Fitch Ratings 2021 Outlook: U.S. States and Local Governments

Fitch's Sector Outlook: Stable

Fitch believes the outlook for U.S. states and local governments is stable relative to a very challenging 2020 credit environment. As the nation continues its recovery from the deep coronavirus-driven trough, states and local governments will continue to face challenges in managing weakened tax revenues with pressure to maintain or increase public services spending. The $2 trillion federal stimulus bill (equal to about 10% of 2019 GDP) passed in March 2020 provided critical direct and indirect aid to states and local governments. Fitch's Issuer Default Rating for states and local governments ratings generally do not assume the receipt of material new federal aid. Additional federal stimulus could support a more robust improvement in credit conditions for the sector by supporting economic growth until an effective vaccine is widely available and mitigating the need for potentially damaging near-term budget balancing measures.

Rating Outlook: Stable

While the number of state and local ratings that are on Negative Rating Outlook is elevated, the vast majority of Rating Outlooks are Stable. Very few ratings are on Positive Rating Outlook. Fitch believes the fundamental strengths of states and local governments, including broad and diverse revenue bases, control over revenues and spending, moderate long-term liability burdens and sound financial cushions will help preserve a high level of credit quality for all but a few issuers.

Rating Distribution Weighting:

Only three states are rated below the 'AA' category — Connecticut, Illinois and New Jersey. About 80% of local governments are rated in the top two categories. Fitch anticipates potential modest erosion in credit quality if the economic impact of the pandemic continues to stifle revenues, but does not anticipate a significant downward shift in ratings.

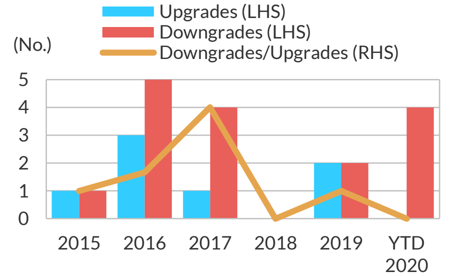
What to Watch

- Slow economic and job recovery through at least the first part of the year will continue to be a drag on personal income, consumer spending and tax revenue performance.
- Mortgage forbearance agreements, delinquencies and defaults, as well as eviction moratoria, may slow or reduce property tax collections. The impact of the pandemic on property values will likely be minimal overall but vary with the size, location and density of the local government.
- The timing and magnitude of recovery in travel and leisure spending is uncertain but is unlikely to be fully realized in 2021, reducing resources for tourism-based economies.
- A sizable additional federal stimulus program would particularly benefit those states and local governments with more limited financial resilience.
- State and local budget policy choices to counteract slow or negative economic growth will vary.
- Changes in public health trends, governmental policy responses to those changes and the timing of vaccine availability will affect the pace and magnitude of recovery.

Amy Laskey, Managing Director, Public Finance and Infrastructure

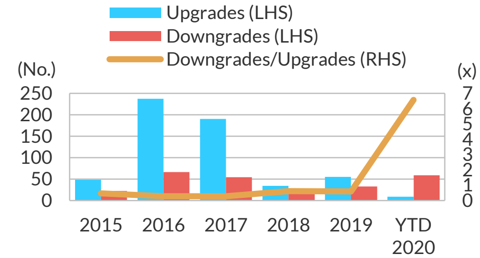
"Fitch believes state and local government revenues will continue to be vulnerable to declines in 2021, with the full impact of the enormous economic dislocation due to the coronavirus pandemic still to be realized."

U.S. States — Rating Changes



Notes: Data as of Dec. 1, 2020 and include public general obligation ratings and Issuer Default Ratings.
Source: Fitch Ratings.

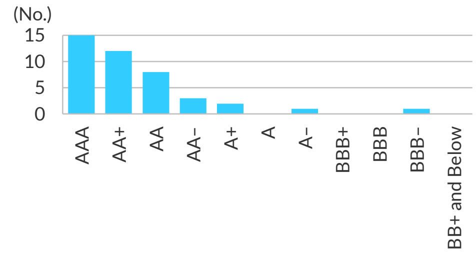
Local Tax-Supported — Rating Changes



Notes: Date as of Dec. 1, 2020 and include all public security ratings.
Source: Fitch Ratings.

States — Rating Distribution

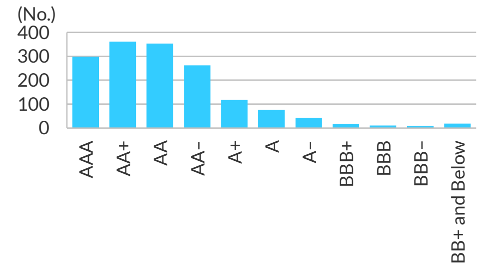
(As of Dec.1, 2020)



Note: Data include public general obligation ratings and Issuer Default Ratings.
Source: Fitch Ratings.

Local Tax-Supported — Rating Distribution

(As of Dec.1, 2020)



Note: Data include all public security ratings.
Source: Fitch Ratings.

What to Watch — Weak Income and Sales Tax Performance

Potentially unprecedented declines in income, sales and other economically-sensitive tax revenues in 2020 were mitigated by timely federal stimulus, accelerated purchases of essential items early in the pandemic's course, and strong economic and revenue performance leading into the pandemic. Tax revenues were bolstered by the federal stimulus provisions including one-time payments to individuals, temporarily enhanced unemployment benefits, which are taxable in most states, and the Paycheck Protection Program.

Drops in in-store purchases were offset by on-line sales, which are taxed in 43 states, following the U.S. Supreme Court's 2018 Wayfair decision. However, consumer spending and employment gains will likely remain uneven. The official and Fitch-adjusted unemployment rates, (the latter accounts for labor force exits) remain elevated. The U.S. has regained a little more than half the jobs lost at the start of the pandemic, with wide variation across the states.

What to Watch — Property Tax Impact Possible, but Delayed

Property taxes for fiscal 2021 are largely based on pre-pandemic assessed valuations. Continued healthy home price growth in most areas will allow property tax revenues received in the latter part of 2021 to rise, although suburban and rural areas are likely to gain — given increased demand for more living space and remote work flexibility— at the expense of some large, dense cities. Elevated mortgage forbearance agreements, delinquencies and foreclosures may lead to delays and potential reduction in property tax payments. Relief from evictions are a benefit to tenants but may hinder landlords' ability to meet expenses, including property taxes. The outlook for commercial real estate may be affected by further delays in expectations for employees' return to offices.

What to Watch — Travel and Leisure Sector Weakness to Continue

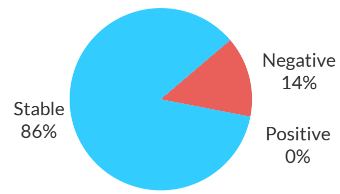
Localities whose economies are dependent on tourism and business travellers and/or have revenue systems that include an emphasis on tourist activity may continue to be especially vulnerable to economic and revenue erosion. Fitch does not expect revenue per hotel room (RevPAR), an important indicator of travel activity, to return to 2019 levels until 2025, with 2021 levels at about 73% of 2019's. Timeshare revenues are anticipated to rebound more quickly but not before 2023. Demand for leisure travel is expected to recover more quickly than for corporate travel. Tourism-focused areas that are easily accessed by ground transportation or with a high percentage of second homes are likely to fare better than fly-to locations whose visitors primarily stay in short-term rentals.

Potential Disrupting Factors

- The timing of widespread coronavirus vaccination will affect the pace and strength of recovery. A widely distributed vaccine early in the year would improve fiscal 2021 and 2022 budget outlooks. Conversely, delays in widespread vaccination, continued virus spread and reactive lockdowns through 2021 would compound the revenue and budget stress experienced over the last few months.
- Timely additional federal stimulus could offset the impact of renewed lockdowns to some extent. The combination of a failure to provide stimulus and delay in vaccine distribution would make 2021/fiscal 2022 more challenging for state and local budgets.

States — Ratings Outlook/Watch

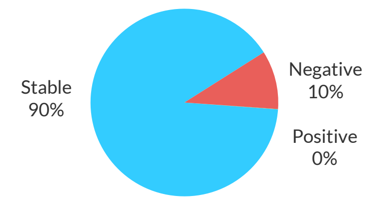
(As of Dec. 1, 2020)



Note: Data Include public general obligation ratings and Issuer Default Ratings.
Source: Fitch Ratings.

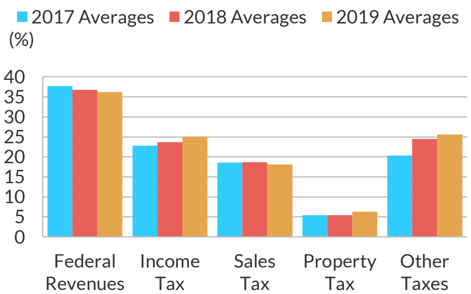
Local Tax-Supported — Ratings Outlook/Watch

(As of Dec. 1, 2020)



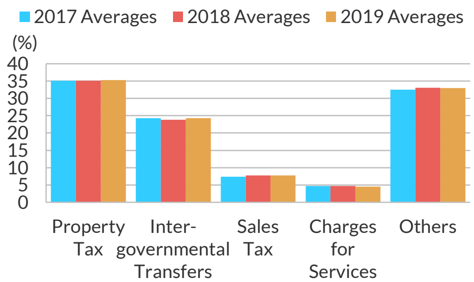
Note: Data include all public security ratings.
Source: Fitch Ratings.

State Total Revenue Sources



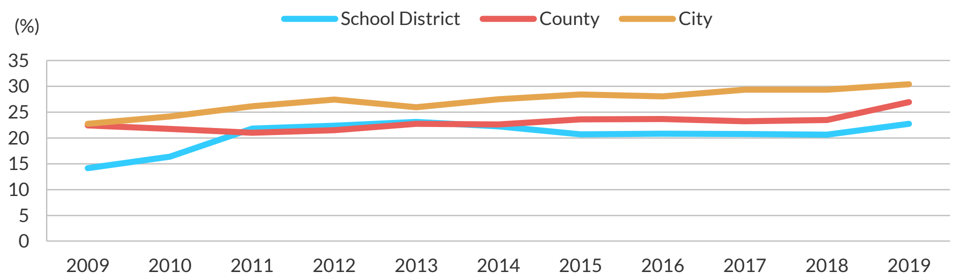
Source: Fitch Ratings.

Local Government General Revenue Sources



Source: Fitch Ratings.

Available Local Government General Fund Balance as % of Expenditures



Note: Fitch portfolio medians
Source: Fitch Ratings.

What to Watch — New Federal Stimulus Would be Helpful

The March and April 2020 federal stimulus bills mitigated the immediate fiscal effects of the pandemic on states and local governments, but Fitch's ratings generally do not assume additional material direct federal support. These bills put state and local governments in a solid position to face the prolonged economic and revenue impact of virus-related containment measures and contributed to relative stability in ratings. In addition to supporting economic activity, the federal government provided direct subsidies through measures including the $150 billion Coronavirus Relief Fund for coronavirus-related expenses and the 6.2 percentage point enhancement to the federal medical assistance percentage match rate for Medicaid spending.

Many of those measures have expired and the pace of economic recovery is slowing from a robust third quarter rebound. Fitch expects 2021 budget balancing will require meaningful, and potentially economically damaging, policy action unless the federal government passes a further stimulus bill. Except for a handful of credits, particularly several states on Negative Rating Outlook, the absence or passage of a new stimulus is not an explicit rating sensitivity.

What to Watch — Policy Action Will Vary

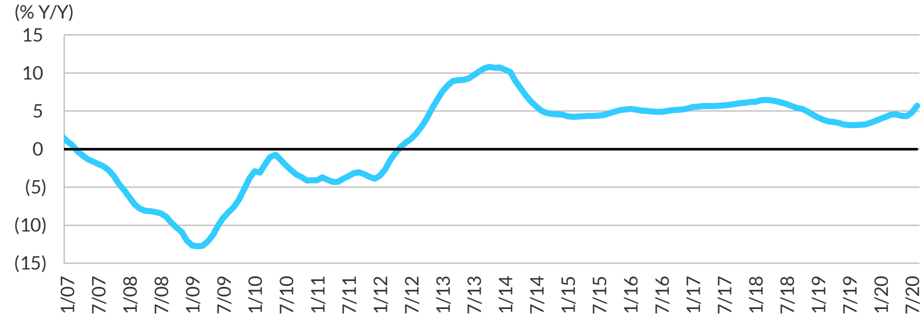
Regardless of federal action, some states and local governments will seek to stimulate their economies by either reducing taxes or increasing use of reserves or borrowing to maintain the current level of services. Others will closely adhere to financial policy goals, cutting spending or raising revenues where needed. Policy approaches will need to balance economic and financial consequences.

The ability to weather the crisis brought on by the pandemic while retaining sufficient financial resilience to address a future economic recession is a key focus of Fitch's analysis. As the preponderance of Stable Rating Outlooks indicates, we believe most if not all states and local governments will be able to manage this balance effectively.

What to Watch - Public Health Trends and Containment Measures

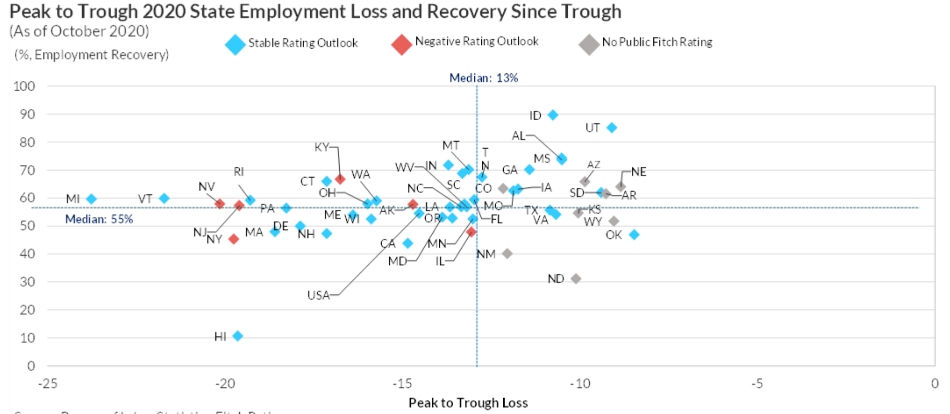
The widespread increases in U.S. caseloads and hospitalizations through the fall are leading to prolonging or re-imposition of virus containment measures in various states, including reduced capacity at offices, stores, restaurants and mass transportation; closure of bars, entertainment venues and schools; and physical distancing requirements. Fitch's current baseline expectation is that a widely available and effective vaccine will be available in the second half of 2021. In the interim, elevated virus spread and a return to severe containment measures could contribute to a continuation or even deepening of depressed sales, income and other economically-sensitive revenues. Property tax revenues in dense urban areas with high levels of office space will be affected but on a lagged basis as renewed lockdowns would further delay employees' return to offices.

S&P/Case-Shiller U.S. National Home Price Index



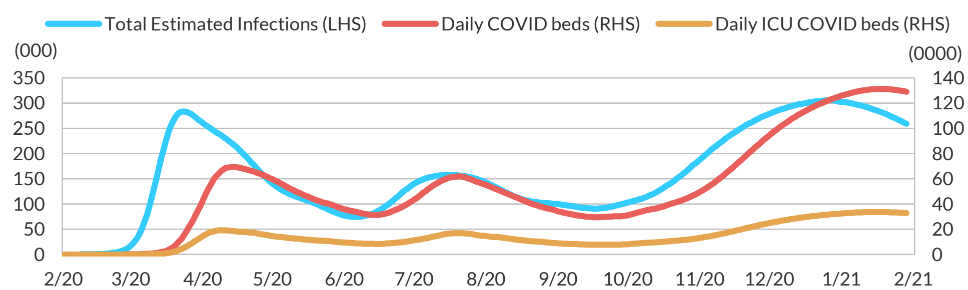
Source: S&P Down Jones Indices LLC.

Peak to Trough 2020 State Employment Loss and Recovery Since Trough



Source: Bureau of Labor Statistics, Fitch Ratings.

U.S. Coronavirus Infections and Hospital Resource Use



Note: Projections begin November 2020.
Source: Institute for Health Metrics and Evaluation.

Outlooks and Related Research

2021 Outlooks

Global Economic Outlook (September 2020)

Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases -- Update (December 2020)

U.S. States' Path to Economic Recovery (Declining Fiscal Support, Slowing Employment Revival and Resurging Coronavirus Expected to Extend Road to Recovery) (December 2020)

Federal Stimulus Uncertainty Does Not Affect Most State Ratings (November 2020)

U.S. States Labor Markets Tracker (November 2020)

US Election Outcome (Divided Congress Limits Credit Impact) (November 2020)

The Next Phase: How Coronavirus-Related Changes Could Permanently Alter the Global Public Finance and Infrastructure Landscape (October 2020)

2020 State Liability Report (Liability Burdens Fall in Final Year of Economic Expansion) (October 2020)

New D-Trend Tool Aids US State Demography, Macro Trend Analysis (October 2020)

Fitch Ratings Launches Comparative Tool for U.S. State & Local Government (October 2020)

U.S. States Ratings and Analyst Coverage List (October 2020)

Mortgage Delinquencies Will Not Notably Affect Property Tax Payments (September 2020)

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