

U.S. Municipal Bond Market

Late and Limited is Better Than Nothing, Lawmakers Finalize \$900 Billion Fifth Phase Relief, No Direct State and Local Aid

Summary

- Democrats dropping the request for state and local aid helped change the political landscape and set the stage for the relief compromise.
- The \$910 billion COVID-19 relief agreement has been described as too little and too late, but others believe it is better than nothing.
- It does not include state and local government aid, but targeted relief for education, transportation and health care is included among other spending items.

What Changed the Political Landscape – Why COVID-19 Relief Now?

Negotiations to complete a fifth phase of COVID-19 relief have repeatedly failed since the middle of the summer. The second wave of business shutdowns, or the mid-summer reopening rollback did not incentivize lawmakers to come to a compromise. The 2020 election results did not do it either. Even the third wave of infections and resulting shutdowns seemed to have a limited impact on the minds of lawmakers when it came to influencing them to hash out a deal. What changed the political landscape, and seemingly influenced lawmakers to finally cooperate was the end of December benefits cliff. And probably more important was the fact that Democrats agreed to drop their request for direct unencumbered state and local government relief. Republicans dropped their request for a liability shield as well. This exchange, along with the idea that Democrats started asking for \$3 plus trillion of aid and the final amount was \$900 billion, could help observers consider the final agreement as more of a success for Republicans as 2020 is set to close.

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Fifth Phase is Most Recent U.S. 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, health care 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. 22, 2020 Potentially	Attached to \$1.4 trillion federal govt. funding measure	Unemployed. relief, PPP, funds for education, transportation, health care, vaccine distribution, etc., but no direct unencumbered state and local govt. relief	910.00
Total Fiscal Policy Response Cost To Date				\$4,543.30

Source: HilltopSecurities.

Please see disclosure starting on page 5.

Fifth Phase Final, Should be Law Soon

Over the weekend D.C. lawmakers finally agreed on a fifth phase of COVID-19 relief. It is going to amount to about \$910 billion (see the latest summary per the Committee for a Responsible Federal Budget; these are the numbers we use in our table on the last page of this report) and the pandemic aid is expected to be attached to a \$1.4 trillion federal spending agreement that funds the federal government through the end of the fiscal year. That means we will see final legislation that will amount to about \$2.3 trillion that includes both the federal spending measure and COVID-19 relief. The final touches were put on the relief agreement on Sunday. Text of the relief bill was released Monday afternoon. Voting is expected to occur in the House and Senate today (late Monday). It is expected the President will sign the combined measures into law soon thereafter. That means there has been a total U.S. fiscal policy response to the COVID-19 pandemic of over \$4.5 trillion.

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Opinions of the relief package vary. Mohamed El-Erian said this morning that it would be hard to find someone that does not think the final relief agreement should not be described as “late and limited.” The Wall Street Journal Editorial Board was more critical of the bargain, writing that while the “aid to small business is warranted, the main relief in Congress’s latest Covid bill is for politicians who want to take credit for doling out more cash to constituents.” Even so, in the early hours of trading on Monday, December 21st market sentiment was focused on the new virus strain discovered in Europe, and resulting shutdown of London, and travel restriction being instituted in Great Britain. Markets did not seem to be focused on the fifth phase of relief success story. This is possibly because relief has already been baked into some investors’ year-end expectations.

Overall, we think the agreement will allow finances to muddle through. It offers a short-term lifeline for schools, mass transit, and health care, and helps avoid the benefit cliff that was soon to occur. The final pact does not include the \$160 billion of direct unencumbered aid to state and local governments as proposed last week. That is because state and local aid became such a political hot potato in recent months and cemented itself as a roadblock to an agreement. Pew potentially began to foreshadow the issue back in 2009 with their report titled, The trillion dollar gap: Underfunded state retirement systems and the roads to reform. Now the total adjusted net pension liabilities of state and local governments, as of fiscal 2020, amount to over \$5 trillion according to an Oct. 20, 2020 Moody’s Investor Service report. An estimate from the U.S. Federal Reserve is close to Moody’s number as well. The Fed estimates total pension liabilities at about \$4.3 trillion (Table L.120, page 99) in the most recent (Dec. 10, 2020) Fed Flow of Funds. This \$4.3 trillion will likely be adjusted upward as the Fed lowers their interest rate assumptions. These liabilities could prove to be an ongoing political roadblock during future negotiations as well.

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Fa la la la...One Trillion (About) of Relief to Flow- State, Local Government Aid is a No Go

The details of phase five are reportedly not all that different than what was proposed last week. They are highlighted by direct payments and an unemployment benefit extension. Here are some of the highlights:

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- An extension of unemployment assistance
- Second round of direct payments, \$600 per person
- Targeted small business relief
- Education funding for K-12 and higher education
- Transportation sector funding
- Health care funding
- The deadline for eligible entities (state and local govts.) to spend the \$150 billion of Coronavirus Relief Fund (CARES Act) money will be extended, but spending must still be on COVID-19 related expenditures
- The new relief bill says that funds cannot be used to reestablish programs like the Primary Market Corporate Credit Facility, the Secondary Market Corporate

Credit Facility, the Municipal Liquidity Facility, or the Main Street Lending Program without congressional approval

- Eviction moratorium to be extended
- Vaccine distribution funding
- Other items, please see table (last page) for more details

We continue to believe that the agreement is likely to have a meaningful near-term economic impact and provide limited stabilization.

Economic Impact and Influence on Public Finance Credit

We continue to believe that the agreement is likely to have a meaningful near-term economic impact and provide limited stabilization. The fifth phase fiscal policy relief is not nearly enough to help the state and local governments that are bearing the brunt of the COVID-19 shutdowns. Those entities are still likely to experience a high level of credit deterioration as a result. Additionally, the overall amount (\$4.5 trillion) of fiscal policy that has been already approved is likely to be a significant barrier to future relief that could be directly focused on state and local governments. The absence of state and local government funding still leaves a hole for public sector leaders who will need to fill somehow unless another round of aid in 2021 is able to be attained by lawmakers. The lack of aid for state and local governments cuts down on public sector financial managers' fiscal flexibility. If revenues do not keep pace with past budget plans, then cuts are likely still coming. As a result, more state and local government jobs could be lost. That being said, the agreement includes targeted aid that will provide a boost or at least a stabilizing effect to K-12 and higher education, transportation (including mass transit), health care, and housing.

The [New York MTA released a statement](#) on Sunday noting that the newly agreed upon federal aid will get them through 2021. And because of the federal funding they will not need to cut service and lay off 9,000 employees as they expected. MTA also noted that a \$8 billion deficit still exists and expressed hope for future funding.

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The final relief agreement should be considered a plus compared to the current fiscal condition for some sectors in public finance even without unencumbered direct aid for state and local governments. The absence of state and local government aid is not a plus for all bondholders as the current environment exacerbates expenditure pressures. This is especially true for those entities with extraordinary pension liabilities. Record equity market gains are unlikely to help the most pressured pension plans. This is because the public pension plans that are not well-funded, do not have enough assets in them currently for asset accumulation to be a meaningful differentiator.

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Major Provisions in the Fifth Phase COVID-19 Relief Bill

Provisions	Amount
Aid to Small Businesses	\$325 billion
Paycheck Protection Program (PPP) Second Draw	\$284 billion
Economic Injury Disaster Loan Advances	\$20 billion
Emergency Grants to Venues	\$15 billion
Other Small Business Relief and Program Expenses	\$6 billion
Deductibility of expenses paid for by PPP loans	--
Extend, Augment Unemploy. Benefits (+\$300/week) for 11 weeks	\$120 billion
Stimulus checks of \$600/person	\$166 billion
Education	\$82 billion
K-12 Education Grants	\$54 billion
Higher Education Grants	\$20 billion
Governor's Emergency Education Relief Fund	\$4 billion
Grants for HBCUs, Minority-Serving Institutions, Tribal Colleges	\$2 billion

Grants to For-Profit Colleges to Provide Financial Aid	\$1 billion
Education Grants for Tribes and Territories	\$1 billion
Health Care	\$63 billion
Funding to States for Testing, Tracing, and COVID Mitigation	\$22 billion
Vaccine Procurement	\$20 billion
Repeal the Medicare Sequester for 2021	\$12 billion
Vaccine Distribution Through the States & CDC	\$9 billion
Support for Health Care Providers	\$9 billion
Mental Health Funding	\$5 billion
Other Health Funding	\$3 billion
Fund Some of the Above with Existing Provider Relief Fund	-\$18 billion
Transportation	\$45 billion
Second Round Payroll Support Program for Airline Workers	\$16 billion
Transit Infrastructure Grants	\$14 billion
State Highway Funding	\$10 billion
Grants to Transportation Service Providers Like Buses and Ferries	\$2 billion
Airport Grants	\$2 billion
Amtrak Funding	\$1 billion
Other Spending	\$80 billion
Nutrition and Agriculture Programs	\$26 billion
Rental Assistance	\$25 billion
Community Lender Support	\$12 billion
Child Care Grants	\$10 billion
Broadband Grants and Investment	\$7 billion
Write-Off \$10 Billion U.S. Postal Service Loan	\$0
Other Tax Cuts	\$30 billion
Extend and Expand Employee Retention Tax Credit	\$20 billion
Increase Earned Income and Child Tax Credit by Allowing Taxpayers to Use 2019 Income	\$5 billion
Reinstate 100% Business Meals Deduction for 2021 and 2022	\$5 billion
Total	\$910 billion

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Source: Committee for a Responsible Federal Budget and HilltopSecurities.

Recent HilltopSecurities Municipal Commentary

- [D.C. Nears an Almost \\$1 Trillion Fifth Phase COVID-19 Relief Compromise](#), December 16, 2020
- [Leadership Working on Support for \\$908 Billion Bipartisan COVID-19 Relief Proposal\(s\)](#), December 15, 2020
- [Gone to Texas, A Land of Opportunity](#), December 14, 2020
- [Final Municipal Liquidity Facility Transactions, Most Likely](#), December 11, 2020
- [Optimistic Scenarios Related to Vaccines and COVID-19 Relief](#), December 10, 2020
- [Funding Deadline Pushed, Hope for COVID-19 Relief Remains](#), December 7, 2020
- [November Sees Third Straight Month of State and Local Government Job Losses](#), December 4, 2020
- [D.C. Deadlines: Government Funding and the "Benefits Cliff," MLF's Expiration, Transit Cuts Announced](#), December 2, 2020
- [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

Readers may view all of the HilltopSecurities Municipal Commentary [here](#).

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