STATEMENT OF
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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.

<u>Water Systems Face Unique Challenges</u>

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.

<u>The federal government needs to provide more assistance to struggling states and local governments</u>

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.