

MacKay Municipal Managers™—What We Expect from the 2022 Midterm Elections

MacKay Municipal Managers considers public policy and the political landscape to be a critical component of the team's investment process. Understanding the fluid nature of leadership priorities and policy agenda, particularly in the heart of election season, is an integral part of the team's credit research approach.

The municipal market will be closely watching the midterm elections this year. Once again, election results in federal Congressional races as well as state gubernatorial and legislative elections and state ballot measures will be impactful on municipal market issuance. Policy agendas of state governments will influence future borrowings and priorities. Historically, the party controlling the White House tends to lose ground in Congress during midterm elections. We expect that voter turnout will be the deciding factor in November 2022 midterm elections and could well set the path to the 2024 Presidential election.

Congressional Races—Federal Legislative Impasse?

Federal elections for control of the US House and Senate sets the stage for a potentially divided Congress and federal government. Heading into the midterms, the Democrats control the House and have a slight advantage in the Senate. A flip to Republican control of the House, thus creating a divided Congress (where the Democrats retain control of the Senate), would in turn create a legislative impasse with little ability to pass new bi-partisan legislation. Furthermore, should Republicans take control of the Senate, any Republican-led legislation would most likely meet vetoes from the President Biden White House. Federal legislation successfully passed by

the most recent democratically controlled bodies of Congress may be less likely next term due to expected Congressional gridlock.

Governors Races—Policy Resets?

This midterm election will decide the future leaders of 36 State Governor's offices, as well as three territories. Incumbents are running in 31 of these gubernatorial elections, with some representing close races. MacKay Municipal Managers considers state Governors to be the states' top managers and policy-setters, which can directly translate to support for many municipal bond-financed programs. State governors' budgets also determine the annual allocation to down-state, local programs such as infrastructure, education and housing. Fortunately, across the country state finances are well positioned due to the strong post-COVID economic recovery and tax revenue collections, as well as the hangover of federal Covid- relief grants. In some instances, state and local governments have until 2024 to spend the remainder of allocated funds.

Ballot Measures—Credit Implications

State ballot initiatives provide a means to implement policy change as well as approve debt financing programs. On November 8th, 37 states will decide on 132 statewide ballot measures, slightly less than the average 164. Key topics will be voting-related polices, abortion, the legalization of marijuana, casino and on-line gambling as well as changes to state tax rate structures. MacKay Municipal Managers is closely watching proposed millionaire tax increases in California and Massachusetts, and a proposed reduction in the state flat tax rate in Colorado. In 2022, the team sees much smaller amounts in bond issuance ballot measures: only \$4.9 billion (\$4.2 billion of which is attributed to the State of New York Environmental Bond proposal), compared to the over \$25 billion in 2018. Several states are considering ballot measures to expand federal Medicaid programs to take advantage of federal and public healthcare support for low income adults and children. Lastly several states are considering bills that would modify existing motor fuel consumption taxes to a vehicle miles traveled standard. The Congressional Budget Office projects that the federal 18.4

cent per gallon federal gas tax will close the Federal Highway Trust Fund's deficit by 2031, which provides nearly 40% of state transportation funding.

Looking Past the Midterms?

While the midterm election results will provide much information about state and local governments' policy paths, the number one issue going forward will be US Federal Reserve policy moves through the end of the year and into 2023. The ability to confront rising inflation without compromising economic growth and employment will be more impactful to municipal market issuance and performance. Elected officials

will be tasked with navigating their governments through these volatile times. While the impact of midterm election results will be followed closely by the team and influence the assessment of related credits, the fundamental credit landscape of the municipal market is one of the strongest observed in decades. We believe the contrast of this strong credit landscape relative to the severe 2022 municipal market dislocation, plus municipals' compelling tax-free income profile and total return potential when employing an active management approach, creates an attractive opportunity for municipal investors.

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