Amazon is not just looking at what incentives they can get out of the deal. They are also looking at the financial standing of the cities vying for the coveted deal. 19 U.S. cities and Toronto, Ontario are all in the hunt. We imagine the retailer is taking into account many attributes, including local workforce capability, transportation, zoning and municipal government health. We think that there are many municipalities with qualified labor forces and good infrastructure but not all municipalities are well run from a debt management perspective.

Budgetary Debt and Unfunded Pensions Weigh on the Decision

Local infrastructure is an important factor Amazon is certainly taking into consideration when choosing a location for their new headquarters. Infrastructure such as roads, airports, and modern public transportation are vital to the eCommerce giant attracting the high-quality talent they seek to employ. Amazon has reported that they are looking to hire up to 50,000 high-paid employees at their second headquarters location, so cites surrounded by quality institutions of higher learning will certainly stand out. Cities under consideration for the new headquarters with aging infrastructure will have to upgrade their systems to stay in the fight. In most cases this would mean adding debt on top of already shaky financial conditions.

Why would Amazon be concerned with the financial condition of the city it chooses for its second headquarters? One big reason would be accounting for future tax liabilities. If a municipality grants tax breaks to Amazon today, and the city's credit profile deteriorates in the future then the city may be forced to increase certain taxes levied on local companies, including Amazon, to help fund those shortfalls.

According to Bloomberg, 8 of the 20 finalists have high debt and pension fund liabilities that could hurt their chances of success. These legacy costs incurred over the last few decades could make them less attractive to the internet giant.

Interestingly, it is some of the largest cities on the short list that are experiencing financial difficulty. The cities of Atlanta, Austin, Chicago, Dallas, Indianapolis, Los Angeles, Philadelphia and Pittsburgh each have more than 250,000 residents and spend the greatest share of their annual budgets on debt, pensions, and retiree medical benefits.

In contrast, smaller metropolises like Columbus and Denver were among the finalists that have relatively low debt service requirements and pension burdens relative to their population base.

The mounting liabilities faced by the eight larger cities could make them less attractive to Amazon when compared to smaller city options.

If Jeff Bezos does go central USA?

We imagine that he would chose Nashville over Chicago.

Let’s take a look at these two final US cities. They are strategic from a national logistical perspective, as they are both centrally located. Being centrally located will allow Amazon to interface seamlessly with both the east and west coasts. Both cities also have a diverse demographics and therefore an equally diverse work force for Amazon to tap into. Finally, both cities are within close proximity of numerous local, well ranked universities, all of whom can provide talented new Amazon hires for years to come.

When compared on location, demographics, infrastructure, and size, Chicago and Nashville stack up fairly evenly. It is when you look into their public finances that Nashville begins to shine as a stronger candidate.

Chicago suffers from deeply troubled municipal finances, many of which are also reflected at the state level. The Chicago Public School System (CPS) is on life support at the mercy of the municipal bond market to finance their perpetual deficits. Chicago’s recent financings have not been used for improvements and new construction but rather to roll-over short term borrowing with significantly higher cost long term bonds.

The Windy City currently is rated below investment grade by Moody’s Ratings, which is considered to be junk bond status, as is its public-school system. Chicago Board of Education bonds are a large holding of the Van Eck Vectors High-Yield Municipal ETF (NYSEARCA: HYD), which yields over 4.25%, more than double the yield on the higher quality iShares National Muni Bond ETF (NYSEARCA: MUB)

Contrast Chicago’s woes to well-run Nashville. Nashville has a stable AA2/AA investment grade bond rating, and is currently home to a number of large companies. Tens of thousands of Tennesseans are employed by companies such as Vanderbilt University Med Center, HCA Healthcare Inc (NYSE: HCA), Kroger (NYSE:KR) and Nissan. The city according to Moody’s possesses strong management and as the state capital possesses a regional tax base that will continue to grow and provide the necessary revenues to support ongoing governmental operations.

Our Guess

When you dig deeper into the municipal finances of the 20 finalists, many once strong candidates begin to fall apart. We see it and we are sure the folks at Amazon do, too. We don’t know Amazon’s future HQ2 location. With all of our quantitative skills and higher education, we may have a 1 in 20 chance of being right. With all of the conjecture, we imagine that it could be an east coast city that wins out, supporting that thesis is a fair amount of media buzz about Atlanta, Raleigh, Washington DC, and Boston.

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