

U.S. Municipal Bond Market

Violent Crime as a Credit and Political Challenge

- Regarding ESG factors, we believe the “S” or Social themes already rank highly with “E” and “G” factors, particularly where cities and city life are concerned.
- Rising violent crime has the potential to negatively impact municipal credit quality. This is especially true for the medium-sized and larger cities.
- There is still uncertainty about how tax policy, work arrangements, and other influences could very well make city living less attractive than it was before Covid. These might not be factors that individually drive people away, but together they could have impactful negative fiscal consequences. Policies that reduce police funding, which can make cities less attractive to residents and potential residents, have not worked.

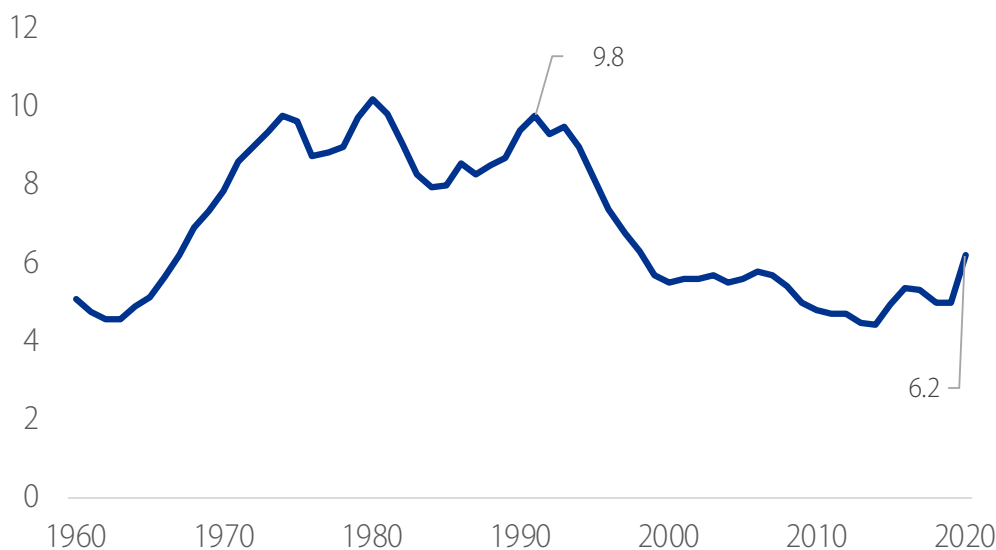
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Recent Policy Failure Related to “S” Factors

Sustainable and responsible investing themes have been central drivers amongst some investors in recent years. A record net \$51 billion was invested in Environmental, Social, and Governance (ESG) motivated funds in 2020, more than double the year before according to Morningstar data. Typically, investors and rating agencies have been able to apply more quantitative measures to the Environmental, and Governance themes when making capital allocation decisions. The “S” or Social part of the ESG acronym began to gain attention amid widespread demonstrations in support of the Black Lives Matter (BLM) movement in the summer of 2020. The BLM movement was fueled in part due to the horrific May 25 murder of George Floyd.

Rising violent crime has the potential to negatively impact municipal credit quality. This is especially true for the medium-sized and larger cities.

U.S. Murder Rate per 100k People, With an Estimated Rise in 2020



Source: FBI, 2020 Estimate (New York Times), and HilltopSecurities.

Fast moving events caused lawmakers to consider, and some did follow-through in response to pressures to Defund the Police. In some instances, police funding was

repurposed and in some cities police funding was even reduced. The [graphic from Bloomberg](#) below shows 18 cities that cut police spending, including New York, Minneapolis, Seattle, Chicago and Boston. The Bloomberg graphic also shows that 24 cities increased police spending.

The business community responded in an almost unprecedented way as the BLM movement gained new momentum. S&P Global reported that 217 of S&P 500 companies pledged financial support, issued some other type of organizational response, or responded via the media. The corporate sectors that led in this outreach include companies in the consumer staples, consumer discretionary, financial and utility sectors. S&P indicated they believe Social factors may soon be as important for companies as the Environmental and Governance factors. The report indicated:

The next step could be the elevation of social factors to the same level as the environment and governance. Only time will tell how social factors, such as racism and inequality, will affect companies' futures. However, failure to address them could have an impact on their ESG performance and, ultimately, on credit quality if loss of customers reduces profitability.

We think "S" or social-related themes already rank in the forefront with the "E" and "G" factors in the public finance sector, and this is especially true where cities and city life are concerned. We illustrate with commentary based on developing violent crime data.

Murder Incorporated

Until seven years ago, violent crimes and murders specifically were falling in U.S. cities. Policy, technology, and policing techniques helped contribute to why the U.S. was the safest it had been in years toward the middle of last decade. The murder rate dropped by more than half from 9.8 murders per 100k people in 1991 to just 4.4 in 2014. A Princeton sociologist recently rejected that the U.S. crime decline has ended, arguing however that it has, "very clearly paused." But, available data suggests

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National Murder Update for 2020, Select Cities

City	Murder (# of) in 2020	Murder (# of) in 2019	YoY Change (%)
Atlanta	150	95	58%
Austin	45	29	55%
Boston	57	37	54%
Chicago	748	481	56%
Los Angeles	343	257	33%
Minneapolis	81	47	72%
New York	437	314	39%
Seattle	47	27	74%

YoY increase among 57 city police agencies 36.7%

Source: Jeff Asher from Crimealytics and HilltopSecurities.

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otherwise. The number of murders has risen since 2014, and experts and the FBI expect a rise in 2020 year over year of somewhere between 25% and 37%. Even more striking is the analysis from Jeff Asher of Crimalytics showing that for the first three months of 2021, murders were up another 18% compared to 2020. Criminologist Joseph Giacalone predicts they will rise more this year too. In other words, it is unlikely that data from the summer of 2020 is only going to be an inconsistency.

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Whether the violent crime decline has ended or merely paused is of concern for U.S. cities, and whether shifts in policing and criminal justice reform contributed to a year-over-year rise in murders matters for several reasons. Lawmakers and residents are finding that potential policy solutions for policing and criminal justice reform are complicated. The leadership choices of some reformers are being questioned. The Economist accurately assessed the recent transition in the landscape when it recently wrote, "In other cities mayors and prosecutors who thought they would be rewarded for championing reform in the name of racial justice are finding that voters prize safety more."

Some mayors who found themselves at the height of their popularity--or at least at the height of press attention last summer--are now considering not running for office again. The topic of crime is already shaping up as an important subject leading up to the 2022 mid-term elections. Democratic strategist James Carville recently tried to get a jump start on the issue at the end of May when he penned, Democrats Are the Anticrime Party. Carville was of course criticized in following days; please see Was that a Parody by James Carville on Crime and the Democrats.

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Will the Rising Murder Rate Impact Municipal Credit?

Effective law enforcement policy intervention will need to simultaneously prioritize safety while taking potential reforms seriously. Almost three out of four U.S. adults favor at least the same amount of police presence. The same Gallup poll results from the end of the summer of 2020 shows that 86% of U.S. adults want police to spend more (19%), or the same (67%) amount of time in their area. About 14% of U.S. adults want the police to spend less time in their area.

Experts and lawmakers have tried for decades to get the correct mix of policy in order to bring down violent crime. While lowering police budgets last year may not have been the only reason violent crime rose in some cities, it certainly did not help.

Coming to a consensus on near-term policy adjustments will be a difficult task to navigate. So far, some cities have failed to do this. Police budgets should not be slashed. This is strongly supported by the year-over-year data and reinforced by the idea that violent crime is expected to continue to rise this year. In fact, quick and decisive action is needed to regain public trust in safety. If lawmakers do not regain citizen's trust, there is likely to continue to be swift political and fiscal consequences.

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Preference for Amount of Time Police Spend in Your Area

Would you rather the police spend more time, the same amount of time, or less time than they current spend in your area?

	More Time (%)	Same Amount of Time (%)	Less Time (%)
Asian Americans	9	63	28
Black Americans	20	61	19
Hispanic Americans	24	59	17
White Americans	17	71	12
U.S. Adults	19	67	14

Source: Gallup (August 2020) and HilltopSecurities.

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The Perception and the Reality of Rising Crime Could be Impactful

We believe that rising violent crime has the potential to negatively impact municipal credit quality, and this is especially true for the medium and larger cities. This possibility is already compounded by the uncertainty surrounding a post-Covid normal

There is still uncertainty about how tax policy, work arrangements, and other influences could very well make city living less attractive than it was before Covid. These might not be factors that individually drive people away, but together they could have impactful negative fiscal consequences. Policies that reduce police funding, which can make cities less attractive to residents and potential residents, have not worked. Wall Street Journal columnist Peggy Noonan wrote in [The Old New York Won't Come Back](#) about the intersection of rising taxes and crime indicating how much a New Yorker, for example, is likely to put up with:

If you tax the rich a little higher, most will stay: There's a lot of loyalty to New York, a lot of psychic and financial investment in it. But if you tax them higher for the privilege of being attacked on the street by a homeless man in a psychotic episode, they will leave. Because, you know, they're human.

It will not be enough to make arguments over crime data details. Concern about crime is [rising, according to recent Gallup surveys](#). Gallup found that from 2014 to 2019, 60% to 74% of those surveyed thought crime was rising. Even if all types of crime rates are not rising, the perception of a rise in crime matters. This perception is enough to have political and fiscal consequences.

We are concerned about both a real rise in violent crime, as well as the perception of a rise in crime. Under either scenario individuals may choose to relocate from the cities in which they live. If this occurs in force, it could add to other potential strains state and local credit may experience in the post-Covid normal.

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