Simpson Thacher

Memorandum

UPDATE: Federal Reserve Expands Municipal Liquidity Facility

May 4, 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.[2] On April 27, 2020, the Federal Reserve issued an updated term sheet[3] expanding the scope and duration of the originally announced MLF program; the Federal Reserve also released guidance in response to frequently asked questions.[4] This updated memorandum supersedes the Firm's April 13th memorandum on this topic and covers the latest available information on the MLF.

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 250,000 residents (reduced from one million), U.S. counties with a population exceeding 500,000 residents (reduced from two million),[5] and Multi-State Entities.[6] The updated population thresholds allow substantially more entities to borrow directly from the MLF than under the initially announced thresholds. The updated term sheet adds a requirement eligible states, cities and municipal issuers must have been rated at least BBB-/Baa3 as of April 8, 2020 in order to participate in the MLF and Multi-State Entities must have been rated at least A-/A3 as of April 8, 2020 in order to participate in the MLF.

States, cities and municipalities will be able to issue new notes directly to the MLF. The updated term sheet provides examples of which types of note security will generally be acceptable, however, note security will ultimately be subject to review and approval by the Federal Reserve. 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

[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] https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200409a3.pdf.

[3] https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200427a1.pdf.

[4] https://www.newyorkfed.org/markets/municipal-liquidity-facility/municipal-liquidity-facility-faq.

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

[6] A Multi-State Entity is an entity that was created by a compact between two or more States, which compact has been approved by the U.S. Congress, acting pursuant to its power under the Compact Clause of the U.S. Constitution.

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 Eligible Issuers 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.

The Federal Reserve indicated that application materials are still being assembled and details regarding application materials and the date on which the Federal Reserve will commence accepting applications for the MLF will be posted on its public website when available.

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

- **Eligible Notes**: Eligible Notes are tax anticipation notes (“TANs”),[7] tax and revenue anticipation notes (“TRANs”),[8] bond anticipation notes (“BANs”),[9] and other similar short-term notes issued by Eligible Issuers (as described below), provided that such notes mature no less than three 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.
- **Eligible Issuer**: An Eligible Issuer is a State, City, County (or, subject to Federal Reserve review and approval, an entity that issues on behalf of the State, City or County for the purpose of managing its cash flows), or a Multi-State Entity.[10] Only one issuer per State, City, County or Multi-State Entity is eligible; provided that the Federal Reserve may approve one or more additional issuers per State, City or County to facilitate the provision of assistance to political subdivisions and other governmental entities of the relevant State, City or County.
    - States, Cities, Counties or entities that issue on their behalf must have been rated at least BBB-/Baa3 as of April 8, 2020, by two or more major nationally recognized statistical rating organizations (“NRSROs”).[11] If a State, City or County was rated at least BBB-/Baa3 as of April 8, 2020, but is

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

[8] 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.

[9] 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.

[10] A list of Eligible Issuers (other than Multi-State Entities) is available here: https://www.newyorkfed.org/medialibrary/media/markets/municipal-liquidity-facility-eligible-issuers.

[11] Currently, the ratings criteria for the MLF refer to ratings provided by three NRSROs: S&P Global Ratings, Moody’s Investor Service, Inc., and Fitch Ratings, Inc. The Federal Reserve is considering including other NRSROs under the MLF.

subsequently downgraded, it must be rated at least BB-/Ba3 by two or more major NRSROs at the time the MLF makes a purchase.

  - A Multi-State Entity must have been rated at least A-/A3 as of April 8, 2020 by two or more major NRSROs. If a Multi-State Entity was rated at least A-/A3 as of April 8, 2020, but is subsequently downgraded, it must be rated at least BBB-/Baa3 by two or more major NRSROs by the time the MLF makes a purchase.

- **Security for Eligible Notes**: Note security will be subject to review and approval by the Federal Reserve. The source of repayment and security for Eligible Notes will depend on the applicable constitutional and statutory provisions governing the Eligible Issuer and should be generally consistent with the source of repayment and strongest security typically pledged to repay publicly offered obligations of the Eligible Issuer. Eligible Notes issued by Eligible Issuers that are not Multi-State Entities will generally be expected to represent general obligations of the Eligible Issuer, or be backed by tax or other specified governmental revenues of the applicable State, City or County. If the Eligible Issuer is an authority, agency or other entity of a State, City or County, such Eligible Issuer must either commit the credit of, or pledge revenues of, the State, City or County, or the State, City or County must guarantee the Eligible Notes issued by such issuer. If the Eligible Issuer is a Multi-State Entity, the Eligible Notes will be expected to be parity obligations of existing debt secured by a senior lien on the Multi-State Entity's gross or net revenues.

- **Limits per Issuer**: The SPV may purchase Eligible Notes issued by or on behalf of a State, City or County up to an aggregate amount of 20% of the general revenue from own sources[12] and utility revenue of the Eligible Issuer for the fiscal year 2017.[13] 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. The SPV may purchase Eligible Notes issued by a Multi-State Entity in one or more issuances of up to an aggregate amount of 20% of the Multi-State Entity's gross revenue as reported in its audited financial statements for the fiscal year 2019.

- **Pricing**: Pricing will be based on an Eligible Issuer's rating at the time of purchase with details to be provided later.

- **Origination Fee**: 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.

- **Prepayment Right**: Eligible Notes purchased by the SPV may be prepaid by the Eligible Issuer at any time, in whole or in part, at par prior to maturity with the approval of the Federal Reserve.

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[12] 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.

[13] 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).

- **Eligible Use of Proceeds**: 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; deferrals or 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 or its political subdivisions or other governmental entities. An Eligible Issuer (other than a Multi-State Entity) may use the proceeds to purchase similar notes issued by, or otherwise to assist, political subdivisions and other government entities of the relevant State, City or County for the purposes listed in the previous sentence.
- **Program Termination**: The SPV will cease purchasing Eligible Notes on December 31, 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.

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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