U.S. Municipal Bond Market

A Boom is Coming. Are Governments Ready?

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

- Some public finance entities, including state and local governments, are more ready than others for the upcoming boom in economic growth and federal relief. The difference between public finance entities wasting versus maximizing this unique opportunity could be as simple as having a plan with measurable goal markers.
- The U.S. Treasury is expected to publish guidance for state and local governments any day now. Treasury had 60 days after the March 11 Rescue Plan Act enactment to provide advice.
- Organizations such as GFOA, Brookings, and the California Legislative Analyst's Office have published recommendations state and local government entities can consider. Common themes: do not use for recurring expenses, do not rush, coordinate, stick to a plan, and measure results.
- We will see if allocated federal funds are simply spent, or if they are maximized to their full potential.

Boom in Two Parts: Economic Activity & Federal Funds

There is a boom coming to U.S. state and local governments and other public finance entities in the form of economic activity and federal funds. But, a key question to consider is: Are they ready? The answer is that some are more ready than others. The difference between public finance entities wasting versus maximizing this unique opportunity could be as simple as having a plan with measurable goal markers. This is especially important when it comes to the soon-to-be-delivered federal aid.

The U.S. Treasury is expected to publish guidance for state and local governments any day now. Treasury had 60 days after the March 11 Rescue Plan Act enactment to provide advice.

A Boom in Economic Growth

During the Wall Street Journal's CEO Council Summit this week, J.P. Morgan CEO Jamie Dimon reiterated his expectation that the U.S. economy is set to boom well into 2023. "The boom is good. Employment is good. Growth is good. Everyone should enjoy it," Dimon said. How good will near-term growth be?

The economists at Moody's Analytics believe President Joe Biden's $1.9 trillion Rescue Plan Act, signed into law on March 11, is going to result in real GDP growth of 8% this year and 4% next year, both higher compared to previous estimates. Their analysis also expects the U.S. economy to return to full employment by fall of 2022. Moody's Analytics also expects an additional jolt from the Build Back Better Agenda if it or components of it are signed into law. The Build Back Better Agenda includes The American Jobs Plan and The American Families Plan. Follow the links to read Moody's Analytics view of the potential impact from these pieces of legislation as well.

A Boom in Federal Funding

Public finance entities should also expect a boom in federal funding. COVID-19 relief checks have been distributed to many individuals helping to stabilize spending and economic activity. Other federal relief has also helped stabilize the U.S. economy. Federal

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

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.

dollars will directly move to state and local governments and other publicf inance entities just as soon as the Treasury Department releases guidance, which is expected any day now. We have identified at least $650 billion of the $1.9 trillion is going to flow to public finance entities. The sectors that will benefit include: state and local governments: school districts, health care, higher education, mass transit, and housing. The funding is going to be so substantial that we have written U.S. public finance could be on the brink of a golden age.

Public finance entities should also expect a boom in federal funding. COVID-19 relief checks have been distributed to many individuals helping to stabilize spending and economic activity.

Federal dollars will directly move to state and local governments and other publicf inance entities just as soon as the Treasury Department releases guidance, which is expected any day now.

The sectors that will benefit include: state and local governments: school districts, health care, higher education, mass transit, and housing.

Examples of Proposals and Suggestions for Methods to Distribute American Rescue Plan Act Federal Funds

Title	Date	State(s)	Author	Notes/ Source
American Rescue Plan Spending: Recommended Guiding Principles	March 2021	Various	Government Finance Officers Association	GFOA website
How should local leaders use their American Rescue Plan Funding	3/23/2021	Various	Brookings	Brookings website
A Framework for Allocating Federal Recovery Funds	5/4/2021	CA	CA Legislative Analyst's Office	CA Legislative Analyst's Office website
Governor Lamont Announces Proposal for Using American Rescue Plan Funds To Rebuild Connecticut's Workforce	4/22/2021	CT	Governor's Office	Identifies spending areas, Governor's Office
Governor John Edwards outlines priorities for $1.6B in American Rescue Plan Funding in Louisiana	4/29/2021	LA	Governor's Office	Identifies spending areas, Governor's Office
Governor Ron DeSantis Announces Federal Stimulus Budget Recommendations	3/16/2021	FL	Governor's Office	Identifies spending areas, Governor's Office
Governor Beshear Signs Bill Related to American Rescue Plan Act	4/10/2021	KY	Press account	Identifies spending areas
Rebuilding for a Better Tomorrow: Montana's Use of Federal American Rescue Plan Funds	March 2021	MT	Montana Budget and Policy Center	Identifies guiding principals
Texas Allocation- The American Rescue Plan Act of 2021	2021	TX	Texas Comptroller	Identifies areas of allocation for Texas

Source: Noted and HilltopSecurities.

How Can Federal Funds Be Spent?

The allocation of the $350 billion Rescue Plan is not quite as restrictive as the 2020 CARES Act relief bill, but there are some limitations. Allocations 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 must be used by Dec. 31, 2024 and will follow this guidance:

- 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 Brookings Institute correctly notes not only that "The stakes are high," but that "The decisions made in the coming weeks— and over the next year regarding the

The allocation of the $350 billion Rescue Plan is not quite as restrictive as the 2020 CARES Act relief bill, but there are some limitations.

Allocations 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.

Brookings notes we will be looking back retrospectively to determine if entities simple spent or invested their money. We believe there could be a slim margin for error based on past experience.

second tranche of funding—will determine whether cities merely enjoy a brief stimulus or seed a new trajectory of inclusive economic growth." Brookings notes we will be looking back retrospectively to determine if entities simple spent or invested their money. We believe there could be a slim margin for error based on past experience.

There have been situations where a lack of planning has created structural imbalances in budgets that are still likely to be very difficult to solve.

There have been situations where a lack of planning has created structural imbalances in budgets that are still likely to be very difficult to solve. A decades-long example is the 2010 report by Pew, The Trillion Dollar Gap, which highlights the faulty decision making that led to pension underfunding just after the 2008-2009 Financial Crisis. State and local pension plan funding levels have consistently dropped since 2001, according to data from The Center for Retirement Research at Boston College (August 2020).

Pension underfunding has caused credit stress in a few meaningful state and local governments in the years leading up to COVID-19. In addition, even though equity market returns have been significant in the last year or so, this is likely to only slightly benefit plans with poor funding levels because they do not have a significant amount of assets that can appreciate in value. Therefore, those plans to do not increase in value as much as plans that have healthy asset levels.

A Lack of Clarification and Guidance

There was pre-release guidance in April from the U.S. Treasury, but it was not substantial. With the first round of money to be released as early as next week, lawmakers are "becoming increasingly frustrated" with the lack of clarity, writes Forbes.

The U.S. Treasury has 60 days from the time the Rescue Plan Act was enacted to provide guidance for how funds will be disbursed. It seems like they plan to use every day of that timeframe because there has still not been any direction given. That guidance is expected to be released any day now. There was pre-release guidance in April, but it was not substantial. With the first round of money to be released as early as next week, lawmakers are "becoming increasingly frustrated" with the lack of clarity, writes Forbes. There have been some guiding principles released, most notably by the Government Finance Officers Association (GFOA) and the Brookings Institute. The California Legislative Analyst's Office just released guidance this week as well.

GFOA published American Rescue Plan Spending: Recommended Guiding Principles to help its membership prepare for disbursement. Its principles center on the following themes:

- Rescue Plan Act money is temporary and should only be applied to non-recurring expenditures
- Entities should be aware of funding for connected state and local jurisdictions
- Use dedicated grants first, save more flexible funds for last
- Spread over the qualifying period (until Dec. 31, 2024)
- Take time to consider alternatives of the temporary funding

There have been some guiding principles released, most notably by the Government Finance Officers Association (GFOA) and the Brookings Institute. The California Legislative Analyst's Office just released guidance this week as well.

The Brookings Institute offered guidance as well in, How should local leaders use their America Rescue Plan Funding? Brookings, as noted above, stressed the opportunity that most government have now. The think tank proposed a three-pronged approach be used related to Rescue Act funding:

- Stabilize – Take steps to balance near-term COVID related costs or expenses.
- Strategize – Make investments following four factors: immediacy, inclusivity, future prosperity, and complementarity.
- Organize – Allocating Rescue Act money is going to require a methodical team effort. The authors cite another Brookings report, How a National Recovery Investment Corps (NRIC) could drive a bottom-up, inclusive economic recovery.

Lawmakers themselves began pushing out ideas about how they would like to spend the Rescue Plan Act money including some soon after the Rescue Plan Act became law in March.

Lawmakers themselves began pushing out ideas about how they would like to spend the Rescue Plan Act money. Some released ideas soon after the Rescue Plan Act became law in March, which are included in the accompanying table. The California Legislative Analyst's Office (CA LAO), the state legislature's nonpartisan fiscal and policy advisor, took a nonpartisan approach to the Rescue Plan's allocation. On May 4, the CA LAO published A Framework for Allocating Federal Recovery Funds, which mirrored some of the aforementioned themes but also stressed tactics specific to California. This is important because although California is projecting a budget surplus this year, it is expecting to fall out of balance in the coming years. Therefore, a key piece of CA LAO's advice is for California lawmakers to take time to develop a plan with "measurable goals and objectives." The CA LAO also notes that taking a little extra time will give lawmakers the ability to see if Washington delivers on infrastructure-related legislation.

The local politics matter where this is concerned. Chicago Mayor Lori Lightfoot has been pushing back on lawmakers who have looked at the Rescue Plan Act money as a "slush fund."

The local politics matter where this is concerned. Chicago Mayor Lori Lightfoot has been pushing back on lawmakers who have looked at the Rescue Plan Act money as a "slush fund," stating, "My expectation is that the money is gonna come…through specific grants that have specific requirements on how the money can be spent… So I want to disabuse people out there and my colleagues in the City Council. This is not $1.9 trillion of a slush fund that we can use every way that we can." Some lawmakers and groups do not want federal funds to be used to pay off past financings, but would prefer to allocate relief directly to Chicago voters.

Recent HilltopSecurities Municipal Commentary

- 100 Days and $6 Trillion – We Analyze the Possibility of an Infrastructure Agreement, April 30, 2021
- 2020 Census Results Show Population Trends and Power Concentration in the U.S. Continue to Shift, April 28, 2021
- Long-Term Capital Gains Potentially at 43.4%; This is Not New Information, April 27, 2021
- How the Dispute Over a SALT Cap Repeal is Becoming an "Economic Civil War", April 23, 2021
- Status of Municipal Bond-Friendly Elements and the American Jobs Plan, April 14, 2021
- We Expect a Multi-Year, But Potentially Temporary, Upswing of U.S. Municipal Credit, March 30, 2021

Readers may view all of the HilltopSecurities Municipal Commentary here.