

Muni bond sector mulls U.S. Supreme Court Rulings

Two recent U.S. Supreme Court decisions could have significant long term implications for the American municipal credit market. Here the Standish¹ municipal bond team considers the rulings and their likely implications.

June saw the U.S. Supreme Court make important new rulings on the state assessment of online retail sales tax and laws governing union membership and payments. Both could potentially bring positive longer term benefits for U.S. state and local governments and the underlying municipal debt markets which support them.

In a technical case, involving South Dakota versus e-commerce giant Wayfair Inc. a 5-4 Supreme Court ruling in favor of the Midwestern state, effectively allowed it – and other U.S. states – new freedoms to pass laws subjecting online retail transactions to sales taxes.

The June ruling overturned a 1992 court decision prohibiting U.S. states from requiring online retailers to collect sales tax unless they had a physical presence in the state. The court's latest decision could, potentially, bring a substantial tax windfall for some U.S. municipal authorities. South Dakota's specific law applies only to out-of-state sellers that deliver more than US\$100,000 of goods or services into the state or engage in 200 or more separate transactions into the state.

While the Standish municipal bond team does not believe the ruling will lead to any major credit upgrades or material spread compression impacting investors it does acknowledge the change could benefit some municipal bond issuers more indirectly over the longer term, depending on their own rules, requirements and state legislation.

The team adds that several factors could drive the impact of the Wayfair decision on specific state and local credits, including whether online sales are already taxed and the magnitude of the dependence on sales tax as a percentage of their general fund.

The U.S. Government Accountability Office estimates that state and local governments could gain between US\$8bn–\$13bn in revenue if states were given the authority to require sales tax collection from all remote sellers, with an average gain of about US\$200m per state. However, Standish expects the additional revenue gains will amount to less than 3% in aggregate, based on annual state and local government tax receipts.

Commenting on the specific impact of the Wayfair decision on sales tax bonds Standish says: "While the decision is expected to increase sales tax receipts overall, the impact on the ratings of sales tax bonds should be minimal, as we expect that the incremental revenues will be relatively small and the bond ratings for a sizeable percentage of sales tax credits already reflect strong debt service coverage."

Union moves

In another significant June court case – Janus v American Federation of State, County and Municipal Employees, the Supreme Court ruled that public unions are now prohibited from requiring workers to pay union dues, overturning a 1977 precedent and potentially weakening their strength and bargaining power.

¹ Standish is a brand of BNY Mellon Asset Management North America Corporation

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While the ruling disappointed unions – which have about 15 million members in the U.S. – it could help municipal authorities limit costly union disputes and negotiations and help local authorities save money in the future.

Commenting on the likely implications of the move, the Standish Municipal Bond Team adds: “We believe the Supreme Court’s ruling will be a long-term positive for municipal credits that directly interact with public sector unions. Budgetary pressures associated with collective bargaining, such as wages, healthcare costs and pension benefits, have been consistent challenges for municipalities.

“Due to the ruling, political influence of unions may diminish, opening the door for reduced benefits and potentially easing long-term financial burdens on state and local governments.”

While Standish acknowledges the potential influence of both the recent Supreme Court rulings, its municipal bond team adds they are unlikely to bring immediate benefits to municipalities and that these might only become clear over the longer term.

“While these decisions are highly significant from a social perspective, we expect they will have a muted impact on state and local finances in the near term. Additional sales tax collections are positive for municipalities, but the extra revenue will be relatively small and likely not impact credit ratings or interest rate spreads.”

“A reduction in union dues may diminish the labor unions’ bargaining power in the long run, but changes to collective bargaining agreements often play out over a long period of time,” the team concludes.

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