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Demographic Destiny: The Impact of an Aging, Moving Population on Municipals.

An aging, increasingly urban population will create revenue challenges for municipalities while increasing demand for hospital and other infrastructure bonds.

Every sector of municipal finance will face new opportunities and risks posed by this demographic shift as the last of the baby boomers retire and millennials begin to buy houses and settle down, according to a report issued by Moody's Investors Service last week.

The primary drivers of this demographic challenge for state and local finances are population growth and an aging labor force, Moody's said.

"The population of the U.S. has been steadily aging over the last decade and will continue to do so through 2055," the report says, adding that in another shift, people have been moving to cities from rural areas. Over the last 100 years, the percent of the U.S. population residing in an urban area has steadily risen and the shift – from rural to urban – is expected to continue.

"The working-age population is growing at a pace similar to overall growth of the total population," the report said. "Approximately 63% of the U.S. population is working age (ages 15 to 64), and we expect that number, as well as the age at which people retire, to continue to rise. Millennials represent the largest portion with the most rapid growth, at 56 million working age in 2017."

Henry Cisneros, former U.S. secretary of Housing and Urban Development and former San Antonio mayor, said he sees dramatic contrasts between places and their economic prospects and their ability to fix and to expand their economies.

"We can look at the problems through two templates," said Cisneros, now a partner at Siebert Cisneros Shank & Co. "In the first, we can look at some of the basic trends — an aging of some the traditional populations, which is very dramatic, where those over 65 will be doubling, while those over 85 years will be tripling in the next 18 years."

Boomers will be earning less, requiring more services, drawing Social Security checks and moving to downsized housing with property accessorized for older residents, Cisneros said.

And the new younger populations will be much more diverse than the rest of the county. They will create educational needs and new schools along with new forms of technology and computer literacy. The upcoming population will also have to face new problems, arising from outsourcing, part-time work, as well as the continuing effects of changing technology, such as artificial intelligence and what that may mean for many jobs.

Another way to look at the scope of the changes is to view the regions across the U.S., where some are growing dramatically while others are seeing slower job creation and population growth, Cisneros said. Some areas in the growing regions will have to tap into public finance to support economic progress.

“The traditional Sun Belt, bicoastal areas, Boston and Washington and along the West Coast from Washington to Arizona will require more schools, better roads, expanded water systems along with airport development, seaports, rail, logistics such as warehouses and freight systems, and new communication systems to support growth in those areas.”

In contrast, he said other stressed areas — such as some of those in the Midwest — will have to oversee a process where managing decline becomes the priority. This is where slow growth combines with a contracting population, where there is an outmigration of younger people while leaving an older population along with aging infrastructure like bridges and water systems.

“It’s very clear that public authorities within the growth areas will have to access public debt,” Cisneros said. “But that won’t be enough — we can’t do it all with public debt — many states and localities have debt caps and other restraints.”

He said America need to address new forms of financing, deploying private capital into public works. “The country needs to be more imaginative and creative with private and institutional capital.”

Other places that are managing decline — such as those in the Midwest — will have to face some hard decisions, such as consolidating services and closing schools. And aging demographics can translate into an inability to generate the revenue to preserve existing infrastructure.

These are the diverse forces across the country, which have profound implications for public finance, he said.

“Moody’s put out a brilliant report and it is critical that public officials read it and understand it, not only at the local level, but at the national level,” Cisneros said.

He stressed that a discussion about a national infrastructure plan was both timely and urgent. “After these elections,” he said, “I am hopeful there can be a bipartisan consensus that infrastructure needs to be at the top of the priorities for the nation. We need to bring up the level of the need — and do it in a national template — not just empowering localities but also finding a national role to fill in the gaps.”

Other also looked at patterns of change in migration.

“Shifting demographics are important, but of at least equal concern is the migration flow in and/or out of cities and states, and what impact those changes have on tax revenues for states and cities,” said Stephen Taddie, managing partner at Stellar Capital Management. “The analysis cannot be ignored by state and local leaders, but sadly, in some cases, officials kick the can down the road for someone else to deal with. We see the results in a number of old Rust Belt cities, where infrastructure is crumbling, social and community services are lacking, and debt levels are spiraling out of control. Forecasting population flows is important in forecasting tax revenue, for if people are fleeing the ship, those remaining split an ever growing liability fewer ways, until the system breaks down.”

“It’s a situation that seems to be the same as we have seen in our latest State of the States report,” said Paul Mansour, managing director and head of municipal credit research at Conning. “We don’t see any dramatic changes over the short term. Rather, there is a gradual change in the population over the long term.”

He said that outside of states and cities with out-migration, like Illinois and Chicago, the population shift was more important to local governments. He said they would continue to be looking at housing stock and prices in the years ahead to determine the effect that these shifts will have.

The aging population may buoy the municipal bond market into the future, said Anthony Tanner, senior vice president at Aquila Investment Management.

“It is likely to support munis because there will be a significant demand — and there will be a plentiful supply of capital to upgrade infrastructure projects that are needed all across the country,” said Tanner, lead portfolio manager of Aquila’s Tax-Free Trust of Arizona.

He also said shifts could be seen in certain sectors, especially health and hospitals, citing his own experiences in Maricopa County.

“I’ve lived here for 15 years and I’ve seen multiple hospitals expand their facilities,” he said, adding that with an aging population it also bodes well for bonds that back senior living and continuing care facilities. “It will be good for those type of bonds,” he said.

Tanner also noted that it is vital for portfolio managers to have a local presence, so that they could monitor changing demographic trends more effectively.

“A local presence can make a significant difference,” he said. “You can observe nuanced changes in localities just by being on the ground there — such as growth in infrastructure. It’s easier to determine the impact when you’re local.”

Changing trends have also captured the attention of the Federal Reserve.

Late last year, Federal Reserve Bank of Cleveland President Loretta Mester said that demographics will be a challenge for policymakers, who will have to constantly evaluate and adapt. “Demographic change will result in a slower-growing and older population,” Mester said. “This transition will likely put downward pressure on the growth rate of potential output, the natural rate of unemployment and the long-term equilibrium interest rate.”

At a separate public finance conference held at Moody’s (MCO) headquarters at 7 World Trade Center in Manhattan last week, panelists looked at the credit implications.

“Demographics — they are destiny. It’s very hard to change demographic trends,” Mark Zandi, managing director at Moody’s Analytics, said in an address at the conference.

“If we have a demographic headwind, which I think we do, that means slower growth, that means less personal income, that means less corporate earnings, that means slower equity price growths, that means less house price growth, that means fewer retail sales — all the things that are necessary to generate revenue,” he said.

Zandi said that top of the list on demographic trends was the aging of the workforce. He cited statistics showing that 10 years ago 3% of workers were over the age of 65; today it’s over 6% and in 15 to 20 years it will be between 9% and 10% of the workforce.

Another big change was immigration, he said, stressing that this was one area where policy change could make a difference. Zandi said that over the next 25 years “the biggest problem will not be unemployment, it will be a screaming lack of labor. We are not going to be able to fill open positions.”

Zandi said that if there was one policy step that the government should take that would be a game changer, it’s immigration reform. “This dynamic is so powerful that at some point we will get reform,” he said.

By Chip Barnett

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