Latest Stimulus Ensures Credit Stability

Sheila R. May, CFA, Principal, Director, Municipal Bond Research

On March 11, 2021, the $1.9 trillion American Rescue Plan (ARP) Act was signed into law, the third major relief package since the onset of the pandemic, following the Coronavirus Aid, Relief and Economic Security (CARES) Act passed in April 2020 and the Coronavirus Response and Relief Supplemental Appropriations (CRRSA) Act enacted in late December. The latest stimulus effort provides direct and indirect aid to nearly every sector of the municipal market and, in doing so, solidifies the resiliency demonstrated by issuers over the past year and enhances fiscal stability in the months ahead.

Whereas the ARP continues to dedicate funding to individual relief, the $350 billion of direct aid to state and local governments is a significant sum and more than double the $150 billion awarded under the CARES Act. The sizeable allocation prompted Moody's to lift its outlook on both state and local government sectors to stable from negative, while noting the $195 billion to be shared by the states represents nearly 16% of their fiscal 2019 own-source revenues. Recall that for most states, tax revenues have exceeded expectations since the onset of the pandemic as stimulus checks and unemployment benefits supported personal income and continued consumer spending. Additionally, personal income tax receipts remained healthy while higher- wage earners suffered fewer job losses and the equity markets posted very strong returns.

Unlike the prior two relief bills, the ARP contains a sizeable commitment to direct aid for local governments, namely $130 billion to be split evenly between counties and municipalities, primarily tied to population. The federal dollars carry few restrictions and may be used for a variety of purposes including water and sewer upgrades, COVID-related expenses, and small business relief. These local funds are supplemental to the $122 billion earmarked for K-12 public schools to facilitate safe and timely reopening. Ongoing federal support of local governments, including school districts is favorable for state finances, since it reduces the call for state assistance from local entities encountering fiscal stress. Similarly, federal aid for public higher education, which totaled nearly $40 billion under ARP, relieves the states of the need to channel funds to struggling institutions, most often smaller colleges with weaker credit profiles.

Another sector to benefit from the March stimulus package was mass transit, receiving $30 billion, including $6.5 billion for the Metropolitan Transportation Authority (MTA) of New York. Given the outsized impact of the pandemic on MTA's ridership and finances, the authority was assigned a negative outlook and downgraded by all three rating agencies in 2020 to its current level of A3/BBB+/A-. The most recent federal award follows two prior grants of $4.0 billion each under the CARES and CRRSA Acts. The latest installment prompted both S&P and Moody's to lift their outlooks on MTA to stable, as the funding offsets projected revenue shortfalls through 2023, alleviates the need for detrimental staff and service cuts and provides valuable time to develop new revenue sources, such as congestion pricing, to supplement operating and capital needs. Continued federal support of MTA affirms the essential nature of this transit agency in the nation's infrastructure system.

The airport and healthcare sectors also factored in the allocation of federal dollars and policy extensions under ARP. Sector support in all three stimulus bills added meaningful funding to existing cash reserves and allowed airports to continue operating and servicing obligations despite lower travel activity. With the ongoing vaccination efforts in the U.S., air travel has picked up considerably in recent weeks, signaling a recovery is underway for the industry. Assistance to the healthcare sector has been delivered through various methods over the past year, including direct payments, cash advances and higher reimbursement levels for services. Although margins weakened noticeably in 2020, fiscal stress has been diminished by government relief efforts, along with a gradual return to a more normal operating environment due to a reduction in the number and severity of COVID-19 cases, as well as the return of patients seeking elective procedures.

Over the past year, the vast majority of municipal issuers has successfully navigated the many challenges posed by the pandemic. The unprecedented level of fiscal stimulus injected into the U.S. economy has played a significant role in enabling government issuers to maintain service levels and honor financial obligations. This latest generous installment ensures credit stability and provides the foundation for a sustained recovery in future months.

All material has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy of, nor liability for, decisions based on such information. This represents the views and opinions of GW&K and does not constitute investment advice, nor should it be considered predictive of any future market performance.