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Hearing to Examine the CARES Act Municipal Liquidity Facility

Testimony by

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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.