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Cannabis Municipal Bonds Could Be The Future.

MPG Consulting has recently authored a report looking at the potential of Cannabis Municipal Bonds (CMB). Adam Orens, Founder of MPG and Sal Barnes, Managing Director, MPG have conducted a theoretical analysis using Colorado showing how the state can translate its cannabis revenue into a short-term bond amount of $166 million and long-term bond issued in the amount of $591 million resulting in $123 million and $438 million available for educational initiatives and infrastructure, respectively.

States and municipalities already use revenue bonds as a way to pay for large projects. The investors of such bonds feel that the risk for these investments is lower since there is a captive source of revenue to pay the interest. The report gives Iowa as an example. That state allocates $55 million in gaming taxes every year to pay the debt on revenue bonds that were issued in 2009 and 2010. That money raised selling these bonds was then used for community revitalization, flood mitigation, and bridge improvement efforts.

Test Case: Colorado

MPG used Colorado as an example of how state and municipal governments could tap into this revenue stream as a way to fund large projects. Although the report stresses, that while Colorado makes a good test case because of its well-tracked tax revenue, it isn't necessarily a good candidate for a CMB. Mostly because the state has already been able to capitalize on the growing tax revenue for various projects – mostly involving education. The authors believe it is a concept worth exploring for newly legalized states.

In Colorado's case, Denver collected $46.8 million in tax and license revenue in 2018. The estimated amount for 2019 is $63.3 million. MPG suggests this revenue will grow 21.6% on an annual basis. Using these figures and calculating future growth, MPG thinks that Denver could offer three-year CMB's at a 1.5% interest rate. The city could issue a $166 million three-year bond resulting in potentially giving $123 million to the education allocation. A 10-year bond issue of $591 million would result in $438 million for education and other purposes.

Since Denver's education needs seem to be met with this new influx of cannabis tax revenue, a CMB would not have as much impact. However, a city that is new to legalization and has more pressing and expensive needs like housing – a CMB might be an attractive solution.

Minneapolis As An Example

MPG Consulting looked at Minneapolis Minnesota as a city that could benefit from CMB. The state has not legalized cannabis, but if it did it could a large city like Minneapolis use the money to address its housing problems. MPG calculated that if the state legalized adult-use cannabis its first-year sales could hit $64 million and eventually reach $182 million in the tenth year. MPG believes that the tax revenue in the first three years would be roughly $63million reaching $343 million in ten years.

The hypothetical case for Minneapolis is that the city could issue $49.4 million in three-year bonds raising $44 million for affordable housing in year one. The current balance for the Affordable Housing Trust Fund is $21 million, so an influx of $49 million would be substantial. A ten-year bond could generate $233 million in the first year. The report also looks at the state in the same hypothetical calculation where the state would reap $385 million from a three-year bond and $2 billion in a 10-year bond.

Banking

Of course, the cannabis industry is challenged with a lack of banking and most of the major debt underwriters want nothing to do with cannabis until it is federally legal. With the current pandemic crisis and an upcoming election, the possibility of any cannabis legislation getting enacted in the near term is remote. The authors though believe that CMB's could still be issued in the current environment.

"When state and local governments collect cannabis tax revenue, the funds are commingled in the general fund with revenue from other sources. The funds then enter the Federal Reserve System," said the report. "Capital raised from CMB's would be no different than any other tax revenue and therefore, in our opinion, would not require any sort of special regulation." The authors do concede that convincing the banks and underwriters to offer the products could still be difficult.

Potential CMB States

The report notes that demand for such a bond could grow as cities and states grapple with the economic fallout of the COVID19 virus. The report suggests that seven states could see the potential in CMB's. These states hold the most promise of legalizing adult-use cannabis in the near term. Those states are Arizona, Connecticut, Montana, Missouri, New Jersey, New York, and Vermont. However, the report notes that only the major east coast markets, Missouri and Arizona could support the CMB. Vermont would not have the tax revenue to make it worthwhile.

"States looking to open adult-use cannabis markets should consider utilizing CMB's to finance crucial infrastructure or strategic public initiatives," read the report. "Strong and accurate estimation of cannabis demand, tax revenue, growth rates, and other market development factors are imperative to calculating proper bond issue size, yield and maturity dates. Finally, banks who sell CMB's must develop diligence methods and models to effectively price these securities."

MPG Consulting said that cannabis revenues are steadier than alcohol and tobacco and more like casino tax revenue. While the idea of Cannabis Municipal Bonds may be novel, it isn't completely unfeasible. The question isn't if they will happen, but when. MPG might be correct that COVID could push states and cities to issue CMB's. Financial institutions may also ease their opposition as they too may need additional underwriting revenue. CMB's could be the next step in legitimizing cannabis.

Green Market Report

by Debra Borchardt

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