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Fed Expands Municipal-Lending Facility to More Localities.

Illinois plans to issue $1.2 billion in one-year notes Friday to become the first borrower to access the central bank's program

The Federal Reserve said it would again broaden the number of local governments eligible for a new lending program as Illinois announced it would be the first borrower to access the facility.

The central bank said Wednesday it would allow all 50 states to designate two cities or counties to sell debts directly to the central bank's program, creating an option for states with less populous municipalities to participate. Many state and local governments are facing cash crises as the coronavirus pandemic has crushed both their tax intake and driven an increase in their spending.

The central bank also said state governors will be able to designate an additional two issuers whose revenues are derived from operating activities, such as airports, toll facilities, utilities or public transit, to be eligible to use the facility on their own.

The changes could allow more than 380 issuers, up from around 260 before the latest changes, to access the emergency-lending program, which was first announced in April.

So far, however, few have shown interest in borrowing through the Fed, which has positioned itself as a high-interest lender of last resort.

Illinois becomes the first to tap the program. It is the country's most indebted state.

Illinois said it would issue $1.2 billion in one-year notes Friday to tide it over until income taxes arrive late in July. The state, which is rated just above junk status, is planning to borrow through the Fed at an interest rate of 3.82%. The rate is more than 10 times what one-year A-rated bonds were going for Wednesday, according to Refinitiv.

"When you can't get anybody else to lend you money, you've got to go to Papa," said Ben Watkins, director of Florida's Division of Bond Finance.

Municipalities can issue up to three-year debt under the program originating in federal coronavirus aid legislation. Congress gave $454 billion for the Treasury to use to backstop losses in Fed lending programs, and the Treasury has committed $35 billion of that money for a central bank effort to backstop municipal debt.

The Fed previously made the program available to all 50 states, the District of Columbia, and one borrower for each county of at least 500,000 people and city of at least 250,000. Those thresholds had already been revised once, down from earlier cutoffs of 2 million and 1 million.

The changes will extend participation in the facility to one extra municipality in six states, including Alabama and Hawaii, that currently have just one eligible municipal issuer, and they will allow two municipal issuers in 15 states, including Idaho and Vermont, that had none eligible before.

The announcement of a muni-buying program from the Fed injected confidence into a faltering market. The interest rate on an A-rated 30-year general obligation bond was 2.14% Wednesday, compared with 2.51% on April 8, the day before the Fed formally announced the muni-lending program.

Both Congress and the Federal Reserve are pumping trillions of dollars into the economy to fight the economic damage caused by the coronavirus. WSJ explains where all that stimulus money is coming from. Photo Illustration: Carlos Waters / WSJ
But the facility itself could be useless to many state and local governments whose ability to borrow for operating costs is limited by local law or state constitution. Illinois lawmakers tweaked that state's law this spring to facilitate borrowing from the Fed facility.

"Balanced budget requirements, legal restrictions on the length for which notes can be outstanding, and prohibitions on counting long-term debt proceeds as current revenue could limit the utility of the Fed's efforts," said Clayton Gillette, a professor at New York University School of Law.

Also making state and local governments wary is the high level of uncertainty about how much revenue to expect. Fitch Ratings cautioned in a report Wednesday that governments borrowing in anticipation of delayed revenues could be disappointed if those revenues are lower than expected when they finally do come in.

Wisconsin capital finance director David Erdman said the state doesn't plan to issue debt for operations, but if it did, he expects it could borrow more cheaply in the market than through the Fed facility.

"But as we've learned from everything that's happened so far in 2020, you really don't know what tomorrow brings," he said.

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