

Federal Reserve Announces New Municipal Liquidity Facility

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On April 9, the [Federal Reserve announced](#) the [Municipal Liquidity Facility \(MLF\)](#) as part of a new series of facilities providing up to \$2.3 trillion in loans to support the economy. The facility aims to ease cash flow pressures on state and local governments as they adjust to a [decline in municipal and state revenues and face greater than expected](#) public health costs due to the COVID-19 pandemic .

The Federal Reserve established the MLF pursuant to its Section 13(3) authority under the Federal Reserve Act (FRA); it was approved by the Treasury Secretary.

The Federal Reserve will operate the facility by recourse lending to a newly-established special purpose vehicle (SPV). The SPV will then purchase eligible notes directly from eligible issuers. The SPV may purchase up to \$500 billion of eligible notes. The Treasury Department will fund the facility with an initial equity investment of \$35 billion from funds appropriated to its Exchange Stabilization Fund under the CARES Act. This structure is similar to that of the [Commercial Paper Funding Facility](#), which the Fed first used during the Global Financial Crisis in 2008-09 (GFC) and which it has recently reintroduced.

Eligible issuers under the MLF include all the states and the District of Columbia, cities with greater than one million residents, and counties with greater than two million residents. Only [10 cities](#) and [16 counties](#) meet the above criteria, according to the latest Census data. To provide aid to municipalities ineligible to participate in the MLF, participating states may utilize the proceeds generated through the issuance of eligible bonds to purchase similar notes from municipalities within their jurisdictions. An eligible state, city, or county may participate through a related entity that normally issues notes on its behalf, but only one issuer per state, city, or county is eligible.

In addition to utilizing proceeds to purchase similar notes from political subdivisions, localities may use proceeds from the sales of eligible notes to the MLF for mitigation of reduced cash flows from income tax deferrals due to extensions to the tax filing deadlines. They may also be used to address reductions in revenues due to COVID-19 or for payments of principal and interest on other obligations.

Notes that are eligible for purchase under the MLF include tax anticipation notes (TANs), tax and revenue anticipation notes (TRANs), bond anticipation notes (BANs), or other short-term debt that matures no later than 24 months after issuance. The price of notes purchased will be based on the issuer's rating at the time of issuance. Issuers are required to pay an origination fee equal to 10 basis points (0.1%) of the principal amount of the notes being purchased by the SPV. The fee will be deducted from the proceeds of the issuance.

The SPV may purchase multiple note issuances from an eligible issuer but the total amount purchased from any one issuer cannot exceed 20% of the issuer's 2017 revenues from their government's own sources and utilities revenues. However, a state may request that the SPV purchase more than the 20% limit to assist municipalities ineligible to participate in the MLF. The purchased notes are callable by the issuer at any time before maturity at par value.

The Federal Reserve plans to stop purchases under the MLF on September 30, although the facility may be extended if needed. The Fed plans to continue funding the SPV until all underlying assets mature or are sold.

Establishment of the MLF follows [previous Federal Reserve efforts](#) to provide liquidity to municipalities. On March 23, the Federal Reserve began accepting highly-rated municipal bonds, commercial paper, and other securities as collateral under the Commercial Paper Funding Facility (CPFF) and the Money Market Liquidity Facility (MMLF). The CPFF and MMLF are similar to programs that the Fed utilized during the GFC, however then municipal debt, tax-exempt municipal commercial paper and municipal securities were not included in the programs. Notably the Fed chose to implement the MLF under its FRA Section 13(3) emergency authority rather than utilize its authority under [FRA Section 14](#), which provides that the Fed can purchase municipal debt with maturities up to six months through its Open Markets Operations. Commenters had called for broader authority than that, a gap that the CARES Act seems to have filled.

During the current pandemic, other countries have also made adjustments to aid municipalities with cash flow needs. Canada has provided a [similar expansion](#) allowing the purchase of municipalities' commercial paper by its Commercial Paper Purchase Program. Other countries have pursued fiscal responses to liquidity squeezes in municipalities, such as Finland's [€100 million allocation](#) to municipalities to support business owners affected by COVID-19.