Fed Expands Support for Municipal Funding Markets

By John Banes, Eric McLaughlin, Andrew Rohrkemper & Eric B. Lewin on April 28, 2020

POSTED IN CORONAVIRUS (COVID-19), FEDERAL RESERVE

The Federal Reserve announced on April 27 the **expansion** of its 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. Key features of the MLF as originally announced are described in **our initial blog** post following the Federal Reserve's April 9 **announcement** of the facility. Relative to the April 9 announcement, the MLF now covers more issuers, will accept notes with longer maturities, requires minimum credit ratings, specifies requirements related to security for notes and has a later termination date.

Under the MLF, the Federal Reserve Bank of New York 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] 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**.

Key features of the MLF as of the April 27 announcement are described below. Additional details can be found in the April 27 revised **MLF term sheet** and in the **MLF FAQs**, initially released by the Federal Reserve Bank of New York also on April 27.

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

- 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 now include:
    - U.S. states, defined to include the District of Columbia;
    - U.S. cities with a population exceeding 250,000 residents (a lower threshold than the original 1 million resident requirement), based on U.S. Census data as of April 6, 2020;
    - U.S. counties with a population exceeding 500,000 residents (a lower threshold than the original 2 million resident requirement), based on U.S. Census data as of April 6, 2020;
    - At the Federal Reserve's discretion, an entity that issues securities on behalf of such state, city or county (which, as the FAQs clarify, might be an authority, agency department, division or other statutorily authorized entity); and
    - **Multi-State Entities** (entities created by a Congressionally-approved compact between two or more states).
  - A list of Eligible Issuers based on population, other than Multi-State Entities, is provided in **Appendix A** to the Federal Reserve Bank of New York's FAQs.
  - The Federal Reserve is considering expanding the MLF to include certain governmental entities that issue bonds backed by their own revenue, and the Federal Reserve will publicly announce any such further expansion at a later date.
  - To be eligible, issuers must meet certain minimum ratings.
    - An issuer, other than a Multi-State Entity, must have been rated at least BBB-/Baa3 as of April 8, 2020 by two or more major nationally recognized statistical rating organizations ("**major NRSROs**"). If rated at least BBB-/Baa3 as of April 8, 2020 by two or more major NRSROs and subsequently downgraded, such an issuer is eligible if it is nonetheless rated at least BB-/Ba3 by two or more major NRSROs.
    - A Multi-State Entity must have been rated at least A-/A3 as of April 8, 2020 by two or more major NRSROs. If rated at least A-/A3 as of April 8, 2020 by two or more major NRSROs and subsequently downgraded, such an issuer is eligible if it is nonetheless rated at least BBB-/Baa3 by two or more major NRSROs.

        - The FAQs clarify that, for now, “major NRSRO” refers to S&P Global Ratings, Moody’s Investor Service, Inc. and Fitch Ratings Inc., with the Federal Reserve considering including other NRSROs.
        - The FAQs also clarify that if an Eligible Issuer does not have an outstanding long-term rating, it must apply for and be assigned a rating on Eligible Notes by at least two major NRSROs prior to issuing to the SPV.
    - Only one issuer is eligible for each state, city, county or Multi-State Entity.
        - The Federal Reserve may grant exceptions to this rule and approve additional issuers per 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;
        - Deferrals or 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 its political subdivisions or other governmental entities.
    - An Eligible Issuer, other than a Multi-State Entity, may also use the proceeds to purchase similar notes issued by, or otherwise to assist, political subdivisions and other governmental entities of the relevant state, city or county for these purposes.
- Eligible Notes must satisfy certain criteria.
    - Eligible Notes may have a maturity of up to 3 years (an increase from the 2-year limit when the MLF was initially announced), may be prepaid by the Eligible Issuer at any time at par with approval of the Federal Reserve (a change from the unilateral call feature when the MLF was initially announced) 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.
    - Eligible Notes are subject to review and approval by the Federal Reserve as to the source of repayment and security for the notes. The Federal Reserve has provided the following guidance:

        - Eligible Notes should generally be consistent with the source of repayment and stro-ngest security typically pledged to repay publicly offered obligations of the Eligible Issuer.
        - For Eligible Issuers other than Multi-State Entities, this generally means general obligation notes or notes backed by tax or other specified governmental revenues.
        - For Eligible Issuers that are authorities, agencies or other entities of a state, city or county, the issuer must commit the credit or revenues of, or obtain a guarantee from, its associated state, city or county.
        - For Eligible Issuers that are Multi-State Entities, the Eligible Notes are expected to be pari passu with existing senior-secured debt secured by the issuer’s gross or net revenues.
- The SPV is limited in the quantity of Eligible Notes of a single state, city, county or Multi-State Entity that it may purchase.
    - For states, cities and counties, 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 other governmental entities that are ineligible to access the MLF.
    - For Multi-State Entities, the SPV may purchase Eligible Notes only up to an aggregate amount of 20% of the gross revenue of the Multi-State Entity as reported in its fiscal year 2019 audited financial statements.
- 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.
- Administrative issues and logistics:
    - Unless the Federal Reserve and the U.S. Department of the Treasury announce an extension, the SPV will cease purchasing Eligible Notes on December 31, 2020 (as compared to the originally announced date of September 30, 2020).

- According to the FAQs, the Federal Reserve will publicly disclose information about the MLF monthly, including names of participants, along with amounts borrowed and pricing.
- The MLF is not yet operational, and the Federal Reserve stated in the FAQs that it will announce the operational date in advance of the MLF commencing operations.
- Application materials are not yet available.
- Questions may be submitted via email to **MLF@ny.frb.org**.