

Federal Reserve Lowers Pricing for Municipal Liquidity Facility

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Original post [here](#).

The Federal Reserve Board [announced](#) August 10 that it would revise pricing for the Municipal Liquidity Facility (MLF). Specifically, the updated [term sheet](#) includes a reduction in the interest rate on MLF loans of 50 basis points across all credit rating categories. The Fed also revised the relationship between interest rates for tax-exempt notes and for taxable notes.

The Fed created the Municipal Liquidity Facility under the authority of Section 13(3) of the Federal Reserve Act. The Treasury, under the authority of the Coronavirus Aid, Relief, and Economic Security (CARES) Act, has made a \$35 billion equity investment in the facility. Read more about the MLF [here](#).

The Fed announced in April that the MLF could lend up to \$500 billion to eligible states, counties, and cities. As of yet, though, it has only extended a single [one-year loan](#) of \$1.25 billion, priced at 3.82%, to the state of Illinois. New Jersey reportedly is also considering requesting a [loan](#) through the facility.

Soon after the Fed launched the facility, a progressive advocacy group [criticized](#) the MLF for unfavorable pricing. According to the group’s analysis, before the reduction in pricing, 97% of eligible cities, counties, and states could find better funding on the market. A [letter](#) signed by 53 progressive members of congress similarly criticized the facility for being “functionally unusable.” In the Third Report of the Congressional Oversight Committee, the Chair of the Fed Jay Powell and Treasury Secretary Steven Mnuchin responded to such criticism by emphasizing that they had intended the MLF to be only a backstop for municipalities that had trouble getting funded on the municipal market. They also cited a Federal Reserve [study](#) showing that the market for municipal securities has recovered since March.

The new pricing for tax-exempt notes is summarized in the table below. Interest rates are calculated by adding the comparable maturity overnight indexed swap (OIS) rate to the spread in the table below, based on the debt issuer’s credit rating. For most high-rated eligible issuers, the new pricing remains uncompetitive with market rates, so utilization of the facility will likely [remain low](#). New York’s Metropolitan Transportation Authority said it [may tap the Fed](#) for half a billion in three-year notes, if pricing beats Wall Street.

Table 1. MLF Spread Table

Credit rating	Spread (bps):
AAA/Aaa	100
AA+/Aa1	120

AA/Aa2	125
AA-/Aa3	140
A+/A1	190
A/A2	200
A-/A3	215
BBB+/Baa1	275
BBB/Baa2	290
BBB-/Baa3	330
Below Investment Grade	540

[Source.](#)

The other change the Fed announced is a minor revision to the rates for taxable eligible notes. Previously, if notes were subject to federal income tax, pricing would be calculated by adding the comparable maturity OIS rate to the spread and dividing by 0.65; now the sum will be divided by 0.7. This improves the interest rate for taxable eligible notes.

This announcement comes as direct aid to state and local governments is unlikely to pass Congress until September. Negotiations over the next round of fiscal spending have [frozen](#) in the Senate, while the White House has stepped in with [four executive orders](#) aimed at continuing expanded unemployment benefits and decreasing payroll taxes. The executive orders did not include funding for state and local governments, who a think tank estimates will face [budget shortfalls](#) of \$555 billion over the next two years.

The Fed says that the pricing will “provide an effective backstop to assist U.S. states and local governments as they weather the pandemic.”