June 23, 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: Federal Reserve Actions to Support State and Local Finance through COVID-19

Dear Secretary Mnuchin and Chairman Powell,

On behalf of the state and local government 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 crisis. We, the undersigned members representing the National Association of State Treasurers (NAST) and the Government Finance Officers Association (GFOA), have formed a joint ad hoc committee on "Federal Reserve Interventions in the Municipal Market" to serve as an issuer-perspective resource as you seek to refine existing facilities and contemplate additional actions in the municipal marketplace.

We now write offering our collective responses to existing Federal Reserve actions to date to stabilize state and local government finances. We also wish to share our thoughts on additional actions the Federal Reserve can take to support our shared goal and Congress' intent to provide "liquidity to the financial system that supports lending to eligible businesses, States, or municipalities."[1] Our comments reflect both our individual opinions and those of the organizations we collectively represent. Furthermore, we have kept our recommendations in line with the Federal Reserve actions we have seen in both the municipal markets as well as other sectors of the economy that have seen bold and unprecedented interventions.

States and local governments have been and will continue to serve on the frontlines of this national crisis. As you know, an historic cash event, prolonged paralysis in bond markets, and impending budget shocks stemming from the pandemic have all culminated at once, forcing many businesses and nearly every state and local government into a state of damage control. Our primary advocacy with our federal legislators based on current fiscal conditions is for additional direct, unencumbered direct funding to plug budget shortfalls and projected losses in revenues resulting from slowed commerce. Our advocacy extends to support the municipal debt market,

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

where state and local government access to credit and budgets will be further stressed at the most inopportune time, particularly as revenues decline as a result of business closures and rising unemployment. We remain particularly focused on programs to further support access to credit for smaller issuers across the country who represent the vast majority of issuers. Many of these jurisdictions were not included in prior congressional support through CARES, while at the same time smaller issuers, as frontline public service providers, will feel the fiscal impacts of this pandemic deeply.

Above all else, we wish to see the municipal credit markets quickly normalized. To that extent, we wish to serve as a resource for you as you seek to implement new policies and facilities (or to augment facilities already in place), but also offer ourselves as a resource in the future as you seek to ramp down these actions in a sustainable manner to protect the long term health and independence of our markets.

[Existing Action] Creation of the Municipal Liquidity Facility

On April 9, 2020, the Federal Reserve announced the "Municipal Liquidity Facility (MLF)," which will provide direct, short-term lending to eligible state and large local governments. The facility was greatly expanded, on April 27, to include a larger universe of eligible local issuers and multistate entities. The MLF is a critical, historic and necessary first step in supporting larger issuers access to credit for cash flow needs, particularly as they face delayed income tax revenues resulting from the IRS's decision to delay tax filing deadlines and the inevitable drop in revenues caused by the nationwide shutdown. We applaud the Federal Reserve's announcements regarding the MLF and appreciate its immediate positive impacts to issuers accessing credit markets over the past few weeks. We also commend the Federal Reserve's responsiveness and consideration to the issuer community's input as it has built upon and improved various iterations of the facility. However, we see great potential in the extension of the MLF to satisfy more present and intermediate term needs of issuers.

A number of questions regarding specifics of the MLF also remain unanswered. We ask that you respond to and provide further clarity on the specific questions set forth in Appendix A hereto in forthcoming guidance.

[Recommended Action] Extending Credit Term of MLF Paper and Creation of a Purchasing Facility to Buy a Broad Range of Securities from the Secondary Municipal Market

We believe the Federal Reserve can provide the most significant next step in relief for issuers by extending the MLF credit facility to issue longer-term paper and also develop an SPV aimed at supporting issuer access to longer term borrowing in the primary market and providing relief to the secondary market. The municipal bond market has recently improved, but it has done so largely based on expectations that the Federal Reserve will take additional actions to stabilize the market when needed. Issuers' access to credit remains fragile and volatile with many planned new money issues on hold waiting for improved market conditions and business decisions hinging on local market conditions. While the weekly outflows

have lowered from those seen in mid-March, even inflows of $1 to $1.5 B per week would take months to recover during a time when credit from our existing capital markets is most needed. Restoring stability to the municipal bond market through supporting primary market transactions and secondary market purchases when needed would provide significant support for state and local governments and their economies by facilitating continued access to credit to finance infrastructure investments.

Furthermore, uncertainty around the duration of the COVID-19 outbreak and the risk of a "second wave" of infections this fall continue to pose significant risks of a second cash-crunch and selloff in the municipal bond market. At a minimum, having such a facility developed in advance and at the ready to begin purchasing in the event of a second market selloff would provide much needed stability to our fragile markets. We believe such a facility is in line with the congressional intent of Title IV of the CARES Act (P.L. 116-136) and note congressional letters supporting the issue.[2, 3]

[Recommended Action] Easing Rules Around / Treatment of Municipal Securities in and Support for Lending to Small Municipal Issuers

While we believe the two aforementioned recommendations will aid access to credit, particularly for larger issuers, we also believe that targeted easing of capital requirements coupled with minor changes to the U.S. Tax Code would further strengthen access to bank loans and lines of credits for smaller issuers. Smaller regional and community banks have played an invaluable role in meeting small issuer needs through the purchase of bank qualified notes (26 USC 265). Often in smaller communities, the bank relationship between an issuer and the community bank is the primary source of capital. Limitations on the deductibility of carrying costs as well as stressed capital requirements and asset caps placed on banks constrain the abilities of banks to meet the credit needs of small issuers.

For these reasons we encourage Bank Regulators, including the Federal Reserve, to examine ways in which changes to asset caps and other rules could improve the capacity of regional and community banks to serve the credit needs of their local communities during these challenging times. With a general decline in economic activity leading to a decline in traditional retail lending, we believe these changes would have a double positive impact. Access to affordable lines of credits to state and local governments could be further enhanced by creating an SPV to lend to banks at the Federal Fund Rate, provided that they exclusively use such proceeds to make loans to or purchase securities from small municipal issuers.

We also encourage Congress to modernize provisions around the deductibility of carrying costs associated with municipal securities to further incentivize banks to engage in the municipal markets. Specifically, we support the inclusion of the "Municipal Bond Market Support Act of

[2] "Letter from Congressman Steve Stivers, Dutch Ruppersberger et. al. Calling for Support for the Secondary Municipal Bond Market." May 1, 2020. See attached.
[3] "Letter from Senator Robert Menendez, Thom Tillis et. Al. Encouraging the Treasury and the Federal Reserve to Take Further Action to Stabilize the Municipal Bond Market." May 14, 2020. See attached.

2019" (H.R. 3967), which would greatly expand the number of small issuers eligible to issue "bank qualified debt" and provide an additional purchaser in our markets to further diversify sources of credit to state and local governments.

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 stimulus that Congress, the Federal Reserve, and the Administration have worked to provide. We urge you to consider using your authority provided in Title IV of the CARES Act and existing powers under Section 13 of the Federal Reserve Act to develop and refine facilities like those outlined above in order to counter the unprecedented impacts of current market uncertainty.

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,

- Colleen Davis, NAST Rep, Treasurer, State of Delaware
- Kenton Tsoodle, GFOA Rep, Assistant City Manager, City of Oklahoma City
- Janet Aylor, NAST Rep, Director of Debt Management, Virginia Department of Treasury
- Dan Huge, GFOA Rep, Public Finance Director, Indiana Finance Authority
- Katherine Kardell, GFOA Rep, Senior Debt Administrator, Hennepin County, Minnesota
- Jessica Lamendola, GFOA Rep, Director of Administrative and Financial Services, City of Topeka, Kansas
- James MacDonald, NAST Rep, First Deputy Treasurer, Commonwealth of Massachusetts
- Sarah Sanders, NAST Rep, Assistant Treasurer for Debt Management, State of Connecticut
- Cindy Harris, GFOA Rep, Chief Financial Officer, Iowa Finance Authority
- Tim Schaefer, NAST Rep, Deputy Treasurer, State of California
- Ben Watkins, GFOA Rep, Director of Division of Bond Finance, State of Florida
- David Erdman, NAST and GFOA Rep, Capital Finance Director, State of Wisconsin

CC: Members of the Federal Reserve Board of Governors
Federal Reserve Bank of New York
Members of the House Committee on Ways and Means
Members of the Senate Committee on Finance

Appendix A

Questions and requests for clarifications and amendments to the Municipal Liquidity Facility (MLF).

- Expansion of Universe of Eligible Issuers: We applaud the Federal Reserve's decision to update the MLF term sheet to more than triple the number of eligible issuers. We also recognize the updated facility still only provides direct lending to less than one percent of the total issuers of municipal bonds. Will the Federal Reserve further expand the universe of eligible issuers to include more smaller communities who are less prepared and have fewer resources and capability of managing the negative economic and fiscal impacts of the COVID-19 crisis and ensuing economic slowdown?

- Credit Risk Sharing of "Downstream" Lending: In keeping with our shared goal of ensuring access to credit for the largest number of issuers possible, would the Federal Reserve share at least a portion of the credit risk of eligible issuers lending to ineligible political subdivisions, municipalities, authorities or other governmental entities?

- Pricing and Taxability: Given that the Federal Reserve would have no federal tax liability for interest earned on MLF securities, we fail to understand why separate pricing matrices for taxable and tax-exempt securities are necessary or helpful. The overwhelming needs of eligible issuers are cash flow borrowings, which are largely prohibited from tax-exempt issuance. Therefore, we anticipate issuers would need, or at least strongly prefer, to issue taxable securities through the MLF and not be penalized with increased borrowing costs but also get the benefit of eliminating IRS compliance expense. We recommend that the MLF consider all securities taxable and priced at a fair rate similar to the matrix developed for tax-exempt securities.

- Certification Requirements: Under the current rules, an issuer must provide a "certification that it is unable to secure adequate credit accommodations from other banking institutions" as well as provide "evidence that participants in the MLF are unable to secure adequate credit accommodations from other banking institutions." We find the current penalty pricing model to make such a certification and demonstration redundant. No issuer would select the MLF as an option if other credit accommodations were available. For this reason, we request that the Federal Reserve reconsider and remove this added burden on issuers.