COVID-19 HAS REDEFINED INFRASTRUCTURE NEEDS: IMPLICATIONS FOR THE MUNICIPAL BOND MARKET

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COVID-19 HAS REDEFINED THE BREADTH AND DEPTH OF THE TERM INFRASTRUCTURE. GOING FORWARD, WE BELIEVE INFRASTRUCTURE WILL NOT ONLY ENCOMPASS TRADITIONAL ELEMENTS SUCH AS BRIDGE BUILDING, BUT ALSO THE INNOVATION TO ENABLE SYSTEMS TO EVOLVE WITH SOCIETY'S NEEDS.

Municipal system administrators and investors are reassessing whether the long-term prospects for many critical sectors of the economy have changed irreparably. We believe municipalities will have to reinvent processes and procedures to deal with the new reality caused by COVID-19 (and likely future pathogens that may inflict different health and economic crises).

RESEARCH & PERSPECTIVES

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KEY TAKEAWAYS

- We believe significant infrastructure financing is coming—it is not a question of if, but of when and what magnitude.
- Cities have weathered economic dislocation and fiscal pressure; we believe they will ultimately evolve and thrive with infrastructure spending and innovation.
- We expect capital to be raised through the municipal bond market as traditional tax-exempt debt or some form of subsidized taxable issuance.

Urgent Infrastructure Spending Needs

TRANSPORTATION

Mass transit systems are facing clear challenges in the COVID-19 era. Apart from air travel, few areas of public infrastructure have been impacted more acutely and more immediately. Normally, transit systems have "maximum capacity usage" built into their operation and funding needs. However, the crisis has dramatically reduced ridership in many metropolitan systems.

Take for example the New York Metropolitan Transit Authority, the country's largest mass transit system. Ridership fell by 90% during the peak of the lockdown. At the time of this writing, the Authority had received $3.9 billion under the CARES Act, borrowed more than $1.1 billion in May, tapped the Federal Reserve Municipal Liquidity Facility for $450 million in August, and borrowed $900 million in September as it sought to maintain its critical level of service amid unprecedented conditions.[1] The need for additional federal fiscal relief is manifest in the challenges confronting this mass transit system. It is a vital infrastructure supporting a metro region that is responsible for nearly 8% of US GDP annually.[2]

Transit usage may eventually return to pre-pandemic levels. However, we believe it is more likely that systems will have to deal with reduced ridership and social distancing requirements for a potentially extended period.

Assuming that urban centers remain a hub of economic, social and governmental activity going forward, transporting large numbers of workers and commuters will continue to be a critical service. Expanding digital connectivity between users and mass transit systems is one measure being considered as a potential future path. We believe this technology would enable planners to more effectively guide users to spread out their commuting times to create greater social distancing on mass transit systems. Ultimately, administrators could control the number of transit system users by requiring a reservation system. Increased reliance on work-from-home scheduling and work days that flex outside the traditional nine-to-five culture could also stagger commuting and increase workforce efficiency.

[1] *The Coronavirus Aid, Relief, and Economic Security (CARES) Act, was a $2 trillion relief package enacted March 27, 2020, to address the public health and economic impacts of COVID-19.*

[2] *https://www.statista.com/chart/9358/us-gdp-by-state-and-region, June 8, 2020.*

CONNECTIVITY

Broadband access is increasingly critical for the efficient functioning of a wide array of activities, including economic, health and education. As this trend accelerates, it is notable that some areas of the country lack broadband access due to geographic location or topographical challenges. In addition, economically disadvantaged communities may be unable to afford private service (see below: Lack of Access).

Working from home has become a new reality for a large segment of the economy, quickly highlighting the need for connectivity. Many sectors have been surprisingly productive in this remote reality. Consider how rapidly telehealth technology has adapted in what is likely a permanent change for the provision of healthcare. The prospects for elementary schools and colleges are also anything but traditional. We believe virtual learning will likely be a part of education at most levels over the medium term and perhaps longer.

LACK OF ACCESS

The trend toward virtual meetings, appointments and classes has made access to high-speed internet connectivity a necessity. The FCC recently estimated that 18 million people, or roughly 5.5% of the population, are currently living in areas without broadband access.[3] Addressing this gap should be a high priority for any policymaker. Affording service is another critical priority. An Associated Press study of US census data concluded that a large percentage of students in kindergarten through twelfth grade did not have adequate access to data or technology. The report concluded that 18% of students lack the ability to access high-speed internet and that 17% of students did not have access to a computer. As instruction continues to migrate online, inadequate access must be addressed quickly to minimize disruption to affected students.[4]

MAINTENANCE

Some infrastructure needs are not new at all, including essential investment in physical maintenance and improvement projects. From bridge failures to levee breaches, there have been too many disasters to cite. They have claimed lives and caused economic devastation because assets were allowed to deteriorate due to inadequate funding. Former Treasury Secretary Lawrence Summers

[3] *2019 Federal Communications Commission, Broadband Deployment Report, May 29, 2019.*
[4] *Associated Press: 3 million US students don't have home Internet, June 10, 2019.*

stated that deferred infrastructure maintenance is "largely unmeasured, unnoticed and passed on to subsequent generations of elected officials." He further noted that the cost of adequate funding for maintenance expenditures pales in comparison to the costs of opting for maintenance deferral over the short term and risking catastrophic failure over the longer term.[5]

The Time is Right

In the current climate of reduced usage and increased unemployment, many important maintenance and system upgrades could take place with minimal disruption. There's a strong case to be made in the current environment: the need is great, system usage is down, labor is slack and interest rates are historically low. Further, we believe if economic stimulus becomes the next policy objective, deferred maintenance programs are "shovel-ready" projects by definition and could begin quickly.

Financing Critical Sectors

We believe public infrastructure is a unique economic asset with critically important benefits. The ability to access water and sanitation, modern and efficient transportation systems and highways, electricity and power are all essential elements of society. Strong public infrastructure facilitates interstate and international trade, mitigates flooding, spans waterways and provides facilities to pursue education. All of these critical sectors are financed in the US municipal market (historically 70% of core infrastructure financing).[6] But many investments require the active participation of a strong federal partner to provide the "equity," without which many projects could not be financed. Infrastructure investment is a public good and the benefits provided can far exceed the revenues they produce.

As the economy and society attempt to recover and move forward from the COVID-19 pandemic, we are hopeful that policymakers will look beyond the short-term budget pressures and instead consider the cost-benefit and potential productivity payoff from a long-term infrastructure investment program. We believe we are far more likely to get a strong and durable economic recovery if infrastructure investment becomes a policy priority over the medium term.

[5] *Brookings Institute, January 17, 2017.*

[6] *Source: Congressional Budget Office, using data from the Office of Management and Budget, the Census Bureau, and the Bureau of Economic Analysis. As of October 15, 2018, most recent data report available.*

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