

U.S. Municipal Bond Market State and Local Relief Not Likely Until July; Delayed by Demonstrations, Other Agenda Items

Summary

- A consensus has seemingly developed for the need for state and local government fiscal relief, but negotiations are going to be delayed because of law enforcement reform talks sparked by recent demonstrations and other legislative agenda items.
- The end effect from any delay is state and local governments will have a reduced ability to deliver needed services, credit quality will take a hit, and near-term economic growth and the potential financial recovery will also be contested as a result.

Lawmakers Position Themselves for Next Round of COVID-19 Relief, Stimulus

There is a quote, often attributed to former German Chancellor Otto von Bismark (1871-1890), cautioning policymaking observers: "Laws are like sausages. It's better not to see them being made." It may help municipal market observers to consider the above wisdom, especially in the coming weeks, or even months, as federal lawmakers debate and potentially approve another round of COVID-19 related relief or stimulus. A consensus has seemingly developed supporting the need for state and local government fiscal relief, however negotiations are going to be delayed due to law enforcement reform talks sparked by recent demonstrations and other legislative agenda items.

The State and Local Government Budget Shortfall

The Coronavirus Aid, Relief, and Economic Security (CARES) Act included \$150 billion that state and local governments were able to use for direct COVID-19 expenditures. This was not meant to be, or even able to be used for budget shortfalls; It was earmarked for only direct COVID-19 spending. Although the CARES Act was substantial in size and even scope, a weakness of the record-breaking package was that it fell significantly short in general state and local government relief. In contrast, the 2009 Recovery Act included about \$282 billion for state and local government programs.¹ What state and locals are facing in 2020 is much different in that the current landscape is and could continue to develop into an even more challenging situation, and there is the potential for fiscal tests to continue past this year.

Near the end of April, state budget shortfalls were forecast to be \$650 billion by the Center on Budget and Policy Priorities, and local government revenue loss was estimated to be about \$360 billion according to the National League of Cities. These estimates are likely to rise. Our approximation back at the beginning of April was that another \$300 to \$600 billion of state and local government relief was going to be needed.² At this point, we now have a better idea of what the economy is facing as it relates to the potential impact from COVID-19. We also know that while area economies are beginning to reopen, social distancing measures are likely to continue to mute business and consumer activities and final revenue numbers. There is the potential for this backdrop to continue for the rest of 2020 and into 2021, but the magnitude of the revenue loss is uncertain. It is likely that at least \$1 trillion is going to be needed to help stabilize state and local government budgets, and most likely more aid will be required as shortfall estimates grow.

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Agreement on Relief, Shifting Lawmaker Priorities

The day after CARES Act legislative work was complete, even before President Donald Trump signed the bill, Speaker Nancy Pelosi clearly indicated that allocating direct relief for state and local governments was her top priority. The speaker voiced her urgency back at the end of March. The House followed through with almost \$1 trillion of direct, unencumbered aid for state and local governments in the \$3 trillion Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act in the middle of May.³

Senate Republicans⁴ and the White House⁵ appear to also be in support of providing relief for state and local governments. Nonetheless, it appears as though the week-long-plus of peaceful and some violent demonstrations have introduced an opportunity for lawmakers to consider law enforcement reform that is likely to consume part of the June legislative calendar. Other non-relief legislative items on the agenda for June include: the National Defense Authorization Act, the Great American Outdoors Act, and the confirmation of circuit court and other nominees.⁶ Therefore, it is not likely that additional aid, relief, or stimulus for state and local governments will be considered until after the July 4 holiday.⁷

It should be considered a positive that lawmakers agree on the importance of state and local relief. The potential timing delay is a substantial impediment to state and local governments who are trying to balance their budgets and close the books on last year, while also preparing for next year. If relief is delayed until July, there will need to be more state and local government budget cuts, which are likely to include even more substantial personnel reductions. The end effect is state and local governments will have a reduced ability to deliver needed services, credit quality will take a hit, and near-term economic growth and the potential financial recovery will also be contested as a result.

Nonetheless, it appears as though the week-long-plus of peaceful and some violent demonstrations have introduced an opportunity for lawmakers to consider law enforcement reform that is likely to consume part of the June legislative calendar.

With delayed relief, state and local governments will have a reduced ability to deliver needed services, credit quality will take a hit, and near-term economic growth and the potential financial recovery will also be contested as a result.

¹ *Recovery Act: One Year Later, States' and Localities' Uses of Funds and Opportunities to Strengthen Accountability*; U.S. Government Accountability Office; March 2010.

² Kozlik, Tom; *Three Key Atypical Credit Risks & Market Update*; HilltopSecurities; April 3, 2020.

³ Kozlik, Tom; *The HEROES Act: House Democrats' Opening Proposition*; HilltopSecurities; May 12, 2020.

⁴ See references in: Bolton, Alexander; *Republicans turning against new round of \$1,200 rebate checks*; *The Hill*; June 3, 2020.

⁵ See references in Restuccia, Andrew and Kate Davidson; *White House Weighs Options for Next Stimulus Bill*; *Wall Street Journal*; June 2, 2020. <https://cdn.media.rollicall.com/author/2019/12/2020CONGRESSIONALCALENDAR.pdf>

⁶ Bolton, Alexander; *Republicans turning against new round of \$1,200 rebate checks*; *The Hill*; June 3, 2020.

⁷ See the 2020 Congressional Calendar here via CQ Roll Call.

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