

## U.S. Municipal Bond Market

# More Hurdles to Financial Equilibrium, Recovery, and Growth

### Summary

- The macroeconomic situation is momentous. Elevated savings likely for prepping, not near-term spending.
- Still no significant ground made on federal relief. “Final” round may come in next month or two, but it will be narrower than HEROES Act, says Leader McConnell.
- The impact from the violent demonstrations and protests across the country could delay state, regional, and city efforts to return to a more normal fiscal landscape.
- Hurricane season begins today. An above average to exceptionally active 2020 hurricane season could be another obstacle.

### Beyond Imagination

The financial landscape municipal entities are facing is beyond imagination. The *Wall Street Journal* published just today, “Cities across the U.S. are hemorrhaging money as the coronavirus pandemic shut down commerce, entertainment and tourism activities that provide much of their revenue.”<sup>1</sup> The article cited a survey by the National League of Cities and Conference of Mayors indicating local governments are anticipating significant budget problems. Almost 90% of those surveyed anticipate revenue shortfalls, and over 50% expect cuts to public safety, the core provision of local governments. Local governments (and state for that matter) are on the front lines of the current difficulties, and this is not a time that they can afford to make any, much less substantial cuts to core programs. State governments are facing budget shortfalls of at least \$650 billion and local governments have seen revenue losses of at least \$360 billion.

In addition, we noted about two weeks ago in our commentary [Municipal Sector Credit Outlooks, Municipal Credit Two Months into the New COVID-19 Normal](#) that “Largely, we see this new COVID-19 normal as a period that will meaningfully test the bounds of financial resources, not as one that tests the entire market’s solvency.”<sup>2</sup> We also qualified that analysis by noting the amount of time it takes to return to “normalcy” and the amount of potential federal relief are two key questions that drive our opinion.

It appears as though the path to at least financial equilibrium, much less recovery and growth may not be as reachable, unfortunately. More hurdles are developing.

### The Macroeconomic Situation is Momentous

Jobless claims rose by another 2 million last week and stand at over 40 million now, amounting to over a quarter of the U.S. labor force. This far exceeds the 8.7 million who lost employment during the 2008 Great Recession. Although individual savings rates are at record levels, that is most likely because of financial prepping. Elevated individual savings are most likely not going to be a boost to 3Q 2020 spending. Those are resources, some via government subsidy, most likely being stashed away for potential stress in the coming months, or even years.

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Keeping the following relationship in mind, no matter what economic indicator is reported in the coming weeks to months is important: A 50% drop followed by a 50% increase (month over month) is still not enough to get you back to neutral – and it is for sure not close enough to begin talking again about overall growth. The more important relationship will be to look at the pace of April to August numbers, according to Stu Hoffman. This will give us a better idea of the speed and durability of any potential for near-term recovery.<sup>3</sup>

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### **On Potential Federal Relief: The “Final” Phase**

No significant ground has been made on a next round of potential relief for state and local governments since the House passed their \$3 trillion Health and Economic Recovery Omnibus Emergency Solutions Act (HEROES Act) in the middle of May. On Friday, Senate Majority Leader Mitch McConnell was quoted as saying the next COVID-19 relief package would be the “final” round. He noted lawmakers could decide on a package in the next month, and it is likely to be narrower in scope than the HEROES Act.<sup>4</sup>

### **More Obstacles**

Events outside the control of state and local governments continued to dictate an even more complicated road to financial equilibrium, recovery, and growth. State, regional, and local economies began to open in recent weeks. We even wrote Friday that New York City anticipates to begin its reopening process by June 8. However, protests against police brutality and institutional racism developed in at least 140 cities across the country. The situation elevated to the point Friday night where the U.S. Secret Service felt it was necessary to take President Donald Trump to an underground bunker, where he stayed for a little under an hour. White House staffers were told to hide their credentials until they approached a Secret Service entry point when they reported for work Monday morning out of an abundance of caution for their safety.<sup>5</sup> Other cities experienced elevated levels of violence as well. Sunday night was the sixth night of such protests and some of them turned destructive. Cleanup is underway, but the events also caused some cities to delay or pause the reopening process.

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There are many questions about insurance coverage being asked to begin the week. Larger retail institutions may have more complete coverage, but smaller retail may not be covered as comprehensively for these type of civil disturbances.<sup>6</sup> Again, this is going to be an obstacle to municipal-related activity for sure. No matter the insurance coverage, this is going to cause delays and lengthen the amount of time it will take for municipal entities to return to financial equilibrium. Historical analysis of the influence of violent demonstrations also shows that property values can become depressed in areas of riot-afflicted cities,<sup>7</sup> and economic activity and tax revenue can be negatively impacted as well.<sup>8</sup>

### **It is Now Hurricane Season**

Hurricane season began today. A higher number of systems already developed in May and experts are forecasting this season to include activity that ranges from above average to exceptionally active.<sup>9</sup> In recent years we have seen an increased financial toll as a result of weather-related events. An above average to exceptionally active 2020 hurricane season could be another obstacle to financial equilibrium, recovery, and growth for municipal entities.

*An above average to exceptionally active 2020 hurricane season could be another obstacle to financial equilibrium, recovery, and growth for municipal entities.*

- <sup>1</sup> Gillers, Heather; *Cities' Next Coronavirus Dilemma: Cut Essential Services or Take Down More Debt*; WSJ; May 31, 2020.
- <sup>2</sup> Kozlik, Thomas; *Municipal Sector Credit Outlooks, Municipal Credit Two Months into the New COVID-19 Normal*; HilltopSecurities; May 20, 2020.
- <sup>3</sup> Hoffman, Stu; *"Down 50% followed by up 50% does not get you back to where you started. Simple math! Important to look at April to Aug economic data compared to a year earlier to get the best sense of the speed and durability of the coming recovery"*; Tweet dated May 26, 2020.
- <sup>4</sup> Pramuk, Jacod; *Next coronavirus stimulus bill will be the "final" one, Mitch McConnell says*; CNBC; May 29, 2020.
- <sup>5</sup> Collins, Kaitlin and Noah Gray; *Trump briefly taken to underground bunker during Friday's White House Protests*; CNN; June 1, 2020.
- <sup>6</sup> Dean, Sam; Laurence Darmiento and Ronald D. White; *Is looting covered by insurance? Depends upon the business*; Los Angeles Times; May 31, 2020.
- <sup>7</sup> Please see Collins, William J. and Robert Margo; *The Economic Aftermath of the 1960s Riots: Evidence from Property Values*; NBER Working Paper Series; May 2004.
- <sup>8</sup> Matheson, Victor and Robert Baade; *Race and Riots: A Note on the Economic Impact of the Rodney King Riots*; Urban Studies, Urban Studies Journal Limited, vol 41(13), pages 2691-2696, December.
- <sup>9</sup> Jones, Judson; *For the first time, a third named storm could form before the start of the hurricane season*; CNN; May 29, 2020.

### Recent HilltopSecurities COVID-19 Municipal Commentary

- [Final COVID-19 Relief, New York City to Reopen June 8, 2020](#), May 29, 2020
- [State of Confusion](#), May 28, 2020
- [Municipal Credit Two Months into the New COVID-19 Normal](#), May 20, 2020.
- [The HEROES Act: the House Democrats' Opening Proposition](#), May 12, 2020
- [Updated Pricing Detail: Federal Reserve's Municipal Liquidity Facility](#), May 11, 2020
- [Municipal Credit and Market Update](#), May 8, 2020
- [Single Family Housing Durability Will Help Endure the New COVID-19 Normal](#), May 6, 2020
- [Credit Deteriorating, Moody's Lowers State Outlook to "Negative,"](#) May 1, 2020

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