Help for State and Local Governments: Federal Reserve Issues Additional Guidance on Municipal Liquidity Facility

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On Monday, April 27th, the Federal Reserve announced additional guidance regarding its Municipal Liquidity Facility (the “Facility”), which was first announced on April 9th and was established to buy short-term debt in municipal markets to address the economic impact of COVID-19. The major changes to the program outlined by the additional guidance are summarized below:

Eligibility. The population thresholds for City and County issuer eligibility were reduced as follows:

- City: 250,000 residents (down from 1,000,000).
- County: 500,000 residents (down from 2,000,000).

Multi-State Entities (“MSEs”) are also eligible to issue notes under the Facility. A MSE is “an entity that was created by a compact between two or more States, which compact has been approved by U.S. Congress, acting pursuant to its power under the Compact Clause of the U.S. Constitution.” For example, The Port Authority of New York and New Jersey would be considered a MSE under this definition.

A list of all “Eligible Issuers,” with the exception of eligible MSEs, is published here. Any changes in population that may be published in future U.S. Census Bureau releases will not affect the list of Eligible Issuers.

Ratings. Issuers must have an investment grade rating (at least BBB-/Baa3) as of April 8, 2020 from at least two (2) major nationally recognized statistical rating organizations (“NRSROs”). Eligible Issuers rated at least BBB-/Baa3 as of April 8, 2020, but whose ratings are subsequently downgraded, must be rated at least BB-/Ba3 by two (2) or more NRSROs at the time the Facility purchases the notes. MSEs must have a rating of at least A-/A3 as of April 8, 2020 by two (2) or more NRSROs. If the MSE’s rating is subsequently downgraded, it must have a rating of at least BBB-/Baa3 by two (2) or more NRSROs at the time of purchase.

Currently, the acceptable NRSROs for purposes of the Facility are (i) S&P Global Ratings, (ii) Moody’s Investor Service, Inc. and (iii) Fitch Ratings, Inc. (though the Federal Reserve indicates it is considering adding other NRSROs under the Facility).

In addition to rating eligibility requirements, Eligible Issuers must receive rating confirmations from each major NRSRO that has an outstanding rating of the Eligible Issuer and evidence that the NRSRO has been notified of the issuance of the notes by the Eligible Issuer.

Political Subdivisions. Eligible Issuers may use note proceeds to purchase notes from, or otherwise assist, any of their political subdivisions or other governmental entities that are not insolvent. The guidance defines “political subdivision or other governmental entity” broadly as “any county, city, municipality, township, village, school district, special district, utility authority, agency or other unit of government, as determined by the Eligible Issuer.” In this instance, the Issuer will bear the credit risk associated with such uses and remains liable for repaying the full amount of the debt to the Federal Reserve.

Term. All notes under the program must mature no later than three (3) years from the date of issuance, which adds an additional year to the previously announced two (2) year maturity restriction.
Security. Security required for notes purchased by the Facility will depend on the constitutional and statutory provisions governing the Eligible Issuer. Generally, for Eligible Issuers who are not MSEs, notes will be general obligations of the issuers or be secured by tax or other governmental revenues of the applicable State, City, or County. For Eligible Issuers who are authorities, agencies, or other entities of a State, City, or County, such issuer must commit either the credit of, or pledge revenues of, the State, City, or County, or have the State, City, or County guarantee the notes issued by such issuer. MSE notes are expected to be parity obligations of existing debt secured by a senior lien on the MSE’s gross or net revenues.

Pricing. Notes under the Facility will be offered at a penalty rate (in other words, a rate that is a premium to the market rate under normal circumstances). The Federal Reserve’s calculation for determining such rates will be based on the Eligible Issuer’s long-term rating and the maturity date, plus a spread over a publicly available benchmark or index. Notes issued under the Facility may be issued on either a tax exempt or taxable basis. It is not yet clear how the tax treatment of the notes will impact the pricing methodology to be established by the Federal Reserve.

Outstanding Notes. The Facility will not purchase outstanding TANs, TRANs or BANs. The Facility will be limited to the purchase of newly issued notes.

Adequate Credit Certification. An Eligible Issuer will be required to certify that it is “unable to secure adequate credit accommodations from other banking institutions and that it is not insolvent.” In making this certifications, Eligible Issuers should consider market and economic conditions the Facility is intended to address. This would include an analysis of the availability and price of credit from other sources. The guidance importantly notes that this certification does not mean the Eligible Issuer is certifying no credit is available, but instead that the prices or conditions in which other credit is available is inconsistent with a “normal, well-functioning market.”

Termination. The Facility’s termination date in which it will cease purchasing notes has been extended from September 30, 2020 to December 31, 2020. The Board of the Federal Reserve and the Treasury Department still retain the right to extend the Facility’s term to a later date.

PFM Financial Advisors LLC ("PFM") has been selected as administrative agent for the Facility. In its capacity as administrative agent, PFM will coordinate and review applications for note purchases under the Facility. It is not clear when PFM will begin accepting applications from Eligible Issuers.

The Federal Reserve’s FAQ containing these new terms can be found here.

Your regular Locke Lord contact and the authors of this article would be happy to help you navigate the provisions of the Municipal Liquidity Facility as it relates to your state or local government.

For more information on the matters discussed in this Locke Lord QuickStudy, please contact the authors.

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