U.S. Municipal Bond Market

Our Revised 2021 Municipal Issuance Forecast: $460 Billion

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- We revised our 2021 municipal issuance forecast up to $460 billion from $375 billion.
- The massive amount of fiscal policy enacted by Washington, D.C. lawmakers, especially the $650 billion of public finance-focused relief in the $1.9 trillion American Rescue Plan Act, is a key reason why we increased our expectations.
- Issuance from federal infrastructure-related programs are not included in our forecast revision. We do not think infrastructure legislation will materialize unless there is a political breakthrough before the end of the year. Lawmakers are still far apart from a bipartisan compromise despite the president's announcement that a deal exists. Democrats are also far apart from getting something done through budget reconciliation. Our outlook on the possibility for infrastructure legislation to emerge may change if a breakthrough occurs, but we do not see one developing based on the current landscape.

Substantial U.S. Fiscal Policy Will Result in Stronger Credit Quality, Higher Issuance

We have never previously revised our municipal bond issuance forecast. But, we have also never, at least in recent times, experienced a worldwide pandemic like COVID-19 and the related policy solutions. Just over 600,000 U.S. COVID-19 related deaths have been reported through the middle of July 2021. An unfortunate number for sure. To help reduce the spread of the coronavirus, many state and local governments curtailed physical interactions and activity in the first quarter of 2020.

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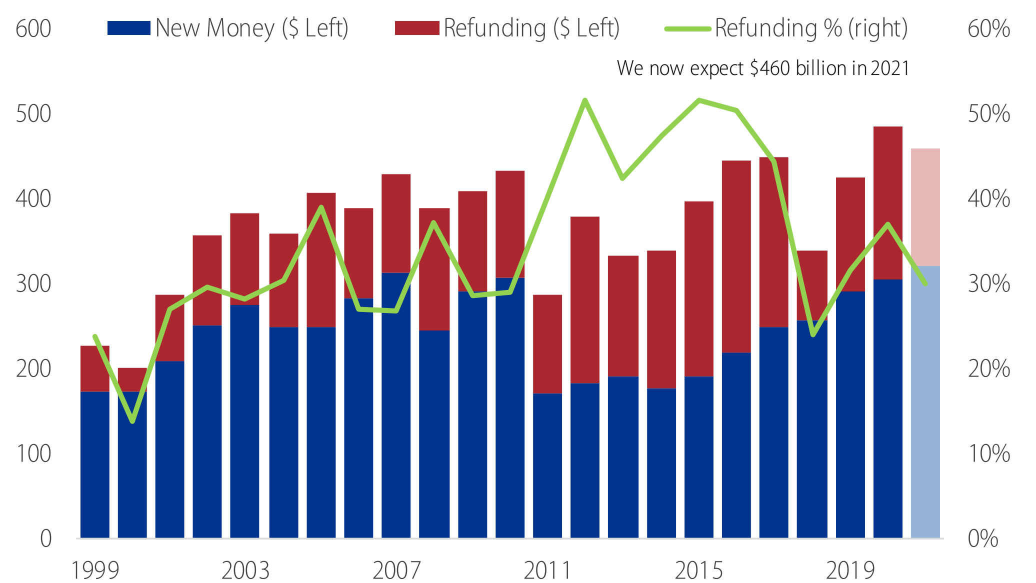
Our Revision: We Now Expect $460 Billion of Municipal Bond Issuance in 2021



Source: Refinitiv, The Bond Buyer, and HilltopSecurities.

To combat the negative impact from the shutdowns, U.S. federal officials unleased an unprecedented amount of monetary and fiscal policy. It was not just the massive amount of federal aid that changed the course of 2021 issuance expectations, but also the funds targeted to the municipal sectors. Our forecast revision is necessary and is specifically required as a result of the sixth phase of COVID-19 relief enacted in March 2021 – the $1.9 trillion American Rescue Plan Act of 2021.

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A Review of Our Previous 2021 Issuance Forecast of $375 Billion

Our Nov. 19, 2020 issuance forecast of $375 billion was stale the moment lawmakers passed the fifth phase of COVID-19 relief back at the end of December 2020. $375 billion was absolutely the right number back in November of last year, at a time when Congress was deadlocked and COVID-19 cases were rising, vaccines were not yet released, and there was hope but no realistic expectation of direct, unencumbered aid for state and local governments. We did contemplate what would happen to municipal issuance considering different political outcomes related to the 2020 elections back at the end of September. We wrote that issuance would be up, potentially substantially, if there was infrastructure and other relief/stimulus (see page 2). However, in our base case we expected the political status quo was unlikely to produce any meaningful relief, much less relief targeted to state and local governments and other public finance participants.

Why We Need to Revise Our 2021 Forecast

Several considerable events occurred since the election, and now we need to revise our number substantially higher. The December 2020 $910 billion of COVID-19 relief alone would have caused us to slightly increase our issuance forecast, but two other potential events were also likely to have an outsized impact on where issuance would end up, so we waited to make our revision. The next two items we were waiting for before we revised our forecast were:

1. Results of the Georgia Senate runoff elections (and the anticipated additional relief we expected as a result),
2. The outcome of talks about an infrastructure (The American Jobs Act and Families Plan) package whether it occurred through a bipartisan compromise or budget reconciliation

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Impact from the Georgia Runoff Elections

Democrats earned a Senate majority (with the vice president's tiebreaking vote) in January after they won both January 5 runoff elections in Georgia. Jon Ossoff defeated Republican incumbent David Purdue and Rev. Raphael Warnock defeated Republican incumbent Kelly Loeffler. This outcome was a surprise to many (including us), but President Joe Biden was the first Democrat to take Georgia since Bill Clinton in 1992, and some believe Democrats had some important momentum behind them.

After the Democrats effectively took control of both chambers of Congress, they were able to push through the $1.9 trillion American Rescue Plan Act of 2021. This was the sixth phase of COVID-19 fiscal policy out of Washington D.C. and the most

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meaningful measure for public finance entities and the municipal bond market because it included $650 billion for public finance sectors (see page 5). The impact to public finance and municipal bond credit quality was profound. This relief caused us to write in March 2021 that U.S. public finance could be on the verge of a Golden Age, and resulted in higher credit sector outlooks for seven of our 11 municipal bond market sectors.

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Potential Impact from Infrastructure

An infrastructure package has been highly anticipated going back at least to last summer when the House passed H.R. 2 or the $1.5 trillion Moving Forward Act, legislation which included several municipal bond-friendly elements. If constructed the right way, we would not have been surprised to see overall municipal issuance higher by $50-$100 billion (annually) if the most effective municipal bond-friendly elements were in fact included in infrastructure legislation that was enacted.

Since last summer, we and most other municipal bond participants and observers have been closely watching to see if Congress could to come to an agreement on infrastructure legislation. We addressed in 100 Days and $6 Trillion – We Analyze the Possibility of an Infrastructure Agreement, Public Opinion Weakening on Economy, Could Impact Legislative Outcomes Including Infrastructure, and most recently after the president falsely announced a deal on infrastructure was reached just before the Fourth of July holiday break in Biden Buys Time by Endorsing Framework; Still No Infrastructure Deal.

Currently, we do not think lawmakers are very close to coming to a bipartisan agreement on infrastructure. We also do not believe Democrats are close to a position where they could successfully pass an infrastructure package using budget reconciliation.

Status of Infrastructure Discussions

Lawmakers were not close to a deal at the end of June, even though they announced an agreement. It was a stalling tactic.

Currently, we do not think lawmakers are very close to coming to a bipartisan agreement on infrastructure. We also do not believe Democrats are close to a position where they could successfully pass an infrastructure package using budget reconciliation. The Democrats still do not have all of their ducks in a row, as there are substantial issues outstanding, including whether New York lawmakers will support infrastructure if they are not able to get a repeal to the state and local government tax (SALT) deduction cap, among others.

Democrats thought a progressive agenda was possible in 2021 after seeing momentum build for some key issues in 2020, including police reform. The president tried to take advantage of the energy by proposing a $2.6 trillion American Jobs Plan and a $1.8 trillion American Families Plan, both of which included a significant expanse of the progressive left's agenda. Although the Biden administration began its first 100 days with the dual successes of increased vaccinations (which facilitated the opening of the U.S. economy) and the passage of the $1.9 trillion Rescue Plan Act, potential political support for a progressive agenda is weakening (if it was ever there at all).

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A key example of the pendulum swinging back in a more moderate political direction is the fact that Brooklyn Borough President Eric Adams will be the Democratic nominee (essentially making him mayor) for New York City mayor. Adams, a former New York City police officer and captain, stressed the importance of public safety during his campaign. Democrats will likely chart a new playbook for how to approach the 2022 midterms if Adams is victorious. This is not a surprise and was detailed in our previous commentary Violent Crime would be a credit and political challenge at the beginning of the summer.

The political reality is while Democrats and Republicans should be able to come to an agreement on infrastructure (page 5), a bipartisan package remains unrealistic. An infrastructure package that happens with only Democrats through the budget reconciliation process is also unrealistic currently.

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Today's Democrats don't want to hear it, but James Carville, Bill Clinton's former political strategist, was probably right when he said that the Democrats "don't have the votes" to be "more liberal" than Joe Manchin. Lawmakers have two weeks in July to debate and the Senate is in session during the first week of August. Following the August session, another long break occurs that lasts until the end of September. Even though it is still July, the legislative calendar is falling away quickly. If Congress really wants to get an infrastructure package done in 2021, a political breakthrough is needed. Without it, we do not see how infrastructure legislation is finalized this year if the current dynamic persists.

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Therefore, we are now comfortable revising our 2021 municipal issuance forecast because we do not expect infrastructure to get passed without some meaningful political breakthrough. If a breakthrough occurs, and infrastructure legislation includes meaningful municipal bond elements, we will publish another revision.

Importance of Municipal Issuance Forecasts

The supply and demand dynamic within the municipal bond market is closely watched by participants and observers. On the low side we see activity close to or as little as $5 billion, or sometimes less during holiday-shortened weeks. A heavier amount of weekly issuance is when we see a week of $10 billion or more. So far this year, monthly issuance was as low as $23 billion (May) and was as high as $46 billion (March). Often, the months of heavy issuance are because of multiple large individual issues. Sometimes the high issuance months include weeks without holidays. We saw a heavy amount of issuance in 2020 because of the interest rate landscape and issuers rushed to complete financings before the November elections. In fact, there was a record amount of monthly issuance of $73 billion (October 2020), edging out $69 billion the market priced in December 2017.

If Our 2021 Forecast was Stale in December, it Became Moldy After the Georgia Runoffs

We normally do not revise our annual forecast of municipal bond issuance, as mentioned. But, because of the unprecedented events that have transpired since we first issued our 2021 forecast, we found it necessary. On Nov. 19, 2020, we forecast a total of $375 billion of issuance for all of 2021. This was in stark contrast

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not only to the record amount of issuance that was developing for all of 2020, but also contrasted heavily with the 2020 issuance forecast of $450 billion for 2020 we published on Dec. 11, 2019.

Market forecasts for 2021 ranged from $375 billion to $550 billion, per this November 24, 2020 Bloomberg article. We thought that any number over $400 billion was overly enthusiastic at that time. If you recall, the landscape just after the 2020 elections was foggy at best and the broader economy and municipal credit possessed several potential headwinds. The municipal credit situation was still very uncertain. The path of the virus' spread was worsening and the holiday wave of infections was ramping up. The prospect for state and local government aid was possible, but only slightly. At this time, it was not expected that the Democrats had a better than average chance of winning both Georgia runoff elections.

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Our New Forecast for 2021 is Now $460 Billion

We now think that we will see about $460 billion of municipal bond market issuance for all of 2021. We will break down why we see this happening. We saw $223 billion of issuance over the first six months of this year. $161 billion (72%) was in the form of new money and $62 billion (28%) were refundings. That amount annualized comes out to almost $450 billion of issuance, and we think that as interest rates stay low, taxable refundings will continue and new money issuance will continue to flow as it did in the first half of the year. Those taxable refundings will also likely continue because as we previously noted, it is doubtful advance refundings with tax-exempts are brought back in 2021, at least based on our read of Washington, D.C. now.

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Revised U.S. Municipal Bond Issuance Forecast (July 14, 2021)

	Revised 2021 Forecast (in $)	Revised 2021 Forecast (% of Total)	2020 (in $)	2020 (% Total)
New Money	$322,000	70%	$304,912	63%
Refunding	138,000	30%	179,667	37%
Total	**$460,000**	**100%**	**$484,579**	**100%**
Tax-Exempt	$326,600	71%	$338,119	70%
Taxable	133,400	29%	146,460	30%
Total	**$460,000**	**100%**	**$484,579**	**100%**

Source: Refinitiv, The Bond Buyer, and HilltopSecurities.

Some perspective- $223 billion is not the highest first half we have seen over the last 10 years, but the third highest. 2015 saw $226 billion and 2016 saw $225 billion -all close together. The difference was that in 2015 and 2016 issuance tailed off and did not meet what was sold in the first half. We expect second-half issuance to just beat out what we saw in the first, but not by much. A $460 billion year is not record-breaking, but it is still a healthy amount of issuance. It is not going to come close to meeting investors' appetites, but it is higher than our $375 billion forecast at least.

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