

Bond Case Briefs

Municipal Finance Law Since 1971

Lawmakers Tangle Over Fed's Muni-Market Rescue.

Debate centers around whether the Federal Reserve has done enough to backstop municipal finances

Lawmakers clashed at a congressional hearing Thursday over whether the Federal Reserve has done enough to backstop municipal finances.

State and local governments are facing historic budget shortfalls due to the coronavirus, and Congress has deadlocked over the prospect of additional federal aid. But those governments have largely regained their ability to borrow in private markets.

Those markets suffered a historic freeze-up in March as the pandemic shut down the U.S. economy. That prompted the Fed to create the Municipal Liquidity Facility.

The idea was to show that the Fed stood ready to back the municipal market as a lender of last resort, rather than attract a flood of borrowers from it. So far, only two borrowers have tapped the facility for funding.

That is a feature, not a bug, of the program, Kent Hiteshew, deputy associate director with the Fed's financial stability division, said at Thursday's hearing before a congressional oversight committee.

Some Democrats, though, say the Fed should be using the program more extensively. Rep. Donna Shalala (D., Fla.) questioned whether more government borrowers could benefit. "The Municipal Liquidity Facility can support \$500 billion in lending but to date has only \$1.65 billion, less than 1% is being used," she said.

The Federal Reserve has repeatedly expanded the criteria for who can participate in the program and has reduced its rates. But it remains off limits to most smaller cities and counties. Even those governments that can access it have generally opted for lower rates in the private market.

Mr. Hiteshew also said there might be reason to extend the program beyond its Dec. 31 borrowing deadline. "There are warning signs in the municipal market that we should all be aware of" including "coming cuts and potential downgrades" from rating firms, he said.

Some Republicans say, though, that the Fed has done enough. "The Municipal Liquidity Facility was not meant to replace private capital markets (or) be a mechanism to bail out state and local governments," said Sen. Pat Toomey (R., Pa.). "Liquidity in the municipal bond market has been restored and as such the MLF in my view should wind down."

Tension over the program mirrors a bigger battle over whether and how much more aid Congress should approve to states and municipalities dealing with revenue shortfalls from the pandemic-induced recession.

A broader relief package has been tied up in part due to an impasse over this particular spending disagreement. Fed Chairman Jerome Powell said Wednesday that municipalities were likely to need

more support from Congress, and he had warned of the limits of the central bank's lending programs to address revenue losses.

"While state and local governments cannot cut their way out of this recession, neither can they borrow their way out of it, and if the legacy is operating deficit financing on state and local balance sheets after this crisis is over, that will limit their ability to finance infrastructure, to educate our students and to care for our elderly," Mr. Hiteshew said.

The two borrowers that have tapped the facility are both facing major budget crises: the state of Illinois and New York's Metropolitan Transportation Authority

Mr. Hiteshew said a third borrower is in the pipeline for a possible deal with the facility and others may use it.

Patrick McCoy, the MTA's director of finance, said at the hearing that his agency ultimately needs aid but called the Fed facility "a critical bridge to a long-term solution." He urged the Fed to expand the program, including by increasing the maximum maturity for facility debt beyond three years and extending the borrowing deadline beyond the end of this year.

The Wall Street Journal

By Heather Gillers

Sept. 17, 2020