U.S. Municipal Bond Market

American Rescue Plan Provides Massive Economic Boost, U.S. Public Finance Could Be on Brink of a Golden Age, Especially if Infrastructure Stimulus Follows

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- The American Rescue Plan Act of 2021 ($1.9 Trillion), is the sixth phase of U.S. fiscal policy in response to COVID-19. Lawmakers have spent almost $6.5 trillion since March 2020.
- U.S. GDP growth forecasts are higher as a result of the latest COVID-19 stimulus package. Public finance entities will benefit from the higher macro-level spending and the direct and almost unencumbered aid included.
- At least $350 billion of the Rescue Plan's dollars will flow to state and local governments. A total of about $650 billion spread across different spending line-items will also significantly support credit quality across many public finance sectors. This capital boost could put U.S. public finance on the brink of a golden age because of the opportunities that currently exist for state and local government leaders, especially if infrastructure stimulus follows later this year. However, the federal aid does not solve every problem. Challenges, some of which are extreme, remain for some.
- Municipal bond credit will be lifted across almost every sector. We now expect that public finance rating upgrades will outpace downgrades in 2021 and most likely in 2022.
- We remain concerned that those entities experiencing structural imbalances before COVID-19 may find it difficult to gain or regain structural balance even with this one-time, short-term extraordinary infusion that can be used until the end of 2024. We also remain concerned about those entities that have been experiencing multi-year pension funding issues. Adjusting to daily life after COVID-19 may take some getting used to as well.
- Infrastructure is likely "close to next" on the list for Washington lawmakers. Timing, form, and whether municipal bond friendly elements are included remains unknown at this time.

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Some COVID-19 Events Might be Forgotten, No One Will Forget the Fiscal Policy Impact Anytime Soon

Some historians have referred to the influenza pandemic of 1918 as "America's Forgotten Pandemic." Various reasons for this are considered, but no one explanation has been made clear.

It could be because the time between 1918 and 1919 in the U.S. were such volatile years resulting from the pandemic, the end of World War I, and the economic circumstances. Americans were reluctant to talk about their experiences after the 1918 pandemic despite the death toll of approximately 675,000 Americans. About 100 years later another pandemic gripped the U.S. COVID-19 has already taken the lives of over 540,000 Americans through March 19, 2021. The amount and pace of daily cases, deaths, and hospitalizations has fallen since the third wave peaked in January. Now, concerns about a potential fourth wave exist.

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American Rescue Plan Act of 2021 was a Sixth Phase Fiscal Policy Response to the COVID-19 Pandemic

Phase	Became Law	Legislation	Details	Amount ($ billions)
Phase 1	March 6, 2020	Coronavirus Preparedness and Response Supplemental Appropriations Act	Research and development, healthcare services and supplies	$8.30
Phase 2	March 18, 2020	Families First Coronavirus Response Act	Testing funds, paid leave, food stamp funding	192.00
Phase 3	March 27, 2020	Coronavirus Aid, Relief, and Economic Security (CARES) Act	Expanded unemployment, PPP, Fed Reserve & industry loans, payroll tax credits, created MLF, other	2,700.00
Phase (3.5 or) 4	April 24, 2020	Paycheck Protection Program and Healthcare Enhancement Act	Expanded PPP, hospital & testing funding	733.00
Phase 5	Dec. 27, 2020	The $1.4 trillion Consolidated Appropriations Act, 2020 was a federal govt. funding measure & included $910 billion of COVID-19 relief provisions	Unemployed. relief, PPP, funds for education, transportation, health care, vaccine distribution, etc., but no direct unencumbered state and local govt. relief	910.00
Phase 6	March 11, 2021	American Rescue Plan Act of 2021	$1,400 payments, $350B S&L aid, expanded unemployed relief	1,900.00
Total U.S. COVID-19 Fiscal Policy Response Cost To Date				**$6,443.30**

Source: HilltopSecurities.

Many of the events of 2020 and 2021 related to health, government policy, and finance could fall out of memory just as the events of 1918 to 1919 did for some. It could be forgotten that in a matter of about three weeks in March 2020, Washington lawmakers went from denying the existence of COVID-19 to wearing masks and allocating $3 trillion (a record amount) of relief to counter its impact, with the primary piece of fiscal policy being the $2.7 trillion Coronavirus Aid, Relief, and Economic Stabilization (CARES) Act. It may be forgotten that financial markets, the municipal bond market as an example, were effectively locked down, or closed, to new business. Billions of dollars of investor money flowed out of municipal and other mutual funds between the middle of March and the middle of April a year ago. The creation and criticism of the Fed's 2020 Municipal Liquidity Facility could very well be forgotten too. However, nothing will be forgotten about how U.S. federal lawmakers reacted to COVID-19 in 2020 and especially in 2021 with the heavy amount of fiscal policy they have since approved.

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Let 'Er Rip

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Plan Act of 2021 (H.R. 1319) totaled $1.9 trillion. This brings the running sum of fiscal policy instituted by Washington lawmakers since March 2020 to almost $6.5 trillion. This massive U.S. policy response significantly dwarves the total $1.5 trillion (see Blinder, page 8) policymakers approved in the wake of the 2008 Financial Crisis.

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This recent feast of largess was arranged by the Congressional Democrats for President Biden. On March 11, the president waved his pen, Democrats in Washington closed their eyes, crossed their fingers, and simultaneously exclaimed, "Let 'er rip!" The Economist writes that, "Mr. Biden's stimulus is a big gamble." Former U.S. Treasury Secretary and economist Larry Summers defended his criticism of the plan. Nobel prize winning economist Paul Krugman likened the U.S. fiscal response to "disaster relief or like fighting a war. When Pearl Harbor gets attacked, you don't say, 'How big is the output gap?'"

U.S. GDP Growth Forecasts Higher After Rescue Plan Becomes Law

Overall expectations are that the government-directed and taxpayer-supported spending will boost growth in the near-term. The Organization for Economic Development (OECD) wrote in an economic update that, "The American Rescue Plan will provide a significant near-term boost to activity." The analysis predicts U.S. employment will rise by 2.25-3 million by the end of 2021. U.S. economic growth is expected to be 6.5%, which is 3.3% higher than the OECD's December 2020 forecast. Economic growth is also expected to be higher in 2022 at 4.0%, which is .50% higher than the December 2020 forecast.

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The U.S. Federal Open Market Committee (FOMC) concluded its most recent two-day meeting this week, revealing no change in monetary policy and remaining resolute to hold rates steady. Fed Chair Jerome Powell said that the economy is a long way from the FOMC's inflation and employment goals, the recovery has been uneven, and the Fed remains committed to using its full range of tools. U.S. central bankers voted unanimously to keep overnight rates at zero and to continue purchasing at least $120 billion of Treasury and mortgage-backed securities. The Fed also raised its expectations of inflation and growth. Its economic outlook projection for 2021 is now +6.5% compared to +4.2% announced at the previous meeting. Please see our March 17 report, Patient Fed Shrugs Off Possibility of Overheating by HilltopSecurities' Scott McIntyre and Greg Warner, for more on this week's FOMC meeting.

Contents of The American Rescue Plan Act of 2021

The American Rescue Plan Act was mostly focused on payments to individuals and safety net spending. There was also direct relief to state and local governments. There was a substantial lack of public investment for such a large fiscal policy action. However, it is likely assumed that some funds may be indirectly invested for long-term economic gain through state and local governments. This sixth phase of COVID-19 relief included a third round of relief payments for individuals, in the amount of $1,400 per person for a total of $410 billion of the total $1.9 trillion. Unemployment benefits were extended until September 2021 for a total cost of about $289 billion. A new spending line-item that was finally included in the $1.9 trillion Rescue Act was $350 billion of direct relief for state and local governments.

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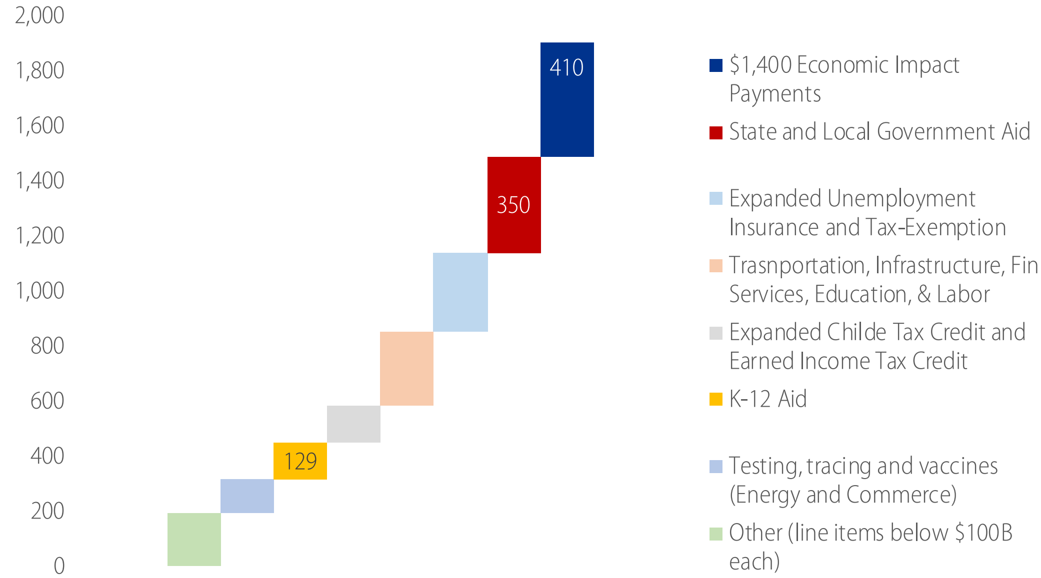
Topline Summary of the $1.9 Trillion American Rescue Plan Act of 2021 ($ in billions)



Source: Tax Foundation, Joint Committee on Taxation and Committee for a Responsible Federal Budget.

Public finance credits in sectors were immediately impacted to the downside, but now COVID-19 cases and deaths have fallen since the beginning of 2021, and vaccinations are continuing across the country.

The American Rescue Plan Act of 2021 is an Extraordinary, but Short-Term Boost to Municipal Credit Quality

When the COVID-19 shutdowns began about a year ago, the worst was feared. Public finance credits in sectors such as transportation and healthcare were immediately impacted to the downside. But now COVID-19 cases and deaths have fallen since the beginning of 2021. Vaccinations are continuing across the country. And state and local government revenue losses have generally not been as severe as originally feared. Analysis from The Urban Institute show that state tax revenues have only fallen 1.8% from April to December year-over-year. In addition, Moody's Analytics recently (Feb. 2021) published a net revenue shortfall for U.S. state governments of only $56 billion for fiscal years 2020 through 2022. Therefore, U.S. states are likely to experience near-term excesses, considering the American Rescue Plan Act included $220 billion (of $350 billion) for state governments.

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Included in the $1.9 trillion American Rescue Plan Act are provisions that provide an extraordinary, but short-term, boost to municipal credit quality across many sectors. It is a massive amount of spending that will directly impact state and local governments, school districts, healthcare, higher education, mass transit, and housing sectors. This boost of capital could be the foundation of what is one day referred to as a Golden Age of U.S. public finance because of the scope of possibilities. This could be especially true if Washington lawmakers are also able to follow through with infrastructure legislation in 2021. We will be reevaluating the sector credit outlooks on each of our public finance sectors, because we expect some could improve as a result of the Rescue Plan infusion. We most recently reiterated our "Negative" State Sector outlook and "Stable" Housing Sector outlook at the beginning of this year.

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Public Finance Sector-by-Sector Impact From the American Rescue Plan Act of 2021

Provision	Amount ($ billions)	Sector(s) to Benefit Most	Credit Relevance
State and Local Govt. Aid	$350.00	U.S. state, local, and tribal governments	Direct fiscal assistance to governments, in some cases totaling as much as 30% of operating revenue (not completely unencumbered, however)
K-12 School Aid	126.00	U.S. state and local govts.	Focused on primary and secondary education funding
Affordable Care Act (ACA) Tax Credits & COBRA Coverage	63.00	Healthcare	More generous tax credits will allow more people to obtain or maintain health insurance and reduce hospitals' uncompensated healthcare costs
Higher Education Relief Fund	39.60	Higher Education	Additional direct aid to universities and colleges; must use a percentage for emergency student financial aid
Additional Aid to Mass Transit Operators	30.50	Mass Transit	Provides financial assistance to sector hard hit by ridership and operating revenue declines
Incentives for non-expansion states under ACA to expand Medicaid	16.40	State govt., Healthcare	If all 12 non-expansion states accept the incentives, each will net an estimated $10 billion (nearly), after their new Medicaid costs
Coronavirus Capital Projects Fund	10.00	U.S. state, local, and tribal governments	Cricital capital projects in response to the public health emergency (Sec 604)
Homeowner Assistance Fund	10.00	Housing	Assistance to homeowners for mortgage payments, utilities and insurance
Emergency housing vouchers	5.00	Housing	Incremental emergency housing vouchers that provide tenant-based rental assistance under Section-8
	$650.50		

Source: Moody's Investor Service, House Oversight Committee, Joint Committee on Taxation, Committee for a Responsible Federal Budget, and HilltopSecurities.

We are adjusting our expectation of how public finance rating upgrades and downgrades are likely to playout in 2021. We wrote in November 2020, No Mass of Public Finance Downgrades Yet, Movement After Evaporating Government Support Better Indicator, after we previously indicated we could see downgrades outpacing upgrades potentially for years in July 2020. We believe that is not likely going to be the case in 2021. Downgrades did barely outpace upgrades in the last three quarters of 2021, but it is very likely that this relationship stabilizes then reverses quickly. We expect that upgrades will outpace downgrades in the near-term, at least through 2021, and perhaps into 2022. Investors should be cautious, however,

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because while this one-time massive infusion of federal capital should largely be considered a positive for public finance credit quality, there are some credits that were experiencing structural imbalances before COVID-19 hit. Those entities have a window now where they can try to correct their fiscal course with additional outside resources, but those that have revenue and spending imbalances may find it even more difficult to gain or regain structural balance as a result of these federal dollars. Those entities with pension funding issues remain a key concern as well. We also will be watching closely to see how public finance entities readjust to the post-COVID-19 normal. New concepts like the potential increase of remote work could be game changers with positive outcomes for some and negative outcomes for others.

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$350 Billion State and Local Government Direct Aid

Washington, D.C. lawmakers came through a little less than one year after Speaker of the House Nancy Pelosi said during a press conference that getting aid for state and locals was a priority and after state and locals dropped their employment levels by about 1.3 million. One of the largest spending line-items in the American Rescue Plan Act is $350 billion of direct and almost completely unencumbered aid for state and local governments. $220 billion is earmarked for states and the remaining $130 billion will flow to local governments. Please see the last page our report where we include a Tax Foundation chart comparing revenues (or revenue losses) with the expected or approximate state-by-state allocations of the $350 billion. There are also approximate allocations that can be found at the House Committee on Oversight and Reform's website. It shows estimated budget allocations by state, local government, and territory. There is also a link for more detail about funding estimates for local governments.

Of the $350 billion for state and local governments, $220 billion is earmarked for states and the remaining $130 billion will flow to local governments.

One of the 2020 CARES Act's criticisms was the $150 billion sent to state and local governments in the beginning of 2020 was restricted to COVID-19 specific purposes. The $350 billion Rescue Plan money is not quite as restricted, but there are some limitations as to use. Allocation will be managed by the U.S. Treasury. Money for states will flow through the State Fiscal Recovery Fund. Money for locals will flow through the Coronavirus Local Fiscal Recovery Fund. Funds can be used for the following purposes, by Dec. 31, 2024, and they possess the following limitations:

- Respond to the COVID-19 public health emergency or its negative economic impacts, including assistance to households, small businesses, and nonprofits, or aid to impacted industries such as tourism, travel, and hospitality
- Provide premium pay for essential workers
- Cover for lost revenue in providing services
- Make investments in water, sewer, or broadband infrastructure
- Allocated funds cannot be used to cover lost revenues from a tax cut
- Money cannot be deposited into pension funds

The full text of H.R. 1319 American Rescue Plan Act of 2021 can be found here.

The bill's original guidance is vague and still requires additional direction from the federal government. We are aware of a process by groups representing state and local governments who are currently communicating with the U.S. Treasury Department

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and other offices in Washington. We expect there could be more clarification from the Treasury Department in the next two months, as reported by Reuters yesterday. The Government Finance Officers Association is currently collecting questions to pose to the Treasury Department.

One provision, or should we say restriction, that is garnering attention is the above section that basically does not allow states to use American Rescue Plan Act relief dollars to cut taxes. In essence, the language does appear to limit the ability to use the infusion to cut taxes. Also please see Rescue Plan Protects Against Using Federal Dollars to Cut State Taxes by the Center on Budget and Policy Priorities. The Ohio attorney general announced a lawsuit challenging the federal government's ability to include such a provision.

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K-12 Funding for Schools

School districts have not only been hit hard since COVID-19 began, but many experienced funding declines since the wake of the Financial Crisis of 2008. The $126 billion ($123 billion for public schools) of K-12 funding is a significant infusion of resources for schools to utilize over the next three years.

Schools face high price tags as they seek to open for in-person learning, close the digital divide, and help keep students across the country from losing too much ground as a result of the time spent outside of the classroom during COVID-19. Please see American Rescue Plan Act Includes Much-Needed K-12 Funding by the Center on Budget and Policy Priorities for more.

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When Will Washington Tackle Infrastructure?

Now that this most recent major fiscal policy effort is completed, attention has already turned to trying to figure out how and when Washington lawmakers could tackle infrastructure. Most observers continue to wonder if there is a bipartisan agreement to be made on infrastructure. It is possible that Democrats tackle infrastructure in the partisan manner they used to deliver the Rescue Plan.

As for what the model could be for near-term infrastructure legislation, House Democrats approved H.R. 2 or the $1.5 trillion Moving Forward Act last June which included various infrastructure, green, and climate change-related spending priorities. The Moving Forward Act also include several municipal bond-friendly elements that many in public finance would like to see included in legislation that become law in 2021. We do not yet know if the Moving Forward Act is what Democrats will use as a starting point for their infrastructure process, but it remains a possibility.

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A Comparison of U.S. State Revenue Changes with American Rescue Act Relief

State	Revenue Change	American Relief Act Aid Allocations			Fed. Aid Calculation	
		State Aid	Local Aid	Total Aid	% of Loss	Per Capita
Alabama	$563,716,794	$2,088,109,980	$1,890,457,564	$3,978,567,544	—	$811
Alaska	($423,777,385)	$1,250,000,000	$257,269,324	$1,507,269,324	295%	$2,060
Arizona	$359,373,486	$4,727,380,641	$2,545,326,640	$7,272,707,281	—	$999
Arkansas	($19,800,000)	$1,625,508,134	$1,198,939,470	$2,824,447,604	8210%	$936
California	$6,167,098,000	$25,672,242,592	$14,943,211,818	$40,615,454,409	—	$1,028
Colorado	$853,587,000	$3,894,086,649	$1,879,159,818	$5,773,246,467	—	$1,003
Connecticut	($242,259,847)	$2,607,685,594	$1,640,619,508	$4,248,305,102	1076%	$1,192
Delaware	($263,695,643)	$1,250,000,000	$305,135,704	$1,555,135,704	474%	$1,597
District of Columbia	($434,620,000)	$1,712,325,487	$493,410,164	$2,205,735,651	508%	$2,075
Florida	($2,634,900,000)	$10,077,563,954	$6,047,585,455	$16,125,149,409	382%	$751
Georgia	$598,533,000	$4,584,350,259	$3,565,534,086	$8,149,884,345	—	$768
Hawaii	($1,151,388,697)	$1,607,573,544	$481,024,078	$2,088,597,622	140%	$1,475
Idaho	$484,103,896	$1,250,000,000	$642,991,105	$1,892,991,105	—	$1,059
Illinois	($443,209,773)	$7,378,600,932	$5,743,479,413	$13,122,080,345	1665%	$1,036
Indiana	($228,700,000)	$3,014,287,495	$2,831,054,188	$5,845,341,684	1318%	$868
Iowa	($43,660,455)	$1,358,228,983	$1,496,214,690	$2,854,443,673	3111%	$905
Kansas	$13,514,896	$1,561,950,910	$1,154,157,645	$2,716,108,555	—	$932
Kentucky	$342,059,355	$2,403,806,436	$1,842,016,986	$4,245,823,422	—	$950
Louisiana	($514,832,133)	$3,160,523,381	$1,960,935,249	$5,121,458,630	614%	$1,102
Maine	$110,714,348	$1,250,000,000	$645,944,718	$1,895,944,718	—	$1,410
Maryland	($2,604,782,910)	$3,811,534,788	$1,952,954,533	$5,764,489,321	146%	$953
Massachusetts	$503,158,772	$4,444,672,468	$3,718,287,046	$8,162,959,514	—	$1,184
Michigan	$215,473,000	$5,569,433,975	$4,394,510,607	$9,963,944,582	—	$998
Minnesota	($470,979,000)	$2,538,554,243	$2,089,287,955	$4,627,842,198	539%	$821
Mississippi	$106,565,829	$1,777,302,931	$1,259,098,668	$3,036,401,598	—	$1,020
Missouri	$52,965,166	$2,773,950,806	$2,499,324,557	$5,273,275,363	—	$859
Montana	($66,558,000)	$1,250,000,000	$409,233,237	$1,659,233,237	1878%	$1,552
Nebraska	$162,771,567	$1,250,000,000	$802,781,938	$2,052,781,938	—	$1,061
Nevada	($650,334,637)	$2,902,454,982	$945,070,418	$3,847,525,399	446%	$1,249
New Hampshire	($54,600,000)	$1,250,000,000	$558,245,183	$1,808,245,183	2289%	$1,330
New Jersey	($145,193,000)	$6,337,020,215	$2,944,569,244	$9,281,589,459	4365%	$1,045
New Mexico	($160,423,717)	$1,594,335,625	$838,780,675	$2,433,116,300	994%	$1,160
New York	($1,229,203,949)	$12,379,759,682	$10,612,147,641	$22,991,907,322	1007%	$1,182
North Carolina	$353,700,000	$5,196,748,534	$3,783,654,988	$8,980,403,522	—	$856
North Dakota	($634,998,008)	$1,250,000,000	$278,536,341	$1,528,536,341	197%	$2,006
Ohio	$1,386,444,000	$5,553,441,961	$5,415,968,242	$10,969,410,204	—	$938
Oklahoma	($520,800,000)	$2,141,538,421	$1,392,397,620	$3,533,936,041	411%	$893
Oregon	($634,914,734)	$2,568,859,439	$1,540,499,474	$4,109,358,913	405%	$974
Pennsylvania	($67,636,000)	$7,183,557,197	$5,765,269,175	$12,948,826,372	10621%	$1,011
Rhode Island	($271,333,333)	$1,250,000,000	$592,841,749	$1,842,841,749	461%	$1,740
South Carolina	($272,600,000)	$2,063,612,223	$1,626,600,061	$3,690,212,284	757%	$717
South Dakota	$131,092,878	$1,250,000,000	$345,024,191	$1,595,024,191	—	$1,803

Tennessee	$135,465,000	$3,763,168,202	$2,464,710,251	$6,227,878,453	—	$912
Texas	($4,081,812,000)	$16,445,251,204	$10,337,277,468	$26,782,528,672	403%	$924
Utah	$727,600,000	$1,493,813,670	$1,012,752,533	$2,506,566,203	—	$782
Vermont	$189,760,000	$1,250,000,000	$305,917,280	$1,555,917,280	—	$2,494
Virginia	$444,400,000	$3,709,339,072	$2,676,624,514	$6,385,963,586	—	$748
Washington	$637,678,000	$4,188,785,028	$2,435,472,640	$6,624,257,668	—	$870
West Virginia	($114,495,000)	$1,230,617,479	$839,702,297	$2,070,319,777	1075%	$1,155
Wisconsin	$2,344,131,000	$3,158,022,885	$2,493,465,345	$5,651,488,231	—	$971
Wyoming	($192,100,707)	$1,250,000,000	$131,311,647	$1,381,311,647	651%	$2,387
Tribal Governments	unknown	$20,000,000,000	—	$20,000,000,000	n/a	n/a
U.S. Territories	unknown	$4,500,000,000	$2,173,214,858	$6,673,214,858	n/a	$1,870
State Subtotal	**($1,689,702,940)**	**$195,300,000,000**	**$128,026,785,142**	**$323,326,785,142**	**11558%**	**$983**
U.S. Totals	**n/a**	**$219,800,000,000**	**$130,200,000,000**	**$350,000,000,000**	**n/a**	**$1,066**

Source: Tax Foundation, Reason Foundation and HilltopSecurities.

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