MEMORANDUM

TO: State and Local Legislators, Executives, & Public Finance Departments
FROM: Robert Hockett, Edward Cornell Professor of Law, Cornell University
DATE: 28 April 2020
RE: Updated Community QE / Fed Municipal Liquidity Facility

INTRODUCTION

This week the Fed announced further easing of its three-week-old Municipal Liquidity Facility (‘MLF,’ ‘Facility’) for States and their Subdivisions struggling to address the national COVID-19 pandemic. Because this revised Community QE, as I’ll call it, will be functioning as a literal lifeline to States and their Subdivisions, and because it remains, in light of its novelty, as unfamiliar as it will be essential, this Memorandum briefly summarizes what the newly eased Facility enables now and will likely enable in future. It also recommends an updated three-phase ‘Game Plan’ for States and Cities to put into operation with all deliberate speed – particularly if they have not yet acted on the earlier Game Plan this author put out at the beginning of April.

I. THE REVISED MLF: KEY CURRENT PROVISIONS

The revised MLF will continue to operate under color of Section 13(3) of the Federal Reserve Act (‘FRA’), which grants the Federal Reserve emergency lending authority in exigent circumstances. The Fed exercises this authority through purchase and hence ‘monetization’ of financial instruments. In this case the instruments in question will be what the MLF Term Sheet calls ‘Eligible Notes’ issued by ‘Eligible Issuers.’ The following provisions are of the most immediate importance. Present exceptions to, and likely future liberalizations of, terms are highlighted along the way.

(1) Direct Purchase. The MLF, as administered by the Federal Reserve Bank of New York (FRBNY), will purchase securities directly from States or their Subdivisions. The securities will not have to be sold first on the ‘open market’ to private sector financial institutions, as is the case with Fed purchases under the FRA Section 14 authority. The ‘window’ through which the Fed will do this, previously scheduled to remain open till the end of September, will now remain open till the end of December.

(2) Three-Year Maturity. The months-to-maturity on the State and Municipal paper in question will be, for now, 36 rather than 12 months as originally anticipated or 24 months...
as announced earlier this month. Crucially, however, these durations could well be extended still further for reasons provided below.

(3) **Eligible Notes.** Presently the Term Sheet requires that Eligible Notes be ‘tax anticipation notes (TANs), tax and revenue anticipation notes (TRANs), bond anticipation notes (BANs), [or] other similar short-term notes issued by Eligible Issuers,’ which can secure lending only up to 20% of each relevant issuer’s ‘general revenue from own sources and utility revenue’ for the fiscal year 2017. Crucially, however, three-year notes enable far more to be characterized as ‘revenue-anticipating’ in character than the earlier-forecast six, twelve, or twenty-four-month notes would have enabled. Moreover, ‘States may request that the SPV purchase Eligible Notes in excess of the applicable limit in order to assist political subdivisions and instrumentalities that are not presently eligible for the Facility’ (emphasis added).

(4) **Eligible Issuers.** The Term Sheet stipulates that Eligible Issuers will be all U.S. States and the District of Columbia, U.S. Counties with populations exceeding 500,000, and U.S. Cities with populations exceeding 250,000. Crucially, however, the Term Sheet permits ‘States [to] request that the SPV purchase Eligible Notes in excess of the applicable limit in order to assist political subdivisions and instrumentalities that are not eligible for the Facility.’ A full list of Counties and Cities that now qualify as Eligible Issuers is available [here](#). Moreover, the Term Sheet now expressly provides for Multi-State Entities established by interstate compacting among any two or more States. Parties interested in the prospect will find contact information to learn more below.

(5) **Eligible Use.** Presently the Term Sheet stipulates that proceeds of Note sales be used ‘to help manage the cash flow impact of income tax deferrals resulting from an extension of an income tax filing deadline; potential reductions of tax and other revenues or increases in expenses related to or resulting from the COVID-19 pandemic; and requirements for the payment of principal and interest on obligations...’ The Fed seeks in these words to encourage perception of the MLF as a tide-over facility meant to assist counterparties in, as the Term Sheet puts it, ‘managing [their] cash flows.’ Crucially, however, other sections of the Term Sheet emphasize the prospect of longer-term ‘rollover’ of Note debt, while analysts also anticipate expansion of coverage from 36-month to longer-term paper as explained immediately below. Moreover, as noted above, three-year instruments allow for far more uses to be characterized as ‘revenue-anticipation’ measures than those customarily associated with that phrase.

### II. The Next MLF: Possible Further Easing Ahead

Much of the language found in the new, as in the earlier, MLF Term Sheet suggests that present conditionality might be loosened even further than it has been already relative to what was anticipated last month and what was first announced this month. There are two additional reasons, outside ‘the four corners of the document,’ which further underwrite expectation of further easing.

(1) **Fed Interpretive Pronouncements.** Chairman Powell and the Fed Board of Governors have publicly encouraged a quite ‘flexible’ interpretation of all conditional language found in the MLF’s Term Sheet. They have also repeatedly stated that they will be
monitoring the municipal debt (‘muni’) markets for signs of resumed volatility, with an eye to intervening yet further to stabilize them if and as necessary. Combined with the many openings for extension and exception specified in the Term Sheet itself as described above, these amount to assurances that the MLF is a ‘work in progress’ whose scope will expand if and as the need for it expands.

(2) Analyst Prescriptions & Predictions. Bond market and public finance experts have called on the Fed to purchase State and Municipal debt with maturities not only in excess of traditional 6-month and 12-month durations, but also in excess of the previous 24-month and the new 36-month durations. The Fed has done nothing to discourage such calls. Most commentators, not to mention ‘smart money’ on the markets, seem now to anticipate upwards of five-year State and Municipal debt to find its way onto the MLF balance sheet before the Facility completes its mission. The fact that the move from 24-month to 36-month notes came within less than three weeks lends color to that expectation. While it of course cannot be predicted with certainty, States and Cities faced with serious crises should judge maturity lengthening more likely than not.

III. A Late April ‘Game Plan’ for States & Their Subdivisions

In light of the above, States and their Subdivisions should be planning for use of the newly eased MLF immediately. This Facility, again, is unprecedented – the Fed is improvising right now. What States and Cities do now in response to the improvisation will thus be decisive in determining what shape the MLF takes as it unfolds. States and their Subdivisions are in other words co-authors of this new authority. It will ultimately be what they make of it. The following updated three-phase ‘Game Plan’ is proposed with that ‘existential’ truth in view.

(1) Phase One: Immediate ‘Quantitative’ Legislative & Executive Sessions. All State Governors and Legislatures, as well as their eligible County and City counterparts, should go into emergency session at once, ‘virtually’ if need be, to determine how much funding to seek from the MLF. The State sessions should also include (a) representatives of the States’ principal Subdivisions, (b) appropriate Public Finance personnel, and (c) representatives of the regional Federal Reserve Banks in whose operational jurisdictions the relevant States and Subdivisions are located. Because the need of funds generally is likely to be recognized and agreed upon even more quickly than the full panoply of uses of funds, Phase One can be limited to deliberation and decision over how much funding to seek and whom to authorize to begin preparations for seeking it. Additionally, States and their Subdivisions at this stage should open regular channels of communication both with the FRBNY, which will administer the MLF, and with their regional Federal Reserve Banks, all of which have Public Affairs Offices for the purpose. The author of this Memorandum is currently organizing webinar sessions for State and Municipal officials on the one hand, and the Public Affairs Offices of regional Federal Reserve Banks on the other hand. Officials may also contact FRBNY’s MLF administrators directly at: Tel: 202-452-2955; Email: MLF@ny.frb.org. A full list of Eligible Issuers, as well as answers to Frequently Asked Questions, is available here.

(2) Phase Two: Subsequent ‘Allocative’ Sessions. Once all Phase One decisions have been reached and the appropriate State and Local personnel have been assigned their Fed-liaising and Note-issuing tasks, States and their Subdivisions can proceed directly to
Phase Two preparations – gathering information, testimony, advice and all other deliberative ‘inputs’ necessary to make sensible allocation decisions in respect of the new funding that will be incoming from the MLF. Crucially, some States and Subdivisions will likely see advantage in establishment of State-wide Coordinating Bodies through which States and all relevant Subdivisions can plan together in issuing Eligible Notes and directing resultant funds. Additionally, some States and Subdivisions will see advantage in developing such coordinating bodies into full Public Banks, which can not only help store and disburse funds, but also can help lever them into additional moneys, as well as ensure that all State residents have access to banking and payment services.

(3) Phase Three. Later ‘Envelope-Pushing’ Sessions. Once Phase Two deliberations end in allocation and, possibly, Coordinating Body or Public Bank chartering decisions, States and their Subdivisions might turn to ‘Phase Three’ deliberations over whether and how to press the Fed for yet further easing of the terms of the MLF Term Sheet. It might be decided, for example, that authorization to purchase State and Municipal paper of longer maturity than 36 months should be sought – even up to 5 year notes as many analysts predict, or that a rollover option should be made more explicit. These questions can presumably wait, however, until current uncertainties ‘on the ground’ are resolved. With any luck, the pandemic might be contained before we reach any Phase 3.

Conclusion

However this may be, what matters now is that Phase One commence, and that it commence ‘with all deliberate speed.’ The author of this Memorandum will continue to watch events unfold, and will follow-up with further reporting and recommendations on an ‘as [seems to be] needed’ basis. He can be reached any time at RCH37@cornell.edu. Best wishes to all as we now reassume control of our public health and productive potential.