Fed's $500 Billion Muni-Lending Plan Faces Hurdles in State Laws.

- **Debt limits, tight repayment rules could weaken reach of loans**
- **Underscores case from governors for direct aid from Washington**

There's a key obstacle threatening to limit the reach of the Federal Reserve's plan to lend to states and cities to limit the financial hit from the coronavirus: state laws.

The central bank's program, the first ever targeted at the $3.9 trillion municipal-debt market, will lend money for as long as two years to states and the largest cities and counties to help them avoid massive budget cuts as the deep economic slowdown decimates tax collections.

But some states, like Colorado and Alabama, may find their ability to draw on the Fed limited by constitutional provisions that make it difficult for them to run up debt. Others, like Maine, Michigan and Illinois, have laws that require repayment of loans within a tight time frame, which could dissaude officials from borrowing.

In some states, legislatures or voters may also need to approve debt issued under the Fed's program before it is set to lapse at the end of September, something that's complicated by social-distancing guidelines that have shuttered statehouses.

The issues are likely to limit the scale of the Fed's lending to states, underscoring the case that governors are making for direct aid from Washington to weather what threatens to be the gravest fiscal crisis in decades.

There's not much that the Fed could do with the existing program — other than perhaps expanding it to long-term debt — to get around some of the states' constitutional and statutory limits, said Dee Wisor, a bond lawyer for Butler Snow and former president of the National Association of Bond Lawyers.

"State-by-state, folks are going to have to work that out," he said.

In Colorado, the state faces a potential barrier from its taxpayer bill of rights, a notoriously difficult-to-change law that limits state taxes and spending. Because of it, voters must approve the "creation of any multiple-fiscal year direct or indirect" debt incurred by the state.

Leah Marvin-Riley, a spokeswoman for the Colorado treasurer's office, said the state has to make sure that its borrowings fit under the constitutional restraints. "We don't know yet how much we would sell, but we do know that we're limited by the TABOR cap," she said.

Caught 'Flat-footed'

New Mexico law says it can't borrow more than $200,000 to "meet casual deficits or failure in revenue." Alabama's 1901 constitution prohibits new debt unless lawmakers find a workaround. In neighboring Georgia, the state cannot directly borrow on behalf of smaller governments, as the Fed's program provides for in places where none of the local governments are big enough to qualify on their own, said Lee McElhannon, director of bond finance for the state.

"I just wonder whether a lot of governments, both state and local, are going to be caught a little bit flat-footed with all this," said Jodie Smith, a public finance lawyer at Maynard Cooper.

The Fed's loans don't have to be repaid for two years, which in theory would give governments time to get through virus-related shutdowns until tax revenue starts to revive.

Yet the time horizon creates an issue for states that have to pay back certain types of short-term borrowings by the end of the fiscal year, which could be in June 2020 or 2021, depending on when they borrow the money. Illinois, New Mexico and Maine are among the states that have such limits.

In Washington, the state can issue debt that's used to cover temporary revenue shortfalls so long as it's paid off within a year. Smaller municipalities in the state also face limits under their short-term borrowings, such as having to pay back certain notes six months after the end of the fiscal year in which they were sold, said Stacey Lewis, a public finance lawyer for Pacifica Law Group.

The Fed is still finalizing details and has asked for industry participants to send feedback.

The Government Finance Officers Association, a lobbying group, asked the Fed to extend its lending program until December because of the hurdles some governments face and the fact that the size of their shortfalls may not be known clearly for months.

Lewis, the Pacifica Law attorney, said she would like to see the Fed shift to buying a broader kind of municipal debt.

"If the Fed wants to really put money out through this program, it will have to listen to what's allowable under state law," she said.

Bloomberg Markets

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April 21, 2020, 6:54 AM PDT

— With assistance by Danielle Moran