



## U.S. Municipal Bond Market

# “Push the Pause Button” Elevating the Level of Political Risk

### Rising Political Risk

The level of political risk influencing the municipal bond market continued its ascent yesterday. We previously identified political risk as being one of the atypical credit risks currently facing the municipal bond market just after the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was signed into law.<sup>1</sup> So far, the reality is close to meeting our expectations, unfortunately. The recent statement about state bankruptcy that has been getting the most attention is not the most important takeaway from the last few days.

### Possibility of U.S. State Bankruptcy Not Imminent, Nor a Likely Solution

It has been very well circulated that Senate Majority Leader Mitch McConnell, during an appearance on the Hugh Hewitt radio show, said yesterday:

“I would certainly be in favor of allowing states to use the bankruptcy route. It’s saved some cities, and there’s no good reason for it not to be available... There’s not going to be any desire on the Republican side to bail out state pensions by borrowing money from future generations.”<sup>2</sup>

We believe this statement was political theater.

We are not aware of any attempt by Washington lawmakers to actually craft legislation or create a pathway allowing U.S. states access to Chapter 9 or something like it. In our opinion, such a pathway would not be an acceptable solution to the current situation facing U.S. state governments anyway. Further, we should note that U.S. state governments do not currently have the ability to file for Chapter 9 bankruptcy. Only a “municipality” that meets the four criteria described in Section 109(c) of the Bankruptcy Code are able to file.<sup>3</sup>

### More Important Takeaway, “Push the Pause Button”

The more important takeaway from McConnell’s recent statements is that he is in favor of delaying, or “pushing the pause button” on additional state and local government relief. There is currently an agreement in Congress for a \$484 billion fourth phase of COVID-19 relief that does not include any direct funds for state or local governments.<sup>4</sup> And lawmakers have run into a roadblock for additional near term aid. McConnell said:

“I said yesterday we’re going to push the pause button here, because I think this whole business of additional assistance for state and local governments needs to be thoroughly evaluated.”<sup>5</sup>

The lack of additional aid, or even a pause in relief could have significant consequences for nearly every state and local government as the economic costs of slowing the spread of COVID-19 worsens. It is the everyday services that most people take for granted that are going to suffer without additional federal relief. Services such as: garbage collection; road and infrastructure maintenance and transportation; police and fire protection; the delivery of healthcare; primary, secondary and higher education; there will be a limited ability to administer programs such as unemployment

Tom Kozlik  
Head of Municipal Strategy & Credit  
214.859.9439  
tom.kozlik@hilltopsecurities.com

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insurance; and other social services will suffer as well. There will also be a potentially tremendous hit to the U.S. economy because state and local government employment make up about 13% of total U.S. employment, and there are many places where significant concentrations of these types of workers reside.<sup>6</sup>

### Stay Focused

This type of fearmongering is not new to the municipal bond market,<sup>7</sup> and this will not be the last time we hear something like it. The threat of state bankruptcy coming from a leader in Congress at this time is not optimal, but again we are not seeing that anything is being considered by federal lawmakers that would allow states such an option. What we remained focused on is the larger picture of what the next allocation of federal aid will look like for the state and local governments who are on the front lines of the battle to contain the spread of COVID-19, despite the rising political risk in Washington.

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<sup>1</sup> We wrote identified political risk as an atypical risk in our April 3, 2020 report titled, [Three Key Atypical Credit Risks & Market Update](#), April 3, 2020.

<sup>2</sup> Dennis, Steven T. and William Selway; [McConnell Says He Favors Letting States Declare Bankruptcy](#); April 22, 2020.

<sup>3</sup> Please see "Eligibility" in [Chapter 9 – Bankruptcy Basics at US Courts.gov](#) for the four criteria.

<sup>4</sup> Everett, Burgess and Heather Caygle; [Senate passes \\$484 billion coronavirus deal after weeks of deadlock](#); Politico; April 21, 2020.

<sup>5</sup> Dennis, Steven T. and William Selway; [McConnell Says He Favors Letting States Declare Bankruptcy](#); April 22, 2020.

<sup>6</sup> Belz, Sage and Louise Sheiner; [How will the coronavirus affect state and local government budgets](#); Brookings; March 23, 2020.

<sup>7</sup> Please see Muni Mania: A Timeline on page 3 of Joe Mysak's [The Muni-Meltdown That Wasn't](#); Bloomberg; Nov 2014.

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