MUNICIPAL CREDIT ALERT

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SMITH SHELLNUT WILSON

INVESMENT COUNSEL AND MANAGEMENT

SSW Research Department
Ray Thompson
Office: (601) 605-1776
Email: rayt@ssw1776.com
website: www.ssw1776.com

Coronavirus Challenges Will Test Local Governments' Credit Strength

Many local governments' economically sensitive revenue streams will endure substantial disruption. Sales and other local consumption taxes have already declined dramatically, and will decline further as the crisis persists. Still, local governments benefit from relatively stable property tax revenue because it takes time for a decline in property values to affect tax revenue. Meanwhile, costs will increase as local governments take extraordinary measures to prevent the spread of the virus.

Local economies will be hurt to the extent that they are exposed to vulnerable industries, such as tourism and business-travel, manufacturing or oil and gas. Tennessee, for example, has a concentration of local governments with high exposure to the crisis, because many cities in the state rely on sales taxes for more than 50% of their revenue and have local economies dependent on auto manufacturing, which is facing disruption in global supply chains and the temporary closure of factories.

While credit quality could diminish for some local governments, a spike in defaults because of the coronavirus outbreak is unlikely. Most local governments will be insulated because of their strong revenue structure, generally good reserves and liquidity, and flexibility to adjust spending priorities. Municipal water and sewer utilities will also remain largely unaffected by the crisis because of the relatively stable revenue that comes with providing a vital public service.

Local governments that provide healthcare services, such as those that own hospitals or run hospital districts, will face a significant test, especially those with weaker liquidity. A surge in infections requiring hospitalization will lead to a spike in patient volumes and potentially overburden systems, depending on how quickly the volumes surge and how long infected patients have to stay. Operating margins will fall as more profitable elective procedures are canceled to free up capacity and preserve resources. Costs are also higher when patient volumes surge because of overtime and other unbudgeted staffing costs.

School districts, despite widespread closures, are unlikely to suffer long term given the strong state support for education generally and the reliability of state funding. States are unlikely to materially reduce school district aid in the remaining months of their fiscal 2020 years in response to the crisis. It is possible, however, that states will reduce funding next fiscal year if the crisis lasts.

Source: Moody’s Investors Service

Smith Shellnut Wilson, LLC
661 Sunnybrook Road, Ste 130
Ridgeland, MS 39157-1813
Office: (601) 605-1776
Fax: (601) 605-1710
Website: www.ssw1776.com