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U.S. Municipal Bond Market

The Fed Backstops $451 Million of NY MTA Notes Despite Efficient Market Conditions

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The Fed's Municipal Liquidity Facility as a Backstop

Yesterday, the U.S. Federal Reserve's Municipal Liquidity Facility (MLF) served as a backstop to the New York Metropolitan Transportation Authority (MTA). MTA solicited bids from Wall Street firms but ultimately rejected them in favor of the Fed's MLF.[1] The Fed lowered pricing on the MLF by 50 basis points last week.[2] The New York MTA loan eventually amounted to, "a true interest cost of 1.92%, 'resulting in savings of over 85 basis points compared to the public market levels,' according to an emailed statement from MTA spokesperson Tim Minton."[3] Ultimately the MTA's MLF pricing was able to attain the borrowing cost it did because of its Kroll Bond Rating Agency AA+ rating,[4] "the MTA's rate implies it was given a composite rating of A+. That grade requires a 190 basis point yield spread to overnight index swaps, which are near zero."[5]

The MLF that has been shaped in recent months possesses the authority to help support or restore normal market access as described in Section 13 of the Federal Reserve Act.[6] The Federal Reserve, through the MLF or otherwise, does not have the authority to engage in fiscal policy actions; Only Congress has the ability to enact fiscal policy. This is a key reason why, overall, the MLF program pricing is, and will likely remain, above market levels for most issuers. It is meant to serve as a backstop and enable efficient market function. The MLF is not meant to operate as a loan program.

This is only the second time a qualified public finance entity has used the MLF. The first was Illinois back at the beginning of June. We still do not expect the MLF to be heavily utilized considering current market conditions even though the backstop was there this week for the MTA and will remain in place until it expires at the end of the year. Last week's MLF change in pricing simply dropped the levels to very high, from extremely high, as we indicated in a previous commentary.[7]

Ultimately the MTA's MLF pricing was able to attain the borrowing cost it did because of its Kroll Bond Rating Agency AA+ rating.

Public Market Conditions This Week

Municipal bond market conditions are operating as efficiently and effectively as ever. On the supply side we were expecting issuers to bring $12+ billion of bonds to market this week; This is a high-issuance week not only for this year but any year. We are also not aware of any public finance offerings that have been pulled from the calendar like we so often did back at the end of March and in the beginning of April because of market concerns. In March and April, liquidity pressures were severe, especially when we saw $31 billion flow out of municipal funds over a six-week period between the beginning of March and the middle of April. However, demand for municipal bonds has consistently been strong since the middle of May. We have seen $21.4 billion flow into municipal mutual funds over the last 14 weeks, per Aug. 12 data released by Lipper. Both the 2 year and 10 year AAA Municipal Market Data (MMD) benchmarks are near annual and all-time lows at 0.14% and 0.67%, as of Aug. 18, 2020. These data points are down significantly from the 2.52% and 2.79% 2020 peaks reached during the March 2020 liquidity event.

Please see disclosure starting on page 2.

[1] Long, Cate. Twitter Post. August 18, 2020; 12:34pm. https://twitter.com/cate_long/status/1295776009548107777
[2] Please see: Kozlik, Tom: Fed Drops Municipal Backstop Pricing by 50 Basis Points, Still Very High; August, 12, 2020.
[3] Albright, Amanda and Danielle Moran; New York MTA Becomes Second to Tap Fed as Banks Demand Higher Yields; Bloomberg; August 18, 2020.
[4] Chappatta, Brian; New York's MTA Is Saved Less By Fed and More by Kroll; Bloomberg; August 19, 2020.
[5] Ibid.
[6] Section 13, Powers of Federal Reserve Banks.
[7] Kozlik, Tom: Fed Drops Municipal Backstop Pricing by 50 Basis Points, Still Very High; August, 12, 2020.

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