

## Overview

As previously reported, on April 9, 2020, the Federal Reserve established a Municipal Liquidity Facility (MLF), which will purchase up to US\$500 billion of short-term municipal notes (Eligible Notes) from selected states, counties, cities and, in accordance with the Federal Reserve Board’s Guidance, Multi-State Entities (Eligible Issuers). On April 27, 2020, the Federal Reserve Board filed a press release, updated term sheet, FAQs page and an appendix outlining the maximum amount of Eligible Notes the SPV will purchase per Eligible Issuer (the Federal Reserve Board’s Guidance). The Federal Reserve Board’s Guidance clarifies the Federal Reserve’s former term sheet and press release, sets forth the MLF’s expanded scope and duration, and addresses next steps for Eligible Issuers. The immediate purpose of the MLF is to address the cash management needs of Eligible Issuers, while also helping restore confidence in the municipal securities market.

## Eligible Issuers

The Federal Reserve Board’s Guidance adds a new type of Eligible Issuer and reduces the population threshold for cities and counties to qualify as an Eligible Issuer as follows:

- US states and the District of Columbia
- US counties with a population exceeding 500,000 residents (rather than 2 million residents)
- US cities with a population exceeding 250,000 residents (rather than 1 million residents), and
- Multi-State Entities, which are defined as an entity that was created by a compact between two or more states with the approval of Congress

The Federal Reserve Board’s Guidance also clarifies that pursuant to section 13(3) of the Federal Reserve Act, an Eligible Issuer must be solvent. Only one Eligible Issuer per state, county or city may participate in the MLF program, and US Territories, including Puerto Rico and the US Virgin Islands, are not included as Eligible Issuers in the appendix.

The Eligible Issuers are required to meet the following rating criteria:

- State, city or county (or an entity that issues securities on behalf of the state, city or county for the purpose of managing its cash flows): As of April 8, 2020, rated at least BBB-/Baa3 by two or more nationally recognized statistical rating organizations (NRSROs), and if the Eligible Issuer was subsequently downgraded, it must be rated at least BB-/Ba3 by two or more major NRSROs at the time the SPV makes a purchase of the Eligible Notes, and

- A Multi-State Entity: As of April 8, 2020, rated at least A-/A3 by two or more major NRSROs; and if the Multi-State Entity was subsequently downgraded, it must be rated at least BBB-/Baa3 by two or more major NRSROs at the time the SPV makes a purchase of the Eligible Notes

Of note, the Federal Reserve is considering expanding the MLF to allow a limited number of governmental entities that provide essential public services on behalf of Eligible Issuers to participate directly in the MLF program. If this subset of entities is included as a new Eligible Issuer, it will be publicly announced at a future date.

## Eligible Notes

The SPV will only purchase newly issued TANs, TRANSs, BANs or other similar newly issued Eligible Notes. The Federal Reserve Board’s Guidance increases the Eligible Notes’ maturity from no later than two years to no later than three years from the date of issuance.

The Eligible Issuers are required to provide standard legal opinions for issuance of debt and disclosures. A legal opinion must include, but is not limited to, an opinion of nationally recognized note counsel as to the validity, enforceability and binding nature of the Eligible Notes. Importantly, disclosures include a written certification that the Eligible Issuer is unable to “secure adequate credit accommodations from other banking institutions and that it is not insolvent.” Prior to the commencement of the MLF, further guidance on opinions and disclosures will be provided by the Federal Reserve Board.

Security for the Eligible Notes will be subject to review and approval by the Federal Reserve and should be generally consistent with the source of repayment and strongest security typically pledged to repay publicly offered obligations (i.e., a general obligations pledge or be backed by tax or other specified governmental revenues). For an Eligible Issuer that is a Multi-State Entity, the Eligible Notes will be expected to be parity obligations of existing debt secured by a senior lien on the Multi-State Entity’s gross or net revenues. Also, if the Eligible Issuer is an entity that issues securities on behalf of the state, city or county, it must either commit the credit of, or pledge revenues of, the applicable state, city or county, or have the state, city or county guarantee the Eligible Notes.

## Limitations

The Federal Reserve Board’s Guidance did not change the amount of Eligible Notes that the SPV may purchase from each state, city or county. The Federal Reserve provided clarity in an appendix outlining the maximum amount of Eligible Notes it would purchase from each applicable Eligible Issuer based on an Eligible Issuer’s general revenue from its own sources and utility revenue for fiscal year 2017.

Regarding Multi-State Entity Eligible Issuers, the SPV may purchase “up to an aggregate amount of 20% of the Multi-State Entity’s gross revenue as reported in its audited financial statements for fiscal year 2019.”

Importantly, upon a request from a state, the 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. The Eligible Issuer, not the MLF, would bear the credit risk associated with any notes it purchased from a political subdivision or other governmental entity.

## Administration and Applications

The Federal Reserve Bank of New York has selected PFM Financial Advisors LLC as its administrative agent for the MLF, with the job of coordinating and reviewing MLF applications based on criteria established by the Federal Reserve Bank of New York. Application materials are being assembled, and details regarding these materials and the date that applications will be accepted will be posted on the Federal Reserve Board’s FAQs page.

## Contacts

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