MUNICIPAL BOND CREDIT PERSPECTIVES | FIRST QUARTER 2020

# The CARES Act: Implications for Municipal Credit

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The COVID-19 outbreak in the U.S. was met with an unprecedented response by Congress in the form of the Coronavirus Aid, Relief and Economic Stimulus (CARES) Act, a $2.2 trillion federal package signed into law on March 27. Although the legislation is complex, the primary benefits to the municipal bond market include $454 billion of Federal Reserve funding for direct purchases of municipal bonds and loans, as well as, $274 billion of public sector aid and $150 billion of direct assistance to state and local governments.

**The CARES Act Summary**

| Sector | Amount $bil |
|---|---|
| Market liquidity & loans | $454 |
| Individuals | $550 |
| Individual & business tax relief | $300 |
| Small business loans | $377 |
| Hospitals & healthcare | $180 |
| State & local aid | $150 |
| Airlines & transportation | $128 |
| Disaster relief & public education | $77 |
| All other | $25 |
| **Total** | **$2,241** |

*Source: Citi Research - Municipal Weekly, April 6, 2020*

Our nation's hospitals are on the forefront of the response to the virus outbreak. A recent Citi Research report notes the relief act provides $180 billion to healthcare providers to offset revenue losses associated with the suspension of higher-paying elective and non-essential services, as well as, additional supply and labor costs associated with the emergency response. Also, the federal government has increased the reimbursement rate for the treatment of Medicare virus patients by 20%, while offering cash advances to providers equal to six months of future reimbursements. In a recent comment, Moody's estimates Medicare accounts for nearly half of all hospital operating revenue, so these program modifications will inject meaningful liquidity into the sector. It is our expectation that large hospital systems with broad geographic distribution, solid operating histories, healthy reserves and reasonable debt levels will be best positioned to navigate the financial pressures of the crisis.

Given the importance of airports to the nation's infrastructure network, the CARES Act allocates $10 billion of funding to buffer revenue shortfalls associated with significant declines in air travel. The distribution will be influenced by enplanement activity, with larger hubs slated to receive greater sums. Furthermore, the legislation provides $50 billion of grants and loans to the airline industry, including $25 billion dedicated to employee salaries. These industry grants are expected to free up available resources for airlines to meet their contractual obligations to airports for the use of airfield and terminal facilities. As the transportation industry is susceptible to cycles and disruptions, airports traditionally maintain sizeable cash reserves. It is our expectation the larger hub airports with strong demand and sound cash positions will manage the disruption in operating revenues.

Mass transit is also an essential component of our nation's transportation system, as evidenced by its role in providing transportation to healthcare and essential service workers during the crisis. Mass transit is heavily subsidized by state and local taxes, yet passenger fares also represent a meaningful revenue component for many enterprises. The relief effort provides $25 billion to mass transit agencies, with the larger systems poised to receive greater funding than their smaller peers. We anticipate the nation's larger transit systems will have access to the necessary funding and assistance from all levels of government to manage the liquidity strain.

Finally, the CARES Act provides $150 billion of direct assistance to state and local governments through the Coronavirus Relief Fund, with the distribution to be based on population. Supplementing the direct aid, is $32 billion of federal funding for public K-12 and higher education. Both education programs are traditional recipients of meaningful state support. Pandemic impacts to the states will be numerous, starting with the liquidity implications of delayed income tax collections and emergency spending, followed by the fiscal pressures of a recession, including declining tax receipts and increasing social service costs. Throughout the past ten years of economic expansion, states have placed surplus monies into "Rainy Day" funds and will enter the downturn with reserves in excess of 2007 levels. Furthermore, the timing of the outbreak will allow states to adjust upcoming fiscal 2021 budgets (which for most begins July 1) for upcoming challenges, a preferred alternative to enacting difficult budget cuts in the midst of the operating year. Our focus remains on states with a positive operating history, ample reserves, prudent management practices, manageable debt and reasonably-funded pensions.

We are encouraged by the passage of the CARES Act and expect additional stimulus efforts in the coming weeks and months as the implications of the outbreak continue to unfold. As always, our research efforts will focus on credit protection, while remaining attentive to any opportunities that may arise.