

CARES Act Financial Assistance to Municipalities: Municipal Liquidity Facility

After much anticipation, the Board of Governors of the Federal Reserve (Federal Reserve) on April 9, 2020 announced additional actions “using its full range of authorities to provide powerful support for the flow of credit in the economy.”

In addition to providing financial assistance to a wide array of businesses, the Federal Reserve is also taking steps to provide access to liquidity for certain states and municipalities.

Specifically, as part of its response to address the negative economic effects stemming from the COVID-19 pandemic, the Federal Reserve will establish a Municipal Liquidity Facility (MLF) that will offer up to US\$500 billion in lending to states, as well as cities with over 1 million residents and counties with over 2 million residents, with the Treasury Department providing US\$35 billion in equity investments pursuant to the CARES Act as credit protection for the MLF.

Overview

Pursuant to the MLF, the Federal Reserve will purchase up to US\$500 billion of short-term municipal notes (Eligible Notes) from selected states, counties and cities (Eligible Issuers). Under the MLF, a Federal Reserve Bank will commit to lend to a special purpose vehicle (Municipal SPV) on a recourse basis, and then the Municipal SPV will purchase Eligible Notes directly from Eligible Issuers. The Department of Treasury will provide an initial equity investment of US\$35 billion to the Municipal SPV in connection with the MLF by using funds appropriated by the CARES Act. Unless further extended, the Municipal SPV will cease purchasing Eligible Notes on September 30, 2020.

General Terms of Municipal Liquidity Facility

- Total program size – Up to US\$500 billion (as of April 9, 2020).
- Eligible Issuers – To help states and large counties and cities better manage short-term cash flow pressures during this unprecedented time, the MLF will purchase up to US\$500 billion of short-term Eligible Notes directly from the following Eligible Issuers¹:
 - US states and the District of Columbia
 - US counties with a population exceeding 2 million residents
 - US cities with a population exceeding 1 million residents

- Eligible Notes – Eligible short-term notes (subject to the Federal Reserve’s review) include the following:
 - Tax anticipation notes
 - Tax and revenue anticipation notes
 - Bond anticipation notes
 - Other similar short-term notes that mature within two years from the date of issuance
- Terms and Conditions of the Municipal Liquidity Facility:
 - Pricing – Pricing the Eligible Notes will be based solely on the Eligible Issuer’s rating at the time of the Municipal SPV’s purchase.
 - Origination Fee – Upon the Municipal SPV’s purchase, the Eligible Issuer will have to pay an origination fee equal to 0.10% (10 bps) of the principal amount of the Eligible Notes purchased by the Municipal SPV, which may be paid from the proceeds of the issuance.
 - Call Right – Eligible Notes are callable by the Eligible Issuer at any time at par.
 - Size limitation – Although the Municipal SPV may purchase Eligible Notes in multiple tranches from an Eligible Issuer, the Municipal SPV may only purchase Eligible Notes from the Eligible Issuer in an amount “up to an aggregate amount of 20% of the general revenue from its own sources and utility revenue of the applicable State, County, or City for fiscal year 2017.” However, upon a request from a state, the Municipal SPV may purchase Eligible Notes in excess of the 20% limit to assist “political subdivisions and instrumentalities” that cannot otherwise directly access the MLF program.
 - Use of Proceeds – Eligible Issuers are also limited in how it may use the proceeds from selling its Eligible Notes to the Municipal SPV. Proceeds may be used to:
 - Help manage the cash flow impact of (a) income tax deferrals resulting from an extension of an income tax filing deadline, (b) potential reductions of tax and other revenues related to the pandemic, (c) increases in expenses related to the pandemic or (d) provide for the payment of principal and interest on debt obligations
 - Purchase similar notes issued by, or otherwise to assist, political subdivisions and instrumentalities for any purpose approved for Eligible Issuers

¹ Importantly, each state, county or city can issue Eligible Notes directly or through an instrumentality that issues debt on behalf of the state, county or city, for the purpose of managing its cash flows, but only one Eligible Issuer per state, county or city may participate in the MLF program, and US Territories, including Puerto Rico and US Virgin Islands, appear to be excluded from the MLF program. Additionally, all Eligible Note issuances are subject to review and approval by the Federal Reserve.

Municipal Liquidity Facility

Department of Treasury

Initial \$35 billion equity investment to the Municipal SPV

Municipal SPV

Capitalized with up to \$500 billion to buy Eligible Notes¹

Federal Reserve

Up to \$465 billion recourse loan to the Municipal SPV

Eligible Issuers²

- U.S. states and the District of Columbia;
- U.S. counties with a population exceeding 2 million residents; and
- U.S. cities with a population exceeding 1 million residents.

*The Municipal SPV may only purchase Eligible Notes from the Eligible Issuer up to an aggregate amount of 20% of the general revenue from its own sources and utility revenue for FY 2017 (the "20% Limit").

Eligible Issuers May Use the Proceeds as Follows:

- Help manage the cash flow impact of:
 - income tax deferrals resulting from an extension of an income tax filing deadline,
 - potential reductions of tax and other revenues related to the pandemic,
 - increases in expenses related to the pandemic, or
- provide for the payment of principal and interest on debt obligations; or
- Purchase similar notes issued by, or otherwise to assist, political subdivisions and instrumentalities for any purpose approved for Eligible Issuers.

*Upon request from a State, the Municipal SPV is not restricted from purchasing more than the 20% Limit of a State's Eligible Notes if such proceeds are used to assist "political subdivisions and instrumentalities."

- 1 Short-term eligible notes to include: Tax anticipation notes; tax and revenue anticipation notes; bond anticipation notes; and other similar short-term notes that mature within 2 years from the date of issuance.
- 2 Each state, county, or city may issue Eligible Notes through an instrumentality that issues debt on behalf of the state, county, or city for the purpose of managing its cash flows.

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