

\$500 BILLION IN DIRECT FEDERAL LOANS AVAILABLE FOR LOCAL GOVERNMENTS

Hodgson Russ Municipal Alert
April 14, 2020

This alert describes a newly-announced Federal Reserve program to support the municipal bond market and the flow of credit and liquidity to state and local governments. Up to \$500 billion in direct federal short-term lending will be made available to help these governments manage cash flow disruptions arising out of the pandemic. These loans can be directly accessed by the largest state, county and city borrowers, and indirectly accessed by smaller governmental issuers (including smaller counties and cities, as well as towns, villages and school districts), once the program is fully in place.

Fed Action: The Federal Reserve (the "Fed") has taken some recent additional actions under the \$2.3 trillion CARES Act to further support the U.S. economy. These actions include the creation of a new federal entity that will make direct purchases of up to \$500 billion of notes of certain local governments. This program is designed to help issuers obtain credit in a difficult market environment, and to manage cash flow stresses caused by the pandemic.

Fed Rationale: The economic crisis has rattled the \$4 trillion municipal bond market. In mid-March, bondholders worried about state and local finances engaged in a wave of panic selling, driving short-term yields higher, and creating a significant liquidity crisis. The short-term market stabilized somewhat when the Fed signaled that it would backstop the municipal bond market, and this move is a significant step in that direction.

New Lending Facility: The Fed is establishing a new "Municipal Liquidity Facility" (the "MLF") that will offer up to \$500 billion in direct lending to state and local governments. The MLF will make the loans by purchasing "Eligible Notes" directly from "Eligible Issuers," as explained below.

Eligible Notes: The MLF will purchase tax and revenue anticipation notes (TRANs), bond anticipation notes (BANs), and similar notes having a term of two years or less. Typical legal opinions and disclosures will be required.

Eligible Issuers: The MLF will make loans directly to states, to counties with at least two million residents, and to cities with at least one million residents. Importantly, these larger issuers may then use the loan proceeds to support (through similar, secondary, loans) smaller governmental units that would not otherwise qualify as

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Eligible Issuers.

Limit: The limit for any Eligible Issuer is 20% of general revenue and utility revenue for fiscal year 2017. However, issuers may ask to exceed this limit in order to assist smaller political subdivisions and instrumentalities.

Pricing/Interest Rate: Pricing will be based on an Eligible Issuer's bond rating at the time of purchase, with details to be provided later.

Origination Fee: The Eligible Issuer must pay to the MLF an origination fee of 0.1% of the principal amount of the loan, but the origination fee may be paid from the loan proceeds.

Early Call Right: The notes purchased by the MLF are callable by the Eligible Issuer at any time, at par, without any prepayment penalty.

Use of Proceeds: Proceeds may be used to help manage the cash flow impact of income tax deferrals resulting from an extension of income tax filing deadlines, potential reductions of tax and other revenues or increases in expenses related to or resulting from the pandemic, and requirements for the payment of principal and interest on outstanding obligations.

Trickle Down Concept: Importantly (for smaller issuers), a large Eligible Issuer may use the loan proceeds that it receives to purchase similar notes that are issued by, or otherwise to assist, their smaller included political subdivisions and instrumentalities, for the same purposes described above. So, for example, if New York State were to borrow from the MLF, it could then use some or all of the loan proceeds to make similar loans to counties, cities, towns, villages, school districts and other political subdivisions in New York that would not otherwise qualify on their own to be "Eligible Issuers." The exact mechanism for this process has not yet been established.

Termination Date: The MLF will make loans through September 30, 2020, unless it is extended.

Some Uncertainties: As with any new program that is put together quickly, some of the details must still be clarified. The Fed is taking specific comments on the plan through April 16, but the broad outlines are in place and are not expected to change.

Further Fed Actions Possible: The Fed will closely monitor conditions in the primary and secondary markets for municipal securities and will evaluate whether additional measures are needed to support the flow of credit and liquidity to state and local governments.

Action Steps: Municipal issuers should carefully monitor their cash flow projections in light of the pandemic. If it appears that a cash flow borrowing will be necessary, please call us so that we can help structure the financing, either through an issue of notes to the market, or through a direct or indirect issue of notes to the new MLF.

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Please check our Coronavirus Resource Center and our CARES Act page to access information related to both of these rapidly evolving topics.

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