August 2020

State and Local Governments Forced to Do More with Less

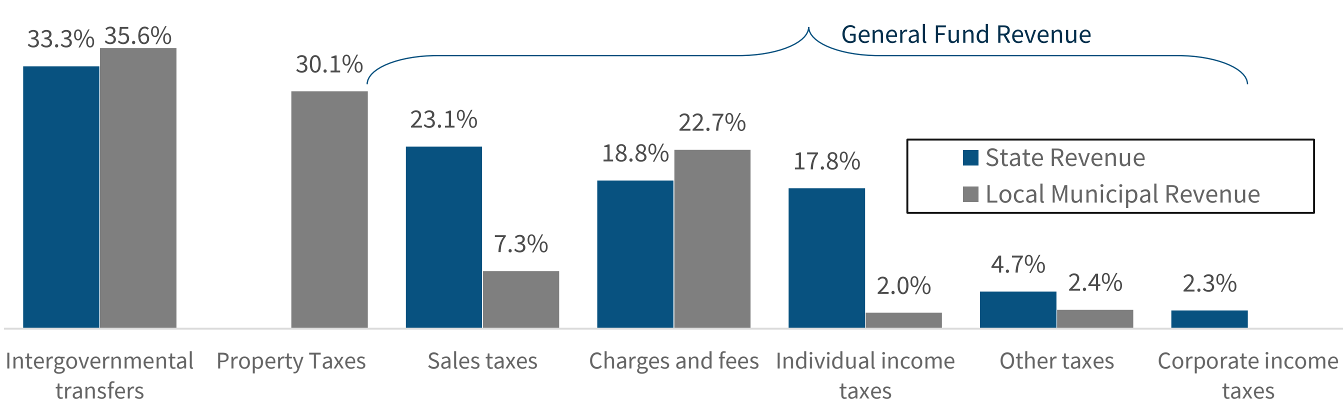
According to the most recent data published by the U.S Census Bureau, state and local government sector operating expenditures represented 15% of all economic activity in the United States in 2017 - measured by Gross Domestic Product (GDP) - making it an influential sector for the economy. However, the COVID-19 pandemic is causing state and local governments to spend more while taking in less revenue. As residents lose jobs, states must allocate more revenue to unemployment insurance. Some of these newly unemployed residents also qualify for Medicaid benefits, requiring states to allocate even more revenue to public healthcare. Simultaneously, with social distancing requirements, as well as general concern from many people in venturing out, much of local economic activity has slowed, giving states less revenue from taxes.

Nevertheless, by law, the majority of state governments must balance their budgets and many local municipalities seek to keep expenses in line with revenue. Forty-five states have fiscal years that run from July 1 – June 30. As a result, the effects of COVID-19 hit state revenues primarily in the last quarter of fiscal year 2020, leaving little time to balance budgets. While many states have built up reserves in "rainy day funds," additional strategies are expected to be implemented to combat revenue shortfalls over the coming year. These can include cutting spending on services, increasing taxes, freezing state and local employees' salaries, and imposing furloughs or layoffs. There has already been an impact on state and local government employment. And with state and local governments looking to trim their budgets, the construction of new affordable housing is expected to be negatively impacted as well.

Sources of State and Municipal Revenue

Revenue for state and local governments comes from several sources. About one-third of the revenue generally comes from intergovernmental transfers. In the case of states, this is money that comes from the federal government, for specific programs like Medicaid, for example. In the case of local municipalities, intergovernmental transfers come primarily from the state government and generally include transfers for affordable housing programs.

Breakdown of State and Local Government Revenue by Category, Fiscal Year 2017



Source: Urban-Brookings Tax Policy Center State and Local Finance Initiative

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The bulk of annual revenue for both state and local municipalities' general funds accounts, which are used to support annual budgets, comes from taxes. For example, in 2017, most states received about half of their revenue from taxes: 23% from sales tax; 18% from individual income taxes; and 7% from corporate income and other taxes. Local municipalities received slightly more than 40% of their revenues from taxes, of which 90% came from property taxes alone. In addition, charges and fees represented another 19% of state revenues and 23% for local municipalities.

A Substantial Share of Jobs Lost

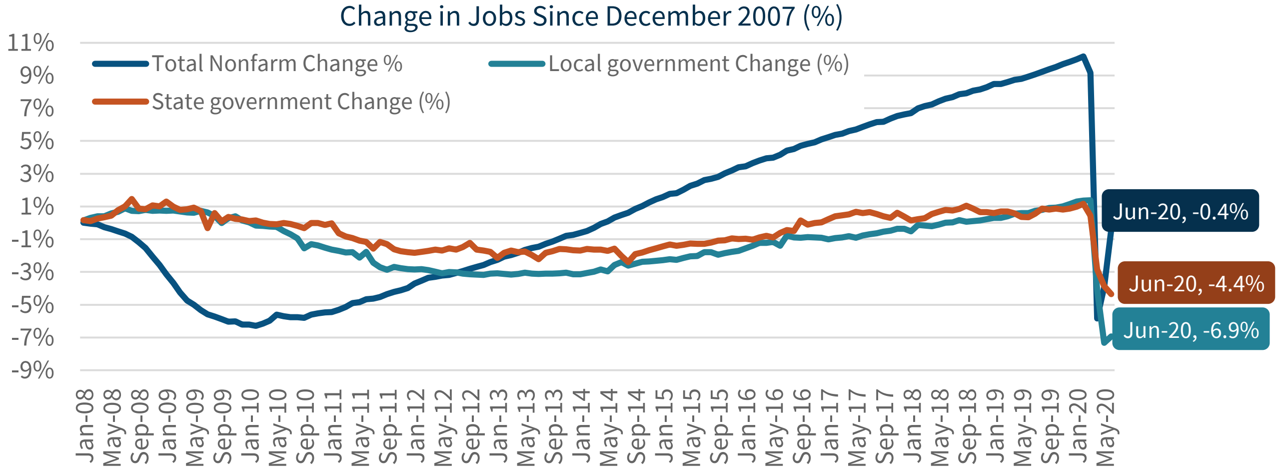
Prior to the pandemic, as of February 2020, there were just under 20 million jobs with state and local governments, representing an estimated 13% of all non-farm jobs in the United States. However, the number of state and local jobs has quickly declined by an estimated 5.5% and 8.2%, respectively, in just four months.

State and Local Jobs Remain Below Level of Last Recession

During the Great Recession, total non-farm jobs declined by a little more than 6% between December 2007 and December 2009. Job losses in state and local governments lagged until April 2010 when employment fell 0.3% below pre-recession levels. The lag reflected ongoing job losses taking place over several months, producing a gradual decline in revenue resulting from the reduction in sales and income taxes from so many people being out of work.

This time, the effects are far more immediate. Because most state governments are under a mandate to balance their budgets by the end of their fiscal year, usually ending June 30, coupled with the fact that state governments also moved the deadline for payment of income taxes to July 15, 2020 to be in line with the federal income tax deadline, state and local governments have already experienced revenue losses. As a result, state and local government job losses have now moved in tandem with national job losses over the past few months. Since the beginning of March through the end of June, state and local governments eliminated just under 1.5 million jobs on a seasonally adjusted basis. This leaves the number of jobs with state and local governments at about 7% and 4%, respectively, below where they were pre-recession at the beginning of December 2007.

Change in Jobs Since December 2007 (%)



Source: Moody's Analytics, Current Employment Statistics S.A., Fannie Mae

State Jobs Lost in Education

Prior to the pandemic, jobs in education represented 48% of all state jobs largely due to big public colleges and universities. However, with school closures due to the COVID pandemic, state jobs in education have borne the brunt of losses as they have declined by an estimated 10% since February, compared to just 1% for state jobs excluding education. This has had a disproportionate impact on some metros.

College Towns Impacted

Metros that lost the largest share of their state jobs in the second quarter 2020 were predominantly smaller metro areas dominated by larger public colleges and universities, like the University of Wisconsin in Madison, Purdue University in Lafayette, Indiana, and the University of Florida in Gainesville. When state schools closed due to COVID-19, many instructors continued teaching students online. But most support staff, including administrative staff and those in food service and building maintenance, were furloughed or temporarily laid off. In addition, the online learning model created less need for instructors. As a result, many of these metros lost a substantial share of their state job base.

For instance, Madison lost 29% of the state job base, Lafayette, Indiana lost 30%, and Ames, Iowa, home to Iowa State, lost 29% of its job base. Some of these temporary furloughs may become permanent job losses. That's because, even if colleges and universities are able to have classes on campus this upcoming fall, fewer classes may be offered, duplicate programs at different branches of state schools may be eliminated, and some students will not return, requiring fewer staff members. In addition, many state schools have already implemented a pay freeze which will further impact spending locally.

State Job Statistics - Select College Town Metros

Metro Area	Total Employment Q1 2020	State Share of Jobs Q1 2020	State Jobs Lost Q1 to Q2 (a)	Total State Jobs (b)	Share of State Jobs Lost (a)/(b)
Madison, WI	405,700	12%	-14,333	50,267	-29%
Lansing-East Lansing, MI	237,733	21%	-8,000	48,833	-16%
Lafayette-West Lafayette, IN	111,900	24%	-7,933	26,333	-30%
Muncie, IN	51,067	18.1%	-2,100	9,267	-23%
Ames, IA	53,133	30%	-4,633	16,033	-29%
Blacksburg, VA	77,267	22%	-3,033	16,733	-18%
Logan, UT	65,000	13.7%	-1,867	8,933	-21%

Source: Moody's Analytics, Current Employment Statistics S.A., Fannie Mae

Metros with State Capitals Not as Hard Hit

Outside of education, state jobs declined by only 1% since February (pre-pandemic) and this is reflected in state jobs in many metros that are state capitals. Many of these metros are aided by having diversified economies. For example, Denver's state job category represents only about 3.1% of the metro's entire job base. Further, although many state agencies have instituted pay freezes, they have not cut jobs – at least not yet. Rather, it seems that most of the state job losses in state capitals are due to temporary layoffs at public colleges and universities. For instance, although Austin lost about 4,700 state jobs, this represented just 6% of state jobs in first quarter 2020. Further, most of these job losses stemmed from temporary layoffs at University of Texas - Austin rather than state agency jobs.

State Job Statistics - Select State Capital Metros

Metro Area	Total Employment Q1 2020	State Share of Jobs Q1 2020	State Jobs Lost Q1 to Q2 (a)	Total State Jobs (b)	Share of State Jobs Lost (a)/(b)
Tallahassee, FL	188,500	24.8%	-2,333	46,733	-5.0%
Raleigh, NC	654,833	7.1%	-5,833	46,800	-12.5%
Richmond, VA	686,900	5.8%	-5,300	40,133	-13.2%
Austin-Round Rock, TX	1,131,700	6.7%	-4,733	76,133	-6.2%
Sacramento, CA	1,021,500	12.2%	-1,767	124,400	-1.4%
Denver, CO	1,538,900	3.1%	133	48,033	0.3%
Albany-Schenectady, NY	469,967	10.9%	133	51,000	0.3%

Source: Moody's Analytics, Current Employment Statistics S.A., Fannie Mae

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Local Job Losses Too

Virtually every metro with municipal jobs has experienced some level of job loss over the past few months. Just as job losses at the state level are being driven by cutbacks at state colleges and universities, job losses in local governments are being driven by layoffs and furloughs at public schools due to school closures. In fact, nationwide, jobs in education at the local level have declined 8% since pre-pandemic levels in February as many school districts have laid off support staff, such as bus drivers, cafeteria staff, and maintenance workers, among others. However, jobs losses in education only account for 55% of local government job losses compared to 90% of state government job losses. As a result, other types of local government jobs were impacted. Excluding jobs in local public education, employment for local governments was down about 8% in June 2020 from pre-pandemic levels in February. Local governments have issued hiring freezes, furloughed staff, and laid off seasonal employees.

Second Quarter 2020 Local Government Job Losses

Among the most populous locations, the New York metro area is estimated to have lost the most local government jobs, at more than 31,000 in a single quarter. The Chicago metro area lost an estimated 20,000 local government jobs, and the Los Angeles metro area with its large unified school district is estimated to have lost almost 14,000 local government jobs. Although Charlotte is estimated to have lost fewer jobs, at just under 11,000 in the second quarter, they represented almost 9% of Charlotte's jobs with the local municipal government.

Local Government Job Statistics - Select Metro Areas

Metro Area	Total Employment Q1 2020	Local Govt. Share of Jobs Q1 2020	Local Jobs Lost Q1 to Q2 (a)	Total Local Govt. Jobs (b)	Share of Local Govt. Jobs Lost (a)/(b)
New York, NY (Division)	7,170,067	10.7%	-31,467	768,067	-4.1%
Chicago-Naperville, IL (Division)	3,742,300	8.8%	-19,567	329,633	-5.9%
Phoenix, AZ	2,221,433	7.9%	-18,300	175,467	-10.4%
Washington, DC	3,347,833	7.7%	-17,967	257,100	-7.0%
Minneapolis-St. Paul, MN	1,992,333	8.3%	-15,900	165,833	-9.6%
Los Angeles-Long Beach, CA (Division)	4,597,833	10.1%	-13,867	464,600	-3.0%
Dallas-Fort Worth, TX	3,826,767	8.8%	-13,567	336,767	-4.0%
Seattle-Tacoma, WA	2,094,867	8.5%	-12,500	178,033	-7.0%
Charlotte, NC	1,240,300	10.3%	-10,867	127,433	-8.5%
Riverside-San Bernardino-Ontario, CA	1,543,033	13.5%	-9,633	208,567	-4.6%
Oakland, CA (Division)	1,177,633	10.4%	-9,133	123,000	-7.4%
San Diego-Carlsbad, CA	1,504,367	10.0%	-8,367	149,767	-5.6%
Atlanta-Sandy Springs, GA	2,861,367	7.6%	-8,300	216,967	-3.8%

Source: Moody's Analytics, Current Employment Statistics S.A., Fannie Mae

Some Housing Trust Funds Rely on General Fund Revenue…

In addition to having a direct impact on employment, the fiscal health of state and local governments may have an impact on the production of affordable housing. State and City Housing Trust Funds (HTFs), which rely on government funding, provide in excess of $2.5 billion annually to advance affordable housing initiatives in their states. HTFs are distinct funds established by state, city, or county governments to support the preservation and production of affordable housing, usually by providing secondary sources of financing. Most programs funded by HTFs assist households earning 80% or less than the median income for their location. However, some state HTFs rely on annual appropriations from their state's general fund, which provides revenue for a state's annual budget. These HTFs are at higher risk of having funds diverted to non-housing state budget items. These may include the Georgia, Kansas, Michigan, New Hampshire, New Mexico, New York, Texas, Utah, and Virginia HTF.

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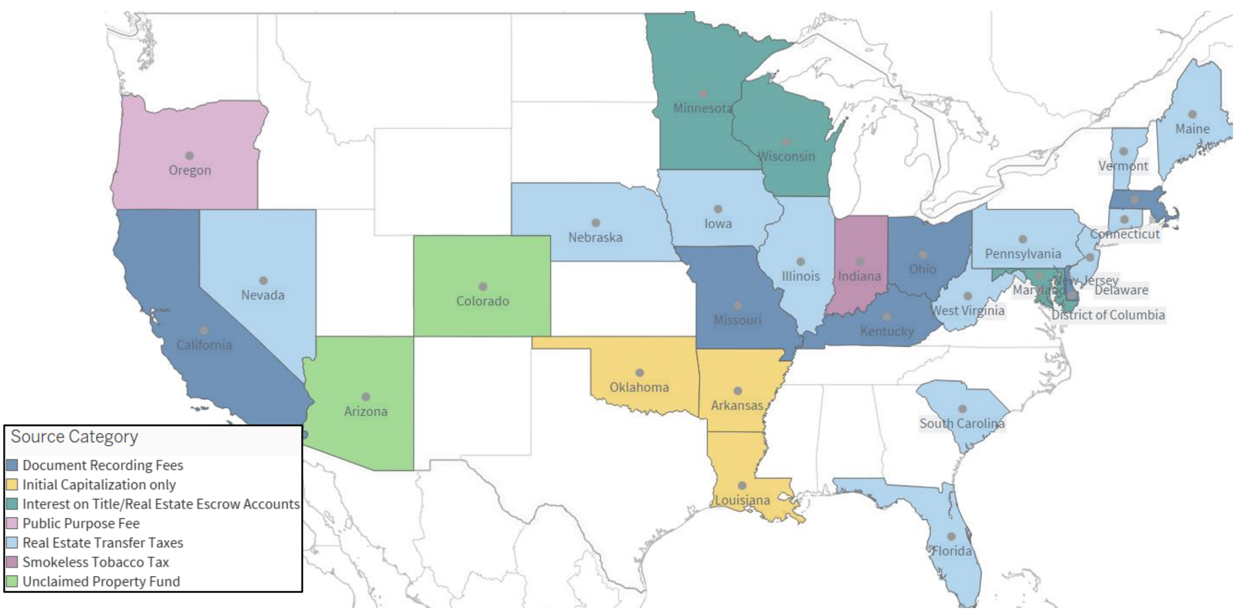
...Others have Dedicated Sources of Funding

Most HTFs have at least one dedicated source of funding, and some have multiple dedicated sources, which leave them somewhat insulated from states' budget processes. The predominant dedicated funding source is real estate transfer taxes, including documentary stamp fees. Fourteen states have adopted this dedicated source for at least one of their HTFs, including Florida, Illinois, New Jersey, and Oregon. Another seven states provide dedicated revenue from document recording fees, including California, Massachusetts, and Ohio. Maryland, Minnesota, and Wisconsin all fund their HTFs with interest on either title or real estate escrow accounts.

Other states have dedicated sources of funding not tied to real estate. One of Oregon's three state HTFs, the Housing Development Grant Program, supports its fund with a Public Purpose Charge, which is a fee on utilities. While Arizona uses net revenue from single-family mortgage programs to fund its HTF, it also dedicates income from the state's unclaimed property fund, which contains unclaimed assets such as stocks and bonds. This source type is also used by Colorado. Finally, Indiana uses e-cigarette taxes to fund its HTFs. However, these sources produce limited revenue.

Several states, including Michigan, have used a large initial source of capitalization such as the National Mortgage Settlement to fund or augment HTFs. However, only Arkansas, Louisiana, and Oklahoma rely exclusively on the original source of funding.

State Housing Trust Funds With Dedicated Funding Sources



Notes: Oregon has three housing trust funds. The General Housing Account Program is funded with document recording fees, the Housing Development Grant Program is funded with utility fees and the Low Income Rental Housing Program is funded with Interest and Fees

Source: Community Change

New Jersey to Spend $60 Million

Despite many states providing dedicated sources of income for their HTF, these funds are sometimes diverted to fill a state's budget gaps. However, New Jersey's HTF, which is funded with realty taxes, does not appear to be at risk of having those funds diverted to non-housing programs this year. According to the *New Jersey Spotlight* published online on August 12, 2020, with the exception of diverting some funds to rental assistance, the state of New Jersey will fully funded its HTF for fiscal year 2020 with $60 million. According to the article, the money will be used to build new units affordable to renters with household income up to 80% of area median income in smaller projects up to 25 units.

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The money will be divided among several funds and roughly half of the $60 million will help pay for developments municipalities have already committed to building.

Some HTF are Specialty Funds

While many of the HTFs address a variety of housing issues for both single-family and multifamily properties, a number have specialty funds to address issues such as homelessness, special needs housing, or rural housing. In fact, one of Nevada's two HTFs provides assistance for low-income owners of manufactured housing from fees levied on mobile home park owners. Several state housing HTFs are dedicated solely to rental housing. These include Hawaii's Rental Housing Revolving Fund, Illinois' Rental Housing Support Program, and Oregon's Low Income Rental Fund. These programs all have relatively stable, dedicated sources of income from fees on real estate transactions.

Select State Housing Trust Funds

State	Housing Trust Fund Name	Revenue Sources
Hawaii	Rental Housing Revolving Fund	Real estate conveyance tax Stamp Taxes
Illinois	Affordable Housing Trust Fund	Real estate transfer tax
	Rental Housing Support Program	Real estate document recording fee
Nevada	Assistance for Low-Income Owners of Mobile Homes	Fees from mobile home park owners
Oregon	Low Income Rental Housing Fund	Interest and fees
Oxnard, CA	Affordable Rental Housing Trust Fund	Developer Impact Fees

Source: https://housingtrustfundproject.org/wp-content/uploads/2020/01/State-htfund-revenue-sources-2020.pdf

Some Dedicated Sources More Stable

As long as commercial and residential real estate continues to exchange hands, dedicated sources based on fees from real estate transactions and earned interest are generally stable sources of income for HTFs, providing states do not elect to divert the revenue. However, as the economy contracts, the number of residential and commercial real estate transactions is likely to decline. As a result, revenue from real estate transfer taxes, document recording fees, and interest on title and real estate escrow accounts will likely decrease in volume, leaving less income to fund HTFs, which in turn means less funding available for affordable housing. By contrast, some HTFs rely on revenue from sources that are expected to be less impacted by adverse economic conditions. For example, Oregon's Housing Development Grant Trust Fund, and HTFs in Arizona, Colorado, and Indiana rely on revenue from utility charges, e-cigarette taxes, and unclaimed property.

Sources of HTF Funding by Stability of Funding

Less Stable — More Stable

No Dedicated Source	Non-Real Estate Taxes	Development Related	Real-Estate Transaction Related	Property Taxes	Less Dependent on the Economy*
Annual Appropriations	Sales Tax	Developer Impact Fees	Realty Transfer taxes	Property Taxes	Unclaimed Property Revenue
General Funds	Hotel/Motel Tax	Inclusionary In-lieu fees	Document Recording Fees	Tax Revenue on Properties…	Smokeless Tobacco Revenue
	Transient Occupancy	Construction Excise Tax	Interest on escrow and title accounts	…previously owned by city of Austin	Public Purpose/Utility Charges

** While Stable, these sources do not provide a significant amount of revenue*

Source: Fannie Mae

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State Housing Finance Agencies Do Not Require Annual Contributions

Like state HTFs, Housing Finance Agencies (HFAs), help finance the development of new affordable housing and the preservation of existing affordable housing. They are generally mandated to help both renters and first-time homebuyers. However, unlike state HTFs, which generally require outside funding, most HFAs are quasi-governmental agencies and are financially self-supporting through their programs. HFAs generate their own revenue through issuing bonds backed by single-family and multifamily housing programs and by earning interest on loans. This leaves them somewhat insulated from state and local revenue shortfalls. Even so, reduced state and municipal revenue may still impact HFAs in several ways.

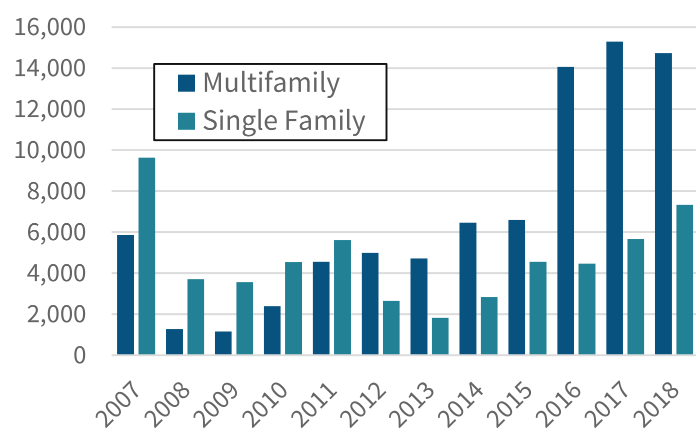
State Housing Finance Agencies May Offset State and Local Budget Shortfalls

A state or city may "sweep" an HFA's excess funds by suggesting that the HFA contribute a defined amount of money to the state to help fill a budget gap. While not usually legally required, most of the time the HFAs comply with the state's request. In addition, a state or city may request that an HFA pick up the administration and funding of a housing program previously run and funded by the state. According to Moody's, as of 2017, more than half of the 49 state HFAs had been asked to provide revenue to their states at some point over the past 25 years.

Multifamily Bond Issuance Doubled

HFAs fund the development of affordable rental housing through the issuance of Private Activity Bonds. As the affordable housing crisis has grown, so has the volume of multifamily bonds issued. According to the Council of Development Finance Agencies, the volume of multifamily bonds issued more than doubled to $14.7 billion in 2018 from $6.6 billion just three years earlier. The volume of multifamily bonds issued in 2018 was double the $7.4 billion volume of single-family bonds.

National Private Activity Bond Activity by Category ($millions)



Source: Council of Development Finance Agencies

Receive Reduced Housing Subsidies During Recessions

According to Moody's, revenue shortfalls may force a state or city to reduce housing subsidies provided to an HFA to pass along to its borrowers. This could include funding for single-family down payment assistance or subsidies on multifamily projects to reduce the interest rate. While this does not impact the financial position of the HFA directly, it could potentially reduce the volume of loans that an HFA is originating if it cannot afford to finance subsidies to replace subsidies lost from the state itself. This is important since any decline in bond issuance will slow the production of new affordable housing.

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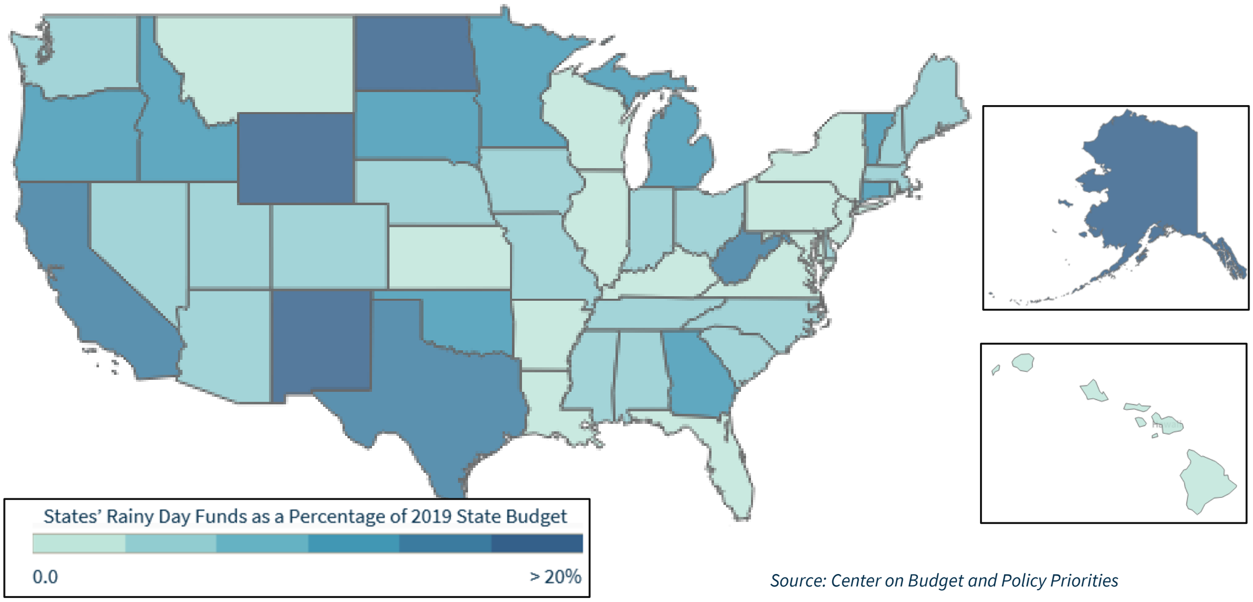
States' Rainy Day Funds as a Percentage of 2019 State Budget



Source: Center on Budget and Policy Priorities

State Rainy Day Funds Designed to Help During Economic Downturns

States are in better shape to weather an economic downturn than they were at the start of the last recession in 2007. To offset lost revenue from recessions, states put money into reserve funds, usually called rainy day funds, to mitigate disruptions to state services during an economic downturn and other unanticipated events, like natural disasters. According to the National Association of State Budget Officers, the average state's rainy day fund balance as a share of general fund spending has grown from 1.6% during the last economic downturn in fiscal 2010, to 7.6% in fiscal 2019.

Looking at state-level data on rainy day funds, the Center on Budget and Policy Priorities notes that two states, Wyoming and Alaska, have built up their rainy day funds to in excess of 85% of the fiscal year 2019 budgets. However, most rainy day funds are more modest. North Dakota and New Mexico, for example, have rainy day funds that represent about one-third and one-quarter of their 2019 fiscal budgets, respectively. Among more populous states, such as Michigan, California, and Texas, their rainy day funds represent between 12% and 18% of their 2019 fiscal budgets. Further, many states funds are below 10% of their 2019 budgets.

A Great Deal of Uncertainty Ahead

During the last recession, state and local governments were able to offset some of the impact of the recession on the economy. However, it is unclear to what extent they will be able to do so during this recession. According to the National Association of State Budget Officers, most states are still in the planning phase for how they will make the necessary adjustments to their existing fiscal 2021 budgets, which already started on July 1, 2020. State and local budgets generally have contracts for services, making it likely that changes across state and local budgets will occur somewhat gradually. In addition, transfers from the federal to the state government make up about one-third of annual revenue. Transfers may increase as the federal government considers new legislation to counteract the economic effect of the COVID-19 pandemic. As a result, we believe it will likely take some time to know the true impact on local economies from state and local budgets cuts due to the loss of revenue from taxes expected over the coming fiscal year.

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