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Statement by
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Board of Governors of the Federal Reserve System
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Members of the Commission—Representative Hill, Commissioner Ramamurti, Representative Shalala, and Senator Toomey—thank you for the opportunity to speak with you about the Federal Reserve’s Municipal Liquidity Facility (MLF), a facility authorized by the Board of Governors of the Federal Reserve System (Board) under section 13(3) of the Federal Reserve Act, with the approval of the Secretary of the Treasury. As you know, the U.S. Department of the Treasury (Treasury) has committed \$35 billion of credit protection to the Federal Reserve for the facility using funds appropriated by the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). I am very pleased to be here today to provide information that I hope will be useful to your important oversight work.¹

As part of the broad financial markets dislocations that occurred amid rising concerns about the COVID pandemic in mid-March, the \$3.9 trillion municipal bond market experienced historic levels of turmoil. The conditions that prevailed during March were unprecedented—far worse than during the onset of the financial crisis in late 2008 or even in the days after 9/11, when the municipal market was briefly closed. Interest rates soared more than 225 bps in just nine trading days, mutual fund investors pulled over \$41 billion of assets out of the market in less than three weeks, and market functioning deteriorated to the point that buyers and sellers had difficulty determining prices. Ultimately, this meant that state and local governments were effectively unable to borrow, with most new issues canceled for lack of investor demand.

Recognizing the severity of the current economic disruption, the Federal Reserve and Treasury responded with a variety of traditional and nontraditional policy responses across many

¹ I joined the Board’s staff in March at the height of the municipal market crisis specifically to work on this facility. I have spent my entire career working in the municipal finance industry, including helping state and local governments raise billions of dollars of capital for infrastructure projects and affordable housing. In 2014, I joined the U.S. Department of the Treasury as its first director of the Office of State and Local Finance where I had primary responsibility for leading the response to the economic and financial crisis in Puerto Rico and worked to enact the Puerto Rico Oversight, Management, and Economic Stability Act.

capital markets. The Federal Reserve quickly moved to use its section 13(3) authority to directly support the municipal markets for the first time in the Federal Reserve's 100-plus-year history.

The announcement of the first set of emergency liquidity facilities—the Commercial Paper Funding Facility (CPFF), the Primary Dealer Credit Facility (PDCF), and the Money Market Mutual Fund Liquidity Facility (MMLF)—had notable positive effects on the municipal markets. In particular, the inclusion of municipal variable-rate demand notes as eligible collateral in the MMLF on March 23 had an immediate and dramatic downward impact on short-term municipal rates, providing both significant interest cost relief to state and local budgets and increased liquidity to the larger fixed-rate municipal market.

Next, on April 9, the Federal Reserve, with the approval of the Treasury, announced the MLF to help state and local governments better manage the extraordinary cash flow pressures associated with the pandemic—caused by both higher expenses of fighting COVID on the front lines and sharply delayed and lower tax revenues from the resulting economic recession. The facility backstops private market capacity to address these liquidity needs by standing ready to purchase the short-term notes often used by state and local governments to manage their cash flows. By addressing the cash management needs of eligible issuers, the MLF was also intended to encourage private investors to reengage in the municipal securities market, including across longer maturities, thus supporting overall municipal market functioning. The fiscal stability of state and local governments—with nearly 20 million employees and the responsibility for delivering essential services to their constituents—is a crucial component of the nation's overall economic health.

Generally speaking, MLF-eligible issuers include all U.S. states, counties with a population of at least 500,000 residents, cities with a population of at least 250,000 residents,

certain multistate entities, and revenue bond issuers designated by their state governors. As of August 31, the facility had purchased two issues for a total outstanding amount of \$1.65 billion.

Consistent with the Federal Reserve's section 13(3) authority, our mandate is to serve as a backstop lender to accomplish these objectives—not as a first stop that replaces private capital. Accordingly, we have established MLF pricing based on a rate that is a premium to normal market conditions as measured over an extended period prior to the pandemic—not any single point in time. We are also required to protect the taxpayer against loss: we cannot make grants or forgivable loans, and we cannot lend to insolvent or highly distressed entities. Therefore, we measure the success of the MLF based not on its volume of lending, but rather on the condition of the municipal securities market and state and local government access to capital.

The MLF has contributed to a strong and rapid recovery in municipal securities markets. State and local governments and other municipal bond issuers of a wide spectrum of types, sizes, and credit ratings have been able to issue securities, including long maturity bonds, with interest rates that are at or near historic lows. The largest source of municipal investor demand has returned. After the historic sharp outflows from municipal bond funds in March, mutual funds have experienced 18 consecutive weeks of positive inflows, boosting demand for municipal securities and contributing to lower rates and record new issuance levels. Many state and local governments have taken advantage of these low rates to refinance their outstanding debt for substantial interest cost savings, with a resulting record issuance of \$225 billion of bonds since April 1. Those municipal issuers that do not have direct access to the MLF have still benefitted substantially from a better-functioning municipal securities market. We are not aware of any

cities or counties with populations below the MLF eligibility thresholds that are currently having difficulty accessing capital at affordable rates.

The Federal Reserve continues to closely monitor the municipal markets and state and local government borrowing conditions and remains vigilant of any dislocated conditions. I look forward to answering any questions you may have about the MLF and the municipal markets.

Thank you.