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For Hiteshew, Fed Muni Backstop Sent Crucial Message.

- **Size showed Fed, Treasury were 'fully committed,' he says**
- **In interview, he says secondary-market facility was possible**

Kent Hiteshew is no stranger to the municipal market. In 2020, he helped the Federal Reserve put together the $500 billion Municipal Liquidity Facility. While the entity didn't make a lot of emergency loans, it did restore equilibrium after the pandemic shattered investor confidence.

The MLF stopped purchasing muni debt at the end of 2020. I caught up with Hiteshew via email last week to ask him about his time at the Fed. He joined the central bank after nearly three decades on Wall Street and a stretch leading the U.S. Treasury's Office of State and Local Finance. The interview has been edited for length and clarity.

JM: The MLF made only four loans to two issuers. Were you surprised more issuers didn't use the facility, or was this by design?

KH: At the time I joined the Fed last year and over the next two weeks as we developed and then announced the MLF, the market was in a state of unprecedented turmoil. During that period, we received many direct and indirect appeals for Fed intervention from both issuers and market makers.

Rather than an attempt at measuring actual loan demand, the $500 billion MLF sizing was based more on the goal of making sure the market understood that the Fed and Treasury were fully committed to using all of our resources to support stabilization and then restore normalization of the municipal market. So, although we believed there was a large but unknown need for the MLF when it was announced, we hoped that the full amount of the facility would never be needed. In the end, the market responded positively and very quickly — rates fell to historic low levels and issuance volume hit record levels. Most issuers who had expressed the need for a facility in March/April were able to access the public markets at interest rates much lower than those of the MLF. So, by the summer, barring a market reversal, we were not surprised by its limited use.

JM: Some people were disappointed that the Fed didn't buy munis in the secondary market, as it did for other asset classes. Did the Fed ever seriously consider doing so?

KH: The Fed certainly could have launched a municipal secondary market facility. But, based on feedback from issuers and other market participants, our first priority was ensuring the availability of operating liquidity to states and local governments so that they could continue to deliver essential services to their constituents during the pandemic. Remember, the federal income-tax filing deadline had just been extended 90 days and most state and local governments with income taxes had to follow suit. Income and sales-tax receipts were plummeting in response to the Covid lockdown and resulting economic seizure. The future was quite uncertain and we believed direct liquidity lending would be the fastest, most effective intervention.

Given the fragmented nature of the muni market, it would have taken longer to design and implement a secondary market facility. If the combination of all of the Fed's monetary policy tools, including the Money Market Liquidity Facility and the MLF, had been insufficient to stabilize the market, a secondary market facility could have been deployed. But, fortunately, that turned out to be unnecessary.

JM: How did your time at the Fed differ from your time at the Treasury?

KH: Much of my time at Treasury involved the Puerto Rico fiscal and economic crisis which required intensive interaction with both the White House and Congress resulting in Promesa. On the other hand, by the time I arrived at the Fed, the Cares Act was already in the midst of being approved by Congress and signed by the president. It provided the equity funding necessary to intervene in the credit markets while complying with the Fed's statutory obligation of protecting the taxpayer against loss. There was not really a question of whether the Fed would intervene in the municipal market but how it would do so.

My role was essentially working with senior Fed officials and the Board to design and execute the muni facility. However, since Dodd-Frank reforms were put in place in 2010, Treasury is required to approve any proposed market intervention by the Fed. So, ironically, I found myself working very closely and collaboratively again with some of my former colleagues at Treasury.

JM: Was all your work at the MLF done remotely?

KH: I worked from home during my entire tenure at the Fed. I had never previously known any of my Fed colleagues, nor did I ever meet any of them during my tenure — except virtually. I think this was pretty typical for all of us. But it was truly remarkable to be a part of an institution responsible for our country's monetary operations and policies that operated entirely remotely. I doubt that could have happened 10 years ago, if not even five.

JM: Were you surprised by how swiftly the municipal market rebounded?

KH: Yes, I think we all were. But I think we need to view the muni recovery within the broader context of the speed with which all of the capital markets and the economy recovered. The combined fiscal and monetary-policy responses of Congress and the Fed were unprecedented in both speed and magnitude. Unfortunately, the recovery has been a "tale of two cities." While the capital markets, including munis, recovered rapidly, we still have over 8 million fewer Americans employed than a year ago, including more than 1 million state and local government employees.

JM: What were (are) the Fed's biggest concerns in the muni market?

KH: I am no longer at the Fed and would not presume to speak for it. But I would point out that the Fed is not responsible for regulating the municipal market and probably does not have a singular policy view of munis. In any case, the Fed is very much interested in transparent and liquid functioning of all credit markets, including munis. Accordingly, I am very glad that the New York Fed has decided to add a full-time muni market specialist to its markets division — the hiring announcement of which should be forthcoming very soon.

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