Report to Congress Pursuant to Section 13(3) of the Federal Reserve Act: Municipal Liquidity Facility

Overview

On April 8, 2020, the Board of Governors of the Federal Reserve System (the Board), by the unanimous vote of its five members and with the approval of the Secretary of the Treasury, authorized the establishment and operation of the Municipal Liquidity Facility (MLF) under section 13(3) of the Federal Reserve Act (12 U.S.C. § 343(3)). The MLF is intended to support lending to state, city, and county governments.

Under the MLF, the Federal Reserve Bank of New York (Reserve Bank) will commit to lend on a recourse basis to a special purpose vehicle (SPV). The SPV will purchase eligible notes directly from eligible issuers at the time of issuance.

Background on the MLF

Recent events have significantly and adversely impacted global financial markets. The spread of the coronavirus disease 2019 (COVID-19) has halted economic activity in many countries, including the United States. The disruption has impacted many different sectors of the financial system. State and local governments are facing substantial increases in expenditures for emergency preparedness and public health responses related to COVID-19. At the same time, the postponement of the federal income tax filing deadline has caused many states to also postpone their state tax filing deadlines, and other sources of tax revenue, including sales, gas, and hotel taxes, have materially decreased. As a result, the need for short-term borrowing by state and local governments is expected to exceed the capacity of investors to absorb such debt at reasonable yield levels for issuers.

In these circumstances, the Board determined that unusual and exigent circumstances existed and approved the establishment of the MLF to help facilitate access to credit and liquidity so that state, city, and county governments are better able to manage the period of dislocations related to the pandemic. The Department of the Treasury, using funds appropriated to the Exchange Stabilization Fund under section 4027 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), will make a $35 billion equity investment in the SPV in connection with the MLF.

Structure and Basic Terms

Under the MLF, the Reserve Bank will commit to lend, on a recourse basis, to the SPV, which will purchase eligible notes directly from eligible issuers at the time of issuance. The Reserve Bank will be secured by all of the assets of the SPV. The MLF is not yet operational.

The term sheet for the MLF is available to the public on the Board's website.[1] The discussion below summarizes these terms and conditions. The Board and Reserve Banks continue to monitor the affected financial markets and to consult with market participants and, accordingly, the terms and conditions governing the MLF may be modified in the future as appropriate.

Eligible Notes. Eligible notes are tax anticipation notes (TANs), tax and revenue anticipation notes (TRANs), bond anticipation notes (BANs), and other similar short-term notes issued by eligible issuers, provided that such notes mature no later than 24 months from the date of issuance. In each case, a note's eligibility is subject to review by the Federal Reserve. Relevant legal opinions and disclosures will be required as determined by the Federal Reserve prior to purchase.

Eligible Issuer. Eligible issuers are U.S. states and the District of Columbia (together, States), U.S. cities with a population exceeding 1 million residents[2] (Cities), and U.S. counties with a population exceeding 2 million residents[3] (Counties) (or an instrumentality thereof that issues on behalf of the State, City, or County for the purpose of managing its cash flows), in each case subject to review and approval by the Federal Reserve. Only one issuer per State, City, or County is eligible.

Limit per State, City, and County. The SPV may purchase eligible notes issued by or on behalf of a State, City, or County in one or more issuances of up to an aggregate amount of 20 percent of the general revenue from own sources and utility revenue of the applicable State, City, or County government for fiscal year 2017.[4] States may request that the SPV purchase eligible notes in excess of the applicable limit in order to assist political subdivisions and instrumentalities that are not eligible for the MLF.

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[1] For term sheets for all facilities, see the Federal Reserve's website at https://www.federalreserve.gov/funding-credit-liquidity-and-loan-facilities.htm.

[2] U.S. Census Bureau, "Annual Estimates of the Resident Population: April 1, 2010 to July 1, 2018," as of April 6, 2020, https://www.census.gov/data/tables/time-series/demo/popest/2010s-total-cities-and-towns.html.

[3] U.S. Census Bureau, "Population, Population Change, and Estimated Components of Population Change: April 1, 2010 to July 1, 2019 (CO-EST2019-alldata)," dataset as of April 6, 2020, https://www.census.gov/data/datasets/time-series/demo/popest/2010s-counties-total.html#par_textimage_739801612.

[4] U.S. Census Bureau, "2017 State & Local Government Historical Datasets and Tables," as of April 6, 2020, https://www.census.gov/data/datasets/2017/econ/local/public-use-datasets.html.

Pricing. Pricing will be based on an eligible issuer's rating at the time of purchase with details to be provided later.

Origination Fee. Each eligible issuer that participates in the MLF must pay an origination fee equal to 10 basis points of the principal amount of the eligible issuer's notes purchased by the SPV. The origination fee may be paid from the proceeds of the issuance.

Call Right. Eligible notes purchased by the SPV are callable by the eligible issuer at any time at par.

Eligible Use of Proceeds. An eligible issuer may use the proceeds of eligible notes purchased by the SPV to 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 or increases in expenses related to or resulting from the COVID-19 pandemic; and requirements for the payment of principal and interest on obligations of the relevant State, City, or County. An eligible issuer may use the proceeds of the notes purchased by the SPV to purchase similar notes issued by, or otherwise to assist, political subdivisions and instrumentalities of the relevant State, City, or County for the purposes enumerated in the prior sentence.

Termination Date. The SPV will cease purchasing eligible notes on September 30, 2020, unless the Board and the Department of the Treasury extend the MLF. The Reserve Bank will continue to fund the SPV after such date until the SPV's underlying assets mature or are sold.

Requirements Imposed on Recipients. The MLF will not impose any new requirements on borrowers with respect to employee compensation, distribution of dividends, or any other corporate decision in exchange for the assistance.

Expected Costs to Taxpayers. The Federal Reserve and the Department of the Treasury, through its equity investment, will bear the risk of loss on the eligible notes purchased by the SPV under the MLF. The MLF includes features that are intended to mitigate risk to the Federal Reserve and taxpayers. In particular, the MLF will receive interest payments and origination fees, and the amount of eligible notes purchased from a State, City, or County will be limited as described above. In addition, the Department of the Treasury will make a $35 billion equity investment in the SPV. As a result, the Board does not expect at this time that the MLF will result in losses to the Federal Reserve.