# Bond Case Briefs

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## A Proposal for the Coronavirus Anticipation Note (CAN).

John Mousseau and I have combined our professional experience with our views of the municipal finance market. With the help of our Cumberland staff, we want to offer a format for immediate assistance designed to address urgent state and local government financing problems. This proposal is only a framework. There are many skilled professionals who can quickly weigh in with ideas; and, ultimately, a final version of our proposed instrument will have to be crafted and brought to fruition at the federal level, combining the U.S. Treasury, the Federal Reserve, and the Congress (maybe?) if the CARES Act doesn't have enough authority.

Here is the basic issue. Under these present emergency conditions, the nearly 90,000 separate municipal identities in the United States are experiencing deferred or permanently lost cash flow. Examples: Tax collections fall or cease. Revenues for services fall or cease. Use and sales taxes, various fees, and all associated sources of revenues decrease suddenly or cease for an unknown period of time. What can these diverse entities do to avoid reducing their important governmental functions and furloughing their labor forces, and to continue to provide essential services?

We propose the creation of a coronavirus cash-flow deficiency anticipation note. Let's call it the Coronavirus Anticipation Note, or CAN, for short. We would model the CAN after other types of anticipation notes. That way, the system does not have to "discover a new wheel." We are already used to tax anticipation notes (TAN), bond anticipation notes (BAN), revenue anticipation notes (RAN), tax increment financing (TIF), and various other types of financing instruments which raise money now and then get repaid after an event is completed or a project is fulfilled or some other target goal is met.

CAN needs a federal backup and a rapid issuance method, either through a national pooled vehicle or a state-by-state pooled vehicle. Because of diverse state taxation rules, we believe that the state-by-state method is probably more suitable. The federal government can backstop the state with a U.S. Treasury guarantee. The guarantee can be pooled. The states can determine allocation to cities and counties and to local or state agencies. Most states have such allocation mechanisms already in place for their various budgets and services. The CANs would have state income tax exemption in the state where they are issued, in addition to being exempt from federal taxes.

Think of the national CAN pool in a form such that the Federal Reserve can add CAN pool notes to the assets on its balance sheet. The Treasury backstop transfers the default risk to the U.S. Treasury, and the states can direct their CAN usage internally, since each state has a better handle on where the cash flow deficiencies reveal themselves. The Treasury already has a municipal information arm in place with the Municipal Issuers Oversight Unit, which was formed in 2014.

Municipal entities are transparent and have audits and usually adopt their budgets in a public meeting. The databases for these entities already exist in regulatory filings of various types, such as MSRB and EMMA.

The idea is to provide a bridge loan to a municipal entity to cover the shortfall in its cash flow during the crisis period. The entity can issue CANs to fill the gap. The states can pool them, as they usually do now with the various forms of pooled vehicles that already exist in the states.

When we get to the other side of this crisis, the CANs can be repaid from revenues, or they can be "termed out" into longer-term bonds with easy amortization. The municipal market is quite capable of handling this process in the normal course of business.

CANs can be the gap funding mechanism for what may be one or two quarters, or one or two years. The timing for launching CAN is important, as those municipal entities are now seeing revenues shrinking every day. One final note: CANs must not be used to make up pension funding gaps or for other longer-term solutions for preexisting structural problems. The purpose of CAN financing is to raise the cash to bridge the coronavirus chasm and its funding gap. Keep it focused and not diluted or diverted to other purposes. There will be infrastructure program proposals for other types of long-term project financing.

We propose that CANs be discussed and developed as a manageable and timely tool for states and municipalities that must now weather both COVID-19 and its impacts on cash flow.

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