3Q.2020 / Muni Election Update

Election 2020 and the municipal bond market

The municipal bond team weighs how various election result scenarios could shape future policy and municipal issuers.

Overview

With November 3rd, 2020 quickly approaching, we detail two potential election outcomes (Democratic Sweep and Divided Government) and their potential positive/negative impacts on the municipal bond market. In addition, we discuss key political issues and their effect on respective municipal sectors.

Biden wins (Democratic Sweep of Presidency, Senate, and House):

_ Less political gridlock and a more favorable landscape for policymaking.
_ Additional round or rounds of stimulus for the economy to cope with the COVID-19 pandemic and ongoing recession. Additional stimulus would provide much needed support to state and local governments for lost revenues due to COVID-19 and mitigate difficult decisions to close budget gaps.
_ Restoration of State and Local Tax (SALT) deductions – would provide more flexibility for local governments in high tax states to increase revenue through tax increases, if necessary.
_ Maintain the Affordable Care Act (ACA) or prioritize a replacement in the event that is it repealed by SCOTUS, which would be a positive for states that expanded Medicaid to its citizens, as well as for not-for-profit hospitals.
_ Likely to pass a green infrastructure plan. This would reduce the infrastructure project backlog and lessen the stress on states to fund much needed repairs.
_ More singular policy related to COVID-19 and potential for restrictive economic measures to control the virus that could again limit state and local revenues.

Biden wins (Republicans maintain control of the Senate):

_ Political gridlock and less favorable policymaking environment.
_ Brinkmanship on debt ceiling and possible federal government shut down hurting state and local governments.
_ Little chance of additional stimulus, potentially prolonging the recession.

Trump wins (with a Divided House and Senate):

_ Unlikely to pass a stimulus bill in support of state and local municipalities.
_ Possible repeal of the ACA with no replacement could put additional pressure on states that expanded Medicaid to its citizens, as well as for not-for-profit hospitals.
_ Likely to pass an infrastructure plan (unlikely to be green). This would reduce the infrastructure project backlog and lessen the stress on states to fund much needed repairs.
_ Unlikely to have restrictive economic measures to contain the virus.

	Democratic Sweep	Divided Government
+ Municipal Bonds	_ Large state and local relief package likely _ Restoration of SALT – provides more revenue raising flexibility to high income and property tax states _ Infrastructure spending proposal – with focus on clean technology _ Higher corporate income taxes may increase demand from banks and insurance companies in tax-exempt bonds. (Biden has proposed an increase in the tax rate for corporations from 21% to 28%.) _ Higher marginal tax rates on high income earners increases value of tax exempt interest (Biden has proposed a higher top rate of 39.6%, up from 37%, for individuals with incomes $400K or over)	_ No change in tax policy and likely extension of the lower personal tax rates that are set to expire in 2025
– Municipal Bonds	_ Negative for energy producing states and regions as expected regulatory hurdles hinder expanded exploration and development of carbon based fuels _ COVID induced travel restrictions could weaken tourist dominated state and local governments, special tax bonds and airport dependent debt	_ Unlikely to provide meaningful fiscal relief to state and local governments – exacerbating COVID-related fiscal stress – downgrades likely _ Top personal income tax rates will remain low relatively _ State government shutdowns lead to cuts in Medicaid spending _ ACA at risk with Supreme Court review _ Urban unrest continues dampening residential activity and weakening city tax bases

	Biden Win	Trump Win
Infrastructure	_ Likely to pass an infrastructure plan that would reduce the infrastructure project backlog and lessen the stress on states to fund much needed repairs. _ Infrastructure funding package would likely have an emphasis on green projects, renewables, and mass transit. _ Funding for infrastructure such as transportation projects would more likely come from higher tax rates instead of from user fees such as tolls.	_ Infrastructure funding is likely to be more supportive of toll roads and airports. _ Airlines, which benefited greatly from the initial CARES Act, would be more likely to receive additional stimulus.
Healthcare	_ Maintain the Affordable Care Act (ACA) or prioritize a replacement in the event that it is repealed by SCOTUS, which would be a positive for hospitals in states that expanded Medicaid to its citizens.	_ Possible repeal of the ACA with no replacement could put additional pressure on states that expanded Medicaid to its citizens.
ESG	_ An increased emphasis on green energy is a negative for energy producing states such as West Virginia, Louisiana, Alaska, South Dakota. _ Expect more policies supportive of ESG considerations in investing.	

Additional election-related issues

_ The State of Illinois will vote on Gov. Pritzker's graduated income tax amendment, which assesses higher tax rates on joint filers with incomes over $250,000. If passed, the tax proposal is expected to raise $3.2 billion in additional tax revenue, according to the Pritzker administration. However, opponents argue it may lead to further outmigration from the state.
_ Repeal of SALT deduction cap – could reduce demand for in-state bonds from high income tax state residents.
_ Compromised infrastructure package – focus on transportation and less on clean energy.
_ Potential restoration of Build America Bonds (BABs).
_ Restoration of tax-exempt advance refunding – could add to tax-exempt supply if rates remain low.

Investment outlook

Regardless of the upcoming presidential election outcome, we remain bullish on municipal bonds. Under a Biden win scenario or Democratic Sweep, municipal bonds are likely to remain in high demand as federal income tax rates are expected to go higher, making the muni tax-exemption more valuable. In addition, under a Biden/Democratic Sweep outcome, further stimulus for state and local government entities is more likely.

Under a Trump win or Divided Government outcome, again we are bullish on municipals as the status quo continues and further stimulus (albeit on a smaller scale) is to be expected. Any weakness in the muni market leading up to the election or post-election, we view as a buying opportunity as technicals are likely to remain strong over the medium-term.

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