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Fitch Ratings: Coronavirus Effects for U.S. States and Locals Still Developing

Fitch Ratings-New York-12 March 2020: The vast majority of U.S. state and local governments are well-positioned to absorb the near-term credit implications from the coronavirus outbreak, but the situation remains uncertain and is evolving rapidly, according to Fitch Ratings.

Local government fund balances are generally robust and state governments typically benefit from exceptional inherent budget flexibility. Some governments, as reflected in lower Issuer Default Ratings (IDRs), are more vulnerable to budget strain from unexpected stress events such as the coronavirus pandemic. Ongoing market declines could increase pension liabilities and contribution needs over time. Capital markets access is generally not a concern given that states and locals typically amortize debt annually and use it primarily for deferrable capital projects. Fitch is assessing whether specific governments face near-term credit risk in this evolving situation. Fitch is reviewing economic and fiscal data, and is in regular touch with issuers.

The high IDRs for most states and locals reflect Fitch's view that they can absorb deterioration in the fiscal and economic environment without immediate effects on credit quality. For cities, counties, and school districts, Fitch's review of comprehensive annual financial reports finds that median available general fund balances were between 20%-30% of fiscal 2018 spending, reflecting the long period of economic expansion most governments have benefitted from.

Nearly all states have robust ability to adjust revenues and expenditures (including downloading costs to locals which are generally positioned to absorb them as noted above), and can tap into various balances on at least a short-term basis. States' median available governmental fund balance as a percentage of fiscal 2018 spending was a solid 8%, as states have likewise benefitted from the long period of economic expansion and generally rebuilt sizable budgetary reserves..

Coronavirus has led to increased spending by states and locals for prevention and treatment measures which are likely to escalate, and it will reduce economic activity and government revenues. Their potential depth and breadth will drive any rating changes. A severe downturn could pressure state and local governments' resilience and trigger more widespread rating implications.

Most states and some locals are susceptible to sometimes meaningful revenue declines absent policy action in the face of a significant financial market and/or economic downturn. States rely primarily on a mix of sales and income taxes, while local governments rely primarily on property taxes and to a lesser extent sales or income taxes. Governments most reliant on discretionary economic activity or directly engaged in healthcare delivery are more at risk. Dedicated tax bonds with more narrow revenue pledges are also at higher risk, though ratings incorporate an assessment of the resilience of these structures to deep historical declines, including through the Great Recession.

Fitch anticipates focusing on several factors over the coming weeks and months including:

–Tourism and visitor-related revenue such as hotel and lodging taxes;
–Sales and use taxes, or similar broad consumption levies such as general excise taxes;

–Severance taxes and other natural resource-related revenues, particularly for oil;
–Personal and corporate income taxes;
–The scope of direct government coronavirus spending;
–Labor market indicators including unemployment insurance filing claims, non-farm payrolls, and unemployment rate;
–Scope of travel or movement restrictions that limit economic activity;
–Federal measures including healthcare funding, direct consumer stimulus or industry-specific support;
–Effects of market volatility on pension systems, including annual contributions and liability burdens.

Fitch has observed anecdotal instances of coronavirus beginning to affect state and local governments with a small sample listed below. Fiscal effects are only just unfolding and Fitch anticipates more actions:

–Hawaii's Council on Revenues recently revised the general fund revenue forecast downward by approximately $300 million over this fiscal year and next, primarily due to coronavirus effects;
–New York's governor recently requested the state comptroller "perform a risk analysis" of the state's revenue forecast, accounting for economic implications of the coronavirus;
–Washington's Department of Health has requested $100 million in supplemental appropriations from the legislature for coronavirus management;
–San Francisco's city controller recently reported sharp declines in hotel occupancy and airport traffic and he estimated city revenue losses in the tens of millions of dollars.

Fitch considers announced measures within the capacity of state and local governments to absorb at current rating levels. There will be additional measures from state and local governments including revenue forecast updates, supplemental appropriations and draws on reserve funds. Many state and local governments are also in the midst of the budget enactment process for the upcoming fiscal year and enacted budgets are likely to account for coronavirus effects to the extent possible.

Plausible estimates as to the extent of the U.S. population ultimately to be afflicted with the coronavirus are wide ranging. A macro and financial market shock can have significant knock-on events, and, depending on the magnitude and duration, the effects on the housing market and other currently unanticipated factors that could affect state and local government credit quality may need to be assessed. Fitch will continue to monitor state and local governments in the context of the shifting and complex effects of the coronavirus.

Contact:

Eric Kim
Senior Director
+1-212-908-0241
Fitch Ratings, Inc.
Hearst Tower
300 W. 57th St.
New York, NY 10019

Arlene Bohner
Senior Director
+1-212-908-0554

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email: sandro.scenga@thefitchgroup.com

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