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Fed Municipal Rescue Won't Avert Fiscal Nightmare, So States Eye Congress.

The money will barely make a dent in resolving local government needs caused by the pandemic, which is threatening to create thousands of fiscal disasters nationwide.

The Federal Reserve's move this month to bail out the municipal bond market with $500 billion in short-term debt was a historic step by the central bank to directly intervene in local government finances for the first time.

It's just not nearly enough, local officials say.

The money will barely make a dent in resolving local government needs caused by the coronavirus pandemic, which is threatening to create thousands of fiscal disasters nationwide. Officials say Congress must provide hundreds of billions more — but this time in direct federal grants — in the next economic rescue package.

"You can't borrow your way out of debt," said Tim Schaefer, California deputy state treasurer for public finance. "Financial solutions are helpful, and we certainly don't want to turn our nose up at them, but what really is going on here requires a fiscal response."

Inaction by federal lawmakers could mean cutoffs or reductions in local services that the pandemic has made even more crucial, right down to paying for ambulances that take coronavirus patients to the hospital, state finance officials said. The tens of thousands of bonds issued in the $4 trillion market by states, cities, counties and other governmental entities also finance projects such as schools, highways, airports and sewer systems.

Put simply, the Fed assistance merely keeps government bank accounts from overdrafting in the short-term.

To be sure, the Fed action April 9 extended a vital line of credit to states, the District of Columbia, counties with populations over 2 million and cities with populations over 1 million, at a time when market rates for short-term debt had been skyrocketing in reaction to the economic upheaval.

But while cash flow is an important and immediate problem, it underlies an even broader fiscal nightmare facing governments nationwide.

That's because the sweeping shutdowns of businesses to prevent outbreaks from overwhelming local hospital systems has come at a steep cost. Revenue dried up because of business closures, stay-a--home orders, layoffs and, in many cases, delayed local tax deadlines designed to align with an extension announced by the IRS in late March.

The magnitude of the costs that lie ahead partly explains the outcry among local leaders at Senate Majority Leader Mitch McConnell's suggestion on Wednesday that municipalities might "use the bankruptcy route" to dig themselves out of a financial morass.

Until then, localities had been encouraged by pledges of support from Democratic leaders in Congress as well as the White House. President Donald Trump on Tuesday tweeted a promise to provide “fiscal relief to State/Local Governments for lost revenues from COVID 19” in the next legislative relief package after Congress reached a deal to top off the popular Paycheck Protection Program offering small businesses forgivable loans.

But the dropoff in revenue is much steeper than the $500 billion credit being offered.

Moody’s Investors Service in an April 15 report said the $500 billion accessible through the Fed’s so-called Municipal Liquidity Facility would amount to more than 10 times the short-term debt issued by governments in all of 2019. But it amounts to only about 20 percent of the approximately $2.4 trillion in revenue that state and local governments collected in 2017, the year the Fed is using to calculate payouts.

The Fed could still take broader action or widen eligibility; right now, the population thresholds leave out impoverished cities such as Detroit and Baltimore.

Senate Minority Leader Chuck Schumer said Monday he told Federal Reserve Chair Jerome Powell that the central bank had set its population threshold “way too high” for the program.

“He assured me that the Fed was similarly working to make the program directly accessible to more cities and counties,” the New York Democrat said of Powell.

But the central bank also suggested that larger governments could use bailout money to help lend to smaller governments.

Recognizing the crisis ahead, Sens. Bill Cassidy, a Louisiana Republican, and Bob Menendez, a New Jersey Democrat, have proposed a $500 billion bailout package for state and local governments.

Many states said they either don’t have infrastructure in place to set up loans to smaller governments or they’re wary of taking on credit risk for towns and counties at increased risk of default.

Michael Decker, senior vice president for federal policy for the Bond Dealers of America, said the Fed should publicly commit to taking on credit risk for downstream loans made to smaller governments.

“We’re urging the Fed to be explicit, when they finalize the details of the program, to be explicit that the Fed will absorb this credit risk and if downstream borrowers default, it’ll be on the Fed and not on the states,” Decker said. “And we think that will go a long way to helping ensure the success of the program.”

The Fed declined to comment for this story.

At the same time, state finance officials said they are doing what they can to aid smaller governments, but they need more help.

“The federal government has the power to print more money, and in these difficult times of uncertainty, states need as much help as they can get from the federal government,” said California State Treasurer Fiona Ma. “And the more help that we get, the more help we can be to local governments, which are looking to us for assistance.”

Sarah Godlewski, the Democratic Wisconsin State Treasurer, said that her office is working to reorient a state trust fund loan program to provide “bridge financing in smaller ineligible communities.”

Godlewski said she has been asking smaller governments: “With limited support from the federal government, how can we help you help Wisconsinites?”

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By KELLIE MEJDRICH

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