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The Federal Reserve's Municipal Liquidity Facility: Providing Financial Relief but at What Cost? - Dinsmore & Shohl

State and local governments throughout the nation are struggling to address the financial impact of the COVID-19 pandemic. The Coronavirus Aid, Relief, and Economic Security Act, or CARES Act, enacted by Congress on March 28, 2020 appears to provide insufficient funding, and many state and local governments need more federal financial assistance. Guided by its mandate from Congress, the Federal Reserve created the "Municipal Liquidity Facility" (MLF) to provide up to $500 billion in short term loans to "eligible issuers," which include states, certain counties and cities, and multi-state entities. Participating counties must have a minimum population exceeding 500,000 residents and participating cities must have a minimum population exceeding 250,000 residents. Only one issuer per state, county, city, or multi-state entity is eligible to participate in the program. The Federal Reserve published a list of eligible issuers (click HERE for the list). Eligible issuers may use the proceeds to support additional counties and cities not identified as eligible issuers. The Federal Reserve is currently accepting letters of intent for eligible issuers. The MLF will be administered on a first-come-first-served basis.

Under the MLF, the Federal Reserve will lend to a special purpose vehicle (SPV) on a recourse basis, which will then purchase notes directly from eligible issuers or act as a backstop to notes competitively sold. While the MLF provides market access to many state and local governments in need of cash-flow relief, the program is not a grant program, but instead intended to help facilitate short-term borrowings. The Federal Reserve has stated that the MLF is intended to serve as a backstop rather than a competitive market participant. In other words, the MLF is a facility of last resort after a state or local government has engaged in an earnest attempt to access the market and has no alternatives or inefficient alternatives. Other important features of the MLF are identified below.

MLF Purpose, Duration, and Note Eligibility:

- Proceeds may be used only to (i) manage the cash-flow impact of income tax deferrals resulting from an extension of an income tax filing deadline, as well as to manage reductions in tax and other revenues and expenses related to the pandemic, and (ii) pay principal and interest on obligations and use the proceeds to buy similar notes issued by "political subdivisions and instrumentalities of the relevant state, city, or county."
- The MLF program ends on December 31, 2020, unless the Federal Reserve and the U.S. Treasury Department decide to extend the MLF.
- The maximum maturity of the notes is three years.
- Notes eligible under the program include tax anticipation notes (TANs), tax and revenue anticipation notes (TRANs), bond anticipation notes (BANs), and other similar short-term notes.
- Eligible notes may be taxable or tax-exempt obligations.
- Eligible notes may be subject to prepayment, and cannot be refunded after December 31, 2020.

MLF Cost and Issuer Eligibility:

- Each eligible issuer that participates in the MLF must pay an origination fee equal to 10 basis points of the principal amount borrowed.
- Certain minimum ratings criteria will apply, which ratings criteria will be used to produce a tiered pricing scale when it comes to determining the ultimate rate of interest.
- Pricing for eligible notes will be in the form of a fixed interest rate determined on the date of pricing, which rate will be based on an overnight indexed swap rate plus a spread which correlates to the rating of an eligible issuer.
- Eligible notes from each eligible issuer cannot exceed 20% of an eligible issuer's general revenues and utility revenues for fiscal year 2017.

Click HERE for a copy of the latest materials in connection with the MLF.

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