March 31, 2020

VIA Electronic Mail

The Honorable Steven Mnuchin
Secretary of the Treasury
Main Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

The Honorable Jerome Powell
Chair of the Board of Governors
The Federal Reserve
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

RE: Implementing Section 4003 of the CARES Act

Dear Secretary Mnuchin and Chairman Powell,

On behalf of the state and local finance officials that we collectively represent, we applaud the actions taken by the Administration, the Federal Reserve and Congress to stabilize our markets through this COVID-19 outbreak. We now write regarding the urgent need for further action to support state and local finances, and our willingness to serve as a resource as you implement various provisions of the Coronavirus Aid, Relief and Economic Security Act ("CARES Act").[1]

States and local governments have been and will continue to serve on the frontlines of this national crisis. As you know, an historic cash panic, prolonged paralysis in the primary municipal bond market, and impending budget shocks stemming from the pandemic have all culminated at once, forcing many businesses and nearly every state and local government into an unprecedented state of damage control. Absent support for the municipal debt market, state and local government budgets will be further stressed at the most inopportune time, particularly as revenues decline as a result of business closures and rising unemployment.

Section 4003(b)(4) of the CARES Act provides at least $454 billion to the Treasury's Economic Stabilization Fund ("ESF") for direct lending, loans, loan guarantees and other investments in support of Federal Reserve lending facilities to eligible businesses, states and municipalities. Below, we have outlined ways in which such facilities can provide essential relief to strained state and local governments, and to further our shared goals of maintaining liquidity in our financial markets and stabilizing the economy. It is worth noting that the following is not an exhaustive list and the needs of the public sector will continue to evolve as this crisis and its ensuing market impacts unfold. The following facilities do, however, broadly address many of the most urgent needs we are hearing from our members at this time.

[1] "Coronavirus Aid, Relief and Economic Security Act." H.R. 748. 116th U.S. Congress. § 4003(b)(4).

Create a temporary "Municipal Securities Purchasing Facility" to provide broad relief to the secondary municipal securities market and restore market conditions necessary for underwriters to resume the volume of primary issues seen prior to the crisis.

The stability of the $3.8 trillion municipal bond market is particularly important during this crisis as state and local governments and the municipal bond market provide critical support for infrastructure, including hospitals and other projects needed to care for and support our citizens. Prior to passage of the CARES Act, issuance of municipal bonds precipitously declined from $10-15 billion per week in February to virtually zero the week of March 16. Before the start of this crisis, the market was on track for a record amount of municipal bond issues, originally projected to exceed $450 billion this year.

The primary market freeze that is denying many municipal issuers the credit they need stems directly from pressures in the secondary market, which drives bond valuations in our market. We believe the most effective way to normalize the volume of primary issues is for the Federal Reserve to begin purchasing a large and diverse array of municipal securities in the secondary market. Widely reported news of this facility being included in the CARES Act touched off a significant recovery in the secondary market last week, and there are tentative signs that the primary market will begin to re-open this week. Market participants appear to be expecting a large, quickly launched, and broad-based facility such as the one we outline.[2] However, if the new facility comes up short of those expectations, we fear that the market will once again take a turn for the worse.

We recommend the facility purchase a sufficient volume of securities in the secondary municipal bond market to normalize Muni-Treasury spreads broadly throughout the municipal market. The facility should include the flexibility and inclusivity to support securities from all types of issuers with a diverse array of credit ratings and terms. We appreciate the Federal Reserve's actions to date, which have provided targeted relief on the short end of the municipal markets, but municipal market benchmarks are largely driven by longer-term maturities. Therefore, the Federal Reserve must also include longer term municipal securities (with maturities up to 30-years) in its purchasing programs. Unlike corporates, municipal securities are predominantly used to finance projects and assets with decades-long life cycles, and as a result, our market is largely composed of longer-term securities. Central bank purchases of longer-term municipal securities are not unprecedented.[3]

In this period of economic uncertainty, the sudden rush for cash continues to hamper issuers' access to lines of credit across the credit rating and term spectrum— impacting communities, critical projects and services throughout the country. Restricted access to the primary market will have an even longer-term negative impact on state and local governments. Moreover, a significant percentage of municipal bonds are held by retail investors, either directly or via

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[2] Funk, Lynne and Aaron Weitzman. "Munis Finish Huge-Rally Week with Another Day of Firmness." *The Bond Buyer*. March 27, 2020. Web access: www.bondbuyer.com/news/munis-stronger-again-after-unprecedented-coronavirus-driven-month

[3] The European Central Bank's 2015 Public Sector Purchase Program serves as a useful benchmark in this regard, and astutely included European municipal bonds from 1-30 years. "Public Sector Purchase Programme (PSPP) — Questions & Answers" *European Central Bank.* Web access: www.ecb.europa.eu/mopo/implement/omt/html/pspp-qa.en.html (March 27, 2020)

investments in funds. Continued distress in this market will exacerbate the effect of this crisis on those investors as well.

Below, we offer recommendations with greater specificity. The facility must be ramped up and then wound down in a sustainable manner when market conditions normalize.

Any "Municipal Securities Purchasing Facility" should:

- Focus on the secondary market in order to alleviate pressures, recalibrate benchmarks and provide sufficient relief to the market to encourage underwriters to resume primary issues at normal market rates.

- Include securities with a broad array of maturities. We appreciate the Federal Reserve's intervention in the shorter end of the market, but also wish to acknowledge the gridlock experienced in the longer end as well. Any facility should not limit eligible securities based on maturity dates. Failure to include both long-term and short-term securities risks the stabilization needed in both ends of the market.

- Include diverse types of securities. Any facility should include bonds, notes, etc. Furthermore, eligible securities should include initial issues, refundings, general obligation, revenue-backed, commercial paper, variable and fixed rate securities, etc. Failure to include such securities risks negative implications for the types of securities that are excluded.

- Include both taxable and tax-exempt municipal securities. For a host of reasons, municipal issuers have issued a historically high number of taxable securities in recent years. Failure to be inclusive of taxable securities risks negative implications for this particular segment of the municipal debt market.

- Include securities issued by a broad array of eligible municipal issuers, including states, instrumentalities and authorities of states, conduit issuers, municipalities, instrumentalities and authorities of local governments, special districts, counties, cities, boroughs, villages, townships, etc. Failure to include the full spectrum of public issuers risks negative implications for those which might be excluded.

- Apply less restrictive credit criteria than those applied to securities purchased from the secondary corporate market. Municipal securities generally present lower credit risk than securities with comparable credit ratings issued by corporations,[4, 5] and therefore pose less real credit risk to the Federal Reserve balance sheets and the American taxpayer.

[4] "US Municipal Bond Defaults and Recoveries, 1970-2018." *Moody's Investor Service*. August 6, 2019.
[5] "2018 Annual U.S. Public Finance Default Study and Rating Transitions." *S&P Global Ratings.* May 31, 2019.

- Be limited in its useful life. We support the involvement of the Federal Reserve to intervene in and stabilize municipal markets through these truly unprecedented times, but we also support the timely and sustainable departure of the Federal Reserve as a participant in municipal markets once the crisis has subsided.

- Be established as quickly as possible and ready to begin stabilizing the municipal bond market as needed in the coming weeks.

Create a Temporary "Bridge Lending Facility" to Provide Lending to State and Local Governments to Cover Financing Gaps Resulting from Delayed Anticipated Revenues.

On March 21, 2020, the Internal Revenue Service (IRS) postponed the filing date for 2020 income taxes from April 15 to July 15.[6] For a number of statutory and political reasons, the IRS's action triggers postponements for state and local filings as well. State and local governments want to support the Federal Government's efforts to increase liquidity in the markets and put cash into the hands of American households. Many state and local governments continue to contemplate plans to postpone filing and payment deadlines for other sources of revenues, including those for state and local property, sales and business occupancy taxes, and other regularly levied fees. Unlike the federal government, many state and local governments have fiscal years that end on June 30, which means postponing revenue receipts beyond that deadline will have additional consequences for our budgets.[7]

For these reasons, we recommend the Federal Reserve create a bridge financing program for states and local governments. Low- or no-interest loans would be backed by the anticipated revenues that have been delayed as a result of state and local COVID-19 response efforts. These loans should be flexible in terms of maturities that align with the duration of the issuer's delay of revenue collection, filing or payment deadlines. The bridge facility should be open to all types of state and local governments and should be inclusive of as many pledged delayed anticipated revenues as possible.

While a private market solution for lending backed by anticipated revenues already exists, the volume of delayed revenues resulting from COVID-19 are beyond what we believe the private market can handle. Flooding the private market with tax and revenue anticipation notes (TRANs) of the volume needed could risk offsetting the positive impacts of other Federal Reserve actions to stabilize the market. Given the large sums of lending that state and local governments will need along with the limited duration of such a need, we find it both appropriate and necessary that the Federal Reserve provide such a facility to bridge the financing needs of states and local governments resulting from these nearly ubiquitous delayed revenues.

Any "Bridge Lending Facility" should:

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[6] IRS Notice 2020-18. March 21, 2020. Web access: www.irs.gov/pub/irs-drop/n-20-18.pdf

[7] "Last year, states collected $65 billion in income tax revenue in the month of April, almost 18% of the annual total." Harrison, David and Heather Gillers. "U.S. Income Tax Delay to Strain States." *Wall Street Journal*. March 25, 2020. Web access: www.wsj.com/articles/u-s-income-tax-delay-to-strain-states-11585143724

- Allow governmental entities in the U.S. to access lines of credit either directly from the Federal Reserve or through conduit banks and loan guarantees in order to bridge financing needs resulting from delays in the collection, filing or payment of taxes and other revenues.

- Include as broad of an array of eligible borrowers as possible including states, instrumentalities and authorities of states, conduit authorities, municipalities, instrumentalities and authorities of municipalities, special districts, counties, cities, boroughs, villages, townships, etc.

- Include as many sources of delayed anticipated revenues as pledged repayment as possible, including taxes on income, property, sales, business occupancy, capital gains and other activities. The facility should also allow for other delayed revenues such as anticipated fees regularly levied on businesses and individuals that have been delayed. The U.S. Census Bureau compiles quarterly summaries on state and local revenues by revenue type, which can serve as a resource here.[8]

- Permit the borrower to borrow at a below market or zero percent rate.

- Be established as quickly as possible and ready to begin providing bridge financing to state and local governments by April 15, the date on which many state and local governments budgeted to receive their full anticipated income tax receipts.

Extend protections and guarantees for Money Market Mutual Funds (MMMFs) to Local Government Investment Pools (LGIPs).

As you know, LGIPs are money market-like funds established by a group of governments or State Treasury for the purposes of safely securing investments. On aggregate, the more than 100 LGIPs nationwide currently manage billions of dollars in total assets under management (AUM) and provide essential cash management services to the local governments they serve.[9] The LGIPs impacted are alike both in function and purpose to MMMFs, including operating with a stable net asset value (NAV). Furthermore, the asset composition of LGIPs tends to be very similar to that of MMMFs. Under the guarantee plan, different treatment of LGIPs from MMMFs could result in local government investors forcing LGIPs to sell the very same assets that federal regulators and the administration are looking to backstop, thus accentuating market liquidity

[8] Government Finance Statistics. *U.S Census Bureau*. Web access: March 29, 2020. Source: www.census.gov/govs/financegen/

[9] 2016 Estimates indicate $250 billion in total AUM. "Voluntary Guidelines for the Management of Stable Net Asset Value Local Government Investment Pools." National Association of State Treasurers (NAST) and National Association of State Auditors, Comptrollers and Treasurers (NASACT). 2016. Web access: www.nasact.org/files/News_and_Publications/White_Papers_Reports/2016_05_Best_Practices_for_Stable_NAV_LGIPs.pdf

stresses. Accordingly, any guarantee afforded to MMMFs should be provided to LGIPs as well to ensure the guaranty would not inadvertently disrupt the existing structure and characteristics of the LGIPs or limit choices for state and local governments.

We are not suggesting any LGIP is in trouble or poor standing as a result of the current COVID-19 outbreak and its ensuing market implications. In fact, they are very conservatively managed and face little risk. However, providing LGIPs with the same ability as MMMFs to tell our municipal investors that their money is backed will help avoid unintended consequences and further calm both markets.

Conclusion

Without timely and strong federal government efforts to support the municipal bond market and compensate for delayed revenues, our state and local governments will be forced to take actions that will exacerbate economic contraction and offset the vital and unprecedented stimulus that Congress, the Federal Reserve, and the Administration have worked to provide.

We urge you to consider using new appropriations authorized in section 4003 of the CARES Act and existing powers under both Sections 13 and 14 of the Federal Reserve Act to develop the facilities like those outlined above in order to counter the unprecedented impacts of these market conditions.

Please consider our organizations, staff and memberships as resources available to assist when and how you need during this process. We have asked Brian Egan (brian@statetreasurers.org | 202-630-1880) and Emily Brock (ebrock@gfoa.org | 540-589-0441) in our respective offices to address any additional questions you may have. Finally, we thank you for your attention and continued action to stabilize our economy.

Sincerely,

Shaun Snyder Christopher P. Morrill Kinney Poynter

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CC: Members of the United States 116th Congress
Members of the Federal Reserve Board of Governors
Members of the Federal Reserve Federal Open Markets Committee