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Muni-Bond Downgrades Rare Even With Few Spared Pandemic's Blows.

- **Moody's and S&P have downgraded about 1% of rated entities**
- **Rating cuts more frequent in 2018 amid economic expansion**

Even as America's states and cities brace for hundreds of billions of dollars tax collections to disappear, the two biggest credit-rating companies have been slow to downgrade municipal debt amid increasing risk for the \$3.9 trillion market.

Since the pandemic raced through the U.S., S&P Global Ratings Inc. and Moody's Investors Service have downgraded about 1% of the municipal borrowers they rate, even as sports stadiums close, college towns and dormitories are emptied after some campuses canceled in-person classes, and the steep drop in travel batters airports and tourism-driven cities.

Halfway through September, Moody's has cut the ratings of about 125 of the approximately 12,000 public finance entities it tracks, 90 fewer than the second and third quarters of 2018, when the economy was eight years into a record expansion. S&P lowered those on 175 of about 20,000 borrowers since late March.

Between them, they downgraded just three states: Hawaii, by Moody's; Alaska and Wyoming by S&P. The biggest city downgraded by S&P was Akron, Ohio.

"Does it make sense that we have a once-in a century pandemic and the rating agencies haven't done anything?" said Vikram Rai, a municipal-bond analyst at Citigroup Inc. "They know about the deterioration. They just haven't acted on it."

The lack of downgrades has contributed to the relative calm in the municipal-securities market, where investors have shaken-off a steady drumbeat of negative news about the financial impacts of the pandemic. Prices have rallied since March, with investors pouring billions back into mutual funds as the Federal Reserve cut interest rates.

Measured Pace

But the market is dominated by individual investors, who tend to move as a herd and likely rely more heavily on bond rating actions than professional fund managers. That leaves it vulnerable if issuers are hit with a wave of downgrades, particularly amid the uncertainty cast by the presidential election.

S&P and Moody's defended their measured pace, saying states and municipalities were much stronger going into this recession than previous downturns and have many tools at their disposal to help through periods of fiscal stress.

And in some municipalities, the expected doomsday hasn't arrived, in part due to the federal stimulus measure that temporarily boosted unemployment benefits by \$600 a week. Cuyahoga

County, home to Cleveland, forecast a 20% decline in sales tax revenue because of the coronavirus. Yet they're down 1.6% through June, although reduction or elimination of enhanced unemployment benefits could hit collections.

"It's a very fluid situation," said Robin Prunty, a managing director at S&P. "What will it look like on the other side of this and is it a short-term budget disruption or longer term structural issue? Those are two different things."

Negative Outlooks

The companies have lowered their outlooks on many corners of the municipal market, putting investors on alert for downgrades if the situation continues to worsen.

Moody's lowered its outlook to negative on all sectors except for housing finance agencies and public electric and water utilities, signaling a greater chance of downgrade in the next 12 to 24 months. The second quarter also marked the first in three years that Moody's public finance downgrades outpaced upgrades.

S&P assigned a negative outlook to about 1,500 entities, meaning there's a one in three chance a rating will change in as long as two years.

States have been helped by savings that built up during the long expansion and an influx of federal aid. Their reserves were an estimated 8% of expenses at the end of fiscal 2020, nearly double the level before the 2008-2009 Great Recession, according to the National Association of State Budget Officers. Property taxes, which back most debt issued by cities, towns and counties, have benefited from a housing-sales boom stimulated by low mortgage rates.

Stimulus Boost

In addition to tapping rainy day funds, municipal coffers were bolstered by the Cares Act, which sent \$150 billion to the states and more than \$160 billion for hospitals, airports, transit, schools and universities.

"In the past, including the Great Recession, we've seen that most government credits have strong resilience because they have flexibility to manage their finances," said Tim Blake, a managing director at Moody's. "The outlook for how long this stress will last, how deep, is very uncertain because it's a unique health-driven crisis."

Moody's doesn't move ratings based on the ups and downs of the economic cycle, only when there's a "severe" change to credit quality, said Naomi Richman, another Moody's managing director. The company has five states on negative outlook: New York, New Jersey, Illinois, Nevada, and Alaska.

"Our ratings aren't intended to reflect the worst position at this point in time — it's a forward look," said Richman.

Looming Election

Citigroup's Rai speculated that rating companies have held back from downgrades, waiting to see whether Congress passes another stimulus package and for the results of the presidential election. Although prospects for more state and muni aid are "zero" according to Rai, a Democratic sweep of the presidency and Congress would likely result in more cash for municipalities.

"They're waiting for some event so they don't have to go and reverse their actions," he said.

Blake rejected Rai's contention, saying Moody's ratings are based on economic data not political assumptions. The company doesn't have plans for multi-notch downgrades, he said.

Failure to get more stimulus will negatively affect municipalities but won't by itself spur rating changes, Moody's and S&P analysts said. What's more important are the actions that states and local governments take to balance their budgets and preserve cash.

"If the federal government announced tomorrow, no more money and we're going to do this premature austerity, we're not going to go ahead the next day and say everyone's done," said Geoff Buswick, a managing director at S&P. "We go back and say how are you going to address this gap."

Looking Ahead

So far, states haven't pushed down draconian cuts onto local governments, although that could change, Buswick said. New York says it will have to cut \$8 billion in local aid without more federal aid while New York City may be forced to cut 22,000 jobs. Meanwhile, New Jersey, which is already the second-lowest rated state plans to borrow \$4 billion to balance its budget, adding more pressure to its A- rating. S&P doesn't expect multi-notch downgrades for states and it's unlikely they will be necessary for municipalities either, Buswick said.

The pace of employment recovery is the most important factor for municipal credit ratings, Blake said.

"In each passing month, it's looking like the rebound of employment may be more extended," he said. "If it becomes very clear that it's going to be a very extended recovery, that distress is more intense, we will have to screen our ratings again."

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By Martin Z Braun

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