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Fed to Extend Loans to More Cities, Counties.

Central bank widens eligibility for new local-government lending program, allowing more than 200 municipalities to participate

The Federal Reserve said Monday it would broaden the number of local governments from which it will buy debt through a forthcoming lending program.

The Fed will allow one borrower for each county of at least 500,000 people and city of at least 250,000, down from earlier cutoffs of 2 million and 1 million, respectively.

The central bank will also purchase debt with maturities of up to three years, instead of any earlier cap of two years.

The Fed will lend up to $500 billion through the facility, and the Treasury Department has provided $35 billion to cover any losses.

After announcing the program earlier this month, the central bank faced strong support from lawmakers and other elected officials to expand the number of municipalities that would be allowed to borrow. Lawmakers in both parties had chafed against the larger population cutoffs, with several saying it would improperly exclude American cities with large minority populations.

The Fed unveiled the program more than two weeks ago and initially limited participation to around 75 issuers—including all 50 states and the District of Columbia. The latest change will allow for as many as 261 state, city and county issuers to participate.

The central bank will require issuers to have been highly rated as of April 8, which is the day before the it announced the creation of the municipal lending program. That could pose a challenge for the city of Detroit, which is now large enough to qualify for the program but has a speculative-grade rating from Moody's Investors Service and S&P Global Ratings.

The program will also allow very highly-rated multi-state issuers, such as the Port Authority of New York and New Jersey, to sell debt through the program. The program, administered through the New York Fed, isn't open to U.S. territories.

The Fed said it is considering expanding the program to a limited number of governmental entities that issue bonds backed by their own revenues.

The market for municipal bonds has recovered significantly since freezing up midway through last month, but prices remain well below where they were at the beginning of March. Thirty-year AAA-rated bonds backed by state taxes yielded 2.13% Monday compared with 1.52% March 2, according to Refinitiv. Bond prices rise as yields fall.

Lobbyists for cities and towns as well as the banks and brokerages that trade municipal bonds have been pushing the Fed to expand its program so smaller communities can participate directly.

The Fed has long seen lending to states and cities as a political minefield. Fed officials worry they might end up holding municipal debts that borrowers can't repay. Left unanswered are questions such as what role the central bank would play in a bankruptcy and if it would support the borrower or line up with other creditors to get its money back.

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—Heather Gillers contributed to this article.