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Muni Market Niche Faces Biggest Test With Sales Taxes Crumbling.

- **Governments' sales-tax backed bonds were seen as less risky**
- **With local collections down sharply, some now have doubts**

The shutdown of businesses across the country is casting a pall over a segment of the \$3.9 trillion municipal-bond market that had been seen as more insulated from risk: debt backed by sales-tax collections.

Illinois, Chicago, Puerto Rico and the state of New York are among governments that have issued such bonds. That allowed them to borrow at a lower cost than by selling debt backed only by the promise to repay, given that the dedicated revenue stream provided investors an extra bit of protection.

But the business closures that have raced through the American economy along with the coronavirus since March are promising to mark the biggest test yet of that premise. In May alone, the sales tax collections of states tumbled by \$6 billion, or 21%, from a year earlier, according to an analysis by the Urban-Brookings Tax Policy Center.

Matt Fabian, an analyst for Municipal Market Analytics, said the sales-tax bonds were designed to be insulated from the state and city budgets, with the revenue behind them typically well above what's needed to cover the debt payments.

"But sales tax bonds weren't built with the pandemic in mind," Fabian said. "You can't have sales transactions go down 80% for months without problems."

The risk hasn't yet had a big effect on the price of the securities, which have rebounded along with the broader market from the March crash triggered by the first wave of shutdowns.

Bonds sold by Chicago's Sales Tax Securitization Corp. that mature in 2040 are trading for yields around 3.6%, down from as much as 4.24% early last month, according to data compiled by Bloomberg. The prices of those sold by still-bankrupt Puerto Rico have also rallied sharply back since March.

Fabian said the unprecedented declines in sales taxes makes it "very likely" that some governments will need to draw on reserves or see the ratings of the securities cut.

Dora Lee, director of research at Belle Haven Investments, which manages \$12.4 billion in muni bond assets, said the economic rout has cast some doubts on how the securities will fare.

"Now that there's a potential for large revenue declines, I think investors are looking for credits that have more financial flexibility than a rigid pledged revenue stream," she said. "We have been extremely cautious when looking at special tax bonds because it's hard to know where the declines will bottom out and I suspect that other investors are in the same boat."

Bloomberg Law

Shruti Date Singh

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To contact the reporter on this story:

Shruti Date Singh in Chicago at ssingh28@bloomberg.net

To contact the editors responsible for this story:

Elizabeth Campbell at ecampbell14@bloomberg.net

William Selway, Amanda Albright

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