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Fed Announces Pricing for Municipal Liquidity Facility

By John Banes, Eric McLaughlin, Eric B. Lewin & Andrew Rohrkemper on May 12, 2020

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The Federal Reserve **announced** on May 11 a revised term sheet and FAQs for its Municipal Liquidity Facility (**MLF**), which will provide up to $500 billion of direct support to states and local governments to help them manage cash flow stress related to the COVID-19 pandemic. Relative to the Federal Reserve's April 27 **expansion** of the facility, summarized in our blog post **here**, the MLF term sheet now contains a pricing methodology, relaxed requirements as to when an issuer must have obtained its credit ratings and modified prepayment terms and conditions.

Under the MLF, the Federal Reserve Bank of New York will lend to a special purpose vehicle (**SPV**) on a recourse basis, and the loan will be secured by all the assets of the SPV. The SPV in turn will purchase newly-issued qualifying debt (**Eligible Notes**) from certain state and municipal issuers (**Eligible Issuers**), and Eligible Issuers may use the proceeds of these sales for specified pandemic-related purposes (**Eligible Uses of Proceeds**). The SPV will receive a $35 billion initial equity investment from the U.S. Department of the Treasury, as authorized by the CARES Act.[1] The MLF is one of several facilities established by the Federal Reserve to provide liquidity in response to the COVID-19 pandemic, under its "unusual and exigent circumstances" powers, all of which are described in **this summary table**.

Key features of the MLF as of the May 11 announcement are described below. Additional details can be found in the May 11 revised **MLF term sheet** and revised **MLF FAQs**.

- Access to the MLF is limited to certain types of municipal Eligible Issuers, which may use the proceeds only for a limited set of purposes.
  - Eligible Issuers include:
    - U.S. states, defined to include the District of Columbia;

- U.S. cities with a population exceeding 250,000 residents (a lower threshold than the original 1 million resident requirement), based on U.S. Census data as of April 6, 2020;
- U.S. counties with a population exceeding 500,000 residents (a lower threshold than the original 2 million resident requirement), based on U.S. Census data as of April 6, 2020;
- At the Federal Reserve's discretion, an entity that issues securities on behalf of such state, city or county (which, as the FAQs clarify, might be an authority, agency department, division or other statutorily authorized entity); and
- **Multi-State Entities** (entities created by a Congressionally-approved compact between two or more states).

- A list of Eligible Issuers based on population, other than Multi-State Entities, is provided in **Appendix A** to the Federal Reserve Bank of New York's FAQs.
- The Federal Reserve is considering expanding the MLF to include certain governmental entities that issue bonds backed by their own revenue, and the Federal Reserve will publicly announce any such further expansion at a later date.
- To be eligible, issuers must meet certain minimum ratings requirements.
    - An issuer, other than a Multi-State Entity, must have been rated at least BBB-/Baa3 as of April 8, 2020 by two or more major nationally recognized statistical rating organizations (**major NRSROs**) and be rated at least BB-/Ba3 by two or more major NRSROs at the time of its issuance of Eligible Notes to the SPV. As set forth in the revised May 11 term sheet, if the issuer, other than a Multi-State Entity, was rated by only one major NRSRO as of April 8, 2020, it is nonetheless eligible if that rating was at least BBB-/Baa3, the issuer is rated by at least two major NRSROs at the time of its issuance of Eligible Notes to the SPV and all such ratings at the time of the issuance are at least BB-/Ba3.
    - A Multi-State Entity must have been rated at least A-/A3 as of April 8, 2020 by two or more major NRSROs and be rated at least BBB-/Baa3 by two or more major NRSROs at the time of its issuance of Eligible Notes to the SPV. As set forth in the revised May 11 term sheet, if the Multi-State Entity was rated by only one major NRSRO as of April 8, 2020, it is nonetheless eligible if that rating was at least A-/A3, the issuer is rated by at least two major NRSROs at the time

    of its issuance of Eligible Notes to the SPV and all such ratings at the time of the issuance are at least BBB-/Baa3.

    - The FAQs now clarify that "major NRSRO" refers to S&P Global Ratings, Moody's Investor Service, Inc., Fitch Ratings Inc. and Kroll Bond Rating Agency, Inc.
    - The FAQs also explain that if an Issuer will first offer Eligible Notes through a competitive sale process, the Eligible Issuer must obtain ratings for the Eligible Notes. If there is no competitive sale process, the Federal Reserve will not require ratings on the Eligible Notes.
  - Only one issuer is eligible for each state, city, county or Multi-State Entity.
    - The Federal Reserve may grant exceptions to this rule and approve additional issuers per state, city or county.
  - Eligible Uses of Proceeds include the management of the cash flow impact associated with:
    - Income tax deferrals due to filing deadline extensions;
    - Deferrals or reductions in tax revenues or increases in expenses due to the coronavirus pandemic; and
    - Interest and principal payments on obligations of the Eligible Issuer or its political subdivisions or other governmental entities.
  - An Eligible Issuer, other than a Multi-State Entity, may also use the proceeds to purchase similar notes issued by, or otherwise to assist, political subdivisions and other governmental entities of the relevant state, city or county for these purposes.

- Eligible Notes must satisfy certain criteria.
  - Eligible Notes may have a maturity of up to 3 years, may be prepaid by the Eligible Issuer at any time at par (or, if the Eligible Notes are purchased at a premium, par plus unamortized premium) plus accrued interest with approval of the SPV (a changed from previously announced permitted prepayment at par with Federal Reserve approval) and include the following instruments:
    - Tax anticipation notes (**TANs**);
    - Tax and revenue anticipation notes (**TRANs**);
    - Bond anticipation notes (**BANs**); and
    - Other similar short-term notes.

  - Eligible Notes are subject to review and approval by the Federal Reserve as to the source of repayment and security for the notes. The Federal Reserve has provided the following guidance:
    - Eligible Notes should generally be consistent with the source of repayment and strongest security typically pledged to repay publicly offered obligations of the Eligible Issuer.
    - For Eligible Issuers other than Multi-State Entities, this generally means general obligation notes or notes backed by tax or other specified governmental revenues.
    - For Eligible Issuers that are authorities, agencies or other entities of a state, city or county, the issuer must commit the credit or revenues of, or obtain a guarantee from, its associated state, city or county.
    - For Eligible Issuers that are Multi-State Entities, the Eligible Notes are expected to be pari passu with existing senior-secured debt secured by the issuer’s gross or net revenues.
- The SPV is limited in the quantity of Eligible Notes of a single state, city, county or Multi-State Entity that it may purchase.
  - For states, cities and counties, the SPV generally may purchase Eligible Notes only up to an aggregate amount of 20% of the general revenue from own sources and utility revenue of the state, city or county for fiscal year 2017.
    - States may request that the SPV purchase Eligible Notes in excess of this limit in order to assist political subdivisions and other governmental entities that are ineligible to access the MLF.
  - For Multi-State Entities, the SPV may purchase Eligible Notes only up to an aggregate amount of 20% of the gross revenue of the Multi-State Entity as reported in its fiscal year 2019 audited financial statements.
- The prices at which the SPV will purchase Eligible Notes will be based on the Eligible Issuer’s rating at the time of pricing, based on a methodology now described in the MLF’s Pricing Appendix at the end of the term sheet.
  - For tax-exempt Eligible Notes, the fixed interest rate will be the OIS rate plus a predetermined spread based on the long-term rating of the security for the Eligible Notes. Taxable Eligible Notes will have the pricing of tax-exempt Eligible Notes, but then divided by .65 as a gross-up.

        - Split credit ratings generally will be addressed using an average rating. The FAQs provide additional information regarding how such averages will be computed.
    - In addition, the MLF imposes an origination fee of 10 bps of the principal amount of an Eligible Issuer's Eligible Notes purchased by the SPV.

- Disclosure
    - By the Federal Reserve
        - According to the FAQs, the Federal Reserve will publicly disclose information about the MLF monthly, including names of participants, along with amounts borrowed and pricing.
    - By Eligible Issuers
        - The FAQs also state that Eligible Issuers offering Eligible Notes in a competitive sale process should anticipate similar disclosure to the MLF as would be ordinary in a public offering. For Eligible Notes for which the Eligible Issuer is not conducting a competitive sale process, the Federal Reserve is requesting certain financial information as specified in the FAQs. Continuing disclosure obligations under Securities and Exchange Commission Rule 15c2-12 will apply, plus additional specified regular public disclosure obligations.

- Administrative issues and logistics:
    - Unless the Federal Reserve and the U.S. Department of the Treasury announce an extension, the SPV will cease purchasing Eligible Notes on December 31, 2020.
    - The MLF is not yet operational, and the Federal Reserve stated in the FAQs that it will announce the operational date in advance of the MLF commencing operations.
    - To participate in the MLF, Eligible Issuers must complete a Notice of Interest (**NOI**) form that will be published on the Federal Reserve Bank of New York's website. The FAQs state that MLF is not a first come, first served program, so NOIs should not be filed until the Eligible Issuer determines its needs.
        - Multiple issuances, up to the Eligible Issuer's limit, are permitted, and each will require a separate NOI.

    - Nonetheless, the FAQs warn against using the MLF like a line of credit through frequent, small issuances, with the Federal Reserve reserving the right to impose limits on number and size of issuance to enforce this.
- The FAQs state that Eligible Issuers must complete an Application before mailing a Preliminary Offering Statement in a competitive transaction and prior to the pricing of any transaction. Moreover, the FAQs add that Eligible Issuers should use standard forms of note and documents they would typically use for a securities sale.
    - Application materials are still forthcoming.
- Questions may be submitted via email to **MLF@ny.frb.org**.

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[1] For more information on the CARES Act, please visit our summary **here**.