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EXAMINATION OF THE MUNICIPAL LIQUIDITY FACILITY ESTABLISHED BY THE FEDERAL RESERVE PURSUANT TO THE CARES ACT

HEARING

BEFORE THE

CONGRESSIONAL OVERSIGHT COMMISSION

ONE HUNDRED SIXTEENTH CONGRESS

SECOND SESSION

ON

EXAMINING THE MUNICIPAL LIQUIDITY FACILITY CREATED BY THE FEDERAL RESERVE, PURSUANT TO THE CARES ACT

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CONGRESSIONAL OVERSIGHT COMMISSION

FRENCH HILL, Representative
BHARAT RAMAMURTI, Commissioner
DONNA E. SHALALA, Representative
PATRICK J. TOOMEY, Senator

AMBER VENZON, *Chief Clerk*

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EXAMINATION OF THE MUNICIPAL LIQUIDITY FACILITY ESTABLISHED BY THE FEDERAL RESERVE PURSUANT TO THE CARES ACT

THURSDAY, SEPTEMBER 17, 2020

CONGRESSIONAL OVERSIGHT COMMISSION,
Washington, D.C.

The Commission met, pursuant to notice, at 10:02 a.m., in Room SD–215, Dirksen Senate Office Building, and via Webex, Hon. Donna Shalala, Acting Chairman, presiding.

Present: Representative Shalala, Mr. Ramamurti, Representative Hill, and Senator Toomey.

OPENING STATEMENT OF MS. SHALALA

Ms. SHALALA. This hearing will come to order. This is a hybrid hearing, meaning that our Commissioners are appearing in person and witnesses will testify remotely.

Before I begin introducing our witnesses, let me first offer a few videoconferencing reminders. Once you start speaking, there will be a slight delay before you are displayed on the screen. To minimize background noise, please click the "Mute" button until it is your turn to speak or ask questions. If there is a technology issue, we will move to the next speaker until it is resolved.

You should all have one box on your screens labeled "Clock" that will show how much time is remaining. All Members and witnesses need to be especially mindful of the 5-minute clock. At 30 seconds remaining, I will gently tap the gavel to remind Members that their time has almost expired.

With that, today we welcome you to this hearing convened by the Congressional Oversight Commission. The Commission's role is to conduct oversight of the implementation of Division A, Title IV, Subtitle A of the CARES Act by the Department of the Treasury and the Board of Governors of the Federal Reserve System. Subtitle A provides $500 billion to the Treasury Department for lending and other investments to, I quote, "provide liquidity to eligible businesses, States, and municipalities related to losses incurred as a result of the coronavirus."

As part of our oversight work, the Commission has decided to hold this hearing today, which will examine the Municipal Liquidity Facility. The Federal Reserve established the Municipal Liquidity Facility to provide up to $500 billion in lending to State and local governments and other municipal issuing authorities.

Today's hearing will have two panels.

Mr. Kent Hiteshew, Deputy Associate Director of the Division of Financial Stability of the Federal Reserve Bank of New York, will testify during the first panel. Mr. Hiteshew also previously served as the first Director of the Office of State and Local Finance at the U.S. Department of the Treasury. Prior to his time at Treasury, Mr. Hiteshew was a public finance banker with JPMorgan and its predecessor firm Bear Stearns. Mr. Hiteshew is a graduate of Rutgers and earned his Master's in City Planning from the University of North Carolina, Chapel Hill.

In the second panel, we will hear testimony from Mr. Patrick McCoy, who is Director of Finance at the Metropolitan Transportation Authority in New York. Mr. McCoy has also previously served as the Executive Director of the New York City Municipal Water Finance Authority, the Executive Director of New York Water, and the Deputy Director of Finance for the MTA. Mr. McCoy earned his Master's degree in Urban Policy Analysis and Management from the New School in New York and has a B.A. from St. Ambrose University.

Mr. Marion Gee is President of the Government Finance Officers Association. In addition, Mr. Gee has served as the Finance Director of the Metropolitan St. Louis Sewer District since September of 2015. Previously, Mr. Gee was the Assistant Finance Director for the city of San Antonio for 4 years. Prior to joining the city of San Antonio, he was employed as Finance Director of the Louisville Metropolitan Sewer District for 11 years. Mr. Gee is a certified public accountant, earned his Master's in Business Administration and his Bachelor's of Science in Business Administration from the University of Louisville.

Mr. Chris Edwards is the Director of Tax Policy Studies at the Cato Institute. Before joining Cato, Mr. Edwards served as a Senior Economist on Congress' Joint Economic Committee. Prior to his time at the JEC, Mr. Edwards was a manager with PricewaterhouseCoopers and an economist with the Tax Foundation. He has authored "*Downsizing the Federal Government*" and is co-author of "*Global Tax Revolution*." Mr. Edwards is a graduate of the University of Waterloo and holds a Master's in Economics from George Mason University.

Dr. Mark Zandi is the Chief Economist at Moody's Analytics. Dr. Zandi is on the board of directors of the Mortgage Guaranty Insurance Corporation and serves as the lead director of the Reinvestment Fund, which makes investments in underserved communities. Dr. Zandi is the co-founder of Economy.com, which provides economic analysis data and forecasting, credit risk services, and research on countries, industries, and economies. Dr. Zandi is also the author of "*Paying the Price: Ending the Great Recession and Beginning a New American Century*" and "*Financial Shock*." Dr. Zandi is a graduate of the Wharton School of the University of Pennsylvania and earned his Ph.D. at the University of Pennsylvania.

We are fortunate to have these five witnesses appearing today and appreciate their time. The Commission would like to note for the record that it also invited the Treasury Department to participate in the hearing, but the Treasury Department declined.

In the absence of a Chair, the Commissioners have agreed to each have 1 minute of opening remarks. I will now recognize myself for an opening statement.

It is no secret that State and local governments are struggling to deal with the economic fallout of COVID–19. They have already cut 1.1 million jobs. The city of Miami in my district, Florida's 27th, has an estimated budget shortfall of nearly $25 million, and the pandemic is not even over yet.

Miamians did not cause this problem. We were actually very prudent. We saved and we went into the pandemic with a $20 million surplus. COVID–19 wiped that out, and now we face a huge deficit.

South Florida's economy relies on tourist dollars, but the tourism industry has been decimated. And while our revenues are down, our expenses are up. We need to pay for PPE to protect our first responders and update school programs to keep our children safe. This problem is not unique to Miami. It is happening all across the country.

The Municipal Liquidity Facility can support $500 billion in lending, but to date only $1.65 billion, less than 1 percent, is being used. I hope we come up with solutions today to get State and local governments the support they need and their residents desperately need.

I yield back. I yield to Senator Toomey.

OPENING STATEMENT OF SENATOR TOOMEY

Senator TOOMEY. Thank you, Madam Chair. Let me just say, some who criticize the Municipal Liquidity Facility may be ignoring its original intended purpose. The CARES Act was meant to resolve the immediate liquidity crunch and economic shock experienced in March of 2020.

The Municipal Liquidity Facility was not meant to replace private capital markets, be a mechanism to bail out State and local governments, nor to be a substitute for fiscal policy. As the name implies and consistent with Section 13(3) of the Federal Reserve Act on which the CARES Act was built, the Municipal Liquidity Facility was meant to be a lender of last resort, to stabilize the municipal bond market, and to provide liquidity.

These were unprecedented actions, and the economy today is in a very, very different place now than it was 6 months ago. State and local revenue shortfalls are far less than what was originally projected. The municipal bond markets have recovered. Municipal bond issuance is higher, up 21 percent year over year through August, as opposed to the down 30 percent of March. And, importantly, municipal interest rates and spreads have returned to their pre-COVID–19 levels.

Economic data is coming in with greater strength than many had forecast, and using this program to do anything more than what it was intended to do, which was to provide temporary liquidity, would, in my view, be inconsistent with congressional intent when it passed the CARES Act. Liquidity in the municipal bond market has been restored, and as such, the MLF, in my view, should wind down.

Ms. SHALALA. Thank you, Senator Toomey.

I now recognize Mr. Ramamurti for 1 minute.

OPENING STATEMENT OF MR. RAMAMURTI

Mr. RAMAMURTI. Thank you, Madam Chairwoman.

In the 6 months since Congress authorized the Treasury and the Fed to offer loans to State and local governments, they have provided two loans for a total of $1.65 billion. That is 0.3 percent of the $500 billion lending capacity of the program.

State and local governments are desperate for help, but the loans offered by this Administration are so punitive that even governments in deep trouble cannot justify using them. Yet, at the same time, the Treasury and the Fed are offering much more generous no-strings-attached support to many of America's biggest and most profitable corporations. It is a shameful disparity that reflects this Administration's priorities, taking care of big-time executives and wealthy shareholders while abandoning emergency responders, teachers, firefighters, nurses, and all the people who count on their help; and it will further widen the racial income and wealth gaps in this country.

Congress needs to provide direct aid to State and local governments immediately, but if Republicans continue to stonewall direct aid, the Fed and the Treasury should offer much more generous loans so that State and local governments can help families, protect jobs, and support our economy.

Thank you, Madam Chair.

Ms. SHALALA. Thank you.

Commissioner Hill.

OPENING STATEMENT OF MR. HILL

Mr. HILL. Thank you, Madam Chair, and thank you to our witnesses for providing your expertise today.

Today we are discussing the Municipal Liquidity Facility. This continues to be a heated topic on Capitol Hill as State and local municipalities determine how best to balance their budgets and fight COVID–19.

Last week, in the House Financial Services Committee we held a hearing precisely on this issue. This challenge varies widely across the Nation. During the hearing last week, I highlighted that the number of COVID cases per State does not correlate with how an individual State's economy is actually faring.

For example, Arkansas and New York are ranked very similarly in the number of COVID–19 cases per capita, but sales tax revenue in my home State of Arkansas is up substantially while down in New York. I will discuss this in more detail.

Ultimately, we need to ensure that our communities can reopen in a safe and secure manner and rebuild our great economy that we experienced at the beginning of this fateful year.

Thank you, Madam Chair, and I yield back.

Ms. SHALALA. Thank you, Congressman Hill.

All Members' statements will be added to the hearing record. Each of the witnesses' full written testimony will also be made part of the official hearing record.

To allow the Members enough time for questions with each witness, we have organized today's hearing into two panels. Mr. Hiteshew of the Federal Reserve will testify in the first panel, and

Mr. McCoy, Mr. Gee, Mr. Edwards, and Dr. Zandi will testify in the second panel.

We will now proceed with the first panel and hear Mr. Hiteshew's testimony. At the end of his testimony we will move to two rounds of 5-minute questioning.

Mr. Hiteshew, welcome. You are now recognized for 5 minutes.

STATEMENT OF KENT HITESHEW, DEPUTY ASSOCIATE DIRECTOR, DIVISION OF FINANCIAL STABILITY, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. HITESHEW. Good morning, Madam Chair, Representative Hill, Commissioner Ramamurti, and Senator Toomey. Thank you for the opportunity to speak with you about the Federal Reserve's Municipal Liquidity Facility. I am very pleased to provide information that I hope will be useful to your important oversight work.

At the outset of the COVID pandemic in mid-March, the $3.9 trillion municipal bond market experienced historic levels of turmoil. Market conditions 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 basis points in just 9 trading days, mutual fund investors pulled over $41 billion of assets out of the market in less than 3 weeks, and market functioning deteriorated to the point that buyers and sellers had difficulty even determining prices. Ultimately, this meant that State and local governments were effectively unable to borrow, with new issues canceled for lack of investor demand.

Recognizing the severity of this market dislocation, the Federal Reserve quickly moved to use its authorities to directly support the municipal markets for the first time in its 100-year history.

First, the inclusion of municipal variable rate demand notes as eligible collateral in the Money Market Liquidity Fund 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 Fed, with the approval of the Treasury, announced the MLF would 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, thus supporting overall municipal market functioning. With nearly 20 million employees—that is 13 percent of all employees in the Nation—and the responsibility for delivering essential services to their constituents, the fiscal stability of State and local governments is a crucial component of the Nation's overall economic health and its recovery. As of August 31, the facility had purchased two issues for a total outstanding amount of $1.65 billion.

Consistent with the Fed'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, but at a discount to stress conditions in March.

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.

By these measures, the MLF has contributed to a strong and rapid recovery in the 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.

Many State and local governments have taken advantage of these low rates to refinance their outstanding debt for substantial debt service savings, with a resulting record issuance of $225 billion of bonds since April 1. And those municipal issuers that do not have direct access to the MLF have still benefited substantially from this better-functioning municipal market.

Of course, the Federal Reserve continues to closely monitor the municipal markets and State and local government borrowing conditions and their access to capital, and we remain vigilant to any dislocated conditions. We look forward to answering your questions today, and I thank you very much for this opportunity.

[The prepared statement of Mr. Hiteshew follows:]

For release on delivery
9:30 a.m. EDT
September 17, 2020

Statement by

Kent Hiteshew

Deputy Associate Director

Division of Financial Stability

Board of Governors of the Federal Reserve System

before the

Congressional Oversight Commission

September 17, 2020

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.

Ms. SHALALA. Thank you very much.

As I mentioned in my opening remarks, the Municipal Liquidity Facility can support up to $500 billion in lending. However, thus far, only two issuers have borrowed a combined total of $1.65 billion, which represents less than 1 percent of the facility's total capacity. Does the facility's non-use indicate a design flaw of the program?

Mr. HITESHEW. Thank you for that question, Madam Chair. We do not think so. This is the first time that the Fed has intervened in the municipal market. It is a complex market made up of 50,000 unique issuers of various sizes, types, purposes, and credit ratings, as I mentioned.

We had to undertake very quickly to enter into the market, and our four principles that were guiding us in terms of our design were: speed to announcement and execution, do not let the perfect be the enemy of the good; ensure that State and local governments had access to liquidity for operating cash—this is what we heard overwhelmingly from individual issuers and associations like GFOA; restore market confidence and stability given the unprecedented liquidity crisis in the market; and, finally, to your point, to design a uniformly applicable, transparent, and easy-to-administer facility.

We started out on April 9 with the core program announcement. We made several changes along the way. As the Chair cites, we are learning as we go here, and we have made these adjustments. But in the meantime, we have experienced—and we think this is due to the totality of the Fed's various facilities—there has been a sharp recovery in the municipal market, and access to the markets has been opened, and notwithstanding the two loans that were made in the MLF, there is broad access to the market, as I mentioned in my opening comments, at historically low interest rates.

So we think the program has been successful. The mere size of the announcement of the program, the $500 billion, had an immediate positive impact. How did that happen? Because long-term investors were comforted that the Fed was standing by to meet the liquidity needs of State and local governments to make sure that they did not run out of cash and they did not default for liquidity purposes as opposed to for credit concerns.

Ms. SHALALA. Thank you. I do have another question.

Mr. HITESHEW. Sure.

Ms. SHALALA. Many potential borrowers and commentators, including three of our four witnesses today in our second panel, believe that the terms of the Municipal Liquidity Facility are too restrictive. The interest rate is too high; the 36-month term is too short; and the use of loan proceeds are overly constraining. We understand that the Federal Reserve lends at a penalty rate and views itself as the lender of last resort. But it also has the discretion to determine what an appropriate penalty should be.

Given the needs expressed by State and local governments experiencing economic crisis, why did the Fed establish stringent terms that render the program unapproachable for most borrowers?

Mr. HITESHEW. We do not believe that the program is rigidly designed. We believe that it is carefully calibrated to meet the purpose of the program. Our pricing is based on the methodology that is grounded in Federal statute, regulation, and our longstanding principles, as adopted by Regulation A in 2015 by the Federal Reserve after a 2-year rulemaking process that included broad public support across the ideological spectrum for the imposition of a premium rate in 13(3) loan facilities.

We have adjusted that rate once over the summer as we saw the municipal market rally, and we wanted to make sure that the backstop continued to provide its intended purpose and to make sure, if there should be a sell-off in the future, that we were tighter to current market rates. So we have been flexible in terms of pricing.

In terms of the maturity, Madam Chair, the purpose of the program is to provide liquidity. Most State and local governments are required, as you know, to have balanced budgets and have very limited capacity to borrow across fiscal years. We wanted to design a program that was applicable to all but that, of course, has to recognize that Federal law cannot supersede local statutes and Constitutions. And so to the extent that issuers have the ability to borrow beyond a year for operating and liquidity purposes, we are available to provide for that. But I think the key is not to look at what the program requirements are but what the results have been in the municipal market. We have State and local governments that are rushing to market to take advantage of interest rates, low interest rates, to achieve significant debt service savings. I believe O'Hare Airport announced a refunding for next week in which the target is 20 percent savings on their bond.

Ms. SHALALA. Thank you.

I yield back and turn to Senator Toomey for 5 minutes of questioning.

Senator TOOMEY. Thank you, Madam Chairman.

Mr. Hiteshew, I think, if I heard you right, when you were discussing how the program—how the pricing works, you said that the pricing by design is meant to be at a premium in terms of the cost to the prior, what I would consider ordinary conditions, but a discount to stressed levels. So, by design, is it fair to say that if the market were to return to something like the prior ordinary conditions, then a typical borrower would be able to go back to the market and access credit at more attractive terms than the MLF offers, and that that is, in fact, exactly what we have seen?

First of all, was that the idea? And, secondly, could you characterize a little bit more the municipal bond market today, the volume, the types of issuers that are able to access it? What is pricing like for these issuers? And as a general matter, what is the availability of credit for municipalities?

Mr. HITESHEW. Thank you, Senator. In fact, you may know that your home State, the Commonwealth of Pennsylvania, borrowed over $400 million yesterday in the marketplace for 20 years at an average interest rate of 1.93. So that is one indication of where rates are.

By design, based on the Fed's monopoly, muni rates are near zero after having approached nearly double digits. The MTA and other issuers in March had variable rate debt that was pricing, as I said, in the high single digits. Today those are at zero. Three-year rates are generally less than 75 basis points. The triple A curve is about 20 basis points at that point. Thirty-year rates with the triple A curve are at 160, generally with a spread for a double layer or single layer issue you are going to come in at under two and a half.

Senator TOOMEY. And can I just interrupt briefly for a quick clarification? So those sound like extremely attractive rates, certainly by historical standards. Are they generally available to issuers?

Mr. HITESHEW. They are. As I mentioned, we have experienced record issuance since the recovery began in April, and, again, with interest rates so low, issuers are even issuing significant amounts of taxable debt in order to refinance tax-exempt that the tax rules do not allow them to otherwise do.

Senator TOOMEY. Because interest rates are so low.

Mr. HITESHEW. That is correct.

Senator TOOMEY. Yeah. Quickly, because I am going to run out of time here, the program by design is available to municipalities above a certain size. What does the program offer to municipalities that are too small to meet that threshold?

Mr. HITESHEW. The program was designed, again, balancing the need to rush to market, to have a perfect program that came too late would not have been of help to the municipal market. So we had to make decisions, as I said, with 50,000 issuers. So we focused on the large ones at first. We slowly increased the number. But the benefit to all the issuers is that the market has recovered, and the vast majority of issuers have access at extraordinarily low rates.

We also developed a feature that allows downstreaming so that States and larger cities and counties have the ability to borrow on behalf of their sub-entities if necessary.

Senator TOOMEY. So States can be a conduit for the smaller municipalities within their borders.

Mr. HITESHEW. Correct.

Senator TOOMEY. Some have suggested that—you know, we have two facilities for corporate debt. We have the primary facility, and we have a secondary market facility. But yet we only have one that is explicitly meant for the municipal debt and that there is an inherent unfairness to that. But wouldn't it be fair to say that the Money Market Mutual Fund Liquidity Facility effectively serves as a tool to provide liquidity in the secondary market for municipal debt?

Mr. HITESHEW. Certainly a certain type of municipal debt, commercial paper programs, supports commercial paper, tax-exempt commercial paper. And the MMLF, the Money Market Fund, supports the RDBs. And as I have noted, in particular, that second program had an enormously positive impact.

In terms of the secondary market, we are very cognizant of the differences in the markets, and munis are very different than corporates, as I think everybody here understands, with the number of issuers and the diversity and the idiosyncratic nature of the marketplace and the relative illiquidity in the marketplace compared to corporates and other markets.

So our thought was—and we were driven by what we were hearing from State and local issuers—get liquidity available to us as soon as possible, and we wanted to do that and also restore market confidence. We thought that designing a secondary market program for munis would have taken longer. Munis, as you may know, have very little ETFs in it, and the secondary market for corporates is largely being executed through the purchases of ETFs.

So while a secondary market facility could have been developed for the muni market, we believe that the MLF was better suited and easier and quicker to get into the marketplace. If we had needed a secondary market facility, we have that capability. But we believe at this point that is not necessary, and we hear from market participants regularly. Every day we are talking to market participants, and we have not heard that they believe one as well. That is the opposite. They do not believe a secondary market facility in munis at this time is necessary.

Ms. SHALALA. Thank you.

Mr. HITESHEW. But, of course, we remain vigilant in terms of changes to markets.

Ms. SHALALA. Thank you.

Commissioner Ramamurti.

Mr. RAMAMURTI. Thank you, Madam Chair.

State and local governments have been hit hard by the COVID–19 crisis, and they are desperately looking for help. Despite that, we have seen report after report of State and local governments taking a look at the loans offered through the Fed's lending program and deciding that they cannot justify taking on such harsh terms. Instead, they are moving forward with sharp budget cuts, cuts to our kids' schools, to housing, to nutrition programs, and more.

Mr. Hiteshew, you are leading the Fed's efforts on this lending program, so I want to understand why you have chosen to make the loans as punitive and unappealing as you have, particularly in comparison to what the Fed is offering corporate America. So let me give you an example. Through its Corporate Credit Program, the Fed has purchased a bond issued by Philip Morris that pays about 0.075 percent interest over a term of more than 4½ years. But the Fed is requiring the State government, like Kentucky, which has the exact same credit rating as Philip Morris, to pay an interest rate of more than 2 percent over 3 years—in other words, a rate more than double what Philip Morris is paying, despite a shorter loan term.

So, Mr. Hiteshew, why is the Fed demanding such a high rate from our own State governments when it is willing to accept such a low rate from a company like Philip Morris?

Mr. HITESHEW. Well, Commissioner, you and I both agree that the serious condition of State and local government balance sheets needs to be addressed, and we believe that monetary policy has limited capacity to do that and, as the Chair has said on numerous occasions, believe that we will need more fiscal policy to get through this situation.

With regard to your specific example, I think there may be a little bit of apples and oranges there, and I believe that you are citing the Secondary Market Corporate Credit Facility. The analog to the muni market is the Primary Corporate Credit Facility for which there have been zero loans made to this point.

Mr. RAMAMURTI. Well, respectfully, Mr. Hiteshew—and, again, sorry to cut you off, but my time is limited. Look, the Secondary

Market Corporate Credit Facility is set up under Section 13(3). It is subject to the exact same rules and regulations as the Municipal Liquidity Facility, and yet there seems to be no penalty rate for corporations, but there is a significant penalty rate for State and local governments, and that is having a serious impact on the functioning of that facility. And, look, there are dozens and dozens of these examples.

Just to give you one more, currently the Fed is using public money to purchase a bond from Chevron at a rate of about 0.09 percent over more than 4½ years while a State like Wisconsin with the exact same credit rating as Chevron has to pay 1.28 percent over 3 years—again, a substantially higher rate despite a shorter term.

So, look, there are two main variables here that affect how punitive these loans are: the interest rate and the length of the repayment term. And I want to understand if there is anything stopping you from making each of these variables less punitive for State and local governments.

So on the rates, as you noted, the Fed has already dropped the interest rates offered to State and local governments by half a percentage point, which means that you were not offering the lowest possible rates before. Is there anything legally that prevents you from reducing the rates further so that they are comparable to what corporations are getting from the Fed?

Mr. HITESHEW. Again, Commissioner, corporations are the Secondary Market Program that you are citing. The Primary Market and the Main Street Facilities both have premiums that are established——

Mr. RAMAMURTI. Mr. Hiteshew, can you answer very simply? Is the Secondary Market Corporate Credit Facility subject to the same 13(3) authority as the Municipal Liquidity Facility?

Mr. HITESHEW. It is. I am not——

Mr. RAMAMURTI. So why is there a difference on the penalty rate?

Mr. HITESHEW. I would like to answer by saying that I am not an expert on the Secondary Market Facilities. We would be glad to put together a call for you with our General Counsel, but they are subject to Reg A. They are in compliance with Reg A in a different manner than open market lending.

Mr. RAMAMURTI. Okay. And I am sorry to cut you off, just because I want to keep moving with my time, and I will take you up on that offer. It sounds like potentially there is an opening here given what you have said.

Here is another example: the repayment term. The lending facilities for mid-sized companies—and, again, these are primary market loans—have a term of 4 or 5 years while the State and local lending program only allows 3-year repayment terms. Is there any explicit legal restriction that stops you from extending the repayment term to 5 years like the corporate facilities offer?

Mr. HITESHEW. There is no legal limitation. We have programs that are designed for different markets to reflect the differences in those markets.

Mr. RAMAMURTI. How about 10 years? Is there anything that restricts it from going to 10 years?

Mr. HITESHEW. The program is designed to restore market conditions through making liquidity available to State and local governments. In general, State and local governments have limited authority to borrow for liquidity——

Mr. RAMAMURTI. Sure, but they could obviously change those laws if the Fed is offering something that is appealing to them.

Look, my time is up. Thank you, Mr. Hiteshew. It sounds like there is no legal restriction that is stopping you from making these terms much more generous. I do not think the Treasury and the Fed should be treating State and local governments worse than big corporations. There is no justification for it legally. There is no justification for it economically. And I hope that the Fed and the Treasury will move quickly to fix these problems.

Thank you, Madam Chair.

Ms. SHALALA. The gentleman yields back. Thank you.

Congressman Hill is recognized for 5 minutes.

Mr. HILL. Thank you, Madam Chair.

Mr. Hiteshew, you mentioned in your testimony the market has largely stabilized from the levels that we saw in April, and that was largely due to the announcement of the MLF. Is that correct?

Mr. HITESHEW. Yes. I would just correct that a little bit by saying I think you have to look at the totality of the Federal Reserve interventions in all the markets. But, certainly, the MLF together with the MMLF and the CP program all had positive impacts on the muni market.

Mr. HILL. And to date, the Metropolitan Transportation Authority of New York, who we will hear from in a few minutes, and the State of Illinois have participated in the program. Are there others that you know of that plan on taking advantage of the MLF?

Mr. HITESHEW. Congressman, as a matter of policy, we do not disclose applicants until the loans are purchased. But there is plenty of——

Mr. HILL. What is your pipeline right now, would you say, in terms of either numbers or dollars?

Mr. HITESHEW. Again, we have ongoing daily conversations with issuers across the country, so we are aware of issuers that are interested in the program. We have one specific issuer that has come into the pipeline and may be doing a financing in the next couple of weeks where——

Mr. HILL. Thank you.

Mr. HITESHEW [continuing]. —The notes may or may not be purchased, depending on, again, market management.

Mr. HILL. I understand.

Mr. HITESHEW. Beyond that, there are a number of other major issuers that are contemplating the program.

Mr. HILL. Thank you. Do you believe the 12/31 deadline for the expiration of this facility should be extended?

Mr. HITESHEW. That is a call for the Board and the Secretary of the Treasury to make as we get closer to the end of the year. As you know, the Municipal Facility was the first facility to be extended from September 30 to December 31. And while we are not by any means projecting that we will see any kind of market turbulence like we saw in March, there are warning signs in the muni market that we should all be aware of. The coming cuts and potential downgrades of State and local governments could affect market conditions, and so we remain vigilant, and we believe that through the end of the year, at a minimum, this is an important facility to, again, backstop the market, provide confidence to the market so that all issuers, whether they are directly eligible or not, have access to affordable capital.

But as we get closer to the end of the year, that will be a determination that the Board and the Secretary will make based on what market conditions look like at that point.

Mr. HILL. Thank you very much.

Mr. HITESHEW. As they will with all the facilities.

Mr. HILL. Chairman Powell has been vocal over the months working with us that the Fed is learning as they go when it comes to designing and implementing these 13(3) facilities. And as noted, on August 11, the Fed lowered the interest rate by 50 bps on the Municipal Liquidity Facility, at which point the Metropolitan Transportation Authority in New York, who we will hear from in a few minutes, took advantage of the program, getting a better rate than it could from the street. And this is to Senator Toomey's point. Since this is a backstop program, as you have testified—and this seems to be in direct contradiction to my friend Commissioner Ramamurti in the sense that the MTA rejected 20 private sector bids for $1.6 billion in offers on their bond anticipation notes and took the Fed up on their offer and placed, if my memory is right, about $450 billion at 1.92 percent at the Fed, even though the street's bids were at 2.79. What is your comment on that?

Mr. HITESHEW. Congressman, the MLF does not set pricing for individual loan purchases but, rather, we use a uniform pricing grid based on average credit ratings——

Mr. HILL. I understand that. I have seen the grid, and I understand it. But, obviously, it was to the advantage of the MTA to come directly to the MLF, which seems to contradict my friend. And I am just curious. If the market rate is 2.79, how does that reflect you being a backstop lender as opposed to someone competing with the private sector?

Mr. HITESHEW. Again, the facility is uniformly applicable and broadly available to eligible issuers, and so on that particular day, that was the result of the competitive bidding process that the MTA undertook. And we are an open lending window, and that was the rate that the MTA qualified for, and that was their decision. Again, yes, we act as a backstop, but, again, with the number of issuers in the marketplace, there will be different prices on different days for different issuers.

Mr. HILL. Thank you, Madam Chair. I yield back.

Ms. SHALALA. Thank you. We will now start the second round of questioning by the Commissioners.

In June, the Federal Reserve lent $1.2 billion to the State of Illinois through the Municipal Liquidity Facility. An economist on our second panel, Mr. Edwards with the Cato Institute, testified it is not appropriate for the Nation's central bank to finance the States because, in his judgment, the States have a large independent fiscal power to tax, save, borrow, and adjust spending. His testimony goes on to say that the MLF is an unneeded central bank expansion into State budget policy.

Do you agree with these statements? Why or why not?

Mr. HITESHEW. The Municipal Liquidity Facility is designed to not only provide liquidity to State and local governments in an emergency situation, but it is also designed to restore market confidence. I think that 6 months since the events, those folks who are not as active in the municipal market cannot appreciate the stress that that market was under in March. You have two issuers on your next panel that can testify to their day-to-day heightened concerns about maintaining their market access during that period of time. And so the MLF has had an enormously important contribution to make to stabilizing the markets for all issuers, and I would not want to comment on his point about the appropriateness of the lending to locals on an individual basis. This is a broad program that is applicable on a uniform basis. We do not pick individual issuers. If you are eligible and you meet the eligibility criteria, you have access to this facility. By design, that is what makes it such a powerful facility.

Ms. SHALALA. Actually, it is not so powerful if only 250 entities are eligible to directly access a facility, and the vast majority of nearly 80,000 public issuers are left out, with the exception that Governors can designate a couple of local governments, which actually pits them against one another when they should be instead working toward common goals.

Why is the Federal Reserve imposing such restrictive limitations to access when over 99 percent of the facility remains unused? Why is the MLF restricted to just a handful of municipalities?

Mr. HITESHEW. Great question, Madam Chair, and I think it goes back to my point about speed to announcement and execution and the complexity of trying to set up a Federal lending window for 50,000—you said 80,000—unique issuers with a wide spectrum of sizes, types, purposes, and credits. So our goal was to identify some of the largest issuers, a signal to the marketplace that those issuers would have full access to liquidity from the Fed window, and in doing so make sure that the market works for everybody.

So if we believed today that we needed to expand the aperture of issuers that were eligible, that is something that we could certainly do, and we would be glad to work with you and your staff and other Members of the Commission to identify underserved issuers that we might be able to expand the program to serve. But, again, the focus is on the number of issuers that are eligible as opposed to what we believe the importance of the program has been to make all issuers have access to capital at historically low rates.

Ms. SHALALA. Dr. Zandi, the Chief Economist at Moody's, testifying in our second panel, is going to testify that State and local governments have already cut more than a million jobs as a result of the crisis. How does the Federal Reserve reconcile its mandate to maximize employment with the very restrictive terms it established for the MLF, terms that severely limit its use by struggling State and local borrowers? That is just a followup question.

Mr. HITESHEW. Madam Chair—excuse me?

Ms. SHALALA. Go ahead.

Mr. HITESHEW. I am sorry. Madam Chair, I would like to pass on that question and have that be addressed to our policymakers and the Chair. I am not here to talk about monetary policy. That is not my expertise. I joined the Fed in March with a strong background in the municipal markets and public policy relating to State and local government finance. So I would say that the Chair has advocated for more fiscal policy to deal with this crisis and that monetary policy tools are limited in their capacity to solve the problem.

I think all of us would agree that while State and local governments cannot cut their way out of this recession, neither can they borrow their way out of it. And if the legacy is operating deficit financing on State and local government balance sheets after this crisis is over, that will limit their ability to finance infrastructure, to educate our students, and to care for our elderly.

Ms. SHALALA. Thank you. I yield back.

Senator Toomey.

Senator TOOMEY. Thank you very much, Madam Chairman. I just want to follow up on a point that Commissioner Ramamurti was making earlier, and I want to underscore the MLF is a primary market facility. In other words, its purpose is to purchase debt directly that is issued directly to the SPV that is set up under 13(3) for that purpose.

The corollary program for corporate lenders is the Primary Market Corporate Credit Facility, and that charges a penalty rate of 100 basis points above whatever the previously prevailing market rate was. And my understanding is there has been a grand total of zero issuance into the Primary Market Corporate Credit Facility.

Mr. Hiteshew, is it your understanding that there have been no direct issues into this corollary program, the Primary Market Corporate Credit Facility?

Mr. HITESHEW. You are correct, Senator.

Senator TOOMEY. So there has been no corporate subsidies going on here. I think there is an important point we need to keep in mind here. This program was never intended to be the mechanism by which we provide subsidized debt to municipalities. It is a fiscal question that that poses. Should the Federal Government be subsidizing any cost of a State or local government? It is a fair question. We can have that debate. But it is a fiscal debate, and that was not the purpose of these programs. But it was the purpose to ensure that municipal and State borrowers would have access to credit.

And so, Mr. Hiteshew, let me ask you this: Much has been made of the fact that there have been only two borrowers under this program. Are you aware of a significant number or any number—tell us what you know about States and municipalities that need access to credit and they cannot get it, they have no access to credit?

Mr. HITESHEW. Senator, I have a long history in the muni market. For better or for worse, a lot of people in the muni market know me, and they know how to get a hold of me. So I have had ongoing discussions with issuers and market participants since the first day on the job.

I can tell you that those first weeks, those first couple months, the phones were ringing off the hook to all Members of the Fed.

Senator TOOMEY. Sure.

Mr. HITESHEW. There were extreme, extreme concerns out there, and that is why we rushed our facility to market so quickly.

Those calls have significantly cut back as issuers have had access to the market without the MLF, without needing to go to the MLF. They go directly to the market.

So I would not pretend to be the person who knows about every State and local government, the 50,000 issuers out there. But of those that are not directly eligible for the program, we are not aware of any, as I said in my testimony. But I am sure there are some. There are some that have serious credit problems, especially if they are secured by, for example, a hotel tax, if they are a real estate transaction. There are credit problems out there. But we believe that the liquidity problems have been addressed.

Senator TOOMEY. So I think I heard you say you are not aware—you assume that they are out there somewhere, but you are not aware of a specific borrower or municipality or State that wants access to credit and simply cannot get it.

Mr. HITESHEW. Not from the MLF.

Senator TOOMEY. Okay. Some have suggested that the terms should extend much longer than the zero to 3 years. Let me ask you this: Is there distress, is there a lack of liquidity, is there a nonfunctioning market at the longer end of the maturity spectrum in the municipal market today?

Mr. HITESHEW. Well, there very much was in March and April and extending into May, and so that was a tradeoff that we had to make, as I said earlier. Do we rush to market something we knew we could make work and that would be large? The $500 billion was not necessarily designed to think that it will all be used, but it was meant to make a statement about the importance of the municipal market and that the Fed was entering that market for the first time in its history. And so by rushing to market a large program, open window, 3 years, which reflects generally what the maximum that State and local governments can borrow for liquidity purposes, we very much hoped and we have been pleased so far that it has translated into confidence at the long end of the market.

Senator TOOMEY. I understand that. But the short question is simply: Is there liquidity at the long end of the market today?

Mr. HITESHEW. There is.

Senator TOOMEY. Thank you.

Ms. SHALALA. The gentleman yields back.

Commissioner Ramamurti.

Mr. RAMAMURTI. Thank you, Madam Chair.

Just quickly on Senator Toomey's point, first of all, the Secondary Market Corporate Credit Facility is subject to Section 13(3), just like this program, and is subject to the same penalty rate requirement, so I fail to see why accepting such a low rate on the secondary market program is okay for companies but we must demand a much higher rate when it comes to municipal borrowers. And, second of all, there is a primary market program for companies, the Main Street Facility, that has done quite a few loans. To date, it offers a 5-year repayment term, so it seems to me like without question that is an analog to the situation and a clear indication that the Fed could certainly extend the repayment term up to 5 years for municipal borrowers as well.

Turning to my next round of questions, the Fed recently issued a new statement on monetary policy. One of the main takeaways was that the Fed's legal goal of full employment is a "broad-based and inclusive goal." Fed Chair Powell also recently released a statement on racial injustice in which he said, "The Federal Reserve serves the entire Nation. Everyone deserves the opportunity to participate fully in our society and in our economy, and these principles guide us in all we do, including monetary policy."

Mr. Hiteshew, I assume you agree with those goals?

Mr. HITESHEW. Broadly. But, again, I am not here to address monetary policy. That is not my expertise, and so I would defer to your comments that the Chair made and would not have any further comment.

Mr. RAMAMURTI. Well, you do in a sense because the Fed lending programs, including the State and local government lending program that you run, are part of the Fed's exercise of its monetary policy power. It has been quite clear about that. So don't you think that the goals that I just described should guide how you design and implement the State and local government lending program?

Mr. HITESHEW. We are very concerned about the fiscal condition of State and local governments. As I said in my statement, 20 million workers, 13 percent of the workforce in the country, and there is—the recovery of the State and local market, State and local fiscal condition is critical to the overall recovery of the economy.

Mr. RAMAMURTI. Yeah, I appreciate that, and thank you for bringing up that point about the people who work for State and local governments, because if you look at that data, in my opinion, it is pretty clear that the Fed is failing to achieve the goals that Chair Powell and others have laid out.

The Fed's corporate credit facilities and other interventions have boosted the stock market, but black families do not share equally in that financial success. They make up more than 13 percent of the U.S. population but own only 1.5 percent of stocks.

Meanwhile, the Fed's failure to provide meaningful help to State and local governments is crushing black workers in particular. State and local governments have already cut more than a million jobs and are projected to cut 2 million more without Federal help, and they employ a disproportionate number of black workers. In fact, a worker who is laid off in the public sector is 20 percent more likely to be black than a worker who loses his or her job in the private sector. And I think that is part of the reason why the black unemployment rate currently is 5.7 percentage points higher than the white unemployment rate.

So when the Fed is stingy with State and local governments and generous with corporations and with Wall Street, it further widens the divide between black and white families in this country.

So, Mr. Hiteshew, if the Fed wants its recent statements to be more than just window dressing, don't you think it needs to do a lot more to account for these huge disparities in its COVID response so far?

Mr. HITESHEW. Commissioner, I think that we restored market access for the vast majority of State and local governments, and that translates directly into benefits in their community and preventing more cuts than have already happened. As I said in one of my comments earlier, we agree with you that State and local governments cannot cut their way out of the steep decline in revenues and the rapid decline in revenues that we have seen, but neither can they likely borrow their way out of it. So——

Mr. RAMAMURTI. I appreciate that, Mr. Hiteshew, and, again, I am sorry. My time is short. Look, I think you have to be realistic about the fact that if no further Federal aid is coming from the Federal Government directly, the tool that you have in front of you can offer significant relief to State and local governments if you make the terms more generous while staying within the law.

And, look, I raised two issues in the first round of questions, which were lowering the interest rate and lengthening the loan term. It sounded like both of those were potentially consistent with the legal restrictions the Fed is operating under.

The other thing I am hoping that you can take a look at is something that the Chair mentioned, which is changing the eligibility requirements for the lending program. So, for example, Guam and Puerto Rico and Indian tribes are shut out categorically from this lending program. Other criteria like the credit ratings and also the fact that you have to be rated by a national statistical ratings organization are also exclusionary.

So will you just commit to me to take a fresh look at each of these eligibility restrictions through the lens of whether they serve what Chair Powell called "the Fed's guiding principles" of inclusion?

Mr. HITESHEW. Commissioner, we would be glad to do that.

Mr. RAMAMURTI. Thank you, Mr. Hiteshew.

I see my time is up, and I yield back. Thank you, Madam Chair.

Ms. SHALALA. The gentleman yields back.

Mr. Hiteshew, let me thank you for your long service and for your time and testimony today.

We will now proceed to the second panel's testimony, and after all the witnesses have given their testimony——

Mr. HILL. Madam Chair?

Ms. SHALALA. Oh, I am sorry. I am so sorry. My good friend Commissioner Hill, please.

Mr. HILL. Thank you, Madam Chair.

I want to follow up on this secondary market discussion that you had with Senator Toomey, and I wondered if you had evaluated the use of closed-in funds as a way to participate in the municipal secondary market. You noted that exchange-traded funds are fairly limited in municipals, but over the decades, closed-in funds, while not large cap, have been. Did you evaluate that as a potential way to support the secondary market?

Mr. HITESHEW. Thank you, Congressman. We have a team within the Fed that works with me on the municipal market and potential responses. I would not want to go into too much detail in terms of the types of interventions we have been evaluating, but suffice it to say that the secondary market intervention in the muni market would be complex. And, again, for the first time there are a number of considerations that we would have to be making. And so, again, we are evaluating the markets, and we are prepared to act if necessary. Closed-in funds and other ways of accessing or intervening into the secondary market have been evaluated, but I would not want to go further than that.

Mr. HILL. Okay, thank you. Let us talk about smaller States like Arkansas who received $1.25 billion of CARES Act money. They also in one of your modifications allowed Governors to designate the largest county or city to be an issuer, potential issuer to the MLF. Have you found that Governors taking you up on that offer have a majority of the States who were "small" and did not have a rated large municipality? Are they taking you up and designating counties?

Mr. HITESHEW. We have not received any indication of that. You would know better than me, Congressman, but we have not heard from the Arkansas Governor about Little Rock, for example.

Mr. HILL. I understand. I fully understand the situation in Arkansas. I just was curious more broadly because it illustrates, I think, Senator Toomey's point that we do not have a lot of Governors actually designating their larger cities or counties that were not previously designated as a large rated issuer.

I do want to talk about another challenge to smaller States, and that is the use of entities to issue debt, to participate in the MLF, and then support lower subdivisions in their State. In my home State, we have the Arkansas Development Finance Authority, ADFA, and it is the exclusive issuer of bonds for State agencies. And, therefore, they have typically acted as a conduit.

Is it the Fed's intention to let these sorts of conduit issuers have access to the program?

Mr. HITESHEW. Congressman, I am familiar with ADFA. I used to work with them a little bit when I was an investment banker. The program was designed initially to deal with State and local governments and their instrumentalities, generally essential service public providers. We broadened the definition, as you noted, to allow Governors to select up to two revenue bond issuers. The only limitation on the revenue bond issuer is that it has to be financing governmentally owned assets, so it is consistent with the State and local government—consistent with the MLF objectives. For example, ADFA probably issues a lot of private activity bonds. Those would not be eligible.

But to the extent that ADFA issues bonds for governmentally owned entities and they have a creditworthy revenue stream, they may be eligible for the program. We would be glad to talk to you about the specifics that you have in mind to determine whether, in fact, that entity would have direct access. I think it depends on what that entity is financing——

Mr. HILL. I understand. Well, I think that is a point of education in our States where you have a facility such as an arena that does not have business now due to the tourism impact and in some States government shutdowns. And, therefore, they are a public facility, sometimes operated by a county, sometimes operated by a facilities board, but they are not typically a bond issuer, and that is why I raise it. Is that something that you think might work under a conduit like an ADFA bond issuer?

Mr. HITESHEW. It may be able to. And, also, of course, the State, or Little Rock, for example, could borrow on behalf of one of these arenas or entities pursuant to the downstreaming provisions of the original MLF design.

Mr. HILL. Right. Thank you for your testimony today. I appreciate your participation with our Commission, and I yield back, Madam Chair.

Ms. SHALALA. Thank you very much, and I apologize, Commissioner. Let me thank Mr. Hiteshew for your time, for your service, and for your testimony today.

We will now proceed to the second panel's testimony. Let me submit for the record a letter from the Treasurer-Tax Collector of Alameda County, Henry Levy. Without objection, for the record.

[The letter follows:]

Alameda County
Office of the Treasurer
and Tax Collector

Henry C. Levy, Treasurer-Tax Collector

Julie P. Manaois, Chief Deputy Tax Collector

BY E-MAIL TO Hannah Garden-Monheit (Hannah_Garden-Monheit@coc.senate.gov)

September 16, 2020

Congressional Oversight Commission
SDG55 Dirksen Senate Office Building
Washington, DC 20510

Honorable Commission Members:

I am the elected Treasurer-Tax Collector of Alameda County in the Bay Area of California. We are a county of over a million and a half people, with an annual budget of approximately $3.4 billion. The county government alone employs almost 10,000 people; many tens of thousands more have jobs in our 14 different cities, 20 special districts, and 18 school districts. Over a half billion of our budget is our own property tax revenue, $75 million is our own sales tax, but the cities, special districts and schools are more dependent on the state revenues, which rely heavily on sales and income taxes.

As everyone is aware, the economic crisis triggered by the novel coronavirus has caused a tremendous downturn in those sales and income tax revenue provided by the state. This will have a devastating impact on our government and the services we provide. But what many may not be aware of is that the tax revenue we do receive will be delayed substantially. The State of California has allowed merchants to delay the payments of their sales taxes and has suspended the imposition of property tax penalties through May, 2021 for all those affected by COVID. These measures are important ways to preserve the businesses and homes of affected individuals, but they have the effect of delaying the collection of our tax revenue. Furthermore, though property taxes tend not to be as pro-cyclical as sales and income taxes, we expect the property tax collection rate to drop precipitously this coming December, the next semi-annual deadline. These effects will impact not only our budget, but the budgets of the cities within Alameda County: Oakland, Berkeley, Fremont, Hayward and others.

Some of this revenue will be received eventually, but in the meantime, we have to adjust to a very different collection regime. A source of low-cost credit would be very helpful to weathering the storm that is -- let me emphasize -- still gathering. In March and April as the virus lockdown was upon us, we discussed ways to meet the coming challenge and were pleased to hear the Fed had opened up a lending facility and that we might be able to access it to help not only our own budget, but the budget of our cities. Unfortunately, the terms of the credit make it challenging to use. The penalty rate charged is an obvious disincentive, and the terms are just barely as long as we think the crisis will last. A crisis of two to three years does not end suddenly. Lending terms of five to seven, even ten years would be more appropriate to help us through the downturn we expect.

Earlier this year, I convened a number of meetings with finance directors of the cities in the county. Of those surveyed, given the cost of the credit and the term lengths, most thought it would be more flexible and less expensive to use private markets. As a result, we abandoned our plan to address this crisis with a joint powers facility to serve the county, hoping that private markets will be able to help our governments individually when needed. However, this is not something that we desired, and I hope that this attitude can be reversed. But, that depends on the terms of the MLF being changed.
There is opportunity here for the Fed to use the funds Congress appropriated to encourage states and counties to act in a macroeconomically constructive way, to batten down and weather the storm instead of jettisoning cargo and abandoning ship. But this would be a different MLF, constructed with the needs of the state and local governments in mind rather than the needs of bond market participants.

Yours truly,

/s/ Henry C. Levy

Henry C. Levy
Treasurer-Tax Collector
Alameda County

The following elected officials of Alameda County want to lend our support for Congress to amend the CARES Act to mandate that the Federal Reserve improve the terms of loans and grants to local and state governments. The Municipal Liquidity Facility has the potential to save jobs and businesses, and the funds would be going to governments who are used to providing well-placed benefits to eligible recipients. Without such funds, the loss of sales, income, and even property tax loss revenue will result in layoffs, foreclosures, and further reduce revenues.

Nate Miley
Alameda County Supervisor

Jesse Arreguin
City of Berkeley Mayor

Alexandra Medina
City of Emeryville City Council

Ms. SHALALA. We will now hear from Mr. Patrick McCoy, Director of Finance of the Metropolitan Transportation Authority.

Mr. McCoy, you are recognized for 5 minutes.

STATEMENT OF PATRICK MCCOY, DIRECTOR OF FINANCE, METROPOLITAN TRANSPORTATION AUTHORITY

Mr. MCCOY. Thank you. Senator Toomey, Representative Hill, Representative Shalala, Commissioner Ramamurti, thank you for holding today's hearing examining the Municipal Liquidity Facility. My name is Pat McCoy, and I serve as the finance director of the Metropolitan Transportation Authority in New York. The MTA provides critical public transportation services to a population of 15 million people, including broad and diverse communities that have been most severely impacted by the COVID–19 pandemic. This region contributes nearly 10 percent of national GDP, and it is only possible because of the MTA.

Much like public service providers across the country, MTA is experiencing unprecedented financial hardship due to the pandemic. Prior to its initiation, the MTA was experiencing an $81 million surplus forecasted for our current year and 6 consecutive months of on-time performance. As a direct result of this pandemic, we have projected a $12 billion loss of revenue across 2020 and 2021.

Our core credit, the Transportation Revenue Bond, with nearly $30 billion outstanding, has been downgraded five times since March, and our long-term credit spreads have increased by over 200 basis points.

The impact continues to be felt, and we are desperately seeking $12 billion in Federal funding just to get us through 2021. Federal funding and financing opportunities through the MLF have been critical to the MTA thus far. However, financing tools are not a substitute for direct funding assistance and cannot solve the unprecedented fiscal crisis that we are facing.

As a frequent issuer with over $46 billion in bonds outstanding, market stability is crucial to the MTA. Between March 18th and 23rd, all U.S. markets experienced a precipitous decline in investor activity due to the pandemic. The $4 trillion municipal market seized up, resulting in short-end yields climbing to nearly 10 percent. With passage of the CARES Act and the MLF, credit markets, including the municipal market, were provided a critical boost in confidence that had a tangible positive impact on the free flow of capital.

To be clear, the MTA, as well as issuers across the country, would prefer funding to financing, especially when it comes to MTA's revenue shortfalls and other operating challenges brought on by the pandemic. The Federal Reserve should maintain this credit program until this crisis plays out. Many municipalities are likely to seek working capital solutions in the capital markets, which could place a significant strain on the municipal market in the near future.

The MTA was able to utilize the MLF in August with an issuance of $450 million of transportation revenue bond anticipation notes. Issuing the notes to the MLF provided a critical bridge to a long-term solution to address the repayment of this debt. Our competitive bid, as noted earlier, resulted in 20 bids from ten banks totaling $1.6 billion at varying rates. The average true interest cost of the bids necessary to clear the issue was 2.79 percent in comparison to the MLF cost at 1.93 percent. As a point of comparison, earlier in the year we issued $1.5 billion in bonds in early January with a true interest cost of 1.32 percent.

I would like to offer a few suggestions for the MLF that have the potential to help governments most in need and to provide issuers across the country the additional support to manage through the pandemic.

My first suggestion is regarding timing. Forecasts from economists broadly agree that the recession effects of necessary shutdowns due to the pandemic will have a lagging effect that will last well into 2021. An extension of the MLF's origination period into 2021 would very likely mean more access for issuers who will need it most.

The 36-month maximum term of the note is too restrictive. Few governments across the country utilize short-term borrowing due to constitutional or local policy-imposed restrictions. The MLF is really only relevant to a few large local governments across the country. If the facility was open to underwriting longer-term securities, a broader set of issuers could use the facility to finance infrastructure and finance COVID-related revenue losses.

Second, the Federal Reserve should reconsider the impact of penalty pricing to participate in the MLF. Provided the policy objective intended by Congress, we would encourage the Fed to refine its pricing structures in a way that would not unduly penalize an issuer.

Finally, access. This pandemic has different revenue and expenditure effects on different types of issuers, and it will continue to have a profound impact on the financial condition of governmental units that will continue to serve on the front lines of this national crisis. Expanding the facility to include an expansive network of essential public service providers will help to underpin the infrastructure we use to keep the country running.

I appreciate your consideration of this testimony. The MTA's consistent and overarching request from our Federal legislators is for direct, unencumbered funding to ensure stability in this environment where revenues are falling drastically short due to suppressed ridership. But our request also extends to support the municipal bond market. We look forward to working with you to improve the Municipal Liquidity Facility.

Thank you.

[The prepared statement of Mr. McCoy follows:]

Congressional Oversight Committee

September 17, 2020

Hearing to Examine the CARES Act Municipal Liquidity Facility

Testimony by

Patrick McCoy, Director of Finance

Metropolitan Transportation Authority (MTA)

Senator Toomey, Representative Hill, Representative Shalala, Commissioner Ramamurti thank you for holding today's hearing examining the Municipal Liquidity Facility established by the Federal Reserve. My name is Pat McCoy and I am the Director of Finance at the New York Metropolitan Transportation Authority. I'm pleased to be here. The MTA, which operates New York's subways and buses, two commuter rail lines and nine tolled bridges and tunnels, provides critical public transportation services in the New York metropolitan region – serving a population of 15 million prior to the devastating COVID-19 pandemic. Nearly ten percent of the U.S. annual Gross Domestic Product (GDP) originates in this region which is possible because of the MTA network.

The COVID-19 crisis has exacted a terrible human, social and economic toll across the nation. Public transportation systems across the country have been devastated by the pandemic. And nowhere has this crisis been more acute than at the MTA.

The MTA is currently experiencing $200 million in revenue losses every week – an unprecedented crisis that eclipses even the Great Depression's impact on our ridership and finances. These declines, compounded by the loss of state and local taxes and subsidies that support our organization, have left us with a $16 billion projected deficit through 2024.

As impact of the crisis continues to be felt, we are desperately seeking $12 billion in federal funding just to get us through 2021. Federal support through direct funding as well as financing opportunities through the Municipal Lending Facility have been critical in helping the MTA continue to operate. However, it is important to note that the MLF is a financing tool, it does not replace the enormous and devastating revenue losses due to COVID-19. It is not a substitute for direct funding assistance and cannot solve the unprecedented fiscal crisis we are facing.

Looking back prior to the passage of the CARES Act in March, all US markets experienced a precipitous decline in investor activity. This ominous activity in the $4T municipal market, an effective seizing up of the marketplace, resulted in short-end yields drastically climbing to near 10%. With subsequent passage of the CARES Act and specifically the Municipal Liquidity Facility, credit markets including the municipal market were provided a critical boost in confidence that had a tangible positive impact on the free flow of capital. While the MLF has not been utilized by many municipal issuers the mere fact that it was available provided investors with the confidence that municipal issuers had a liquid backstop available to purchase their short-term obligations. The reaction to this facility was felt immediately as credit spreads began to narrow shortly after the announcement of its availability. The MLF is an important backstop to desperately needed federal dollars, but issuances into the facility must be repaid within 36 months. That said, at the same time, the MLF has taken a somewhat limited view of its role as only to calm the short-term liquidity market when it could have taken a broader approach to provide effective credit subsidies, as it has with respect to corporate credit markets.

In the MTA's case, Variable Rate Demand Bonds (a municipal market equivalent of commercial paper) climbed from a weekly rate of 83 basis points to our maximum rate of 9%. After enactment of the CARES Act, short-term bond costs reduced significantly – our current daily and weekly resets are ranging from 3 to 10 basis points. However, to be clear the MTA as well as many states and municipalities across the country are still facing devastating challenges. While the CARES Act provided significant aid to private sector industries, the public sector did not fare as well.

To be clear: Before Covid-19 hit, the MTA was making the best progress it had seen in decades, with an expected $81 million operating surplus in 2020, and six consecutive months of on-time performance above 80 percent and strong ridership. To achieve this, the MTA has cut almost $3 billion of annually recurring expenses from our budget over the last decade and are in the process of cutting another $300-400 million. We are aggressively consolidating functions and finding efficiencies to deliver customers the modern transportation system they deserve. The MTA has already identified $540 million in cuts through reductions in consultant contracts, overtime and non-labor expenses in 2021.

Now, the MTA is preparing for drastic and necessary reductions that include possible service cuts of up to 40% on subways and up to 50% on the Long Island and Metro-North railroads – cuts that will reverberate throughout the entire economy. The MTA could potentially lay off more than 8,000 workers to reduce expenditures. This is compounded by a looming fare hike and potentially gutting the historic $51.5 billion capital construction plan necessary to bring the 116-year-old system into the 21st Century. Without federal support for our $12 billion request, we will be forced to take drastic and draconian actions that will have a profound negative impact on mobility in the New York Metropolitan region. We simply cannot cut our way out of this crisis.

Making matters worse, the MTA's credit ratings are experiencing extreme stress – our core credit, the Transportation Revenue Bond, providing a gross pledge of a diverse and deep revenue stream has been downgraded five times since March the most recent downgrade occurred on September 14 from Moody's Investors Service, which lowered their rating from A2 to A3. All four rating agencies rating the Transportation Revenue bond currently have the credit on a negative outlook.

The MTA is a capital-intensive organization that borrows in the public Capital Markets. We use the proceeds of these issues to fund a significant portion of our "state of good repair" program as well as needed expansion projects that target important underserviced areas of the MTA's 5,000 square mile service area spanning all of New York City and the seven surrounding counties. MTA's long-term credit spreads have increased by over 200 basis points since the crisis has begun. Which leads me back to the importance of the MLF.

The Federal Reserve Bank should maintain this program until this crisis plays out, many municipalities are likely to seek working capital solutions in the capital markets which could place a significant strain on the municipal market in the months ahead. The existence of this program as a buyer of last resort will ensure that credit spreads do not continue to widen which will only worsen an already unprecedented situation.

Section 4003(b)(4) of the CARES Act provided appropriation for the federal reserve to establish monetary policy that would give parameters to the Federal Reserve to create a lending or investing program (whether in the primary or the secondary market) in order to provide security to municipal issuers throughout the crisis. Other parts of CARES Act were carefully designed fiscal policy, such as bolstering already-existing programs like FTA apportionments. The Coronavirus Relief Fund additionally provided $150 billion in funding that falls short of the current need estimated to be $500B for States alone[1].

To be clear: Fiscal policy providing new direct aid remains critical and urgent and monetary actions, particularly the MLF in the municipal market should be extended to ensure stable markets. Both remain necessary to blunt the negative impact COVID-19 is having and will continue to have on our economy in the near years to come.

The key point here is that again, as an issuer, I would prefer funding to financing, especially when it comes to MTA's revenue shortfalls and other operating challenges brought on by the COVID-19 pandemic.

The MTA was able to utilize the MLF in August with an issuance of $450 million of Transportation Revenue Notes. I want to thank the State of New York and Senator Schumer for their advocacy on behalf of the MTA on this matter. The MTA has an extensive capital financing program with a large and diverse portfolio that totals $46 billion of outstanding debt. The note issued to the MLF defeased an existing note that was due on September 1. This provided the MTA with time to establish a long-term solution to address the repayment of this debt. Because we were able to issue into the MLF, we will now plan pay the MLF note off or finance it with long term bonds sometime in the next 36 months under more favorable market conditions. The ability to repay the note at any time prior to the maturity date without a penalty is a highly valuable feature of the MLF.

[1] https://www.cbpp.org/research/state-budget-and-tax/states-need-significantly-more-fiscal-relief-to-slow-the-emerging-deep

To establish a market baseline, MTA conducted a competitive bid of the note that was ultimately placed with the MLF. We received 20 bids from 10 different banks totaling $1.6 billion at varying rates. Market feedback from the bidders was that there was little to no pre-sale investor demand so the bids consisted of levels that the underwriting community was willing to risk their own capital, this is not unusual but it highlights the wait and see posture the investor community was taking. The average clearing true interest cost of the bids was 2.79%, in comparison to the Municipal Liquidity Facility at a true interest cost of 1.93%, a far preferable and less expensive choice for the MTA.

As a point of comparison, a similar Bond Anticipation Note that the MTA issued prior to the pandemic in January 2020 was issued at a true interest cost of 1.32%.

Despite the pandemic, the trains must keep running, as does the water, sewer, education, refuse collection; and in so doing, governments across the country need access to capital to provide the infrastructure necessary to provide essential services. State and local issuers using the tax-exempt bond have delivered 75% of our nation's infrastructure needs. Beginning with the advent of COVID-19, that investment has stalled.

I would like to offer suggestions for the MLF that have the potential to help governments most in need and to provide issuers across the country the additional support to manage through the pandemic.

First, I would ask you to consider two elements of timing: facility termination and bond terms. The Federal Reserve has established the termination of the origination date of new debt as of December 31, 2020. When established, that may have been a reasonable termination date due to the uncertainty of timing of the pandemic. As our understanding of the impact and depth of pandemic has become somewhat clearer over these past months, we must acknowledge the forecasts from economists who have broadly have agreed that the recession-effects of necessary shut downs will have a lagging effect that will last well into 2021. Closing the window on December 31 will hardly capture the needs of states and local governments (even those limited few that are eligible entities today). An extension of the MLF's origination period into 2021 would very likely mean greater access for issuers who need it most.

The other timing challenge is presented in the 36-month maximum term of the MLF. Few governments across the country utilize short-term borrowing that extends beyond 60 months due to constitutional or local policy-imposed restrictions on short-term borrowing, including borrowing for operations. Because of this, the MLF is only relevant to a few large local governments across the country. If the facility was open to underwriting longer-term securities, benefits would be twofold. Issuers would be assured that there is a buyer for their capital financing needs. Most importantly, issuers could free up liquid resources that could be used to address the crisis.

The Federal Reserve should reconsider the impact of penalty pricing to participate in the MLF. The MTA accessed the facility at an opportune time. Just after our August 26 closing, the Federal Reserve changed its term sheet to include a new 50 basis point increase in pricing to account for rating disparity in a given credit[2]. Should market conditions change, as they surely will, the Federal Reserve should carefully consider whether the MLF is continuing to support state and local governments as intended by Congress.

Issuers of municipal debt follow a well-established issuance and post-issuance regime, structured by SEC Rule 15c2-12 as modified by the Dodd Frank Act. This process is guided by a host of participants including disclosure counsel and bond counsel, underwriters, investors and municipal advisors. Provided the policy objective of the MLF is to provide a backstop to the municipal market, we would encourage the Fed to refine its pricing structures in a way that would not penalize an issuer.

The third recommendation that would be a welcome change to the MLF from the issuer community is the concept of access. When initially proposed, the facility was only open to a small universe of very large issuers, principally states and large cities and counties. Thankfully, the facility was later expanded to include revenue bond issuers, and by virtue of that change, the MTA. This pandemic has different revenue and expenditure effects on different types of issuers. The challenges to the MTA that I articulated earlier are larger and more pronounced than the stresses felt by many other State and local issuers, nonetheless the COVID_19 pandemic is and will continue to have a profound impact on the financial condition of governmental units far and wide.

State and local governments have been and will continue to serve on the frontlines of this national crisis. The MTA's consistent and overarching request from our federal legislators is for direct, unencumbered funding to ensure stability in this environment where revenues are falling drastically short due to suppressed ridership. Our advocacy extends to support the municipal debt market, 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. The MTA desperately needs $12 billion in federal funding to get through 2021. This is not hyperbole. Without additional funding we will be forced to make a series of untenable choices that will further devastate our growth and recovery for years to come.

I appreciate your consideration of this testimony and look forward to continuing to work with you on improving the municipal liquidity facility.

[2] "In addition, the applicable spread will be increased by 50 bps if the spread corresponding to the lowest rating of the credit for the Eligible Notes is more than 50 bps above the spread corresponding to the average rating of the credit for the Eligible Notes." MLF FAQ.

Ms. SHALALA. Thank you, Mr. McCoy.

We will next turn to Mr. Marion Gee, the President of the Government Finance Officers Association and the Finance Director of the Metropolitan St. Louis Sewer District.

Mr. Gee, you are recognized for 5 minutes.

STATEMENT OF MARION GEE, PRESIDENT, GOVERNMENT FINANCE OFFICERS ASSOCIATION, AND FINANCE DIRECTOR, METROPOLITAN ST. LOUIS SEWER DISTRICT, MISSOURI

Mr. GEE. Thank you. Senator Toomey, Representative Shalala, Representative Hill, and Commissioner Ramamurti, thank you for holding today's hearing on the Municipal Liquidity Facility created under the CARES Act. I am Marion Gee, and I am honored to be here in my capacity as President of the Government Finance Officers Association. But I will also share some insight with respect to the Metropolitan St. Louis Sewer District where I serve as Finance Director.

The CARES Act was an important start to provide some relief to State and local governments as we attempted to navigate the response to the COVID–19 pandemic. The response continues and further assistance is needed. The first best option is to provide direct Federal funding as it can be rapidly deployed; whereas, borrowing is inherently most costly and time-consuming. Since additional funding is not a guarantee, the Federal Government must explore other ways to help State and local governments as we navigate these challenging times.

Today I will focus on the MLF, specifically why local governments and State governments are not using that, and recommendations to enhance its effectiveness to public sector entities.

Not all public entities providing vital services are the same, and each face unique challenges that require practical solutions to help us face those challenges. As currently designed, the MLF is too costly of a solution for us, nor is access widely granted. We all need clean, safe water to take the important step of washing hands and for other hygienic purposes to protect the public health.

The National Association of Clean Water Agencies projects the total impact to clean water utilities nationwide from lost commercial and industrial revenues at $12.5 billion over the year and $3.8 billion of revenue losses from increased household bill delinquencies due to the COVID–19-related job losses.

Commercial water usage on which my agency bases a portion of its bills is projected to decrease by roughly 17 percent over the current fiscal year. We will face additional challenges as water usage relating to residential customers is increasing. The revenue losses and substantial costs for maintaining services pose a significant challenge for public entities like mine.

Next, my State and local government colleagues face similar revenue struggles and will continue to do so into 2021. Since more direct funding is uncertain, we need additional options from our Federal partners at a low cost and recognize the uncertainty regarding how long this public health crisis will last.

Income, property, and sales taxes are among the main sources of revenue for State and local governments. Since revenues generally lag behind economic changes, the full picture of the pandemic's impact on these will be unknown for some time.

This leads me to the MLF. As currently designed, it is not a practical solution for many public entities. Direct access to the MLF is too restrictive for most public entities. Only 250 entities are eligible to directly access the facility, leaving out the vast majority of nearly 80,000 public issuers. My agency is not an eligible entity to directly access the MLF unless it is designated as an eligible revenue bond issuer by the Governor.

Access should be expanded to a larger, more diverse pool of issuers. The MLF's 36-month term should be lengthened, and borrowers should have greater flexibility with regard to the use of the proceeds. The vast majority of public entities issue debt for capital needs more than they do for operational needs. Issuing 36-month debt is rare. Increasing flexibility so borrowers can use proceeds for investments like capital projects means job creation and boosting the economy.

The Fed should extend the underwriting deadline of the MLF beyond December 31, 2020. The facility is currently set to expire at the end of the year, even though we will not know the extent of revenue challenges State and local governments will face until well into 2021.

The MLF pricing is unduly punitive. The penalty pricing structure of the MLF term sheets does not make it a viable solution for municipal issuers like my agency. Pricing should be competitive with the market or lower; issuers in dire circumstances should not be penalized. The Fed should create a facility to provide relief by purchasing municipal securities in the secondary market, similar to the secondary purchasing program in the Secondary Market Corporate Credit Facility. Given the uncertainty regarding the duration of the COVID–19 pandemic, we could see a replay of this year's cash crunch and selloff in the muni market.

Thank you for the opportunity to address the Commission today. I am happy to address any questions.

[The prepared statement of Mr. Gee follows:]

STATEMENT OF
MARION GEE

PRESIDENT GOVERNMENT FINANCE OFFICERS ASSOCIATION
AND
FINANCE DIRECTOR, METROPOLITAN ST. LOUIS SEWER DISTRICT, MISSOURI

ON BEHALF OF THE GOVERNMENT FINANCE OFFICERS ASSOCIATION

MUNICIPAL LIQUIDITY FACILITY ESTABLISHED BY THE FEDERAL RESERVE AND TREASURY DEPARTMENT, PURSUANT TO THE CARES ACT

BEFORE THE
CARES ACT CONGRESSIONAL OVERSIGHT COMMISSION

SEPTEMBER 17, 2020

Senator Toomey, Representative Shalala, Representative Hill and Commissioner Ramamurti, thank you for holding today's hearing on the Municipal Liquidity Facility created under the Coronavirus Aid, Relief, and Economic Security Act earlier this year. My name is Marion Gee and I am the current President of the Government Finance Officers Association (GFOA). My remarks here today are in my capacity as President of GFOA, although I will share some insight from the Metropolitan St. Louis Sewer District (MSD) where I serve as the Finance Director.

About the MSD and the GFOA

The MSD was created in 1954 when voters approved to combine 79 regional sewer water districts into one city-wide system for the collection, treatment, and disposal of wastewater. The MSD's primary mission is to protect the public's health, safety, and water environment by responsibly providing wastewater and stormwater management. With more than 9,600 miles of sewer lines, St. Louis is home to the country's fourth largest sewer system – not to mention one of the oldest.

GFOA represents over 21,000 public finance officers from State and local governments, schools and special districts throughout the United States. GFOA is dedicated to the professional management of governmental financial resources by advancing fiscal strategies, policies and practices for the public benefit, including issues related to issuing tax exempt bonds and investing public funds. On behalf of the GFOA and its members, I appreciate the opportunity to provide comments at this hearing on the Municipal Liquidity Facility.

Together with the members of GFOA and the public issuer community we applaud the efforts of Congress and the Treasury Department to implement monetary policy as we faced one of the greatest public health challenges in modern history. Between January and today, our country has experienced unprecedented hardship and change. State and local governments have worked extremely hard to ensure the viability of their communities and the public services that they provide. Passing the Coronavirus Aid, Relief, and Economic Security Act (*CARES Act*) in late March was an important start as state and local governments across the country grappled with how best to respond to the outbreak of the virus.

The direct funding provided by the CARES Act has provided some relief to states and local governments through different appropriations vehicles. Although the MSD was not a direct recipient of any CARES Act funding, many state and local government members of GFOA were recipients, whether through the Coronavirus Relief Fund, the Education Stabilization Fund, the

Airport Infrastructure Fund or FEMA. Yet state and local governments need Congress to provide more direct funding. A majority of states and their local governments are just a few months into their new fiscal years, and many face budgetary shortfalls that are not expected to resolve anytime soon. The aid provided to date is not enough to get us through this crisis and stave off austerity measures that will place additional pressures on essential public services and drag down the entire economy. Direct federal assistance can be readily and rapidly deployed to address this crisis, whereas borrowing is inherently more time-consuming and costly.

Notwithstanding that direct aid is the best first option, I want to focus my comments today on the Municipal Liquidity Facility (MLF), including why governments, with the exception of two, are not using it and on recommendations to enhance its effectiveness to public sector entities.

First, I would like to start by emphasizing that not all public entities providing vital services are the same, yet we stand together providing essential services to citizens across the country. Public utility providers like the MSD face unique challenges created by the pandemic. However, as the Federal Reserve has currently designed the MLF, it is too costly to be a useful tool to help us face those challenges and in any event access to it is not widely granted.

States and local governments vary in the communities they serve and the means by which they provide their services. The COVID-19 pandemic has had, and will continue to have in the near term, a broad ripple effect on the revenue sources critical to states and local governments. While more direct and flexible fiscal aid is needed, the Federal Reserve can help states and local governments by providing low cost borrowing as another tool to utilize.

Finally, while the MLF is an important piece of the initial and necessary response to the COVID-19 pandemic — it is currently not a practical response for many in the general government community. The Treasury and the Fed can take steps to make the MLF a more practical option, which has the potential to simultaneously save taxpayer dollars and boost the economy.

Water Systems Face Unique Challenges

Among the measures stressed by public health offices to combat the spread of COVID-19 is frequently washing your hands. This underscores the vital importance of clean and safe water as a means to protect public health. Drinking and clean water providers are facing major revenue losses and substantial costs for maintaining services to both low income and financially distressed households during the ongoing pandemic. The shortfalls continue to pose a challenge to organizations like the MSD as, without further assistance, there a limited number of ways to address the problem – undesirable solutions like delaying investments in water infrastructure and increasing rates on household. This is a terrible position to be in as we do not want to choose providing clean water over not creating additional burden on families who are already struggling to persevere in the current health and economic crisis.

The financial impacts we are facing from COVID-19 are unfortunately not unique among the water sector. The National Association of Clean Water Agencies, of which MSD is a member, has projected the total impact to clean water utilities nationwide from lost commercial and industrial revenues at $12.5 billion over the year, as well as $3.8 billion in revenue losses from increased household bill delinquencies due to COVID-19-related job losses. Similar projections have been developed for the drinking water sector, totaling $13.9 billion. In sum, that is a $30 billion impact to local water and wastewater utilities, a financial strain that is currently being felt by local communities and ratepayers.

Commercial water usage on which my agency bases a portion of its bills is projected to decrease by approximately $20 million – approximately 17 percent of our commercial revenues – during our current fiscal year ending June 30, 2021. We will face additional fiscal challenges as water usage relating to residential customers is increasing as more of this customer class stays home while moratoriums have been rightfully implemented on local water utility's ability to discontinue services due to non-payment during this pandemic.

The federal government needs to provide more assistance to struggling states and local governments

Just as the characteristics and needs of each state and local government differ, the revenue sources each level relies upon differ as well. Income, property, and sales taxes are among the most prominent sources of revenue for state and local governments. And the full picture of how the pandemic will impact these is still being determined, as many states and local have recently begun a new fiscal year. Since revenue declines generally lag behind economic changes, it may be some time before we have a complete picture. Due to the drastic increase in unemployment over the last six months, we can expect substantial declines in the sales tax and income tax receipts given their relation to employment. In June, Moody's Analytics reported that state and local governments face a $500 billion in projected budget shortfalls through 2022.

Over 1 million public sector jobs have been lost since the national emergency was declared in March. Without additional federal aid, we could see additional job losses and other drastic measures implemented to ease the budgetary stress. Surveys conducted of GFOA's membership and our sister organizations like the National League of Cities and the National

Association of Counties are finding common themes among the potential measures, including delaying much-needed infrastructure investments and reducing vital human services and community development support.

Due to the uncertain timeframe of the COVID-19 public health emergency, expenses related to stopping the spread of the virus will continue to take its toll on state and local budgets. But adding lost revenues to the mix will only magnify the budgetary impacts of the health crisis. A recent GFOA survey of Coronavirus Relief Fund (CRF) prime receipts found that additional aid would be helpful – an overwhelming 91 percent of respondents stated they would benefit from additional federal aid. The decrease in sales and gross receipts tax remains a major concern for respondents over the next 12 months. Unfortunately, recent negotiations failed to produce additional aid, which heightens the need to provide additional practical options for states and local governments.

The Municipal Liquidity Facility as currently designed is not a practical solution for many public entities

When the Federal Reserve announced the formation of the MLF in April, GFOA was generally supportive of the effort to provide emergency liquidity to states and localities. Stability in the $3.8 trillion municipal bond market is particularly important during this crisis as state and local governments and the municipal bond market provides critical support for the infrastructure – including clean water – needed to care for and support our citizens. We acknowledge that the creation of the MLF effectively calmed the municipal market at a critical time. That said, the Federal Reserve has taken a limited view of its role as only to calm the short-term liquidity market when it could have instead viewed the mission as providing effective credit subsidies, as it has with respect to corporate credit markets. Not much of the MLF's capacity has been used – $1.65B is 0.3% of the $500B lending capacity of the MLF.

GFOA expressed some concerns with a number of the program's details throughout the development of the MLF. Examples of concerns and possible ways to address them are as follows:

- Direct access to the MLF is too restrictive for most public entities. There are only 250 entities eligible to directly access the facility, which leaves out the vast majority of nearly 80,000 public issuers. The MSD, despite our substantial service area, is not an eligible entity to directly access the MLF unless it is designated an eligible revenue bond issuer by the governor.

In its most recent revision, the terms of the MLF permits governors to grant access to revenue bond issuers and some cities and counties that are under the original population threshold. Granting each governor the ability to designate additional entities that otherwise would not be eligible to directly access pits local governments against one another even though we are working towards common goals during this crisis. While access to every public issuer is not warranted, access should be expanded to a larger, more diverse pool of issuers. Further expanding eligibility would help to relieve the pressure on all types and maturities of municipal securities. This would especially be important since we still face uncertain times ahead in the municipal market.

- The MLF's 36-month term should be lengthened and borrowers should have greater flexibility on the use of proceeds. Many states in the US have either constitutional or policy restrictions that limit governmental entities from borrowing for operating capital needs. Forcing public issuers to work within the existing 36-month term for many eligible entities would necessitate a constitutional amendment or policy change, which is a highly formidable task even under non-pandemic circumstances. The vast majority of public entities in the US issue debt more for capital needs than operational needs, and thus rarely issue 36-month debt – a point that especially holds true for the MSD. From a practical standpoint, extending the term of the notes available to eligible entities through the MLF should be considered.

  Additionally, increasing the flexibility on the use of proceeds will help jurisdictions make investments that could provide long-term benefits for communities. The needs and strengths of every community differ, thus the pandemic and economic crisis will play out differently for each state and local government. The Federal Reserve should allow for a broad use of the proceeds to allow jurisdictions to utilize them in ways that best suit their needs, such as undertaking long-overdue capital projects. Investments like this mean job creation and improving the infrastructure of a local economy.

- The Federal Reserve should extend the underwriting deadline of the MLF beyond December 31, 2020. The facility is currently set to expire at the end of this year, even with the state and local government budget crisis just beginning. As described above, the revenue challenges of state and local governments are in their nascency, yet the facility will cease to underwrite new obligations on December 31. GFOA members are only now beginning to think about 2021 budgets and will very likely incorporate downward pressure on revenues, increasing expenditures in ensuring public service delivery and delayed capital spending. If the window were to remain open in 2021, it is very likely eligible entities would access the facility.

- The MLF pricing is unduly punitive. The penalty pricing structure of the MLF term sheet unfortunately does not make it a viable option for municipal issuers, which is very likely the primary reason we see underutilization of the facility. In fact, the MSD cannot utilize the MLF due to its unfavorable pricing structure. *Pricing should be competitive with the market or lower; issuers in dire circumstances should not be penalized*. The Federal Reserve should make the rate as low as possible for states and local governments as this saves taxpayer dollars, saves jobs, and prevents drastic budget cuts that may irreparably hurt local communities.

- The Federal Reserve should create a facility to provide relief by purchasing municipal securities in the secondary market, similar to the secondary purchasing program in the Secondary Market Corporate Credit facility. There remains some uncertainty in the coming months regarding the duration of the COVID-19 pandemic and whether we might see a second wave of infections. This may create a replay of what we saw earlier this year of a cash-crunch and selloff in the municipal market. Developing a special purpose vehicle aimed at purchasing municipal securities and thus providing relief to the secondary market should be considered.

- Finally, we recommend exploring additional ways to enhance the ability for smaller issuers to access capital. We believe that targeted easing of capital requirements along with minor changes to the U.S. Tax Code would further strengthen access to bank loans and lines of credits for smaller issuers. 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 their ability to meet the credit needs of small issuers. GFOA has supported bipartisan legislative efforts like the “Municipal Bond Market Support Act of 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 diversity sources of credit to state and local governments.

Thank you for the opportunity to address the Commission today. 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 backtrack on the vital stimulus that Congress, the Federal Reserve and the administration have worked to provide. We urge you to refine facilities like those outlined above in order to counter the unprecedented impacts of current market uncertainty.

Ms. SHALALA. Thank you, Mr. Gee.

We will next turn to Mr. Chris Edwards, Director of Tax Policy Studies at the Cato Institute.

Mr. Edwards, you are recognized for 5 minutes.

STATEMENT OF CHRIS EDWARDS, DIRECTOR, TAX POLICY STUDIES, CATO INSTITUTE

Mr. EDWARDS. Thank you very much for inviting me to testify today. I will discuss the Municipal Liquidity Facility and State budget challenges. I have two general points.

First, with the economy rebounding, State revenues likely will not fall as much as originally projected. Further aid from the Fed or Congress is not needed, in my view.

Second, the MLF undermines market discipline on State borrowing and risks politicizing the Fed.

Regarding the State budget situation, Bureau of Economic Analysis data for the second quarter of 2020 show that total State and local tax revenues dipped just 3 percent from the first quarter. Sales and income tax revenues fell, but property tax revenues increased slightly. Home prices in July were up 5 percent over last year, and if they stay up, that will help boost city and county budgets in the months ahead.

During the recession a decade ago, local tax revenues did not fall, and that is because property tax revenues remained stable.

Looking at the BEA data from the first to the second quarters, total State and local tax revenues fell $13 billion, but total Federal aid to the States soared $193 billion. That suggests to me that the States generally are not short of cash, although some places like New York City do face big challenges.

A recent NCSL survey of 37 States found that tax revenues are expected to be down 10 percent on average in 2021 compared to original projections. That translates into just a 4 percent tax revenue drop from the 2019 peak. Most States can handle a downturn with the rainy day funds and spending restraint going ahead. It is true that the States differ. New Jersey and Illinois saved zero in their rainy day funds, even after 11 years of economic expansion. That was totally irresponsible, in my view. If Illinois had saved in its rainy day fund, it would not have needed the MLF loan. And, again, if Illinois had been more responsible and saved in its rainy day fund, it would not have needed the Federal Reserve loan.

Here are some concerns about the MLF. Finance expert Robert Pozen warned in an op-ed that expanding the MLF could politicize the Fed. I mean, imagine if the Fed began making regular loans to the States. All those swarms of lobbyists that currently surround Capitol Hill today would open offices surrounding the Fed's headquarters on Constitution Avenue in Washington. That really would not be a good outcome.

In general, State and local governments are far more fiscally responsible than the Federal Government, and not just because they have balanced budget requirements but also because of the discipline of credit markets. State and local governments have strong incentives to act with fiscal prudence to boost their credit ratings and lower their borrowing costs.

Federal Reserve intervention into State and local finance undercuts incentives for fiscal responsibility. It makes no sense for the central bank to undermine market interest rates, which properly reflect market risks and credit risks, in order to reward fiscally unsound jurisdictions.

The first MLF loan went to Illinois, which has probably the worst-run finances in the Nation. Did the MLF loans stave off a liquidity crisis in Illinois? Not at all. The MLF loan allowed Illinois to increase its 2021 general fund budget by 5.9 percent, including $250 million in salary increases for State workers. So the MLF loan discouraged needed restraint in Illinois, in my view.

In the long run, congressional and Fed subsidies undermine incentives for State and local policymakers to build rainy day funds, to reduce their debt loads, and to pursue restraint.

So, in closing, what about the economy in general? Some analysts support more Federal aid and Fed loans to the States, believing it creates a large multiplier boost to the economy. I cite evidence in my written testimony that those multipliers may not be large. While government spending may boost GDP in the short run, a negative side effect is crowding out or shrinking the private sector, which undermines long-term growth. In the long run, growth comes from innovation in the private sector, and if you crowd out the private sector, you are going to reduce innovation and growth in the long run.

More deficit spending also means higher taxes down the road, and with the economy now recovering, it is not prudent or fair, in my view, to burden younger Americans with even more government debt.

In sum, the MLF undermines the healthy discipline of the municipal bond market and the discipline it creates for State and local governments. Going forward, the States should build larger rainy day funds so when the next recession hits, they will be much better prepared.

Thank you very much.

[The prepared statement of Mr. Edwards follows:]

State Budget Challenges and the Municipal Liquidity Facility

Statement of Chris Edwards, Cato Institute

before the Congressional Oversight Commission

September 17, 2020

Members of the commission, thank you for inviting me to testify. I will discuss the Municipal Liquidity Facility (MLF) within the broader context of budget challenges facing the states. Congress and the Federal Reserve created the MLF to provide loans to state and local governments with short-term financing needs during the recession.

Earlier in the year, news stories described the state budget situation as devastating, but with the economy rebounding state tax revenues likely won't fall as much as previously thought. The states are facing budget challenges, but they can restrain spending and tap rainy day funds to balance their budgets without further aid from Washington.

While the MLF was a well-meaning response to the crisis, it is not appropriate for the nation's central bank to finance the states. State governments are not subdivisions of the federal government. They have large independent fiscal powers to tax, save, borrow from markets, and adjust spending to handle economic ups and downs. As for local governments, they should look to state governments to backstop their finances within our federal system.

State Budget Challenges

State governments must balance their general fund budgets each year, which is more difficult during recessions if revenues are falling. Early in the crisis, news articles speculated that state tax revenues were plunging so fast that there would be "financial devastation."[1] Moody's Analytics projected that state general fund revenues would fall 15 to 20 percent.[2]

However, recent data suggest more manageable state budget gaps. U.S. Bureau of Economic Analysis (BEA) data for the second quarter of 2020 (April to June) show that total state and local tax revenues dipped just 3 percent from the first quarter (January to March). Sales and excise tax revenues were down 6 percent, income tax revenues were down 2 percent, and property tax revenues rose 1 percent.[3] Compared to the second quarter of 2019, state and local tax revenues for the second quarter 2020 were down 3 percent.

Commentators often conflate the budget situations of state and local governments, but they are quite different. While income and sales tax revenues have dipped for state governments, local governments raise 72 percent of their tax dollars from property taxes, which rose modestly in the second quarter.

During the recession a decade ago, local tax revenues nationwide did not fall because property tax revenues were flat for two years and then started rising again, and that was true even though home prices fell substantially at the time.[4] During the current recession, home prices are rising. Average U.S. home prices in July were up about 5 percent from a year earlier, and prices are expected to continue rising modestly.[5] Commercial property prices are down this year, but the drop is substantially less than during the last recession, at least so far.[6]

An August National League of Cities analysis that projected large budget gaps for city governments is based on an assumption that property tax revenues would plunge.[7] But so far, that does not seem to be happening.[8] Of course, the recession is hitting some cities and states harder than others, but there is no national crisis in local government finances.

The modest overall decline in state and local tax revenues during the second quarter of 2020 can be compared to the huge increase in federal aid for the states in that period. State and local tax revenues fell $13 billion from the first to the second quarters, but overall federal aid increased by $193 billion, according to the BEA.[9] Overall state and local revenues (from taxes, federal aid, and other sources) rose from $716 billion in the first quarter of 2020 to $893 billion in the second quarter.

State and local budgeting is more challenging than during the boom years, but there has been no collapse in funding for schools and other services. Congress has aided states with the $150 billion Coronavirus Relief Fund, $442 billion for the unemployment compensation expansion, $172 billion for extra Medicaid benefits, $30 billion for education funding, $111 billion for disaster relief, $66 billion for SNAP benefits, $26 billion for public transportation, and other aid.[10] Some federal relief money is still in the pipeline flowing to local governments.

A September survey of 37 states by the National Conference of State Legislatures found that general fund tax revenues are estimated to be down 10 percent in 2021 compared with pre-crisis projections.[11] That expected drop from projections translates into a drop from the 2019 revenue peak of about 4 percent.[12]

Also, regular federal aid for state and local governments amounts to almost $700 billion a year and pays for one-quarter of state and local budgets.[13] Thus, a 4 percent drop in state tax revenues translates into a smaller percentage drop in overall state revenues even without all the additional federal aid passed this year.

How should states deal with budget gaps? They should freeze or cut spending and tap their rainy day funds. Going into the recession in 2020, rainy day fund balances totaled 8.7 percent of annual general fund spending for the states as a whole, which is substantially higher than the 4.8 percent going into the last recession in 2008.[14] Many states have started drawing from their rainy day funds for their 2021 budgets.

However, the size of rainy day funds varies widely. Going into the recession, the funds totaled 10 percent or more of annual spending in 20 states, but they totaled less than 5 percent in 12 states.[15] Among those less-prudent states, New Jersey, Pennsylvania, Illinois, and Kansas had saved virtually nothing going into 2020. It is hard to sympathize with state governments that have empty rainy day funds after an 11-year economic expansion.

Municipal Liquidity Facility

With $35 billion from Congress, the Federal Reserve created the MLF in April to loan through a special purpose vehicle up to $500 billion to state governments and large local governments. To date, the MLF has lent $1.2 billion to the state of Illinois and $450.7 million to New York's Metropolitan Transportation Authority (MTA).

The MLF is a foray into a new activity outside of the Fed's role of ensuring stability in the financial system. When there was pressure a decade ago for the Fed to lend to state and local governments, then Fed chair Ben Bernanke was opposed. He said regarding state and local loans and possible defaults: "This is really a political, fiscal issue," not a central bank issue.[16] This year, Robert Pozen warned against expanding the MLF: "The central bank's independence would be undermined if it became a big purchaser of long-term bonds from financially weak but politically influential local governments."[17]

The two MLF loans have saved the issuing entities interest costs, but that is not a goal worth undermining federalism for and pushing aside market interest rates.[18] Market interest rates reflect important information about risk. State and local debt issuers have strong incentives to balance their books and act with fiscal prudence to boost their credit ratings and ease access to borrowing at lower interest rates. It makes no sense for the Federal Reserve to undermine market signals and essentially reward fiscally unsound jurisdictions with loan subsidies.

In general, state governments are far more fiscally responsible than the federal government, not just because they have formal balanced-budget rules, but also because of the discipline of credit markets. Federal Reserve intervention undercuts incentives for state fiscal responsibility. The MLF has been little used, but the precedent it creates is troubling.

It is not a surprise that the State of Illinois was first in line to receive a loan because it has perhaps the most poorly managed state finances in the nation.[19] It has the lowest credit rating among the states and one of the highest relative loads of debt and unfunded liabilities.[20] Illinois has billions of dollars of unpaid bills to state suppliers, which proliferated even when the economy was growing.[21]

Federal aid to ill-managed jurisdictions undermines their incentives to make needed fiscal reforms. For Illinois, state-source general fund revenues are expected to fall 4 percent in 2021, but the state is increasing program spending 2.2 percent and overall spending 5.9 percent based on funding from the MLF and other new debt.[22] Despite the recession and inability to balance its books, the state is going ahead this year with $261 million in pay raises for state workers.[23] Illinois should at least be freezing spending—as other states are doing—to get out of its vicious debt cycle.

New York's MTA was in deep trouble even before the recession.[24] It has a huge debt load and large looming costs for deferred maintenance and capital investment.[25] Subway ridership was dipping even before this year, and the health crisis may deliver a long-term blow.[26] New York's subways and buses have high operating costs which fares only partly cover.[27] Rather than borrowing from the federal government or the central bank, the MTA should be restructuring. It is out of the purview of this hearing, but transit agencies can be run without massive debts and bloated costs. Hong Kong successfully privatized its subway two decades ago, and the efficient system gets no taxpayer subsidies for operating or capital costs.[28]

Congressional and Federal Reserve subsidies or bailouts undermine incentives for state and local policymakers to pursue needed reforms. That can also be true of business bailouts, but there is a difference between businesses and governments: businesses don't directly control their revenues, and this year revenues at many businesses plunged because of health-related closings. By contrast, governments always have the power to tax and thus can raise whatever revenues they need. Spending cuts and rainy day funds are preferable means of closing budget gaps, but ultimately state and local governments have powers to raise revenues that businesses do not.

The New York Fed's FAQ on the MLF says that it "… discourages use of the Facility as the unusual and exigent circumstances that motivated the program recede and economic conditions normalize."[29] Economic conditions and the municipal bond market are normalizing, indicating that the MLF should be discontinued on its own terms.

Looking Ahead

When tax revenues fall during recessions, state governments should tap their rainy day funds, cut low-value programs, freeze salaries, and postpone new initiatives. Millions of American businesses have tightened their belts in recent months, so why not governments? Today's lean budget climate is an opportunity for state and local agencies to improve efficiencies.

Some analysts support greater aid to the states believing that it creates a large multiplier effect to boost the economy. However, a 2019 review of the academic literature by the University of California's Valerie Ramey suggests that the government spending multiplier is likely less than 1.0, meaning that higher government spending shrinks the private sector. Ramey found:

> For multipliers on general government purchases, the evidence from developed countries suggests that they are positive but less than or equal to unity, meaning that government purchases raise GDP but do not stimulate additional private activity and may actually crowd it out. …. In summary, most estimates of

> government spending multipliers for general categories of government spending for averages over samples are in the range of 0.6 to 0.8, or perhaps up to 1. The evidence for multipliers above one during recessions or times of slack is typically not robust.[30]

Thus, while the government may be able to boost measured GDP in the short run with more spending, the government will end up being larger and the private sector smaller. Also, more government debt from extra spending means higher taxes down the road and thus reduced output in the long run.

Policymakers should consider that debt-financed spending pushes costs forward onto younger generations of Americans. Federal debt held by the public has now eclipsed $20 trillion, and state and local governments are also pushing trillions of dollars of debt and unfunded retirement costs onto future taxpayers. With the economy now recovering, it is not fair or prudent to increase government borrowing and spending further. Going forward, the states should close budget gaps by using rainy day funds and restraining spending.

After the economy recovers, the states should prepare for the next downturn by reducing their debt loads and building larger rainy day funds. After its budget crisis a decade ago, California created a more robust rainy day funding mechanism.[31] The state's fund grew from 4.6 percent of annual spending in 2014 to 13.7 percent by 2020.[32] A California legislative report noted that the new mechanism, "takes volatile revenues off the table in good economic years so that they can be used to reduce the need for cuts in bad economic years."[33]

States can also reduce boom-bust cycles in their budgets by adopting more stable sources of tax revenue. Sales tax revenues are usually more stable than income and capital gains tax revenues during recessions, although this recession may be somewhat different.[34] Also, flat-rate income taxes are generally more stable revenue sources than highly progressive income taxes.

In sum, state and local governments are not helpless in the face of recessions, and they should be better prepared next time. The MLF is an unneeded central bank expansion into state budget policy. States can borrow in private markets, and local governments should look to state governments if they run into financial troubles. Expanding federal aid and loan programs for the states will undermine incentives for the states to pursue needed spending reforms and better prepare for the next downturn.

Thank you for holding these important hearings.

Chris Edwards

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[9] U.S. Bureau of Economic Analysis, Table 3.3, https://apps.bea.gov/iTable/index_nipa.cfm. The BEA data is annualized, so I divided by four.
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[11] National Conference of State Legislatures, "Coronavirus (Covid-19): Revised State Revenue Projections," September 10, 2020. Jared Walczak summaries other state revenue projections at Jared Walczak, "State Forecasts Indicate $121 Billion 2-Year Tax Revenue Losses Compared to FY 2019," Tax Foundation, July 2020.
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Ms. SHALALA. Thank you, Mr. Edwards.

We will next turn to Dr. Mark Zandi, Chief Economist at Moody's Analytics.

Dr. Zandi, you are recognized for 5 minutes.

Dr. Zandi, are you on mute?

Mr. ZANDI. Sorry about that. I apologize.

Ms. SHALALA. We do it all the time.

Mr. ZANDI. I do as well. I apologize.

STATEMENT OF MARK ZANDI, PH.D., CHIEF ECONOMIST, MOODY'S ANALYTICS

Mr. ZANDI. To start over, I just want to thank the Commission for the opportunity to speak and participate today. And I also would like to say that my comments are my own and do not represent those of the Moody's Corporation.

I do have a few charts I would like to show. We will see if we can do that along the way. I will reference them as we go. I will make three points.

First, the finances of State and local governments have been hit hard by the crisis. At Moody's Analytics we estimate that State and local governments in their totality will suffer budget shortfalls of somewhere between $450 billion and $650 billion through fiscal year 2022 depending on the ongoing pandemic. This is a shortfall relative to a flat budget baseline that just assumes that States have enough funding to keep the lights on and avoid layoffs. They do not include any real discretionary budget increases or address any long-term structural problems such as pension or post-employment benefits, and they assume that all of the rainy day funds that the States have are used.

States suffering the biggest expected budget shortfalls are shown in red and orange in the first chart, so if you can see that. States dependent on their oil and natural gas industries, including Alaska, Louisiana, North Dakota, and West Virginia, will suffer among the most serious budget shortfalls since energy prices have collapsed in the crisis. And States hit hard by the virus, such as Connecticut, New York, New Jersey, and those with large tourist industries, such as Florida and Hawaii, will also suffer outsize budget shortfalls.

Some suggest that State and local governments were profligate spenders prior to the pandemic and should not be supported. There is no evidence of that. As you can see in this second chart, as a share of GDP, State and local government spending pre-pandemic was consistent with their spending during the past 30 years. Most have done an admirable job of raising rainy day funds prior to the pandemic. If you add it all up, it was close to 10 percent of total State government revenue. Only a handful of States—Illinois, Kansas, and Pennsylvania—did not sock something away.

The second point I would like to make is that, without additional fiscal support from the Federal Government, State and local governments will have no choice but to cut back on payrolls, essential government services, and critical programs, and this will severely impact Americans in nearly every community and exacerbate the Nation's serious economic problems. We estimate at Moody's Analytics that failure by lawmakers to provide any additional direct aid to State and local governments will threaten the recovery. The odds of recession, return to recession is high. It will cut as much as 3 percentage points from real GDP and erase almost 3 million jobs over the next 2 years. This is on top of the little over 1 million jobs State and local governments have cut in the past 6 months in response to the crisis. That is equal to 6 percent of all jobs. And you can see that in the third chart that I would like to show.

These jobs include obviously very critical jobs, police officers, firefighters, health care workers, emergency responders, social service providers, teachers. These are folks that are critical at any point in time, but particularly in a pandemic.

Finally, my third point is that since it is increasingly unlikely that Congress and the Administration will come to terms on more aid to State and local government, at least anytime soon, the Federal Reserve's 13(3) Municipal Liquidity Facility should be made more generous to facilitate its use by hard-pressed State and local governments. To this end, I would make a few recommendations, some of which you have already heard. I would extend the facility's expiration date beyond the end of this year. I would lower borrowing costs to make them less punitive. I would lengthen terms to make this more operational. I would allow for a deferred payment structure such as that provided in the Main Street Lending Facility for mid-sized companies. And, finally, I would permit MLF funds to be used more broadly than they are currently.

Policymakers deserve a lot of credit for responding aggressively to the pandemic. They have used the Federal Government's resources to help bridge American households and businesses to the other side of the pandemic. The Federal Government's financial support has run out, but the pandemic rages on. The bridge is unfinished. Unless lawmakers act quickly to extend it, many lower-income households and small businesses in particular face financial devastation. Congress and the Administration should agree to another significant fiscal rescue package that includes substantial direct aid to State and local governments, and the Federal Reserve should become more expansive in its implementation of the Municipal Liquidity Facility.

Thank you.

[The prepared statement of Mr. Zandi follows:]

Written Testimony of

Mark Zandi

Chief Economist, Moody's Analytics

Before the Congressional Oversight Commission

September 17, 2020

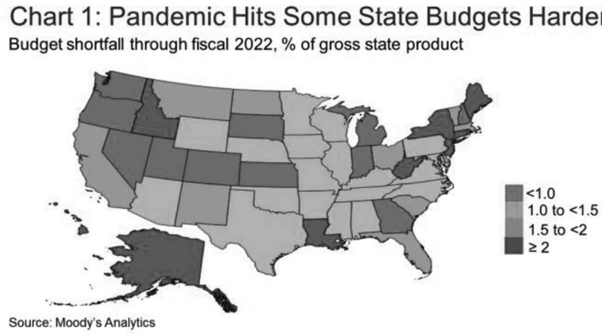
The finances of state and local governments across the country have been hit hard by the COVID-19 crisis. Moody's Analytics estimates that state and local governments will suffer budget shortfalls of $450 billion to $650 billion due to the pandemic. Without additional financial support from the federal government, state and local governments will have no choice but to further cut payrolls, essential government services, and critical programs. This will severely impact Americans in nearly every community and exacerbate the nation's serious economic problems. Since it increasingly appears that Congress and the Trump administration will not come to terms on additional direct aid to state and local governments any time soon, the Federal Reserve's 13(3) Municipal Liquidity Facility, established early on in the pandemic, should be made more generous to facilitate its use by hard-pressed state and local governments.

Budget shortfall

The COVID-19 crisis has choked off tax revenues that state and local governments rely on to fund services and jobs. More than one-fifth of American workers are either unemployed, working reduced hours, or suffering a pay cut because of the pandemic. Their massive loss of wages means a huge decline in personal income taxes. Meanwhile, nearly all businesses are disrupted in some way. Their profits and thus corporate tax revenues have been hammered. And with few people traveling, going to movies, or purchasing cars, sales tax revenues have fallen sharply as well. Property tax revenues are next to suffer, since commercial real estate values and even house prices in many places will likely eventually slump.

The COVID-19 crisis has also caused demand to surge for state and local government services and support programs. Public hospitals have been filled with COVID-19 patients, and the millions who have lost their jobs need unemployment insurance, Medicaid, and help with housing and other living costs. Just when Americans need their government most, cash-strapped cities, counties and states across the country have no option but to slash the help they provide.

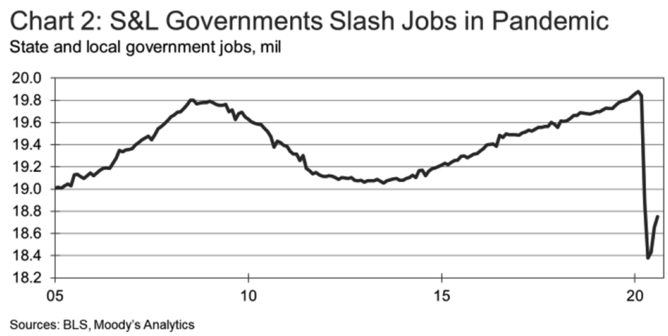
States dependent on their oil and natural gas industries, including Alaska, Louisiana, North Dakota and West Virginia, will suffer among the most serious budget shortfalls (see Chart 1). Energy industries have been rocked by the fallout from the virus and the collapse in global energy prices. States hit hard by the virus, such as Connecticut, New York and New Jersey, and those with large tourist industries, such as Florida and Hawaii, will also suffer outsize budget shortfalls.



But no state will escape the financial hit caused by the crisis. Nationwide, we estimate that state and local governments will have COVID-19 budget shortfalls totaling at least $450 billion through fiscal 2022, and as much as $650 billion if there is a serious second wave of the virus. This is stunning—equal to approximately one-fifth of precrisis annual state and local government revenues—and does not include the direct healthcare costs states are bearing to battle the virus. The federal government should pick up these healthcare costs, and so far it has.

These budget shortfall estimates are based on an update to an analysis Moody's Analytics did, first in April 2020 and again in June 2020. They represent the difference versus a flat-budget baseline, or what states would need just to keep the lights on and avoid layoffs. The estimates do not include any real discretionary budget increases or address any long-term structural problems such as pensions or other post-employment benefits.

There are misplaced concerns that state and local governments were profligate spenders prior to the pandemic and should not be bailed out. As a share of GDP, their pre-pandemic spending was consistent with their spending during the past 30 years (see Chart 2). Most also did an admirable job saving for a rainy day during the record-long economic expansion. Rainy day funds were ample before the crisis hit—close to 10% of state government revenues. Only Illinois, Kansas and Pennsylvania did not sock something away.



States are in such a tough bind because they have balanced-budget laws. Unlike the federal government, they cannot run budget deficits for very long. Most times, this is considered a feature and not a bug. It ensures that states remain fiscally disciplined. But in tough times, like now, if the states do not get help from the federal government, they have no choice but to quickly cut jobs and programs, worsening conditions.

State and local governments do have debts. A handful of states have seriously underfunded their pension systems and racked up billions in unfunded liabilities. But those liabilities have no bearing on COVID-19 budget shortfalls. States with some of the best-funded pensions in the country are still taking huge budget hits from the pandemic. Other state debts finance infrastructure projects for roads, airports, healthcare centers and schools.

Large bang for the buck

The federal government typically comes to the aid of state and local governments in economic downturns. It did so in a big way during the financial crisis just over a decade ago and to great effect. Although that aid did not forestall budget and job cuts, it significantly mitigated them and allowed localities to delay needed austerity measures until the economy was back on track. According to a particularly well-done academic study of the $260 billion in state and local government aid in the American Recovery and Reinvestment Act stimulus, passed at the height of the financial crisis in early 2009, the support resulted a year later in 2.1 million to 2.8 million additional jobs. This implies that if federal lawmakers today provided enough funds to simply fill state and local governments' budget hole for fiscal 2021, it would result in well over 2 million additional jobs by this time next year.

Helping state and local governments is one of the most effective ways to support the economy in a downturn. For each dollar spent by state and local governments, Moody's Analytics estimates that the economy sees an estimated benefit of $1.34 approximately one year later. In other words, the economy sees an immediate 34% return on the dollar.

The economic multipliers, or bang for the buck, for state and local government aid are among the highest of any policy step lawmakers can take (see Table 1). For context, at the top is food assistance at over 1.6, while the lowest are corporate tax breaks such as a lower marginal tax rate and loss carryback at close to 0.3. Every dollar to a state or local government quickly goes to paying salaries, providing essential government services, or administering programs that largely benefit lower- and middle-income households. All of the funds get into the economy quickly.

Table 1: Fiscal Stimulus Multipliers

As of 2020Q2

	Bang for the buck
Tax cuts	
Refundable lump-sum tax rebate	1.21
Nonrefundable lump-sum tax rebate	1.00
Temporary tax cuts	
Child Tax Credit, ARRA parameters	1.35
Earned Income Tax Credit, ARRA parameters	1.23
Job Tax Credit	1.18
Making Work Pay	1.16
Payroll tax holiday for employees	1.14
Payroll tax holiday for employers	1.03
Across-the-board tax cut	0.98
Housing Tax Credit	0.79
Accelerated depreciation	0.52
Loss carryback	0.27
Permanent tax cuts	
Extend alternative minimum tax patch	0.52
Make dividend and capital gains tax cuts permanent	0.38
Cut in corporate tax rate	0.32
Spending increases	
Temporary increase in food stamps	1.67
Temporary federal financing of work-share programs	1.60
Extending unemployment insurance benefits	1.49
Increase infrastructure spending	1.43
Increase defense spending	1.39
General aid to state governments	1.34
Low Income Home Energy Assistance Program (LIHEAP)	1.11

Note: The bang for the buck is estimated by the one-year $ change in GDP for a given $ reduction in federal tax revenue or increase in spending.

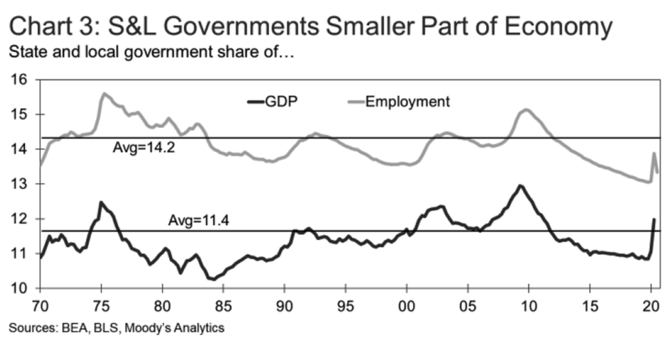
Source: Moody's Analytics

The economic bang for the buck from federal aid to state and local governments would be especially large in the pandemic given how low interest rates are and how likely they are to remain very low. The Fed recently changed its framework for conducting monetary policy and made clear that it will not begin to normalize rates until the economy is at full employment and inflation has been consistently above the Fed's 2% target for a considerable period. The Fed is thus likely to keep short-term rates close to zero for the next several years.

Economic fallout

If the federal government does the right thing and quickly helps state and local governments with additional aid, it will go a long way toward helping the broader economy through the remainder of the pandemic and quickly restoring the economy to full employment after the pandemic. If lawmakers fall short, the entire economy threatens to backslide into recession. Moody's Analytics estimates that a failure by lawmakers to provide additional direct aid to state and local governments will cut as much as 3 full percentage points from real GDP and erase almost 3 million jobs over the next two years.

This will be on top of the 1.1 million jobs state and local governments have cut in the past six months in response to the COVID-19 crisis, equal to almost 6% of all such jobs. These jobs include police officers and firefighters, healthcare workers, emergency responders, social service providers, and teachers—critical jobs at any time but particularly in a pandemic. And it is not as if state and local governments are cutting bloated payrolls. Prior to the pandemic, state and local governments had the same number of employees on their payrolls as they did about 15 years before the financial crisis. As a share of total employment, state and local government payrolls prior to the pandemic were as low as they have been since the 1960s (see Chart 3).



Many state and local government programs will also be cut significantly. The burden of these cuts will fall largely on lower- and middle-income Americans, many of whom rely on food, housing and educational assistance, medical care, unemployment insurance, and other social services. These are the same generally lower-income households that have suffered the brunt of the job and income losses during the pandemic.

The cuts to jobs, services and programs will likely occur quickly if it becomes clear that lawmakers will not be able to come to terms on more state and local government aid in the next few weeks. If lawmakers are unable to agree to provide this support and include it in or along with a continuing resolution to fund the federal government at the start of the next fiscal year in October, then it is highly unlikely that state and local governments will receive any help until after the next president is inaugurated in late January. State and local government officials have been holding off on major budget decisions until they have clarity on the financial resources they will have to work with. Once clear, given the extraordinary budgetary pressures they face, they will have no choice but to scale back quickly.

Municipal Liquidity Facility

Although it would be a far more preferable outcome for state and local governments and the economy if Congress and the Trump administration agreed to more direct aid to state and local governments, if such support is not forthcoming or is not sufficient, then the Fed's Municipal Liquidity Facility should be made much more generous. To be sure, although only the state of Illinois and New York City's Metropolitan Transportation Authority have used the facility to date, the backstop to the municipal bond market provided by the facility has eased investor concerns, allowing borrowing costs to remain low and the municipal bond market to function well. Municipal bond yield spreads have narrowed since the early days of the pandemic, particularly for more highly rated municipal issuers, and municipal bond issuance has remained ample. Nonetheless, the facility should play a more supportive role in shoring up the shaky finances of state and local governments. At minimum, the Fed should treat state and local governments as well as it does corporate borrowers that enjoy better interest rates and longer terms.

To this end, policymakers should consider the following changes to the Municipal Liquidity Facility:

(1) Lower borrowing rates, including as low as the federal funds rate;
(2) Lengthen the term to closer to 10 years;
(3) Extend the facility's expiration date, which is currently the end of this year;
(4) Allow for a deferred payment structure such as that provided in the Main Street Lending Facility; and
(5) Permit MLF funds to be used for broader purposes like capital infrastructure that can stimulate the economy (they are currently restricted to short-term cash flow).

Policymakers, including the Federal Reserve, Congress and the Trump administration, deserve a shout-out for responding aggressively to the pandemic. They have used the federal government's financial resources to help bridge American households and businesses to the other side of the pandemic. But the federal government's financial support has run out while the pandemic rages on. The bridge is unfinished. Unless lawmakers act quickly to extend it, many lower-income households and small businesses in particular face financial devastation. Congress and the Trump administration should agree to another significant fiscal rescue package that includes substantial direct aid to state and local governments, and the Federal Reserve should become more expansive in its implementation of the Municipal Liquidity Facility.

Ms. SHALALA. Thank you. Thank you, Dr. Zandi, and the other witnesses as well for their testimonies.

As with the first panel, we will move to two rounds of 5-minute questioning of these witnesses. I will recognize myself for 5 minutes of questions.

Dr. Zandi, let me start with you. Mr. Edwards, a fellow economist, testified that the States are facing budget challenges, but they can restrain spending and tap rainy day funds to balance their budgets without further aid from Washington. He also said that millions of American businesses have tightened their belts in recent months, so why can't governments?

In your expert opinion, can State and local governments simply tighten their belts in lieu of additional Federal assistance? What would be the economic and social consequences of such a proposal?

Mr. ZANDI. I think the fiscal pressures here are incredibly intense, and I mentioned $450 billion to $650 billion through fiscal year 2022, so over the next 2 years, and that assumes that they use all of the rainy day funds that were quite ample coming into this. And if there is no additional support, then State and local governments will be put into a position of significantly cutting back. That means payrolls, more job loss, as I mentioned, 2 to 3 million more in job loss, and that is going to happen relatively soon, relatively quickly, if they do not get the aid. That means cutbacks in essential government services. You know, the key programs, many of those programs are critical to supporting the most hard-pressed in our communities—lower-income households, smaller businesses. And this would be devastating to the economy, very procyclical, exacerbating the end downturn.

I should point out, you know, providing aid to State and local government in recessions is tried and true. We do this every single time we face this because we know that if the Federal Government does not provide help to State and local governments, they will have to make those cuts. That will exacerbate the recession and make things worse for everyone and for the broader fiscal situation. So this is something that we have done in each recession. We did it in the financial crisis. There is lots of good academic research that shows that. And not doing it here would be a significant error.

Ms. SHALALA. Thank you.

Mr. McCoy, Mr. Edwards testified that the two MLF loans have saved the issuing entities interest costs, but that is not a goal worth undermining federalism for and pushing aside the market interest rates. You represent one of the issuers that borrowed under the MLF. How do you respond to that testimony? What would be the impact to the MTA and your city's residents if the Federal Reserve provided no aid either through the MLF or otherwise?

Mr. MCCOY. Thank you for the question. You know, I believe that without the MLF, we would incur higher costs. We know that, and I included that in my testimony. The facility has both practical applicability as well as psychological applicability to the entire market, and that has clearly had a very calming influence on the market, and the availability of this facility for State and local issuers cannot be underscored enough. To not have it, I think we would see a very different environment in the municipal market today, much more challenging conditions for issuers to get in and borrow money at rates that, you know, would have been common pre-COVID.

I hope that answers your question.

Ms. SHALALA. Thank you.

Mr. Edwards, your fellow panelists all warn of devastating job cuts, service cuts, and slow economic rebound across the country if additional Federal aid is not provided. My city, Miami, had a surplus and a rainy day fund, yet we are also facing devastating cuts. Despite overwhelming testimony to the contrary, you state that there is no national crisis in local government finances. Could you please explain why you believe that to be the case?

Mr. EDWARDS. Thanks for the question. I agree with Dr. Zandi that, you know, some States and some jurisdictions are in trouble. Some energy-producing States, like Wyoming and Oklahoma, have seen a drop in revenues. In some cities, like New York City, they are in trouble. Hawaii is in trouble because, you know, they depend on tourism, of course.

But, generally, if you look back at the recession 10 years ago, local governments actually did not lose revenues overall, and that is because property tax revenues are very stable. And it looks again like during this recession—if things do not get worse; they seem to be getting better—that for local governments in general that is what we find, because property tax revenues will stay strong.

I would also say that, you know, there is continuing to be some money in the pipeline from aid that Congress has already passed. I noticed in a news story a couple days ago the legislature of North Carolina just now appropriated $1 billion from the CARES Act, which was passed 6 months ago. North Carolina is just getting around to actually appropriating the money now, the $1 billion.

I also noticed in another news story a couple weeks ago that Idaho used $200 million from the CARES Act to cut property taxes in the State.

So, you know, yes, some jurisdictions are in trouble, but there are plenty of other jurisdictions, and I think most jurisdictions, that are going to do fine, frankly, without further aid.

Ms. SHALALA. Thank you. I could not disagree more. I think much of that money was obligated.

Let me yield and turn to Senator Toomey for 5 or 6 minutes of questioning. We seem to be going on.

Senator TOOMEY. Thank you.

Ms. SHALALA. Whatever you need.

Senator TOOMEY. Thank you, Madam Chair.

Let me follow up on this. According to multiple published news reports, last month the Governor of New Jersey proposed a $40 billion budget that is $1.3 billion more than the budget from last year. This summer, the State of Connecticut gave its unionized State workers a 5.5 percent raise. In July, Illinois gave hundreds of millions of dollars worth of pay raises to its workers. Some States, like New York, have delayed a scheduled pay increase, but they have not canceled it because they are expecting a Federal bailout.

Mr. Edwards, does that kind of behavior suggest to you dire circumstances that can only be met with additional Federal money?

Mr. EDWARDS. I agree with your point there. There are a lot of States here that are—you know, they are not doing what they can to restrain spending in this recession. As I pointed out, Illinois just passed a budget where the general fund was increased over 5 percent. If Illinois had built up a rainy day fund, say, of 10 percent of their spending, that would have been around $4 or $5 billion. That would have easily covered their short-term cash flow problem. And I actually do not think there was a cash flow problem in Illinois. It is just that they were able to borrow at a lower Federal rate.

I think that, you know, during a recession, I think State and local governments are learning valuable lessons here. They have to plan ahead. They should lower their debt load in anticipation that we will have another recession down the road, and they should build a bigger rainy day fund.

So, you know, State and local governments are not subdivisions of the Federal Government. They have enormous fiscal powers by themselves. And I do not think they ought to be running to Washington whenever they get into fiscal trouble. I think they can solve their own problems.

Senator TOOMEY. So let me look at it from another perspective. Mr. Zandi in his testimony, written and oral, tells us that the total projected shortfalls through fiscal year 2022 are between $450 billion and $650 billion if there is a serious second wave of the virus. Now, we had a little bit of a second wave in some States over the summer. That clearly has abated. And economic numbers are coming in much stronger than were projected by just about anyone in recent months.

So according to Mr. Zandi, the budget shortfall estimate through 2022 is $450 billion, maybe higher. But how much money have we already sent to State and local governments?

I would like to submit for the record a page from the Committee for a Responsible Federal Budget, Moody's Analytics, September 16, 2020, coronavirus funding for State and local governments, and it gives a breakdown that adds up to $456 billion. That is how much we have already sent to State and local governments, and the projected shortfall by Mr. Zandi and Moody's Analytics is for a shortfall of $450 billion or up to $650 billion if there is a serious second wave.

So, Mr. Edwards, first of all, I do not know if you have drilled down into these numbers, but as you point out, there are many municipalities where property taxes are coming in at or above last year. Do you agree with this range of likely shortfalls? And is there a reasonable likelihood that we have already sent as much money to the State and local governments as their entire shortfall is likely to be?

Mr. EDWARDS. Well, first, you know, with respect to Dr. Zandi's projections, no one knows the future. Perhaps he is right about the size of those shortfalls; perhaps they are lower, as I think. I would say there is a measurement issue here. Again, if you look at the National Conference of State Legislatures' survey of 37 States from a couple weeks ago, they show that tax revenues will be down 10 percent next year from projected increases. But projected increases were around 6 percent, so that really translates into about a 4 percent revenue loss from the 2019 peak. I do not think that is a crisis level of reductions. I think State and local governments ought to be able to handle those sorts of revenue shortfalls.

So, again, I think, you know, local governments could come through this pretty well because it does look like property tax revenues will stay up. It is true that in some central business districts the office commercial real estate will fall, but industrial property prices are staying high as well. So, you know, I think local property tax revenues will be fine, and I think States are going to be able to handle the modest State tax reductions.

A last point on that, actually. You know, the new CBO Federal projections came out a couple weeks ago, and they have Federal revenue falling—total overall Federal tax revenues falling 5 percent in 2020, 1 percent in 2021; then they are going to start booming again and rise 15 percent in 2022. So the CBO does not think that Federal revenues are really going to fall all that far now, and usually State and local tax revenues do not fall as far as Federal revenues because the Federal tax system is more progressive. So I think State and local governments will be fine. I am hoping they will be fine. But, you know, I could be wrong. We do not know the future.

Senator TOOMEY. Thank you.

Thank you, Madam Chairman.

Ms. SHALALA. Thank you.

Commissioner Ramamurti.

Mr. RAMAMURTI. Thank you, Madam Chair.

Just quickly on the point about a second wave, and, look, we have plateaued in a situation where 1,000 Americans are dying every day, and we are about to enter winter flu season, and we have seen in other countries already a resurgence of the virus. So I think the idea that we have put a possibility of a second wave behind us is not correct.

But, look, even though we are 6 months into this crisis and State and local governments are in rough shape, as we have heard from the issuers today, the Fed's lending program has made only two loans to date. So, Mr. Gee, you represent State and local government financing officers across the country. Do you think the Fed's State and local lending program has had so little uptake because State and local governments already have all the resources that they need?

Mr. GEE. No, sir, I do not. I believe that the reason that you do not see usage centers around the way that the program is structured. As I mentioned earlier during my remarks, the 3-year term is restrictive, as is how the proceeds can be used. State and local governments are basically penalized if they use that liquidity facility, which is why I think you will not see issuers take advantage of it.

Mr. RAMAMURTI. Thanks. And, look, we have talked about it in the abstract, but I just want—you are on the ground, so I want to get your sense of what are the concrete impacts of this budget crunch. If State and local governments do not get additional help, either directly through the Federal Government or through this lending program, what are the consequences of that? And who is bearing the brunt of those changes?

Mr. GEE. Citizens are bearing the brunt if no action is taken. What we are seeing is crucial services being cut, things like homeless prevention services, public health-related services. So we are not out of the woods yet. I think that some may have too rosy of a viewpoint that things are turning around. Quite frankly, that is not what I am seeing or hearing from my colleagues throughout the country.

Mr. RAMAMURTI. Thank you. And, look, there has been plenty of data talking about this idea of a K-shaped recession where people who were already well off coming into the crisis are doing okay, but people with lower incomes are really suffering. And, of course, the cuts to State and local government that you are talking about also tend to fall disproportionately on those folks who are already suffering.

So let us talk about how to make this program more useful within the legal restrictions that Congress has created. Mr. Gee, your testimony asks for the Fed to set their rates as low as possible within the law. Mark Zandi, who just testified, said that the rate could go as low as just slightly above the Federal funds rate, which, in other words, is pretty close to zero. How low of a rate would you support?

Mr. GEE. I would support anything that is at a market level or more than a market level. You are not going to get participation in the program if the rates are punitive.

Mr. RAMAMURTI. Thank you.

Mr. GEE. And they currently are.

Mr. RAMAMURTI. Thanks. And, Mr. McCoy, I want to bring you in here because your testimony noted that even though you ended up using the Fed's lending program, the MTA paid an interest rate of 1.9 percent, which was actually quite a bit higher than the 1.3 percent that you paid just before the pandemic hit for a similar type of note. So, by contrast, the Fed's interventions have already allowed big corporations to actually pay less to borrow now than what they were typically paying pre-pandemic.

So let us say that the Fed did the same thing for you that it has done for big corporations. Say that they provided a rate of about 1.3 percent instead of 1.9 percent. How much would that end up saving the MTA over the life of the loan?

Mr. MCCOY. Sure. Thank you for the question, Commissioner. So the rate that we received through our MLF issuance saved the MTA $8.235 million over the 3-year maturity. Just to give you more granular detail, a one-basis-point change in the rate is equivalent to $135,000 on that $450 million loan. So it clearly saved us money, and that was a good thing. But, again, you know, I come back to the other part of my testimony where we talked about the revenue loss that we are experiencing. One of the other witnesses talked about, you know, property taxes not being impacted so severely by COVID. Well, here at the MTA we do not receive property taxes. We are not a taxing entity. We rely on fare box revenues, and we have the highest fare box recovery ratio of any public transportation provider in the country. That means when our ridership dropped down by 95 percent due to COVID, our revenue hit was immediate and severe. And we are continuing to forecast severe impacts from reduced ridership well into 2023. So——

Mr. RAMAMURTI. Thanks, Mr. McCoy. I hear the Chair hitting the gavel. Just to do the math quickly on that point, if you had gotten a rate similar to what you had gotten pre-pandemic of 1.3 percent, doing the math, that looks like that is about a $4 million savings, which I imagine would allow you to keep some people on payroll. It would allow you to potentially offer more transit services or lower-cost services. That money makes a real difference.

And so, look, I keep coming back——

Mr. MCCOY. Correct.

Mr. RAMAMURTI [continuing]. —To this point. If we are able—if the Fed is able to offer State and local governments just the same type of deal that it is offering corporations right now, it can make an enormous difference in people's lives. It can make a difference in the lives of children and people with disabilities and seniors and others who are often more dependent on services that the State and local governments provide. That is really what is at stake here.

Thank you, Madam Chair.

Ms. SHALALA. Thank you.

Congressman Hill, I owe you as much time as you would like.

Mr. HILL. Thank you, Madam Chair. You owe me nothing, just your friendship.

I thank our panelists again for being here. Very interesting testimony. Very informative.

I want to begin my questions in this round to talk about this difference that both Mark Zandi referenced and Mr. Edwards on the uneven nature of the economy reopening and the uneven burden around the States, and recognize our States have lots of authorities to control their own destiny, which we have heard about.

I have a slide, if I could put that up for our viewing audience and my fellow Commissioners. I looked at tax revenues for different States, and in this instance I decided to look at it based on the impact of the virus. So you can see Arkansas, Texas, New York, and California. These are States that are not normally compared to one another, but I am using approximately 2,000 cases per 100,000 infection rates. But in the case of Arkansas and Texas, those Governors basically kept their States open in fighting the coronavirus, trying to minimize the impact on dislocation of their economies. And you can see that tax revenues in July year over year are up 14.9 percent in Arkansas, 4.3 percent in Texas. And our friends in New York who bore a huge brunt at the beginning of this terrible pandemic, tax revenues year over year in July are down almost 9 percent and in California down 45 percent.

I would like to insert that in the record, Madam Chair. Thank you.

[The slide follows:]

Comparison of Sales Tax Revenue versus Covid Cases

State	Sales Tax July YoY% Change	COVID Cases per 100k	Ranking
Arkansas	14.9%	2,340	10
Texas	4.3%	2,274	13
New York	-8.6%	2,287	12
California	-45.0%	1,918	23

As of September 15, 2020; Source: *The Arkansas Democratic Gazette, The Wall Street Journal*, Arkansas Department of Finance and Administration, Texas Comptroller

Congressman French Hill (AR-02)

Mr. HILL. Also, Mr. Zandi I think made a very important point about economic concentrations so that if you are heavily in tourism, like Hawaii or my friend from Florida, or in the oil and gas business as noted in his statistics on North Dakota or Oklahoma, you have also additional burdens, not necessarily per se connected to the pandemic, but we have a major dislocation in the oil and gas market partially as a result of the economic shutdown around the world and supply conditions.

When you look at June 30, of the 46 States that end their fiscal year in June, 8 States actually had overall tax growth when including personal income, corporate income, and sales tax income. And I also want to highlight that, in addition to the Municipal Liquidity Facility, as Senator Toomey has noted, we have distributed billions of dollars out to our States directly and indirectly. And when you look at both direct and indirect, it is about $700 billion distributed to the States.

To that end, Mr. Edwards, let us talk again about your way States can cover their budget shortfalls. I think in your testimony you said that people—or States had built up their rainy day funds to about 13 percent of a typical annual revenue budget. Is that right?

Mr. EDWARDS. It is a bit less. I think it is about 9 percent going into this, although there is a measure called "total balances" which are essentially all the extra cash that States have kicking around. That is higher, maybe up around 12 percent.

Mr. HILL. And you also noted that you felt many of the States could access the market quite successfully. I was looking at all of our States' bond ratings before this hearing, and 90 percent of our States are rated double A or better. Wouldn't they have regular access to the capital markets?

Mr. EDWARDS. That is absolutely right, and, in fact, all States would have better access at lower interest costs if they reduced their debt burdens during economic growth years. So, you know, the MTA, for example—I sympathize with the plight of the MTA in New York. It is in terrible trouble. But they would be in a lot better position if New York area policymakers had not let the MTA get so deeply in debt. It is deeply in debt. The interest costs as a share of its cash flow have risen pretty dramatically.

States can avoid getting into that position. Some States finance a lot of their capital investment pay as you go. Most roads and highways in the United States are financed mainly pay as you go, meaning gas tax revenues. So if you look at some States, like Nebraska, they have very low debt loads. That really bodes well for those sorts of States. When you go into a recession, they are in a much better financial position, it seems to me.

Mr. HILL. Thank you. I will also note for the record, Madam Chair, that Illinois, of course, as we have talked about here, has accessed the market successfully and participated in the Municipal Liquidity Facility. It has the lowest rating of the States I reviewed at BBB. New Jersey, which was just reported to us this morning, is entering the market and has an expanded budget, is single A minus; Kentucky and Connecticut at single A; and Senator Toomey's home State of Pennsylvania at A-plus. So essentially all of our States, the 90 percent of States that are double A or better or these States that even have slightly lower rating—modestly slightly, I might add—have all accessed the market quite successfully.

Thank you, Madam Chair. I yield back.

Ms. SHALALA. Thank you, Congressman Hill.

We will repeat our order of questioning, and each Commissioner will now have a second round of questions for these witnesses. I will start by recognizing myself for 5 minutes.

Dr. Zandi, according to Mr. Edwards' testimony, economic conditions in the municipal bond market are normalizing. I represent Miami. He clearly missed my community. And he also said it is not fair or prudent to increase government borrowing and spending further. Among other things, he cites projected versus actual State and local revenues.

Do you agree with his assessment of the economic outlook and his statement that additional Federal assistance is not fair or prudent? And could you repeat your recommendations with regard to the Municipal Liquidity Facility and additional Federal assistance or otherwise?

Mr. ZANDI. Sure. Well, thank you. No, I think the budget situation is very serious, and it is a script being written, that there is a lag. We are already seeing a lot of the revenues get pummeled here, but there is a very significant lag between what is going on in the economy and when it shows up in tax revenue, you know, particularly like income tax revenue. A lot of what we are observing now is based on final settlement payments in 2019 income when the unemployment was 3.5 percent and wage growth was strong. It does not reflect what is happening in 2020.

So I think as we get more numbers toward the end of this year going into next year, we are going to see significant declines in income tax revenue in more and more States across the country. This is an ecumenical problem regionally. It is not just, you know, a few States. It is going to be—much of the country is going to be involved in this.

The same is true for property tax revenue. That is a long lag. You know, the problem this go-around is that house prices as much—that was the problem in the financial crisis. This go-around it is going to be commercial real estate values, and it is going to take a while for that to flow through and it is going to have a big impact on revenues for lots of local governments across the country.

And I think it is clearly evident—I mean, we can pick anecdotes across the country, but for me, the thing that encapsulates the stress most vividly and clearly is that State and local governments in the last 6 months have reduced payrolls by 1.1 million jobs, 6 percent of their workforce. And I think in the last couple, 3 months they have delayed those cuts because they hoped and they believed—because most everyone believed—that they would get some additional Federal Government aid to help support them. And now as it becomes increasingly clear that that aid is not coming through, they are not going to get that aid, I think these cuts are going to become quite significant.

So we are going to see how things go here pretty quickly, I think, over the next few months, certainly by the end of the year, how serious this is and how much economic damage it is going to cause to communities across the country.

Finally, I would say that $450 billion low-end estimate of the budget shortfall through fiscal year 2022 is on top of the Federal Government support that has already been provided. So in those calculations, that is history; that is in the data. It is $450 billion on top of that, assuming no significant increase in infections going forward, so it is very significant.

So in that context, what I just described to you, that outlook, I think it is critical that we look for other tools to try to support State and local government in the Municipal Liquidity Facility. Here is what I would do. The first thing I would do is extend it, because, you know, this is a script being written. The pandemic is not going to be over on December 31, 2020. We have to extend it.

Secondly, we have to lower the rate. The Fed is willing to do this. They lowered it once. I think they need to lower it again, make this less punitive so it opens up access.

Third, extend the term. You have already heard from the other folks that are on the ground here that 36 months is just not practical. That means it is not particularly useful.

Fourth, I would really think about expanding out what the money can be used for.

And, fifth, you know, think about how you can defer some of these payments to make it a little bit more attractive.

Here is the thing: I could be wrong. Actually, I hope I am wrong. You know, hopefully the world, our economy, the fiscal situation turns out a lot better than I am anticipating. But, look, I fear that I am right; and if I am right and we are not prepared for it—if we do not prepare for it—you know, Policymaking Economic 101. When you have a lot of uncertainty, you press on the accelerator. You do more than you think is necessary because you do not know. And I assure you we do not know. This pandemic is still ongoing.

Ms. SHALALA. Thank you.

Senator Toomey.

Senator TOOMEY. Thanks, Madam Chair.

Mr. Gee, we took a look at where the St. Louis Sewer District debt is trading in the secondary markets, and according to our sources here, it looks like they are trading at the lowest yields in at least 5 years. Paper with 3 years' remaining life is trading at 21 basis points. And you suggested that the MLF should be offering rates below what the market is offering. But, obviously, this whole program is ultimately backstopped by U.S. taxpayers.

How much lower than 21 basis points should taxpayers be lending money to the St. Louis Sewer District when it can borrow money for 21 basis points in the capital markets?

Mr. GEE. Well, sir, I am not suggesting that taxpayers lend money specifically to my agency. I was speaking in terms of State and local governments, which may not be in as good financial shape as our agency. We are a triple A-rated utility, so the conditions that we are currently facing may not be as dire for us as they are for some of my colleagues at the State and local governments. But I think what we are asking for is to simply make the MLF competitive. And as it exists right now, it is not competitive. So if you are actually looking for entities to utilize this facility, then I believe that the rate structure needs to be at market rates or lower.

Senator TOOMEY. I cannot disagree with the notion that if the goal is to get people to borrow, you have to give them a better deal than what they can get in the capital markets generally. That is just not my goal. My goal was always to ensure that we would have a liquid functioning market, and we have that.

Mr. Edwards, two questions. The first is we have never had an MLF before, but we have had recessions before. We have had all kinds of disasters before. How have States and municipalities managed through difficult times in the past? That is one question.

Then the second is we have a very wide range among our States and certainly among municipalities in terms of expenses per capita, in terms of tax regimes and tax revenue per capita. And the people of the various States get to decide through the elections they hold what kind of regime they want.

If the Federal Government is going to be a sort of permanent backstop, bailout mechanism, how does that change the mechanism of accountability in State government?

Mr. EDWARDS. That is a great question, and one of the things I am really concerned about here is the incentives for State and local governments going forward. The more the Federal Government gets involved in this sort of emergency loan to State and local governments, the less incentive they have to be prepared for the future. As Dr. Zandi noted, most States did build up substantial rainy day funds after the last recession. California, for example, was really hard hit during the recession a decade ago, and to their great credit, they built up a very large rainy day fund. So that is great. So you have to think about forward-looking incentives here.

To go back to some of the previous discussion, people have compared the Federal Reserve's mechanisms for businesses and governments. But there is a basic difference here in that governments can always raise tax revenue. They have fiscal power. They can always issue debt, and they can always trim spending. Businesses during recessions, especially when State and local governments are mandating closures of millions of small businesses, they often do not have a choice. They get into terrible fiscal and financial trouble because the revenues just disappear in front of their eyes. Governments are really never in that situation because they can always rely on taxation. And for local entities like the MTA, I think the first backstop ought to be State-level governments and not the Federal Government. I think State-level governments have enormous fiscal power, and if their local governments get into trouble, I think that should be mainly their responsibility.

Senator TOOMEY. Thank you.

Madam Chair, I yield back my time.

Ms. SHALALA. Thank you.

Commissioner Ramamurti.

Mr. RAMAMURTI. Thank you, Madam Chair.

Mr. Edwards, you have testified today that the Federal Government should not help State and local governments in part because "debt-financed spending by the Federal Government pushes costs forward onto younger generations of Americans." You actually made the same argument in 2008 when you opposed Federal aid for State and local governments in the midst of that recession. You wrote, "Spending on a stimulus package would be funded by additional government borrowing, and the burden of that borrowing would fall on young people and future taxpayers." You wrote that in a section you titled "Rising Federal Debt is Fiscal Child Abuse." Are those your words?

Mr. EDWARDS. Yeah, that is right. I believe it is.

Mr. RAMAMURTI. So that phrase, "fiscal child abuse," in my view is a pretty shocking thing to say, especially when you look at what States are being forced to do right now because they are not getting Federal aid. Here are just some of the examples: Alabama and California are cutting funding for early childhood education programs; Wyoming is cutting $10 million from its public pre-school program for kids with disabilities; Oregon is delaying a program to help children from low-income families with mental health issues; and Missouri, New Jersey, and Texas are slashing funds and laying off workers dedicated to protecting children from actual child abuse.

All of these changes will have lasting effects on this generation of kids, especially the most vulnerable among them. So, Mr. Edwards, how much actual harm to kids today are you willing to tolerate based on your concern about so-called fiscal child abuse?

Mr. EDWARDS. Those children will grow up, and Federal, State, and local governments have been enormously irresponsible by getting the United States enormously into debt. The Federal Government has $20 trillion of bond debt now. Those costs are being pushed forward, so in the future either those spending programs that you mentioned will have to be cut or taxes will have to be raised. An increasing share of the earnings of young Americans in the future will have to go, for example, to pay the foreign creditors, which reduces the U.S. living standard——

Mr. RAMAMURTI. Okay, so, look, Mr. Edwards—I am sorry. My time is short. But it sounds to me like your answer is you are going to accept quite a bit of harm to kids today based on the concern that, I do not know, I guess the debt will go up, and maybe corporations in America will have to pay slightly more in taxes in the future.

Look, it is incredibly cheap for the Federal——

Mr. EDWARDS. Those programs you mentioned are State programs, so the State governments, they should make—they should balance the costs and benefits of funding those programs.

Mr. RAMAMURTI. Mr. Edwards, look, the point I am making——

Mr. EDWARDS [continuing]. —Federal issue——

Mr. RAMAMURTI. Excuse me, sir. The point I am making is that it is incredibly cheap for the Federal Government to borrow right now. The interest rates are under 1 percent for a 10-year repayment term. And I think it is, frankly, perverse to cite your concern for children to justify cuts that will do actual harm to children right now. And I think it is especially perverse coming from a lot of the same folks who happily supported adding $2 trillion in debt a couple years ago to hand tax cuts to big corporations and the rich.

But, look, even setting aside this moral question of whether we should make our kids suffer lasting harm today rather than borrow at record low interest rates, it is also just terrible economic policy. Experts across the political spectrum agree that every dollar of Federal aid to State and local governments produces more than a dollar's worth of economic growth. Mr. Zandi has said that. Glenn Hubbard, who was the Chair of President George W. Bush's Council of Economic Advisers, has said that. And the nonpartisan Congressional Budget Office has said that. They have each found that a dollar of State and local aid produces about $1.20 or $1.30 in growth.

But, Mr. Edwards, you dispute that point in your testimony, citing a single study. You write, "A 2019 review of the academic literature by the University of California's Valerie Ramey suggests that a dollar of Federal aid would actually result in less than a dollar of growth." Is that right?

Mr. EDWARDS. Yeah, that is absolutely right, and it was not just a single study. She reviewed all the academic economic studies over the last decade, and she concluded that the multiplier for government spending was probably less than one. There is no certainty here, but she thought probably. I would say also——

Mr. RAMAMURTI. Okay. Thank you. Mr. Edwards, thank you. That is all I wanted to know. But, look, I actually took a careful look at the study, and it also says later that when monetary policy is very accommodative—in other words, when interest rates are low and will be low for a long time—government spending in the United States can generate $1.50 or more in return for every dollar. So as I am sure you know, Mr. Edwards, interest rates are currently at zero, and the Fed announced yesterday that it was percentage to keep them that through 2023.

So do you agree that the study you have cited actually suggests a return of far more than a dollar on every dollar we dedicate to State and local aid right now?

Mr. EDWARDS. No. I think that there was a lot of uncertainty with what she said about—she called it "zero lower bound." Her main central conclusion was that the multiplier was from about 0.6 to 0.1. And if you look at her other studies on her Web page over the last decade, similarly, you know, they suggest perhaps lower multipliers than other people have found. Dr. Zandi——

Mr. RAMAMURTI. Thank you, Mr. Edwards, just because my time—and I want to be respectful of the Chair. Look, I agree that there was some uncertainty, and I wanted to be extra sure about all this. So yesterday I called up the author of the study, Professor Ramey, to ask her specifically what she thought, and she wrote me a short letter in response, which I would like to submit for the record. And Ms. Ramey says, "My estimate of the likely multiplier for Federal grants or loans to State and local governments, conditional on the current economic and policy situation, is likely to be somewhere between 1.2 and 1.5." So I am glad that we resolved that question.

[The letter follows:]

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September 16, 2020

Bharat Ramamurti
Member
Congressional Oversight Commission
SDG55 Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Ramamurti:

This letter summarizes my responses during our September 16, 2020 telephone call, when you asked me for my estimate of the likely multiplier for Federal grants or loans to state and local governments, conditional on the current economic and policy situation. My best estimate is that the multiplier is likely to be somewhere between 1.2 and 1.5.

As the third full paragraph on page 90 of my 2019 Journal of Economic Perspectives article summarizes, the range of multiplier estimates during normal times is 0.6 to 1, but the multiplier estimates are higher during periods when monetary policy is very accommodative. My work with Sarah Zubairy on the U.S. and Miyamoto et al. on Japan suggests multipliers around 1.5 during periods of monetary accommodation. Large-scale macro models also predict higher multipliers during these periods.

A package that involves grants or loans by the Federal government to state and local governments has the potential to stimulate the economy because it can relieve the balanced-budget constraints currently faced by many states. Such relief would hopefully allow them to avoid layoffs of government employees despite declines in their tax revenues. Preserving employment relationships in private business (small and large) and in government is important not only for stabilizing personal incomes in the short-run, but also for providing a foundation for a speedy recovery of the economy once the direct effects of the pandemic subside.

Sincerely,

Valerie Ramey

Valerie Ramey
Professor of Economics

Mr. RAMAMURTI. Look, I am running short on time, but if this is the best case against more Federal support to State and local governments, then I think that position is pretty laughable.

Thank you, Madam Chair.

Ms. SHALALA. Congressman Hill.

Mr. HILL. Thank you, Madam Chair.

Mr. Gee, let me express all of our thanks to you for helping navigate COVID–19 for Metro St. Louis, and also thank you for your leadership for government finance officers across the country. I cannot think of a more challenging period or more interesting period for that work.

We have talked a lot about the Municipal Liquidity Facility today, but we have also talked about the billions of dollars that have been sent to the States. I know listening to the Missouri congressional delegation, there has been some complaining about the Governor of Missouri's sharing of that money with State and local governments. And I note in the U.S. Treasury IG report that about 26 percent of the money sent to Missouri has been spent to date.

But I looked at St. Louis County, particularly, that got $173 million directly to St. Louis County, and yet in that same IG report, only about 6 percent of it has been spent, $11 million. And I wondered, has St. Louis County shared any of the CARES Act money with you in your official capacity in the sewer and water aspect of Metro St. Louis?

Mr. GEE. Well, thank you, sir, for the question. Let me just start off by pointing out with governmental entities, there is a difference between spent and encumbered. I would argue that the majority of the funds have been encumbered, meaning that they have been earmarked for specific use. It is true that you may have instances in which those dollars have not been spent, but the funds have been encumbered.

With respect to your question regarding the St. Louis County government, we have not requested any CARES Act funding from that governmental entity. I cannot really speak to their finances. I am not part of St. Louis County government.

Mr. HILL. Have you asked for any CARES Act funding from any entity in Missouri, the city of St. Louis, the county of St. Louis, the State of Missouri?

Mr. GEE. We have not requested any CARES Act funding. We have requested some funding from FEMA that would cover some of our PPE-related expenditures.

Mr. HILL. Right, well, I recognize your point, and I accept it on encumbered. That number is a moving target in the States. They will initially legislatively approve a large allocation and then end up not needing it, and so that number is a moving target. In Arkansas, it is well over 80 to 90 percent considered by the legislative council on what they would like to spend the money on, but they have spent far less than that.

Has the State of Missouri, to your knowledge, allocated money to the smaller cities and counties outside St. Louis? To your knowledge, has the Governor allocated money for their use?

Mr. GEE. It is my understanding that funds have been allocated to the counties and the cities, and the counties have allocated funds to some of the smaller cities that were not eligible for a direct allocation.

Mr. HILL. Thank you.

Dr. Zandi, to you, thanks for all your work with our States. I believe we use your forecasting model in the State of Arkansas for our revenue forecasts, so we are grateful for your influence across a lot of economics in our country. And you have been describing the stress that you see in State and local revenues going out to 2022. Do you think the U.S. economy will rebound and have a positive GDP growth in the fourth quarter of this year? And, also, do you think it will have a GDP increase, positive increase, for the calendar year of 2021?

Mr. ZANDI. Well, I think it depends on two things, one, the pandemic and how it unfolds, but let us just put that to the side and let us assume that the pandemic remains roughly where it is today in terms of infections and deaths. But the second is whether Congress and the Administration are able to come together and pass some additional fiscal rescue support to the economy in the next couple, 3 weeks before you go away for recess.

If you do and it is a substantive package that includes aid to State and local government, then I think we will get a positive quarter. We will get growth that is somewhere 3, 4, 5 percent annualized in Q4. If you do not, if there is no additional support, I think we will likely go back into recession by the end of the year with negative job numbers and rising unemployment. So I think a lot depends on what happens in Washington, D.C., over the next 2 to 3 weeks.

Mr. HILL. Considering that recessionary risk and the pandemic risk, would you recommend in 2021 a $4 trillion increase at the Federal Government level?

Mr. ZANDI. I am sorry. A rescue package of $4 trillion?

Mr. HILL. No. Would you recommend a tax increase at the Federal Government level of $4 trillion in fiscal year 2021?

Mr. ZANDI. No. I think until the economy is back on its feet and we are, you know, closing in on full employment, I think it is important for the Federal Government to continue to provide significant support both through significant additional spending and I would not raise taxes in any significant way until we are close to full employment.

Once we are at full employment, I do think we need to pivot it, and we need to really focus on our long-term fiscal situation as a Nation. That will require tax increases and government spending will shrink, both——

Mr. HILL. Thank you very much. I yield back.

Mr. ZANDI. On that I think we need to be very aggressive. Thank you.

Ms. SHALALA. Thank you.

On behalf of the Congressional Oversight Commission, I would like to thank all of our witnesses for their time and testimony today. A special thanks to the Senate Finance Committee for allowing us to use their hearing room. I also want to thank our Commissioners, my fellow Commissioners, for their participation today and for their thoughtful questions; and, of course, our staffs for their assistance with this hearing.

Commissioners may also submit followup written questions for the record.

This hearing is now adjourned.

[Whereupon, at 11:44 a.m., the Commission was adjourned.]

REP. FRENCH HILL
BHARAT RAMAMURTI
REP. DONNA E. SHALALA
SEN. PAT TOOMEY

SDG–55 DIRKSEN SENATE
OFFICE BUILDING

WASHINGTON, DC 20510
(202) 224–5050

Congressional Oversight Commission

The Honorable Steven T. Mnuchin
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

September 29, 2020

Dear Secretary Mnuchin:

As you are aware, on September 17, 2020, the Oversight Commission conducted a hearing regarding the implementation of the Municipal Liquidity Facility, at which a representative of the Federal Reserve and certain other witnesses appeared and testified. The Oversight Commission had also requested that the Treasury Department provide a representative to testify at the hearing, but the Treasury Department declined to do so.

Section 4020(b) of the CARES Act charges the Oversight Commission with the duty to conduct oversight of both the Treasury Department and the Federal Reserve with respect to Subtitle A, Division A programs. Pursuant to Section 4020(e)(1), (4) of the Act, the Oversight Commission requests your response to the attached questions regarding the Municipal Liquidity Facility. In light of the Oversight Commission's monthly reporting obligations, we ask that you provide the information requested in this letter by October 16, 2020.

Thank you for your attention to this matter.

Sincerely,

/s/
French Hill
Member of Congress

/s/
Bharat Ramamurti
Commissioner

/s/
Donna E. Shalala
Member of Congress

/s/
Pat Toomey
U.S. Senator

CONGRESSIONAL OVERSIGHT COMMISSION
Questions for the U.S. Treasury Regarding the Municipal Liquidity Facility Established by the Federal Reserve Pursuant to the CARES Act.

Questions for the Record Submitted to U.S. Treasury from the Congressional Oversight Commission

Question 1: What is the Treasury Department's role in establishing, designing, modifying, and operating the Municipal Liquidity Facility?

Question 2: Who is the point person at the Treasury Department responsible for matters involving the Municipal Liquidity Facility?

Questions for the Record Submitted to U.S. Treasury from Commissioner Bharat Ramamurti & Congresswoman Donna E. Shalala

Question 1: In particular, what role has the Treasury Department played with respect to determining each of the following? Please separately describe any involvement of the Treasury Department in proposing, revising, approving, rejecting, or otherwise weighing in on the following:

a. The amount of the equity investment

b. The original rates

c. The revised rates

d. The term length

e. The types of notes eligible

f. The limitations on uses of loan proceeds

g. The facility's expiration date

h. The original population thresholds

i. The revised population thresholds

j. The gubernatorial designation process

k. The number of Revenue Bond Designations permitted each jurisdiction

l. The credit rating thresholds

m. The requirement that borrowers be rated by a National Statistical Ratings Organization

n. The eligibility of issuer types other than U.S. states, cities, and counties

o. The eligibility of Guam

CONGRESSIONAL OVERSIGHT COMMISSION
Questions for the U.S. Treasury Regarding the Municipal Liquidity Facility Established by the Federal Reserve Pursuant to the CARES Act.

p. The eligibility of Puerto Rico

q. The eligibility of other U.S. territories and possessions

r. The eligibility of Indian Tribes

s. Any other aspect of the rates, terms, or conditions

Question 2: Has the Treasury Department rejected or declined to approve any proposals (whether formally denominated as proposals or not) from the Federal Reserve with respect to the items listed above (Question 2(a)-(s)) or that otherwise pertain to the Municipal Liquidity Facility? If so, please separately describe each such proposal and the Treasury Department's reasons for not approving it.

Question 3: As a legal matter, does the Treasury Department believe the current Municipal Liquidity Facility rates could be decreased, while still complying with the CARES Act, Section 13(3) of the Federal Reserve Act, and accompanying regulations?

Question 4: As a policy matter, does the Treasury Department believe the rates should be decreased?

Question 5: As a legal matter, does the Treasury Department believe the term length for Municipal Liquidity Facility loans could be increased beyond three years, while still complying with the CARES Act, Section 13(3) of the Federal Reserve Act, and accompanying regulations?

Question 6: As a policy matter, does the Treasury Department believe the term length should be increased?

Question 7: Does the Treasury Department believe that cuts to state and local governments' spending would be a drag on the economic recovery?

Question 8: Does the Treasury Department believe the Municipal Liquidity Facility is a substitute for direct aid to state and local governments?

Question 9: Does the Treasury Department believe promoting employment is an objective of the Municipal Liquidity Facility?

Question 10: Does the Treasury Department believe that the Municipal Liquidity Facility, as currently structured, accomplishes Subtitle A's purpose "to provide liquidity to [States and municipalities] related to losses incurred as a result of coronavirus"?

Question 11: Does the Treasury Department believe that the Municipal Liquidity Facility should be extended beyond its current expiration date of December 31, 2020?

Question 12: Given the minimal participation in the Municipal Liquidity Facility to date, does the Treasury Department believe that the population and designation restrictions for "Eligible Issuers" remain necessary? If so, why?

CONGRESSIONAL OVERSIGHT COMMISSION
Questions for the U.S. Treasury Regarding the Municipal Liquidity Facility Established by the Federal Reserve Pursuant to the CARES Act.

Questions for the Record Submitted to U.S. Treasury from Commissioner Bharat Ramamurti

Question 1: As a legal matter, does the Treasury Department believe the term length for Municipal Liquidity Facility loans could be increased to ten years, while still complying with the CARES Act, Section 13(3) of the Federal Reserve Act, and accompanying regulations?

Question 2: Does the Treasury Department believe the Municipal Liquidity Facility has legal authority to sustain losses?

Question 3: Does the Treasury Department believe it would be acceptable for the Municipal Liquidity Facility to sustain losses?

Question 4: What amount of losses, if any, is the Treasury Department willing to sustain?

Question for the Record Submitted to U.S. Treasury from Senator Pat Toomey

Question 1: Given the municipal bond market's significant recovery since March, does the Treasury Department believe it is still necessary for the Federal Government to intervene in the municipal bond market?

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 16, 2020

The Honorable French Hill
U.S. House of Representatives
Washington, DC 20515

The Honorable Donna E. Shalala
U.S. House of Representatives
Washington, DC 20515

Mr. Bharat Ramamurti
Commissioner
Washington, DC 20515

The Honorable Pat Toomey
United States Senate
Washington, DC 20510

Dear Members of the Congressional Oversight Commission:

I write in response to your September 29, 2020 letter enclosing questions from the Congressional Oversight Commission and individual commissioners regarding the Municipal Liquidity Facility established under the Coronavirus Aid, Relief, and Economic Security Act.

The Department of the Treasury remains committed to working with the Commission to accommodate its interest in these and other issues. To this end, responses to the questions included with your September 29 letter are enclosed.

If you have further questions, please direct your staff to contact the Office of Legislative Affairs.

Sincerely,

Frederick W. Vaughan
Principal Deputy Assistant Secretary
Office of Legislative Affairs

Enclosure

Enclosure: *Department of the Treasury Responses to Questions from the Congressional Oversight Commission Regarding the Municipal Liquidity Facility*

<u>Questions Submitted from the Congressional Oversight Commission</u>

Question 1: What is the Treasury Department's role in establishing, designing, modifying, and operating the Municipal Liquidity Facility?

***Response*:** Secretary Mnuchin and Chair Powell agreed on the policy goals of the program in light of events in the municipal bond market and the broader economy. The terms and conditions of the Municipal Liquidity Facility were determined by joint discussions between the Board of Governors of the Federal Reserve System (Federal Reserve) and the Department of the Treasury.

The Federal Reserve performed the necessary financial, legal, and market analysis, developed proposed terms and conditions, created the program documentation and website, and operationalized the Municipal Liquidity Facility in accordance with Section 13(3) of the Federal Reserve Act and Regulation A. Treasury and Federal Reserve staff jointly reviewed events in the municipal bond market and the status of state and local government finances.

Treasury reviewed and approved the creation of the facility and all the term sheets and frequently asked questions prior to their release. Treasury also approved the use of funds appropriated to the Exchange Stabilization Fund under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, making a $35 billion commitment to the special purpose vehicle (SPV) established by the Federal Reserve Bank of New York in connection with the Municipal Liquidity Facility.

Question 2: Who is the point person at the Treasury Department responsible for matters involving the Municipal Liquidity Facility?

***Response*:** Secretary Mnuchin and Chair Powell had discussions multiple times weekly regarding each of the facilities created by the Federal Reserve using funds from Treasury under the CARES Act, including the Municipal Liquidity Facility. In connection with these regular discussions, the Secretary approved the Municipal Liquidity Facility and the Treasury funding and reviewed all term sheets and frequently asked questions, as well as economic and market analyses developed by the Federal Reserve.

<u>Questions Submitted from Commissioner Bharat Ramamurti and Congresswoman Donna E. Shalala</u>

Question 1: In particular, what role has the Treasury Department played with respect to determining each of the following? Please separately describe any involvement of the Treasury Department in proposing, revising, approving, rejecting, or otherwise weighing in on the following:

a. The amount of the equity investment
b. The original rates

c. The revised rates
d. The term length
e. The types of notes eligible
f. The limitations on uses of loan proceeds
g. The facility's expiration date
h. The original population thresholds
i. The revised population thresholds
j. The gubernatorial designation process
k. The number of Revenue Bond Designations permitted each jurisdiction
l. The credit rating thresholds
m. The requirement that borrowers be rated by a National Statistical Ratings Organization
n. The eligibility of issuer types other than U.S. states, cities, and counties
o. The eligibility of Guam
p. The eligibility of Puerto Rico
q. The eligibility of other U.S. territories and possessions
r. The eligibility of Indian Tribes
s. Any other aspect of the rates, terms, or conditions

***Response*:** Following discussions with the Federal Reserve on the Federal Reserve's analysis of the appropriate size of the Municipal Liquidity Facility, and based on the Federal Reserve's modeling of potential losses by the facility, the Federal Reserve and Treasury determined the percentage of equity from Treasury required to support the facility, and the Federal Reserve and Treasury worked to determine the appropriate size of the facility.

With respect to the original design and various terms of the Municipal Liquidity Facility, the Federal Reserve and Treasury came to agreement on the needs and policy goals of the program, based on municipal financing needs and the authorities under the CARES Act and the Federal Reserve Act. Federal Reserve economists, market analysts, and other staff conducted the necessary research and market outreach and developed the terms, conditions, structure, and operating model for the facility. Treasury reviewed and approved the terms and conditions of the Municipal Liquidity Facility consistent with the agreed-upon needs and policy goals.

Regarding the various revisions to the facility, the Federal Reserve and Treasury discussed feedback from the market and state and local governments on the facility, and the evolving conditions of the municipal bond market. The Federal Reserve conducted the additional research and analysis, developed amendments to the facility term sheet, and adjusted its operating model as informed by this additional information. Treasury reviewed the amendments in light of participant feedback and market conditions, as well as the original policy goals of the facility.

Question 2: Has the Treasury Department rejected or declined to approve any proposals (whether formally denominated as proposals or not) from the Federal Reserve with respect to the items listed above (Question 2(a)-(s)) or that otherwise pertain to the Municipal Liquidity Facility? If so, please separately describe each such proposal and the Treasury Department's reasons for not approving it.

Response: Treasury and the Federal Reserve engaged in extensive deliberations regarding the Municipal Liquidity Facility and worked together to reach agreement on the appropriate structure, terms, and conditions of the facility. Treasury did not decline any formal proposal.

Question 3: As a legal matter, does the Treasury Department believe the current Municipal Liquidity Facility rates could be decreased, while still complying with the CARES Act, Section 13(3) of the Federal Reserve Act, and accompanying regulations?

Response: Section 13(3) of the Federal Reserve Act grants statutory authority to the Federal Reserve to determine the rates charged on its lending facilities, with prior approval of the Secretary. On August 11, 2020, the Federal Reserve reduced the pricing methodology to determine the rates for borrowing from the Municipal Liquidity Facility.

Question 4: As a policy matter, does the Treasury Department believe the rates should be decreased?

Response: Treasury does not currently believe the rates should be decreased. The reduction of the facility's rates on August 11 enables the Municipal Liquidity Facility to continue to operate as a backstop in supporting market access by state and local governments.

Question 5: As a legal matter, does the Treasury Department believe the term length for Municipal Liquidity Facility loans could be increased beyond three years, while still complying with the CARES Act, Section 13(3) of the Federal Reserve Act, and accompanying regulations?

Response: Section 13(3) of the Federal Reserve Act grants statutory authority to the Federal Reserve to determine the term length under its lending facilities, with prior approval of the Secretary of the Treasury. The CARES Act does not impose term length restrictions on amounts borrowed under Section 13(3) lending programs.

Question 6: As a policy matter, does the Treasury Department believe the term length should be increased?

Response: Treasury does not currently believe the term length should be increased. The Federal Reserve and Treasury continue to monitor market stability and issuer market access.

Question 7: Does the Treasury Department believe that cuts to state and local governments' spending would be a drag on the economic recovery?

Response: Reduced overall spending by state and local governments could contribute to a short-term decline in GDP.

Question 8: Does the Treasury Department believe the Municipal Liquidity Facility is a substitute for direct aid to state and local governments?

***Response*:** Federal funding, in the form of grants or direct aid, and Federal financing, in the form of loans including through the Municipal Liquidity Facility, are separate and distinct policy tools. One or the other may be employed, or they may be employed together, depending on the policy goals and the expected costs to the taxpayer.

Question 9: Does the Treasury Department believe promoting employment is an objective of the Municipal Liquidity Facility?

***Response*:** As provided in section 4003 of the CARES Act, the purposes of the Municipal Liquidity Facility include "to provide liquidity to eligible businesses, States, and municipalities related to losses incurred as a result of coronavirus" and to "provid[e] liquidity to the financial system that supports lending to eligible businesses, States, or municipalities."

Question 10: Does the Treasury Department believe that the Municipal Liquidity Facility, as currently structured, accomplishes Subtitle A's purpose "to provide liquidity to [States and municipalities] related to losses incurred as a result of coronavirus"?

***Response*:** Yes. The municipal market's recovery since March and the Municipal Liquidity Facility's continued operation serving as an effective backstop are accomplishing this purpose for issuers.

Question 11: Does the Treasury Department believe that the Municipal Liquidity Facility should be extended beyond its current expiration date of December 31, 2020?

***Response*:** At this time, the Treasury Department does not believe that the Municipal Liquidity Facility should be extended beyond its current expiration date of December 31, 2020. The Federal Reserve and Treasury continue to monitor market stability and issuer market access in order to determine whether any changes to this expiration date would be warranted.

Question 12: Given the minimal participation in the Municipal Liquidity Facility to date, does the Treasury Department believe that the population and designation restrictions for "Eligible Issuers" remain necessary? If so, why?

***Response*:** The facility's low utilization reflects a recovered and functioning municipal securities market. Indeed, the municipal securities market stabilized in large part because the Municipal Liquidity Facility established a backstop. Treasury does not believe the facility requires a change to the definition of eligible issuers.

Questions Submitted from Commissioner Bharat Ramamurti

Question 1: As a legal matter, does the Treasury Department believe the term length for Municipal Liquidity Facility loans could be increased to ten years, while still complying with the CARES Act, Section 13(3) of the Federal Reserve Act, and accompanying regulations?

***Response*:** Section 13(3) of the Federal Reserve Act grants statutory authority to the Federal Reserve to determine the term length under its lending facilities, with prior approval of the Secretary of the Treasury. The CARES Act does not impose term length restrictions on amounts borrowed under Section 13(3) lending programs.

Question 2: Does the Treasury Department believe the Municipal Liquidity Facility has legal authority to sustain losses?

***Response*:** Congress appropriated funding to pay for losses in facilities established under Section 4003(b)(4) of the CARES Act, and the funds contributed by Treasury to the Municipal Liquidity Facility SPV under such authority are both legally and economically exposed to any potential losses that may be incurred by the program. Importantly, Section 13(3) of the Federal Reserve Act additionally requires that facility loans be secured "sufficient[ly] to protect taxpayers from losses," and collateral be assigned a "lendable value" that is "consistent with sound risk management practices … to ensure protection for the taxpayer." The terms of the program have been designed to meet these statutory requirements as well.

Question 3: Does the Treasury Department believe it would be acceptable for the Municipal Liquidity Facility to sustain losses?

***Response*:** As noted above, funds contributed by Treasury to the Municipal Liquidity Facility SPV are both legally and economically exposed to any potential losses that may be incurred by the facility. A range of potential outcomes is possible: while Treasury may not experience losses on its investment in the facility, in other cases Treasury could experience losses. While Treasury does not consider taxpayer losses a desirable policy outcome, the incurrence of losses would be acceptable.

Question 4: What amount of losses, if any, is the Treasury Department willing to sustain?

***Response*:** Treasury committed $35 billion as a backstop to the Municipal Liquidity Facility. Treasury does not currently anticipate any losses on this facility, but Treasury could experience a loss up to the amount of that backstop that is drawn by the facility's SPV.

<u>Question Submitted from Senator Pat Toomey</u>

Question 1: Given the municipal bond market's significant recovery since March, does the Treasury Department believe it is still necessary for the Federal Government to intervene in the municipal bond market?

***Response*:** Treasury does not currently believe the Municipal Liquidity Facility should continue to serve as a backstop after its scheduled end date of December 31, 2020.

NATIONAL ASSOCIATION of COUNTIES NACo

September 24, 2020

The Honorable French Hill
1533 Longworth House Office Building
Washington, D.C. 20515

The Honorable Donna Shalala
1320 Longworth House Office Building
Washington, D.C. 20515

The Honorable Pat Toomey
248 Russell Senate Office Building
Washington, D.C. 20510

Commissioner Bharat Ramamurti
SD-G55 Dirksen Senate Office Building
Washington, D.C. 20510

Dear members of the Congressional Oversight Commission:

On behalf of the National Association of Counties (NACo) and the 3,069 counties we represent, thank you for holding last week's hearing to examine the Municipal Liquidity Facility (MLF) established under the Coronavirus Aid, Relief, and Economic Security (CARES) Act. As members of NACo's Fiscal Policy and Pensions Subcommittee, we understand the importance of this critical program, which works to support county governments impacted by the COVID-19 pandemic.

While we appreciate federal efforts made thus far, counties and our residents continue to experience devastating health and economic impacts as we remain on the frontlines of the ongoing coronavirus pandemic. America's counties agree on the following principles:

- Counties of all sizes need access to additional direct, flexible funding to fight this pandemic, rebuild the economy and strengthen our communities

- The U.S. Department of Treasury and Federal Reserve should expand access to the Municipal Liquidity Facility to help address local government budget challenges and support the national economy

Counties of all sizes need access to additional direct, flexible funding to fight this pandemic, rebuild the economy and strengthen our communities

While the CARES Act was an important first step, the aid provided is not enough to support our efforts to effectively implement containment and community mitigation strategies that will preserve the health and safety of our residents and local communities.

Counties across the country are in desperate need of additional assistance to protect the lives of citizens and re-open the economy. The CARES Act did not contain funding to offset the drastic state and local revenue shortfalls that county governments are experiencing across the country, nor did it provide any relief to local governments with populations under 500,000. In fact, only five percent of the nation's counties were eligible to receive direct payments from the U.S. Department of Treasury.

The detrimental fiscal impact of COVID-19 extends far beyond urban counties. Counties with populations below 500,000 are also taking a major hit to our budgets. New NACo research estimates that the COVID-19 pandemic could have a $202 billion budgetary impact on counties of all sizes through fiscal year 2021, including $172 billion in lost revenue and an additional $30 billion in COVID-19 response costs.

In total, counties are estimated to lose $35 billion in sales tax revenue through fiscal year 2021. Across the nation, 69 percent of counties that levy local option sales tax have reported a decline in sales tax revenue as a result of COVID-19, with losses ranging from 7 to 41 percent. Furthermore, counties are also facing cash flow challenges due to the delayed collection and timing of property taxes. State and county authorities in 16 states across the nation have extended property tax deadlines or penalty relief for late payment.

This tremendous loss of revenue and increase in costs may ultimately result in cuts to essential county services including public safety, social services, child protective services, mental health, homelessness, jail diversion, reentry and more.

To maintain mandated balanced budgets, many counties have already been forced to cut costs by furloughing or laying off workers. Since the start of the pandemic, there have been more than 800,000 jobs lost in the local government sector – 332,000 of which were non-education jobs ranging from law enforcement officers to health care practitioners, social workers, maintenance crews, construction works, administrative support and more. **In total, local governments have lost 1.2 million jobs since the outset of the pandemic.**

Beyond the impacts on our workforce, the financial fallout from COVID-19 has forced cuts and delays in capital investments. NACo's research finds that 66 percent of counties have cut, or delayed infrastructure maintenance and 54 percent have cut or delayed new infrastructure projects. These cuts will mitigate cash flow shortages in the short-term but will have long-term economic impacts and disrupt critical local development.

If counties are to continue to play a significant role in mitigating the spread of the COVID-19 virus, we need a robust coronavirus relief bill that ensures counties of all sizes have access to additional direct, flexible funding to fight this pandemic, rebuild the economy and strengthen our communities.

The U.S. Department of Treasury and Federal Reserve should expand access to the Municipal Liquidity Facility to help address local government budget challenges and support the national economy

The MLF is an important piece of the initial and necessary response to the COVID-19 pandemic. Although the MLF provided some stability to the municipal bond market when it was established, it is not practical or accessible to entities that need it most – state and local governments.

To ensure that state and local governments may take advantage of this tool, we recommend that the U.S. Treasury and Federal Reserve take the following steps to make the MLF more accessible:

- **The Federal Reserve should extend the MLF's underwriting deadline beyond December 31, 2020.** Under the CARES Act, the facility is currently set to expire at the end of this year even though the state and local government budget crisis is just beginning. For example, according to NACo's research, while 27 percent of counties have already experienced reduced property tax collection in the current budget cycle, this number may almost double to 43 percent during next year's budget cycle.

- **The Federal Reserve should lower the MLF population threshold so that more counties are eligible to sell short-term debt to the facility.** While we appreciate that the Federal Reserve lowered the population threshold for counties from 2 million residents to 500,000, the new threshold still leaves out the majority of our nation's counties. In fact, under the new population threshold, only 5 percent of counties have access to the MLF. As mentioned earlier, counties of all sizes are facing dire fiscal impacts. Expanding the scope of the MLF would help relieve some of this pressure and is an important step to stabilize the municipal market in the future.

- **The Federal Reserve should restructure the facility's pricing structure and lower the current rates.** As of September 18, the facility had purchased only two issuers, which demonstrates that the MLF's current pricing is unfavorable for many municipal issuers. For example, in Fresno County, Calif., the MLF offers a 1.20 percent rate for AA governments wishing to borrow, in comparison to the county's short-term TRAN of 0.18 percent. Therefore, Fresno County has decided to not use the MLF since there are other less costly rates the county can borrow from. The Federal Reserve should make the rate as low as possible for local governments to save taxpayer dollars and jobs as well as prevent future drastic budget cuts.

Thank you for your continued hard work and leadership during these challenging times. We would welcome the opportunity to discuss this issue further. We are committed to a solution that helps our nation mitigate, respond, and recover from this historic crisis.

Sincerely,

Members of NACo's Fiscal Policy and Pensions Subcommittee:

Hon. Kevin L. Boyce
Commissioner
Franklin County, Ohio

Hon. Laura Montoya
Treasurer
Sandoval County, New Mexico

Hon. Kurt A. Gibbs
Board Chair
Marathon County, Wisconsin

Hon. Cindy Bulloch
County Assessor
Iron County, Utah

Hon. John Wilson
County Assessor
King County, Washington

Hon. Dolores Ortega-Carter
Treasurer
Travis County, Texas

Hon. Nathan Magsig
Supervisor
Fresno County, California

Hon. Brian Sullivan
Treasurer
Snohomish County, Washington

Diane Dillon

Hon. Diane Dillon
Supervisor
Napa County, California