HilltopSecurities
A Hilltop Holdings Company.

U.S. Municipal Bond Market

Still No Full Recovery for State & Local Governments, nor Hours Worked

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

Summary

- We are still seeing meaningful challenges for state and local government credit quality about eight months after the COVID-19 shutdowns began.
- Moody's Analytics revised their state budget shortfall down from $500 billion to a still hefty $450 billion (through FY22).
- Moody's Investor Service is projecting the annual change of state tax revenue to be 6.0% in fiscal year 2021. There is a wide range of results state-by-state, however.
- The Center on Budget and Policy Priorities published state revenue forecasts that are declining across the board. Results in California (-21% [high-end]), Hawaii (-23%), and Massachusetts (-31% [high-end]) are among the worst.
- Data from Homebase shows that hours worked by hourly workers have risen substantially since April, but the numbers have leveled off well below normal since June.
- No federal relief is expected before the election, however there could be help for state/local governments and schools depending upon what happens on or just after Nov. 3.

Negative Impact to U.S. State Government Revenues, Magnitude Differs

We are expecting a mostly negative, but decidedly mixed, impact to state government revenues as far as magnitude is concerned. The budget shortfalls states are likely to be facing have declined slightly according to analysis by Moody's Analytics (MA). Just after the initial COVID-19 shutdowns, MA forecast a $500 billion state budget shortfall (through FY22). In September, they lowered their forecast to a still hefty $450 billion. The Center on Budget and Policy Priorities (CBPP) reported that states experienced budget shortfalls of about $430 billion for the three years between FY09-FY11, for comparison purposes.

We are expecting a mostly negative, but decidedly mixed, impact to state government revenues as far as magnitude is concerned.

The magnitude is decidedly different state to state, as we noted. Moody's Investor Service projects the annual change in state tax revenue will be -5.5% (FY20) and -6.0% (FY21).[1] States such as Hawaii, Louisiana, and New York will be among the states most negatively impacted. Maine, Rhode Island, and Vermont will be the least impacted.

US State Revenue Decline Forecasts, Select States (FY21)

State	Decline	Decline as % of pre-COVID-19 Revenue Projections
California	$26-$32B	17-21%
Colorado	$968M	20%
Connecticut	$2.6B	13%
Florida	$3.4B	10%
Iowa	$360M	4%
Massachusetts	$2.8-$9.6B	9-31%
Nevada	$1.2B	26%
New Jersey	$7.3B	18%
Texas	$8.8B	15%

Source: Center on Budget and Policy Priorities and HilltopSecurities.

Please see disclosure starting on page 4.

This week, the CBPP released an updated, state-by-state overview of the revenue declines they are forecasting. There are similarities to the Moody's Investor Service analysis in that the magnitude differs state to state. Some states like Arkansas (-3%), Iowa (-4%), and Maryland (-3%) are only expecting small declines. States at the other end of the spectrum include California (-21% [high-end]), Hawaii (-23%), and Massachusetts (-31% [high-end]), which are expecting significant revenue declines as a percent of pre-COVID-19 revenue projections for FY21.

This week, the CBPP released an updated, state-by-state overview of the revenue declines they are forecasting.

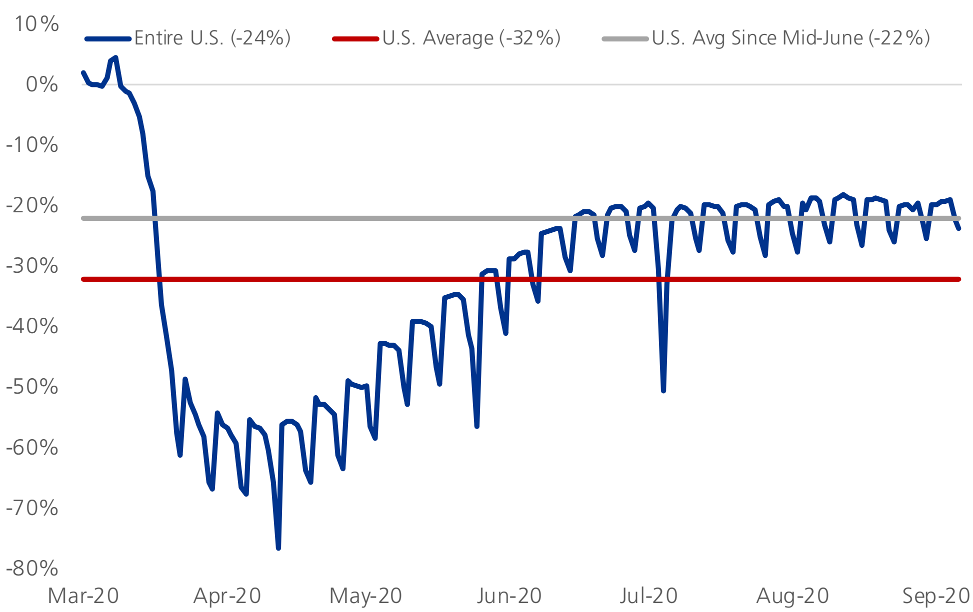
Local Government Credit Quality is Dropping and Will Deteriorate Further for Years

The credit quality of local governments in the U.S. public finance sector has largely been declining and while we have not yet seen massive downgrades in the sector, we do expect downgrades to continue, and we expect downgrades will outpace upgrades for years, as we wrote here in August.

The extent to which credit quality deteriorates still remains uncertain. Large drivers continue to be the virus trajectory and how long the below-normal level of business continues. A good way to analyze the level of business activity nationally, by state, or city is using Homebase data. Homebase tracks hours worked in every state and major metro area. The national indicators fell as low as 75% in April but has since plateaued at an average level of 22% since mid-June. The fact that activity has plateaued does not bode well for the near-term unless something is able to kick-start activity to more normal levels. Worse yet is that the point at which the activity has leveled off in areas such as Los Angeles (-34%), New York (-38%), San Francisco (45%), and others are worse than the U.S. trend. New York state and New York City were already downgraded by Moody's at the end of last week. It is hard to see downgrades not occurring if activity continues at a pace well below normal as it seems to have nationwide.

A good way to analyze the level of business activity nationally, by state, or city is using Homebase data, which tracks hours worked in every state and major metro area.

Hours Worked by Hourly Employees



Source: Homebase and HilltopSecurities.

Federal Relief for States, Locals and Schools Not Imminent; Talks Fell Through

Since the passing of the CARES Act, aid for state and local governments and schools has been a focus for Speaker Nancy Pelosi and the House Democrats. In an unfortunate turn of events yesterday, the White House walked away from negotiations for a fifth phase of COVID-19 relief. It now appears now there is a minimal chance for federal relief that public finance entities could use to plug budget gaps.

It now appears now there is a minimal chance for federal relief that public finance entities could use to plug budget gaps.

That being said, if former Vice President Joe Biden takes the White House and Democrats take the Senate and hold the House, a significant amount of relief could be over the Nov. 3 horizon. If President Trump stays in the White House, a divisive political landscape is likely to continue and the potential for relief is uncertain. We wrote more on what could happen in municipals as a result of the Nov. 3 elections in Election 2020: Results Will Impact the Economy, Markets, and Municipal Bonds.

If Joe Biden takes the White House and Democrats take the Senate and hold the House, a significant amount of relief could be over the Nov. 3 horizon.

Preliminary Estimates of Declines in US State General Fund Tax Revenues (FY21)

State	Fiscal Year	Decline	Decline as percent of pre-COVID-19 revenue projections
Alaska	2021	$882 million	15 percent
Arizona	2021	$873 million	7 percent
Arkansas	2021	$206 million	3 percent
California	2021	$26–$32.2 billion	17–21 percent
Colorado	2021	$2.6 billion	20 percent
Connecticut	2021	$2.6 billion	13 percent
Delaware	2021	$283 million	6 percent
Florida	2021	$3.4 billion	10 percent
Georgia	2021	$2.5 billion	9 percent
Hawaii	2021	$1.8 billion	23 percent
Idaho	2021	$37 million	1 percent
Illinois	2021	$4.6 billion	12 percent
Indiana	2021	$2.0 billion	12 percent
Iowa	2021	$360 million	4 percent
Kansas	2021	$549 million	7 percent
Kentucky	2021	$361–$659 million	3–6 percent
Louisiana	2021	$970 million	10 percent
Maine	2021	$528 million	13 percent
Maryland	2021	$673 million	3 percent
Massachusetts	2021	$2.8–$9.6 billion	9- 31 percent
Michigan	2021	$2.5 billion	10 percent
Minnesota	2021	$3 billion	12 percent
Mississippi	2021	$275 million	5 percent
Missouri	2021	$1 billion	10 percent
Montana	2021	$380 million	15 percent
Nebraska	2021	$50 million	1 percent
Nevada	2021	$1.2 billion	26 percent
New Hampshire	2021	$229–$395 million	9–15 percent
New Jersey	2021	$7.3 billion	18 percent
New Mexico	2021	$598M - $1.5B	8 - 19 percent
New York	2021	$13.3 billion	15 percent
North Carolina	2021	$2.6 billion	10 percent
Ohio	2021	$2.3 billion	9 percent
Oklahoma	2021	$1.4 billion	16 percent
Pennsylvania	2021	$1.2 billion	3 percent
Rhode Island	2021	$516 million	12 percent
South Carolina	2021	$754 million	7 percent
Tennessee	2021	$1.4 billion	10 percent
Texas	2021	$8.8 billion	15 percent
Utah	2021	$757 million	9 percent

State	Fiscal Year	Decline	Decline as percent of pre-COVID-19 revenue projections
Vermont	2021	$182 million	11 percent
Virginia	2021	$1.3 billion	6 percent
Washington	2021	$3.4 billion	13 percent
Washington, D.C.	2021	$985 million	11 percent
Wisconsin	2021	$2 billion	10 percent
Wyoming	2021	$236 million	21 percent

Source: Center on Budget and Policy Priorities and HilltopSecurities.

[1] Handful of states will bear the brunt of coronavirus-induced tax revenue decline; Moody's Investor Service: Sept 25, 2020.

Recent HilltopSecurities Municipal Commentary

- White House Walks Away from COVID-19 Relief Talk Table, October 6, 2020
- 29 days, October 5, 2020
- President Trump Tests Positive, October 2, 2020
- Election 2020: Results Will Impact the Economy, Markets, and Municipal Bonds, September 29, 2020
- How Long Will We Work From Home?, September 25, 2020
- Rush to Market Continues, $14 Billion of Municipal Issuance Coming Next Week, September 18, 2020
- "March to Common Ground" Bipartisan Proposal Calls for $500 Billion for State/Local Governments, September 15, 2020
- Municipal Issuers Rushing to Market Before Election "Month", September 14, 2020
- Watching How U.S. Fiscal and Monetary Policy Impacts the Municipal Bond Market, September 8, 2020
- In a K-Shaped Recovery, Governments and Non-Profits Could Be Among Those That Fade, September 4, 2020
- Hotel California (Such a Lovely Place), Unique Tax Policies Under Consideration, September 2, 2020
- State and Local Aid is Key Roadblock, Says COS Meadows, But Offers $300 Billion, September 1, 2020

Readers may view all of the HilltopSecurities Municipal Commentary here.