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Fitch: American Rescue Plan Boosts State and Local Government Budgets

Fitch Ratings-New York-11 March 2021: The $1.9 trillion US federal stimulus package passed by Congress and expected to be signed into law by President Biden would significantly boost near-term revenues for states, local governments, transit systems and education providers through both direct aid and economic stimulus, according to Fitch Ratings. House Resolution (H.R.) 1319, or the American Rescue Plan (ARP), is not expected to alter the long-term credit fundamentals of state and local governments but it should bridge near-term fiscal gaps. Thus, positive credit implications are likely limited to credits on Negative Outlook where funding of near-term deficits is a concern. The impact on credit quality for any government will be affected by the entity's level of fiscal stress, plans for using its allocation and the flexibility in applying the funds under the law.

Our ratings do not assume receipt of any additional direct aid for public finance entities until enacted. The ARP would provide a significant one-time infusion into these entities' budgets and a significant short-term lift to the tax revenues that support states and local governments, given the strong economic boost. Actions to unwind measures taken to address the pandemic-driven uncertainty, such as deficit financing, deferring capital needs or drawing on reserves, could be positive for credit quality. Conversely, enhancements to programs requiring ongoing spending could create long-term budget pressures.

The ARP is more than twice the size of the $900 billion package passed in December and, unlike the December package, the new proposal provides substantial direct aid to state and local governments. The $350 billion in direct aid more than doubles the $150 billion in Coronavirus Relief Fund (CRF) aid provided in the Coronavirus Aid, Relief and Economic Security (CARES) Act. ARP aid can be used to cover costs or replace revenue lost due to the pandemic, giving governments wide latitude in the application of the funds, and the use of funds would not be subject to an expiration date.

As approved by the US Senate and the US House, $195.3 billion will be allocated among the 50 states and the District of Columbia, with $25.5 billion split evenly, and most of the remainder allocated based on each state's proportion of seasonally-adjusted unemployed individuals for the three-month period ending in December 2020. California (AA/Stable), Texas (AAA/Stable), New York (AA+/Negative) and Florida (AAA/Stable) are all in line for more than $10 billion each. Fitch's lowest-rated states, Illinois (BBB-/Negative) and New Jersey (A-/Negative), are estimated to receive $7.5 billion and $6.4 billion, respectively. Territories and tribal governments will also receive allocations.

Local government funding totals $130.2 billion, with $45.6 billion going to cities based on a formula including population, growth, poverty and housing overcrowding. Large cities with ratings on Negative Outlook, including New York, NY (AA-); Philadelphia, PA (A-); Chicago, IL (BBB-); and Los Angeles, CA (AA), will also get significant funding relative to their budgets. The bill provides $19.5 billion to states to allocate among other municipalities or (non-entitlement units of government) and the remaining $65.1 billion to counties through a population-based formula.

Proposed direct aid to governments also includes $30 billion for transit compared with $14 billion in the December bill and $25 billion in the CARES Act, almost $130 billion for K-12 schools, significantly above the $54.3 billion in the December package and the $13.5 billion in the CARES Act, and $10 billion for a Coronavirus Capital Projects Fund aimed at broadband expansion with a minimum $100 million distribution to each state, the District of Columbia and Puerto Rico.

Allocations for K-12 schools will prioritize districts with high percentages of students from low-income families. This aid would ease the financial burden on both states, which fund the bulk of K-12 education, and local districts, which have incurred additional expenses to implement safety measures at schools.

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