BDA urges Fed to provide short-term muni intervention

By Sarah Wynn

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Bond Dealers of America is urging the Federal Reserve and Treasury to focus their coronavirus relief on lending to states and localities during the pandemic, while stressing that the support should end as soon as practical.

In a letter sent Friday, BDA voiced its support for Section 4003 of the Coronavirus Aid, Relief, and Economic Security Act, signed last week. That section encourages the Fed to start voluntary purchases of longer-maturity municipal securities through a new $454 billion Economic Stabilization Fund. That fund will provide direct lending, loan guarantees among other investments to support the Fed's lending facilities.

"The municipal securities market is a vital national asset because it is the means by which states and localities raise capital to finance infrastructure," BDA CEO Mike Nicholas wrote in the letter. "The market has suffered significantly over the last several weeks, with the cancellation or postponement of new issuance, price volatility of historic proportions, and a significant deterioration of liquidity."

Mike Nicholas, BDA CEO, wrote a letter to the Federal Reserve and Treasury Friday asking for issuer support and advocating for short-term intervention.

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BDA wants the Treasury and Fed to focus on issuers as they take next steps.

The group wants the Fed to consider a standby, short-term lending facility for states and localities experiencing cash flow timing shortfalls. This would be the most anticipated part of what the Fed might do in the municipal market, said Michael Decker, BDA senior vice president of policy and research.

The primary market all but dissolved for two weeks causing uncertainty for many market participants. A lack of new issuance continues to be a problem.

"As we move through the economic downturn, a lot of issuers are going to find themselves needing cash flow financing or working capital financing," Decker said.

Short-term borrowing could tide issuers over until tax receipts or other revenues come in, Decker said. Issuers could place tax or revenue anticipation notes directly with the Fed, Decker added.

BDA wants short term intervention from the Fed to provide support for the secondary market, which has continued to see volatility over the last couple of weeks.

Some dealers have reported that their municipal inventories are "full" and they are unable to take more bonds onto their balance sheets, Nicholas said.

Decker said the Fed could do something similar to what it did a few weeks ago in the corporate

market. The Fed set up a Secondary Market Corporate Credit Facility which creates a special purpose vehicle to purchase bonds. The Fed then does the financing for the SPV's portfolio and a third party portfolio manager then makes investment decisions.

BDA expects more pressure on the municipal market in the coming months, but stressed that the muni market generally is a safe asset class with long-term default rates close to zero.

As the economic slowdown continues, BDA expects credit conditions among some issuers to deteriorate. However, BDA urged the Treasury and Fed to plan on ending its support to the muni market as soon 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," Nicholas wrote.

BDA was among several muni groups sending letters to the Treasury and Fed over the past two weeks.

Sarah Wynn Reporter

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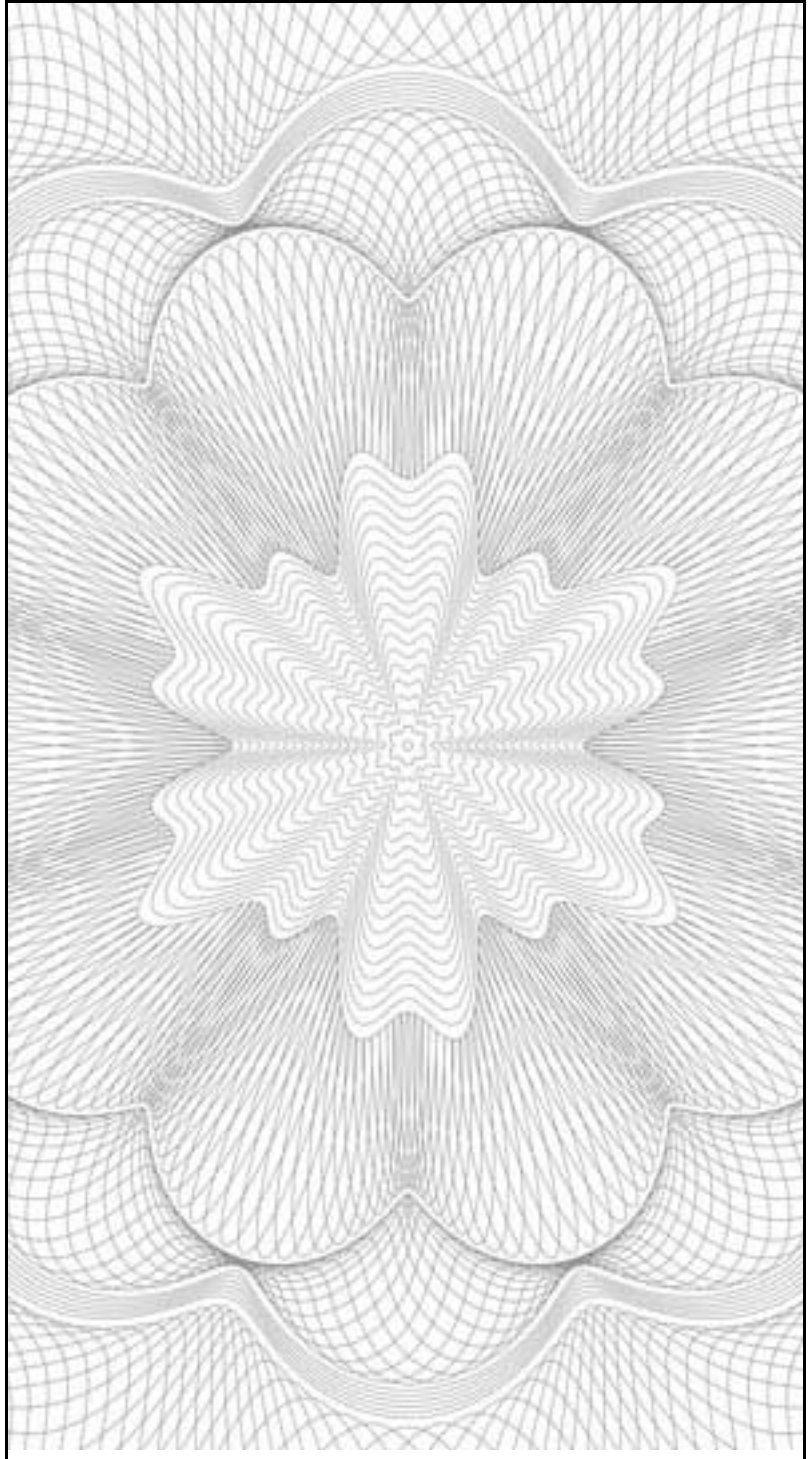

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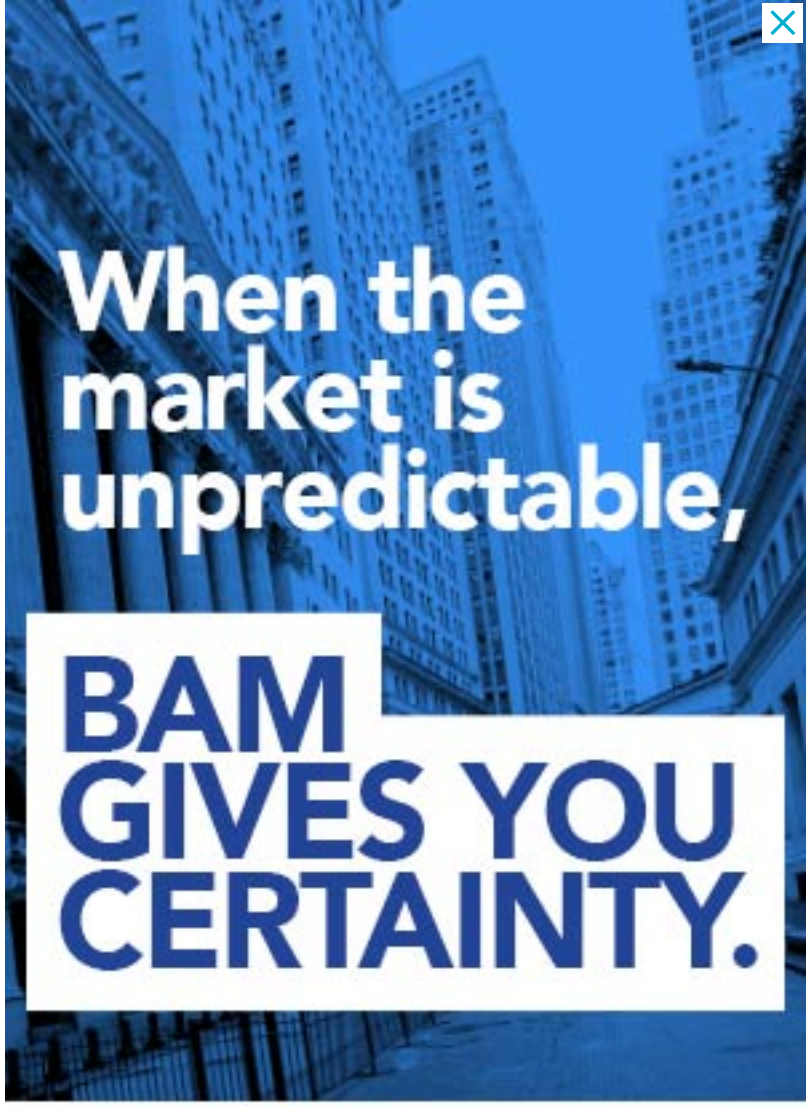

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