Bond group asks Treasury, Fed for robust municipal support

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The Federal Reserve and Treasury Department should focus on direct purchases from issuers to help ease distress in the municipal bond market caused by the coronavirus pandemic, a top trade group said in a letter sent today.

“We recommend that Treasury and the Fed concentrate the majority of your municipal market resources on ‘purchasing obligations or other interests directly from issuers as permitted by the Act,'” reads the letter, which was signed by Mike Nicholas, CEO of Bond Dealers of America, and addressed to Treasury Secretary Steven Mnuchin and Federal Reserve Chair Jerome Powell. The D.C.-based trade group represents banks and securities firms active in the bond market, and is referring to the $2 trillion stimulus bill signed into law last week.

“This is especially true for issuers expected to be particularly hard hit by the crisis such as those dependent on travel-related taxes or fees,” BDA said.

The group zeroed in on a section of the law that's being closely watched by both state and local governments as well as businesses. The provision grants authority to Treasury and the Fed to administer $500 billion in loans or direct purchases to businesses as well as state and local governments.

There are some set-aside amounts within that total for certain industries like airlines, but state and local governments have access to $454 billion that could help prop up municipal finances in distress.

But there’s been broad concern that municipal problems could fall by the wayside as businesses compete for the funding. Concern also stems from the Fed’s historic unwillingness to get too heavily involved in municipal finance in previous downturns.

The group also urged the Fed in its letter to consider establishing a “standby, short-term lending facility for states and localities experiencing cash flow timing shortfalls.”

The request has become more urgent as municipal bonds continue to struggle with volatility as investors move funds out of the market.

And while the Fed took limited action to ease shorter-term municipal debt stress on Mar. 20, it wasn't broad enough, advocates and local governments say.

Part of the urgency for this kind of facility has to do with short-term funding shortfalls local governments are beginning to experience immediately following the economic drop-off after the coronavirus pandemic shuttered businesses across the country.

Exacerbating the problem for some governments is an announced delay in revenue collection by the IRS, which led many localities to delay their own local tax deadlines.

Moody’s Investors Service zeroed in on the problem in a report on March 27, warning the tax shift means a large portion of state and local government revenue will arrive three months later than usual and could create unexpected holes in short-term budgets.

BDA made clear in the letter that while it wanted broad support, it also wanted it to be as brief an intervention as possible.

“In general, to maintain a healthy municipal market and not create an artificial dependency, we urge Treasury and the Fed to plan on ending its municipal market support program as soon as practical,” the group wrote.