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Fed Moves to Shore up Municipal Funding Markets

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The Federal Reserve announced on April 9 the **creation** of the Municipal Liquidity Facility (**MLF**), which will provide up to $500 billion of direct support to states and local governments to help them manage cash flow stress related to the COVID-19 pandemic. Indirect support to states and local governments is already being provided through the Federal Reserve's **Money Market Mutual Fund Liquidity Facility**, which we describe **here**. The MLF is one of several facilities established by the Federal Reserve to provide liquidity in response to the COVID-19 pandemic, under its "unusual and exigent circumstances" powers, all of which are described in **this overview chart**.

Under the MLF, a Federal Reserve Bank will lend to a special purpose vehicle (**SPV**) on a recourse basis, and the loan will be secured by all the assets of the SPV. The SPV in turn will purchase newly-issued qualifying debt (**Eligible Notes**) from certain state and municipal issuers (**Eligible Issuers**), and Eligible Issuers may use the proceeds of these sales for specified pandemic-related purposes (**Eligible Uses of Proceeds**). The SPV will receive a $35 billion initial equity investment from the U.S. Department of the Treasury, as authorized by the CARES Act.[1]

Key features of the MLF are described below. Additional details can be found in the **MLF term sheet**.

- Access to the MLF is limited to certain types of municipal Eligible Issuers, which may use the proceeds only for a limited set of purposes.
    - Eligible Issuers include:
        - U.S. states, including the District of Columbia;
        - U.S. cities with a population exceeding 1 million residents, based on U.S. Census data as of April 6, 2020;

        - U.S. counties with a population exceeding 2 million residents, based on U.S. Census data as of April 6, 2020; and
        - Instrumentalities that issue notes on behalf of such state, city or county.
    - Only one issuer is eligible for each state, city or county.
    - Eligible Uses of Proceeds include the management of the cash flow impact associated with:
        - Income tax deferrals due to filing deadline extensions;
        - Potential reductions in tax revenues or increases in expenses due to the coronavirus pandemic; and
        - Interest and principal payments on obligations of the Eligible Issuer (or, if the eligible issuer is an instrumentality, that issuer's corresponding state, city or county).
    - An Eligible Issuer may also use the proceeds to purchase similar notes issued by, or otherwise to assist, political subdivisions and instrumentalities of the relevant state, city or county for these purposes.

- Eligible Notes have a maturity of up to 2 years, are callable at any time at par and include the following instruments:
    - Tax anticipation notes (**TANs**);
    - Tax and revenue anticipation notes (**TRANs**);
    - Bond anticipation notes (**BANs**); and
    - Other similar short-term notes.

- The SPV is limited in the quantity of Eligible Notes of a single state, city or county that it may purchase.
    - The SPV generally may purchase Eligible Notes only up to an aggregate amount of 20% of the general revenue from own sources and utility revenue of the state, city or county for fiscal year 2017.
    - States may request that the SPV purchase Eligible Notes in excess of this limit in order to assist political subdivisions and instrumentalities that are ineligible to access the MLF.

- The prices at which the SPV will purchase Eligible Notes will be based on the Eligible Issuer's rating at the time of the purchase.
    - The Federal Reserve has stated that additional pricing details are forthcoming.

    - In addition, the MLF imposes an origination fee of 10 bps of the principal amount of an Eligible Issuer’s Eligible Notes purchased by the SPV.

- Unless the Federal Reserve and the U.S. Department of the Treasury announce an extension, the SPV will cease purchasing Eligible Notes on September 30, 2020.

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[1] For more information on the CARES Act, please visit our summary **here**.