

# **Bond Case Briefs**

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## **Fed's Muni Facility Leaves States Charting Tricky Path to Access.**

- **U.S.'s second-biggest economy exploring ways to deploy program**
- **Fed urged to increase eligibility so more entities can get aid**

As pandemic-plagued state and local economies start to feel the effects of vanishing tax revenue, officials like Texas Comptroller Glenn Hegar are trying to figure out how to build the mechanisms that can get cash from the U.S. central bank to all the places in need.

The Federal Reserve has launched an array of emergency lending facilities to help the U.S. economy during the virus lock-down, including one for municipalities that could support up to \$500 billion of assistance to states and big cities. But the rules are strict: only cities with a population of more than one million, or counties with more than two million inhabitants, are eligible.

That means the vast majority of communities across the country will have to get the funds from their states, and many states don't have mechanisms for this process.

### **Seeking Answers**

"We don't have a current program in Texas, and most states don't," Hager told Bloomberg News Tuesday in a telephone interview. "I don't know at this point exactly how we're going to do it, mechanically, but we're trying to get those answers as quickly as we can despite multiple fronts of uncertainty."

Changes may be on the way, even before the program is up and running.

The Fed said when it launched the Municipal Liquidity Facility on April 9 that it "would evaluate whether additional measures are needed," and has since signaled it was open to doing more, even as U.S. lawmakers called publicly for further steps. Senate Democratic Leader Chuck Schumer on Monday said in a statement that Fed Chairman Jerome Powell assured him the Fed was "working to make the program directly accessible to more cities and counties."

The economic hardship is already severe. The stay-home orders that have been issued in most places around the U.S. have led to record claims for unemployment benefits as businesses shut their doors. The subsequent plunge in consumer spending and other activity has likely already wiped out \$200 billion in state and local government revenue, an amount equal to about 10%, TD Economics' Johary Razafindratsita and Sri Thanabalasingam wrote in an April 16 note.

### **Bipartisan Calls**

Republicans and Democrats alike have called for various additional levels of Fed aid to the muni market. Idaho Senator Mike Crapo, whose state does not have any cities or counties that would directly qualify for the Fed's facility, called on the central bank to allow for more municipal entities to have access to the program.

Beyond the technical issues of having to set up a way to pass the Fed's facility funds from the state onto the smaller entities, some states may opt out of the facility for political or legal reasons.

"Citing statutory, constitutional, logistical, or just political hurdles, not to mention a reluctance to take (more of) the credit risk of their own local governments, multiple states seem likely to pass on the opportunity for a cheaply-financed local government liquidity facility," Municipal Market Analytics' Matt Fabian and Lisa Washburn wrote in an April 20 note.

Texas's Hegar said that right now it doesn't look like the state itself will need to tap the Fed's facility. But it may need to on behalf of smaller towns and counties that don't qualify. While three cities and three counties in the country's second-most populous state qualify for the Fed's facility, the state is home to 1,600 local governments.

#### Erode Significantly

"For this fiscal year, we know we're OK, even though we do know that tax receipts are probably going to erode pretty significantly when we start seeing the data from March collections, much less April collections," Hegar said.

Texas is not getting hit with the drop in personal income tax revenue that many states will see, as it doesn't collect income tax.

On average, about half of state government revenues come from individual income and sales taxes, according to Amanda Page-Hoongrajok, an assistant professor of economics and finance at Saint Peter's University in Jersey City, New Jersey. Most states have laws preventing them from running budget deficits, so drops in revenue streams have to be matched with cuts elsewhere.

Following the 2008 financial crisis, state and local government spending was subdued for years, Page-Hoongrajok said.

"If they don't give state governments more aid, we're going to see a prolonged recovery," she said. "They're not going to be able to recover from a drop in incomes and consumer spending this severe."

### **Bloomberg Economics**

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