

U.S. Municipal Bond Market

D.C. Deadlines: Government Funding and the “Benefits Cliff,” MLF's Expiration, Transit Cuts Announced

Summary

- The Federal Reserve’s Municipal Liquidity Facility (MLF) will not be among the Fed programs to be extended 90 days. The MLF will expire at the end of the year.
- There is a busy December 2020-January 2021 legislative calendar that could impact municipals. Federal government funding runs out on Dec. 11, there is a “Benefits Cliff” at the end of December, the Jan. 5 Georgia run-off results will help decide the party that controls the Senate, and another round of COVID-19 relief remains in question.
- Record supply was absorbed by steady municipal market demand in 2021. \$72 billion of bonds were sold in October, slightly beating December 2017’s \$69 billion.
- We expect overall municipal bond issuance will be down in 2021. Issuance is likely to fall to about \$375 billion according to our analysis.
- More public finance government job losses were announced by transit agencies in San Francisco and Washington D.C. this week. We expect public finance government employee losses to mount without a clear indication of federal aid from Washington.

Some Answers for Investors Out of Washington

Some clarity is developing in Washington, D.C. as the election aftermath dissipates. Former Fed Chair Janet Yellen is positioned to be President-Elect Joe Biden’s Treasury Secretary. Yellen is highly qualified and will bring a different level of experience to a politically appointed position that is usually staffed by an individual with a corporate background.

Yesterday, the U.S. Federal Reserve Bank announced in a Nov. 30, 2020 statement that it would extend by 90 days several lending facilities initially set to expire Dec. 31, 2020. Extended programs include:

- Commercial Paper Funding Facility
- Money Market Mutual Fund Liquidity Facility
- Primary Dealer Credit Facility
- Paycheck Protection Program Liquidity Facility

The Municipal Liquidity Facility (MLF) is not among the Fed programs that will be lengthened, and now that Nov. 30 has passed, we are unlikely to see it used again before it officially expires at the end of December. In the middle of October, we wrote that the MLF should be extended and still believe that to be the case even though the program was little used. The true purpose of the MLF was misunderstood from its inception. It acted as an essential backstop in the event U.S. capital markets froze like it did in March-April 2020. Now as the third wave of the pandemic intensifies, it is uncertain what could bridge the gap for state and local government liquidity needs between now and a pre-COVID landscape that occurs after vaccine distribution if the municipal market hiccups.

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Other Fed programs set to expire by the end of the year, along with the MLF, include:

- Primary and Secondary Market Corporate Credit Facilities
- Term Asset-Backed Securities Loan Facility
- Main Street Lending Program

There is a busy calendar of upcoming events that have accumulated for December, highlighted by the Dec. 11 funding deadline and the end of the month "benefit cliff."

Treasury Secretary Steven Mnuchin requested the unused funds from these programs be returned to Congress. Some believe the Biden administration would be able to resurrect the expired programs.

Questions Remain Unanswered in Washington

As the month of December begins there are still more questions that need answers, despite the above developments. There is a busy calendar of upcoming events that have accumulated for December, highlighted by the Dec. 11 funding deadline and the end of the month "benefit cliff." News and positioning could be meaningful despite the lame duck session.

Important December and January Legislative Dates, Deadlines

- Dec. 11, 2020 (Friday) - U.S. federal government funding runs-out
- Dec. 31, 2020 (Thursday) - "Benefit Cliff" (includes: unemployment benefits, eviction moratorium expires, student loan relief runs out, and others.)
- Jan. 3, 2021 (Sunday) - Earliest 117th Congress can begin. Likely to be moved back after the Georgia Senate elections.
- Jan. 5, 2020 (Tuesday) - Georgia Senate run-off elections
- Jan. 20, 2021 (Wednesday)- Inauguration Day

U.S. Senate Status

Who controls the Senate in the 117th Congress still remains an open question. Georgia will hold two run-off elections on Jan. 5 because neither Senate race resulted in one candidate receiving at least 50% of the vote in the Nov. 3 elections. Currently, polling remains very tight in both Senate races.

Today, there is a bipartisan group of Senators floating a \$900 million compromise that would include, among other items, unemployment benefits and \$240 billion of state and local government aid.

A Senate Bipartisan Compromise for COVID-19 Relief Pitched

The potential for another round of COVID-19 fiscal relief remains at issue. Today, there is a bipartisan group of Senators floating a \$900 billion compromise that would include, among other items, unemployment benefits and \$240 billion of state and local government aid (lowered to \$160 billion in a later draft).

Municipal Market Supply and Demand

Another \$832 million flowed into municipal mutual funds just before Thanksgiving, per Lipper data. Monthly flows have been down slightly (but still positive) September through November compared to the summer but that is likely due to the fact that summertime flows were bolstered by inflows coming back into the market after March and April concerns. Through Nov. 25, net flows for the year have been \$16.7 billion. Through this same time period last year, we saw \$55.5 billion flow into municipal funds.

Record supply was absorbed by steady municipal market demand in 2021. Since June issuers sold two months of \$40+ billion, two months of \$50+ billion, and \$72 billion in October. November issuance was much lighter at only \$18 billion, and we expect a below-average amount of December issuance as well.

Issuance for the week of Nov. 30 is expected to be somewhere in the neighborhood of \$7-7.5 billion. Total municipal bond market issuance through the end of November has come in at \$440 billion. Therefore, it is very likely that we will set a new record of annual issuance this year, just beating 2017's \$448 billion.

In November, we forecast that we expect \$375 billion of issuance in 2021. There will be two key driving forces of municipal bond supply next year. The first reason we believe issuance is going to be lighter in 2021 is because we believe there was likely

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issuance accelerated into 2020 as entities sought to take advantage of low interest rates before the election. The second reason we expect issuance to fall is because state and local governments and other municipal bond issuers are likely going to approach 2021 cautiously. We think there is still a significant amount of uncertainty about what revenues could look like for the rest of FY21 and for the beginning of FY22. Therefore, issuers will be less likely to sell higher levels of new money bonds and add more annual expenditures. This dynamic is also very much like what we saw from 2011 all the way to 2015.

One method that the federal government uses to subsidize state and local government infrastructure is through the municipal bond tax-exemption tax expenditure.

More Public Finance Job Losses Announced

We indicated that jobs in the state and local government sectors were the few that lost jobs in recent months overall after the October nonfarm payroll data was released.

We noted in that report and reiterate our expectation that: We expect that additional state and local government job losses will mount without a very clear indication from the federal government that relief is on the way.

This week transit agencies in San Francisco and Washington, D.C. announced staff layoffs and plans to cut back on service.

Recent HilltopSecurities Municipal Commentary

- [Infrastructure Gap Barely Dented by Record 2020 Bond Sales, Expect Lower 2021 Issuance](#), November 19, 2020
- [President-elect Continues to Indicate "Worst Pandemic in a Century Requires Attention"](#), November 17, 2020
- [Third Wave Worsens, Increases Potential for Shutdowns](#), November 12, 2020
- [Renewed State and Local Government Job Pain, More Expected](#), November 10, 2020
- [Daily Record Number of COVID-19 Cases Surpasses 100k, Continues Rising](#), November 6, 2020
- [No Mass of Public Finance Downgrades Yet, Movement After Evaporating Government Support Better Indicator](#), November 3, 2020
- [The Slow Rebound of Air Travel](#), November 2, 2020
- [Clarifying the Magnitude of COVID-19 Related Federal Aid for State and Local Governments: \\$277 Billion, Much Restricted](#), October 22, 2020
- [What We're Watching This Week: Third Wave, Election 2020, Government Relief](#), October 19, 2020
- [The Next, Next Thing in 2020: What the Next COVID-19 Wave Means, Higher-Ed Enrollment Update, Supply & Demand](#), October 16, 2020

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