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S&P: The Post-Election Landscape For U.S. Public Finance

Key Post-Election Issues For U.S. Public Finance



Stimulus

Another round of stimulus is possible but it's not likely to include funds for state and local governments despite a Biden win if the Senate is controlled by Republicans. Absent this additional stimulus we see more credit pressure and a slower economic recovery. Other relief measures such as expanded unemployment benefits would be broadly supportive of the economy.



Pandemic policy

Any movement toward a national COVID-19 strategy could relieve funding pressure for frontline responders and may help with challenges associated with a very uneven health recovery to date. Successful production and distribution of a vaccine will also have significant economic implications.



Economic initiatives

The economy is a fundamental credit factor across U.S. public finance. In addition to monetary and fiscal policy direction we will also focus on key issues such as trade, immigration, and energy policy.



Tax policy

Major tax policy shifts could be challenging but our focus would be on treatment of municipal bonds, state and local tax deductibility, and rate changes that could have broader economic implications.



Health care

Support for and legal status of the Affordable Care Act are key issues in 2021 for the not-for-profit health care sector and states. While major health care policy changes are unlikely with a divided Congress, policy direction is important as health care remains a major driver of the economy.



Infrastructure

A federal infrastructure program would be a positive development across municipal finance and would have substantive economic benefits. While there has long been broad bipartisan support for infrastructure, there has not been broad bipartisan support for funding it.



Regulation

For public power and water utilities, environmental regulatory changes will be the key area of focus due to the potential for financial and operational impacts.

With the presidential election over, S&P Global Ratings offers a focus on the post-election landscape and what will be the key drivers related to credit across the broad and diverse U.S. municipal market. While U.S. fiscal federalism allows significant autonomy for the state and local government and enterprise obligors that comprise the municipal market, there are clearly fiscal interdependencies as well as regulatory and policy linkages with the federal government that influence their credit quality. Although there were substantive differences in the campaign platforms (see "U.S. Election: Promises, Policy, And The Potential Effects On The Economy And Corporate Credit," published Oct. 19, 2020, on RatingsDirect), actual policy shifts during President-elect Joe Biden's tenure will depend in part on the composition of Congress, which will be finalized in January. Administrative actions will also be something to watch. In the graphic above we highlight key issues we think will require credit focus across U.S. public finance. Below, we offer more detailed sector-specific views.

States: Uneven Economic Rebound And Policy Uncertainty Continue

The ongoing COVID-19 pandemic and subsequent recession have affected the credit quality of states; over a quarter of our ratings in the sector have a negative outlook or have been downgraded, to date. A path to economic recovery remains unclear and shows meaningful regional variations. States have been aided by existing federal stimulus packages in funding pandemic response costs, but there has been little in the way of replacement of lost revenues. The November ballot measures were successful in legalizing recreational drugs and various types of gaming. Both will continue to provide new and additional revenues to states where taxed, although the amount of the revenue is not significant in replacing revenue streams lost to the pandemic. Other tax-raising measures on a statewide level generally failed. Some states continue to face budgetary imbalances for the remainder of fiscal 2021 as well as into fiscal 2022. For credit maintenance we would expect to see a number of options being utilized to balance current and out-year budgets, including expenditure cuts, reserve draws, other revenue raising options, and even limited deficit borrowings. There remains a possibility of additional federal stimulus, although it will likely have with more restrictions on use.

Fiscal policy with focus on health care

Federal grants to state and local governments are concentrated in three major functions: health; income security; and education, training, employment, and social services. The most significant single program area is grants to states for Medicaid—estimated at \$458 billion of federal outlays to states in fiscal 2020, up from \$370 billion in fiscal 2016, an increase of 24%. The federal budget deficit in fiscal 2020 is estimated to be \$3.1 trillion, up from \$585 billion in fiscal 2016. Considering that entitlement programs—including Medicaid—are major drivers of the long-term fiscal deficits at the federal level, we expect that these programs will continue to be a short- and long-term focus. The U.S. Supreme Court is currently considering the case *California v. Texas* that brings into question the constitutionality of the Affordable Care Act (ACA), and with it, potential enforceability and funding to states for Medicaid expansion, which is a centerpiece of the law. Should Medicaid and Medicaid expansion funding be altered, states would need to consider the structure of their health care programs and this would likely lead to changes in the overall budget structure as well.

Infrastructure

From a credit perspective, we continue to look at the various economic policy decisions at the state and federal level. A once bipartisan policy issue that affects credit and economic direction is federal involvement, incentives, and funding of large-scale infrastructure projects. In a recent report we noted that in the decade following the Great Recession there was a \$1.5 trillion decline in state capital spending and infrastructure investment, compared to the capital spending growth trends prior to 2009 (see “Infrastructure After COVID-19: Risk Of Another Lost Decade Of U.S. State Government Capital Investment,” published Oct. 29, 2020, on RatingsDirect). This new paradigm was due to a number of factors, but mostly reflects a challenging operating environment and growing fixed-cost obligations, like pensions and other benefit costs through the lower-for-longer recovery period. A cohesive federal infrastructure program could help avoid another decade of underinvestment in the nation’s infrastructure and concurrently act as an economic stimulus (see “Infrastructure: What Once Was Lost Can Now Be Found—The Productivity Boost,” May 6, 2020).

Energy policy

Another economic policy widely discussed on the campaign trail was around energy. Energy policy, most frequently packaged in a simplistic debate over fracking, could have a credit impact on energy-dependent states, but as we recently wrote (“How Diverging Energy Policies In The U.S. Presidential Election May Affect Credit Quality,” Oct. 23, 2020), we do not expect the Biden energy platform to have a meaningful credit impact on the nation’s oil-producing states, but it could accelerate developing trends toward less mineral extraction. However, an outright ban on new onshore

permitting on federal lands could add pressure to certain states like New Mexico and Wyoming which are the largest recipients of federal royalty payments.

Local Government: Post-Election, Credit Pressure Does Not Subside

Stimulus

Local governments remain on the front lines in fighting the pandemic, and with no post-election movement toward a meaningful state and local government stimulus package, we expect some governments will implement sizable expenditure cuts. Many issuers kept aside stimulus received earlier this year in anticipation of a third spike in COVID-19 cases; that will help manage costs but will not cure the budget gaps caused by revenue shortfalls. Severity and duration of this fall's COVID-19 spike will play an important role in how prepared local governments are for 2021, particularly if any enhanced social distancing measures result in a notable slowdown in economic activity, especially during the holiday season.

Economic/fiscal policy

How much time elapses before a meaningful economic recovery will be a critical part of how local government credit quality is affected by a new president, and we do not anticipate the pace of recovery will be the same for everyone. Our expectation for an uneven health recovery includes both physical and fiscal health, and some regions and states will be hit harder than others. In the meantime, we expect there will be more one-time measures used to close budget gaps, including an increased use of reserves and some deficit bond issuance. Our focus when evaluating the budget balancing strategies of local governments remains on the long-term effect of choices made now, particularly if assumptions for 2021 recovery are optimistic or if one-time strategies include deferring maintenance or reducing pension contributions.

Infrastructure

Looking further out in a Biden Administration, any major infrastructure package that includes local governments and schools would be a win-win in terms of both job creation and facility improvements.

Tax Policy

Reinstatement of tax-exempt advance refundings would be a benefit to governments. Their elimination as part of the Tax Cuts and Jobs Act resulted in more limited refunding options thereby reducing budgetary flexibility.

Pandemic Policy

Although more good news like Pfizer's announcement last week on a workable vaccine could come sooner than anticipated, we do not think it is likely to result in a quick return to business-as-usual for local economies; the imbalance is likely to be prolonged. In the meantime, we expect there will be deterioration in credit quality that could result in negative outlook revisions as the economic recovery takes (or doesn't take) shape. This could extend to downgrades in the most acute situations where short-term strategies have clear negative implications for long-term credit strength.

Health Care: ACA Support Is Key, But Watch Pandemic Response And The Supreme Court

We believe that a Democratic administration, and a potentially mixed Congress (or lack of a super majority of Democrats in the Senate depending on the Georgia runoff elections) coupled with the pandemic and economic challenges, is unlikely to yield large health policy changes over the next couple of years. That said, we believe that the incoming administration's support of the ACA and coordination of a national COVID-19 strategy could be a net incremental benefit for not-for-profit acute care providers, as they represent a departure from the policies of the current administration. Other policy initiatives put forth by the new administration may take longer to play out, if

implemented, and require additional details to allow for assessment of the impact on the not-for-profit acute care sector. Finally, the results of the California v. Texas case at the Supreme Court, along with the final determination of the Senate makeup, could have implications for the new administration's efforts to expand coverage and protections established by the ACA, and ultimately for not-for-profit hospitals. There are several key areas that we are watching.

ACA support and expansion

With likely less ability to make major health policy changes such as introducing a public health insurance option or reducing the Medicare age, we believe that the new administration will continue to support the ACA through administrative actions to encourage insurance coverage within the current ACA framework, which we view as incrementally beneficial for not-for-profit acute care hospitals. Examples of actions could include restoring funds for ACA consumer outreach and sign-ups, elimination of short-term health plans, and elimination of certain Medicaid waiver programs with eligibility restrictions.

Other proposals and views of the new administration

If the new administration is able to move forward on larger initiatives such as the public health insurance option or lowering the Medicare eligibility age, we believe it would likely take some time and the impact would initially be incremental and depend on the details. For example, providers could be negatively affected by a public insurance option if reimbursement tilts towards governmental rates and depending on how individuals and employers respond, but this could be partially offset by expanded insurance coverage. Other initiatives that we will monitor include potentially increased scrutiny of M&A activity which could negatively affect a hospital or health system's ability to fulfill strategic growth goals and address specific challenges. We view positively bi-partisan efforts to support rural health providers and telehealth, while the ongoing shift to value-based reimbursement would be viewed as neutral as most hospitals and health care systems have continued to invest in this area.

National strategy to address COVID-19

If effective—and likely over the medium to long term—a national strategy to address COVID-19 could keep infections at more manageable levels and minimize disruption at hospitals as well as help manage supply expenses. However, it may not be possible for a national strategy to make a meaningful impact to hospitals in the near term given the currently high infection rates and different state approaches to managing the pandemic thus far.

ACA legal challenge

We are monitoring the Supreme Court case California v. Texas which challenges whether the ACA can remain in place given there is no penalty associated with the individual mandate. There are different potential outcomes but a full strike-down of the law, which many believe is unlikely, would have the largest negative impact to individuals covered by various ACA programs as well as to acute-care providers. Among other changes, a full strike-down of the ACA would reduce eligibility for Medicaid and private insurance, or would rescind coverage for individuals currently covered under ACA programs. The new administration's ability to enact a remedy quickly, should there be an adverse ruling against the ACA, would be important to minimize disruption both to individuals and providers but may be a challenge if there is a split Congress. While we've seen hospitals adjust and accommodate to other adverse decisions, it may be more challenging to absorb the disruption now given the current operating challenges related to the pandemic. If the Supreme Court rules that the main provisions of the ACA can remain in place, we expect the new administration will continue its efforts to expand and strengthen coverage discussed above.

Higher Education: Potential Benefits From Increased Funding And Revised Immigration Policies

For higher education, a Biden administration would likely lead to a significant change in priorities, and a reversal of position on certain issues, that could be credit-positive for colleges and universities. We expect the key policy focus areas for a new administration will be on the federal student loan program, the funding environment for federal grants and contracts, and possible revisions to immigration student policies affecting international students, and oversight of Title IX. Of most immediate significance will be the outcome of any additional funding for pandemic relief. Also, the pause on student loan payments currently in place for millions of Americans is set to expire soon and monthly payments will resume in January. If no actions are taken, this could cause material stress and uncertainty for borrowers at a time when coronavirus cases are rising and unemployment levels remain high, and could result in an increase in defaults.

Because of the breadth of colleges and universities serving the higher education market, the above federal policy issues would affect post-secondary institutions differently depending on the size and scope of the organization. Discussions around expanding free college, and further supporting workforce training and historically black colleges and other minority-serving institutions, are expected to continue. For smaller colleges and regional universities, any changes to the federal student loan program, or political pressure or legislation regarding student access, tuition levels, or post-graduation employment, could significantly affect operations and enrollment. Students at these institutions tend to be the most price-sensitive and in need of the most financial and academic assistance, and the institutions themselves highly reliant on tuition and fees as their main source of revenue. Larger, comprehensive research and national/international colleges and universities will be more affected by the outlook for federal grants and contracts, and international students.

Housing: Financial Benefits May Be On the Horizon

Housing credits may see future financial benefits. Biden's "Build Back Better" plan provides support for additional unemployment benefits as well as other support for the economy and efforts to contain the pandemic. To the extent it is achieved, it will be a credit positive for the housing sector by improving currently unemployed owners' and renters' capacity to meet their housing payments.

Biden's \$640 billion housing plan, "The Biden Plan for Investing In Our Communities Through Housing," released in February, also includes several notable features that would be a credit positive for the housing sector. These include a downpayment tax credit for first-time homebuyers that could drive increased demand for HFA single family mortgages, resulting in higher fee or annuity income. Biden's plan goes so far as to indicate its willingness to partner with state housing finance agencies in at least one instance: to help national service workers, including teachers and first responders access homeownership in certain neighborhoods. It also provides for expanded funding for community development financial institutions. The plan includes an expansion of the Low Income Housing Tax Credit program and the implementation of a new renter tax credit program. The plan also includes significant increased funding for the Section 8 voucher program—a positive for those PHAs that administer these programs.

Transportation: Show Me The Money

Infrastructure

We do not anticipate significant changes in the transportation infrastructure picture under a Biden Administration barring bipartisan agreement on funding sources, an obstacle that has stymied every grandiose plan in the past 20 years. The 2020 presidential election of course featured party platforms promising significant transportation infrastructure spending for repairing roads, bridges, and highways—with very different policy choices in terms of delivery and execution—but equally silent with respect to how to pay for it. An attempt to advance private transportation investment was made during the Trump Administration (see "President Trump's Infrastructure Plan: A Substantive Shift To Private-Sector Funding," Feb. 14, 2018), but it ultimately failed to get traction. We anticipate a

similar outcome for the alternate reform agenda from the Biden Administration focusing on public investment while simultaneously addressing climate change, social equity and other policy objectives. Without some grand bargain, this 180-degree change in priorities will run into the same status quo roadblocks imposed by the current political gridlock and federal budget math (i.e. finding new revenues or budgetary offsets). And while states have been back-filling spending with gas tax increases and other measures, they risk another period of under-investment as the COVID-19-triggered recession is expected to pressure transportation budgets.

Transportation legislation

Before too long, the Biden Administration will encounter the can kicked down the road this past fall called the FAST (Fixing America's Surface Transportation) Act highway law, which was set to expire on Sept. 30 but will now expire in the fall of 2021. Unable to reconcile different proposals, Congress passed and President Trump signed into law an extension that provided certainty of funding to states and regional infrastructure providers including transit agencies. But looming in the next reauthorization will be difficult decisions regarding a long-term solution to make the Highway Trust Fund (HTF) solvent. The HTF gets its revenues from a 24.4 cents-per-gallon diesel tax and 18.4 cents-per-gallon gas tax last increased in 1993 but pays out more every year than it takes in. We anticipate a Biden Administration to be more supportive of big ticket, urban rail, and transit system projects—another reversal of the Trump era focus on rural investment—and may signal future budgetary emphasis in any COVID-19-related stimulus bill, which many large transit systems are requesting.

Public Power: Tightening Environmental Regulations Likely

S&P Global Ratings expects the Biden Administration to pursue tightening environmental regulations governing the electric industry and its fuels. Such measures could directly and indirectly affect public power and electric cooperative utilities' operations, their costs of doing business, retail rates, their financial flexibility, and possibly their ratings.

Energy policy

During the run-up to the election, Joe Biden and Kamala Harris voiced unfavorable views of fossil fuels. The Biden energy platform—including recommitting to the Paris climate accords and variants on the Green New Deal—might be costly and technologically challenging. Whether the new administration can achieve its objectives could depend on the composition of the Senate, which will not be known until January. However, it is possible that the administration will bypass legislative gridlock through executive orders and regulatory pronouncements. We see precedent for such actions in the 2015 Clean Power Plan, one of the most far-reaching carbon emissions regulations to come out of the Obama Administration's Environmental Protection Agency.

If a Biden administration restrains fracking, natural gas prices could rise sharply. Natural gas is the primary input for producing electricity in the U.S. Consequently, consumers might see higher electricity costs. Higher retail rates could limit utilities' financial flexibility and potentially erode financial margins. We believe rate affordability plays an important role in influencing public power and electric cooperative utilities' credit ratings. In addition, because affordability and consumer acceptance place limits on the rates utilities charge for essential electric service, it is possible that spending for environmental compliance costs could come at the expense of investments in the reliability and safety of the electric grid. In recent years, many state initiatives for reducing carbon emissions, other greenhouse gas emissions, and the solid byproducts of electricity production, emphasized utilities transitioning to wind and solar resources. Some of the more ambitious of these initiatives appear to discount the intermittency of renewable generation and the insufficiency of existing storage technologies to counter intermittency. Neither solar nor wind produce electricity around the clock and current technologies do not provide capacity to store enough of the surplus

solar and wind electricity produced during peak production hours to cover the nonproduction hours and could lead to less reliable electric service (see “California’s Rolling Blackouts Could Foreshadow Rating Pressures For Public Power And Electric Cooperative Utilities,” Sept. 10, 2020). Federal initiatives that build on state initiatives and that do not appropriately account for intermittency and storage issues could face similar pitfalls.

We expect the trend of significant coal plant closures seen in recent years to continue during Biden’s presidency. If public power and electric cooperative utilities are compelled to close undepreciated power plants, their financial performance could face pressures. Although public power and electric cooperative utilities can look to their essentially captive customer bases to recoup uncompensated investments, this could be financially burdensome to customers, particularly if these utilities need to secure alternative sources of electricity production that add costs.

Ultimately, whether the new administration’s environmental policies will affect the credit ratings S&P Global Ratings assigns to public power and electric cooperative utilities will depend on how much of the campaign platform translates into new regulations and legislation, and its costs.

Water Utilities: Regulatory/Environmental Policy Issues Are Key Focus

Fiscal policy

We would expect that a President Biden’s first budget would double down on environmental protection, on top of his platform of giving environmental justice a higher priority, so it is likely those programs will be preserved if not increased.

Regulatory focus

S&P Global Ratings anticipates that the Biden Administration will end the “two for one” whereby the Trump Administration had a stated goal not to implement new rulemaking unless two existing rules could be eliminated. In fact, we expect increased regulation-and, potentially legislation-related to the federal Safe Drinking Water Act. There is bipartisan support even in a divided Congress to consider formal rulemaking on per- and poly-fluoroalkyl substances compounds, though less certain would be any federal participation in remediating certain contaminated sites. We also expect finality on the long-awaited update to the 1991 Lead and Copper Rule; final public comments were received earlier in 2020. It is unclear if Biden would modify or even rescind the October 2020 executive order related to water. That executive order established a federal “sub-cabinet” aimed at reducing bureaucracy and duplication of efforts among agencies and departments tasked with federal water supply and watershed management, among other stated goals.

Environmental, social, and governance policies

Because President-elect Biden also made climate change a centerpiece of his campaign, we would expect him to swiftly re-commit the United States to the 21st Conference of the Parties, commonly known as the Paris climate accords. In our view this is more impactful to electric and gas rather than water and sewer utilities. However, if recent proposed legislation—none has yet moved beyond committee—is any indication, Congress has acknowledged the rising cost of utility services to households and the related social credit factor of affordability. Specifically, one bill proposed a drinking water version of the federal Low Income Home Energy Assistance Program, which provides grant money to qualifying communities for certain expenses like customer bill pay assistance programs. This would be especially welcomed in communities that saw outsized COVID-19 economic destruction.

Infrastructure

We do anticipate that Biden will propose some type of infrastructure stimulus package, although it is not yet known which asset classes might be targeted. It would not be unreasonable to assume policy

goals aimed at improving mitigation from and adaptation to impacts from climate change. Lastly, once the report to Congress from the recent federal stormwater task force is received, likely in early 2021, there could also be additional federal support, at least for technical assistance for infrastructure projects that naturally lend themselves to pre-disaster resilience.

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