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The MTA Could Be the Last to Tap the Fed's Muni Facility. Wall Street Watchers Fret Its End.

New York's Metropolitan Transportation Authority is on track to grab one last slug of federal pandemic aid before it and other public authorities lose a key source of relief at year's end: the Federal Reserve's municipal lending program.

The MTA said it plans to sell nearly $3 billion in bonds by the end of the year to the Fed's Municipal Liquidity Facility, a move that will help the agency cope with a plunge in ridership and close a $1.1 billion budget deficit this year, according to a presentation from CFO Robert Foran at a Nov. 18 board meeting.

Five Fed programs will expire at the end of this year, even as Covid-19 cases soar and some state governments impose partial shutdowns to control the virus' spread. The programs were created or revived earlier this year to provide a financial bridge for a wide range of institutions affected by the pandemic.

Several facilities were designed for the large banks, bank trading desks, and money-market funds that were squeezed during the short-term rush for cash in the early stages of the pandemic. Yet the programs that are closing mostly cover borrowers that could face financial pressure over a span of years, such as large corporations, midsize businesses, nonprofits, and state and local governments.

Municipal-market and Wall Street strategists have argued that the MLF in particular should be extended, because it can take months or even years for state and local governments to experience the full impact of recessions on their budgets from trends such as declines in property values. Municipalities are required to file 30 days in advance before they tap the facility, meaning that any other eligible state or local government that wants to borrow from the Fed has until Nov. 30 to file their own notice of interest.

"We still don't know what the next three, four, five, or even six months will look like. It makes sense to me that they extend it just in case there are high levels of shutdowns or something unexpected happens," said Tom Kozlik, head of municipal strategy and credit with Hilltop Securities. "I think [the municipal lending] program was set up for such an event. And it should be extended."

It wasn't. In a letter last week calling to Fed Chairman Jerome Powell to let the programs expire and return unused funds, Treasury Secretary Steven Mnuchin said that he believes the Fed's programs were successful, citing declines in yields on highly rated municipal bonds. And in a response published Friday, Powell said that the Treasury does have the option of using existing funds for "any Federal Reserve lending facilities that are needed to maintain financial stability and support the economy."

Still, muni bonds haven't rebounded to prepandemic levels, unlike corporate debt markets. The iShares National Muni Bond exchange-traded fund (ticker: MUB) has climbed about 15% since the end of March, compared to the iShares iBoxx $ Investment Grade Corporate Bond ETF's (LQD) roughly 30% rally.

Citigroup strategist Vikram Rai, another vocal supporter of extending the MLF, said in a Nov. 23 note that he thinks the Treasury made the wrong call. “For now, the markets have largely brushed off the announcement, which is expected. But it would be easier to trigger weakness and volatility. For [example], say a high-profile deal faces weak demand,” he wrote. “It could be enough to have a ripple effect and fan investor fears—this in turn could cause volatility spikes.”

Mnuchin also pointed out that only two state and local governments had used the facility as of Oct. 31: The MTA and the state of Illinois. Their borrowing combined adds up to a combined $1.7 billion, though that sum will rise to $4.6 billion after the MTA’s next planned use of the facility. That is indeed small compared to the broader market, which totals $3.9 trillion.

But strategists say that the MLF didn’t need to be used extensively to provide a backstop to the market.

“The importance of the MLF was always the fact that it was there, even if it wasn’t going to be used,” said Tom McLoughlin, fixed-income strategist at UBS. “As a consequence, it calmed a lot of nervous investors that there was this opportunity to borrow as a last resort.”

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By Alexandra Scaggs

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