Fed Announces Reduced Borrowing Costs for Municipal Issuers.

- **Fed is lowering spread on tax-exempt bonds by 50 basis points**
- **Terms of the emergency Fed lending program had been criticized**

The Federal Reserve said Tuesday it would reduce borrowing costs in its Municipal Liquidity Facility, an emergency lending program for state and local government issuers launched in response to the coronavirus pandemic.

"The revised pricing reduces the interest-rate spread on tax-exempt notes for each credit rating category by 50 basis points and reduces the amount by which the interest rate for taxable notes is adjusted relative to tax-exempt notes," the Fed said in a statement. "Today's changes will ensure the MLF continues to provide an effective backstop to assist U.S. states and local governments as they weather the pandemic."

The program was announced in April but has only made a single loan so far, despite the dire fiscal situation facing state and local governments due to lost tax revenues and increased expenditures amid the pandemic. The state of Illinois said in June that it would draw $1.2 billion from the Fed facility at an interest rate of 3.82%.

Barclays Plc municipal strategist Mikhail Foux said the change is a "step in the right direction" but added the central bank should cut rates further if it wants to foster the usage of the facility. "The rates still need to be adjusted," Foux said.

Too Pricey

Tuesday's adjustment follows criticism of the program on the grounds that the cost of borrowing was prohibitive. House Democrats led by Washington Representative Pramila Jayapal and Wisconsin Representative Mark Pocan sent Fed Chair Jerome Powell a letter on Aug. 5 requesting that the pricing be reduced to encourage more borrowing.

State and local debt recorded a massive selloff in March but has since recovered after the Fed announced the program. Yields on one-year AAA-rated municipal debt have plunged to 0.06%.

There's one big borrower that may be able to soon take advantage of the lower borrowing costs. New York's Metropolitan Transportation Authority, facing a plunge in ridership and massive shortfall, may sell debt to the Federal Reserve as part of an upcoming bond-anticipation note sale, according to a Moody's Investors Service report.

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By Matthew Boesler and Amanda Albright

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