Simpson Thacher

# Memorandum

## Federal Reserve Establishes Municipal Liquidity Facility

April 13, 2020

As part of the $2.3 trillion loan program announced on April 9, 2020,[1] the Federal Reserve established the Municipal Liquidity Facility ("MLF") pursuant to the Federal Reserve's emergency lending authority under section 13(3) of the Federal Reserve Act. The MLF will offer up to $500 billion in lending to U.S. states and the District of Columbia, U.S. cities with a population exceeding one million residents, and U.S. counties with a population exceeding two million residents.[2] States, cities, and municipalities will be able to issue new notes directly to the MLF. These funds will help offset the delay in state and local tax receipts caused by the deferral of the tax filing deadline and any short term losses in tax revenues resulting from reduced business and consumer activity due to the coronavirus disease 2019 ("COVID-19") pandemic.

Under the MLF, a Federal Reserve Bank will commit to lend to a special purpose vehicle ("SPV") on a recourse basis. The SPV will purchase notes directly from states and municipalities at the time of issuance. The Treasury Department will make an initial equity investment of $35 billion in the SPV in connection with the MLF. The MLF will have the ability to purchase up to $500 billion of municipal notes.

A summary of the key terms of the MLF is provided below.

- **Eligible Notes**: Eligible Notes are tax anticipation notes ("TANs"),[3] tax and revenue anticipation notes ("TRANs"),[4] bond anticipation notes ("BANs"),[5] and other similar short-term notes issued by Eligible Issuers (as described below), provided that such notes mature no less than two years from the date of issuance. In each case, a note's eligibility is subject to review by the Federal Reserve. Relevant legal opinions and disclosures will be required as determined by the Federal Reserve prior to purchase.

[1] The remaining $1.8 trillion goes towards a $350 billion expansion of the Small Business Administration's Paycheck Protection Program through term financing backed by PPP loans to small businesses, expanding the size and scope of the Primary and Secondary Market Corporate Credit Facilities and the Term Asset-Backed Securities Loan Facility by $750 billion and $100 billion respectively, and the establishment of the Main Street Business Lending Program that makes $600 billion in new financing available to eligible small- and medium-sized businesses.

[2] City and county populations are based upon census bureau data.

[3] Tax anticipation notes are issued by states or municipalities to finance current operations before the tax revenues used to repay the notes are received.

[4] Tax and revenue anticipation notes are issued by states or municipalities to finance current operations that will be repaid from tax and other revenues sources.

[5] Bond Anticipation Note are short-term notes issued by states or municipalities issued to finance projects in advance of a larger, future bond issuance that would fund the repayment of the notes.

- **<u>Eligible Issuer</u>**: An Eligible Issuer is a State, City, or County (or an instrumentality thereof that issues on behalf of the State, City, or County for the purpose of managing its cash flows), in each case subject to review and approval by the Federal Reserve. Only one issuer per State, City, or County is eligible.
- **<u>Limits per Issuer</u>**: The SPV may purchase Eligible Notes from an Eligible Issuer up to an aggregate amount of 20% of the general revenue from own sources[6] and utility revenue of the Eligible Issuer for the fiscal year 2017.[7] 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 eligible for the MLF.
- **<u>Pricing</u>**: Pricing will be based on an Eligible Issuer's rating at the time of purchase with details to be provided later.
- **<u>Origination Fee</u>**: The origination fee will be equal to 10 bps of the principal amount of the Eligible Issuer's notes purchased by the SPV. The origination fee may be paid from the proceeds of the issuance.
- **<u>Call Right</u>**: Eligible Notes under the MLF are callable by the Eligible Issuer at any time at par.
- **<u>Eligible Use of Proceeds</u>**: An Eligible Issuer may use the proceeds 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 of the relevant Eligible Issuer. An Eligible Issuer may use the proceeds to purchase similar notes issued by, or otherwise to assist, political subdivisions and instrumentalities of the relevant State, City, or County for the purposes listed in the previous sentence.
- **<u>Program Termination</u>**: The SPV will cease purchasing Eligible Notes on September 30, 2020, unless the MLF is extended by the Federal Reserve and Treasury Department. The Federal Reserve Bank will continue to fund the SPV until the SPV's underlying assets mature or are sold.

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[6] General revenue from own sources includes revenue from taxes, education, hospitals, highways, air transportation, sea and inland port facilities, natural resources, parks and recreation, housing and community development, sewerage, solid waste management, interest earnings, special assessments, sale of property, and other general revenue.

[7] Source: U.S. Census Bureau, 2017 State & Local Government Historical Datasets and Tables, as of April 6, 2020 (https://www.census.gov/data/datasets/2017/econ/local/public-use-datasets.html).

We offer a dedicated team of advisors to help businesses weigh available options and seek assistance under one or more of the liquidity and support programs established under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). Whether in the form of direct funding from Treasury, loans or other credit support from a Federal Reserve lending facility or participation in Small Business Administration loan programs, our team has the expertise to help navigate the complex political and legal challenges associated with obtaining government financial assistance and the experience to help access the programs if a decision is made to do so.

Led by Lee Meyerson, who guided the Firm's financial crisis team that advised Treasury in developing, structuring and documenting its $250 billion TARP program for purchasing equity in U.S. financial institutions and related programs, and Keith Noreika, who recently served with Treasury Secretary Mnuchin as acting Comptroller of the Currency, a role in which he also acted as a director of the FDIC and member of the Financial Stability Oversight Council, the cross-disciplinary team also includes financing and governance lawyers, as well as former Treasury and Federal Reserve counsel.

See our Accessing Emergency Government Support Programs webpage for further information.

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