In Brief

GFOA STANDING COMMITTEES | FEDERAL UPDATE

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GFOA COMMITTEES

Checking in on GFOA Committees for Debt Management and Retirement and Benefit Administration

Our column on GFOA's standing committees is a way for us to share their work throughout the year. And if what we are doing excites you, please consider throwing in your hat when applications open!

DEBT COMMITTEE PROVIDES FEDERAL ADVOCACY AT A CRITICAL TIME

In March 2020, during the initial market shock and material disruption of the coronavirus pandemic, debt committee Chair Kenton Tsoodle and committee Vice Chair Kathy Kardell wanted to mobilize the committee as a resource for members—and one of the things it provides is camaraderie. They created a standing meeting each Wednesday for the committee to convene, share their experiences, and assess the federal proposals under consideration to address the COVID-19 pandemic.

In the third week of March, the municipal bond market experienced unprecedented levels of volatility, testing municipal bond issuers who were poised to enter the market with significant infrastructure financings. Debt committee members debated numerous proposals and methods for the Federal Reserve to participate in the municipal bond market in order to calm the volatility and work the stabilize it. They also connected with leadership at the Treasury and the Federal Reserve to discuss tools that are in place and others that are yet to be created.

Upon passing the Coronavirus Aid, Relief, and. Economic Security (CARES) Act, the Federal Reserve was authorized to spend up to $454 billion to participate in the municipal bond market, either as a lender of private placement debt or as a secondary market investor.

On April 9, the Federal Reserve, in response to this Congressional authorization, announced the parameters of the new Municipal Liquidity Facility (MLF) it put in place to help state and local governments, per Section 4003 of the CARES Act. The program allows states and large cities and counties to access the facility, which will purchase short-term notes to help governments alleviate some of the budget pressures that are occurring, and will continue to occur, due to delayed and deferred tax and fee inflows. In short, the policy objective is to provide liquidity in the municipal marketplace in the short term.

Many of the details are still to be determined, including the rates the Federal Reserve will offer and other transactional details.

The debt committee applauds the Federal Reserve's careful interpretation of the legislative intent of the CARES Act and supports the Fed's efforts to provide emergency liquidity to states and localities facing severe uncertainties as a result of this crisis. And since the April 9 announcement indicated that certain terms and features of the MLF are still being resolved, the debt committee provided feedback.

- **Eligible entities.** The Fed's announcement specifies that only states, counties with populations of at least 500,000, and cities with populations of at least 250,000 are eligible to access the MLF directly. As many have noted, this approach serves two potential policy purposes. On one hand, it provides a narrowed pool of potential credits—states and the mid- to large-local governments—access to short-term capital. On the other hand, it doesn't allow public utilities and political subdivision issuers direct access to the facility. In its most recently issued FAQ, the Fed notes, "The Federal Reserve is also considering expanding the MLF to allow a limited number of governmental entities that issue bonds backed by their own revenue to participate directly in the MLF as eligible issuers. Any decision to include any such additional eligible issuers would be publicly announced at a future date."[1]

According to the Fed's term sheet, "States may request that the Special Purpose Vehicle (SPV) purchase eligible notes in excess of the applicable limit in order to assist political subdivisions and instrumentalities that are not eligible for the facility."[2] In so doing, states that participate will act as intermediaries and will assume the risk of the credits of all borrowers.

The debt committee recognizes the Federal Reserve's considerable efforts to launch and maintain the MLF, which will provide much-needed immediate assistance in critical areas.

While all governments should have access to this relief, current stresses experienced by local governments, instrumentalities, and political subdivisions are an additional burden to state governments that are experiencing similar burdens themselves. GFOA recommends that the Fed explicitly provide assurances to states against losses associated with defaults and other credit events experienced by borrowers that access the facility through their state governments.

Additional guidance is needed to address concerns with the parameters of the MLF program, especially because only one issuer per state, city, or county is eligible to use the facility. Each state has unique constitutional issues that may impair its ability to meet this requirement; in other words, the credit for a bond bank type entity that addresses the needs of subdivisions and instrumentalities may need to be different and separate from the state's credit. Also, creating a bond bank type entity could restrict the state's ability to access the facility.

Finally, GFOA has requested that the Fed provide assurances that eligible issuers are able to draw down funds through the facility as needed. There will be better use of the facility if issuers do not have to incur negative carry on a lump sum draw.

- **Extended termination date.** The Fed extended the initially proposed termination date of September 30, 2020, to December 31, 2020. GFOA requested this extension because, as the Fed's announcement suggests, states are intended to be the conduit for local government units below the population threshold for accessing the program. Few states have such statutorily created facilities and creating one would require state legislative action as well as clearing administrative and legal hurdles. GFOA will continue to monitor states as they consider using certain intermediaries as the issuer of the debt. In addition, the coronavirus pandemic seems to have just started and, because of the time needed to process tax collections, states and other units of government will need time to determine the extent of their liquidity needs. This timeline will vary for each state but, in general, states and local governments may not have fully assessed their needs by September. With the deadline extended, it is especially important for governmental borrowers to work with states or eligible local government entities to assess their needs.

Allowable use of proceeds. GFOA also has asked for more specifics about the allowable use of proceeds. Without more clarity, governments may discover several years down the road that the Fed's interpretation of use of proceeds differs from their own issuance. In particular, governments may borrow for "expenses related to losses incurred as a result of the coronavirus."[3] This may mean different expenses and revenue losses for different types of governments. Therefore, GFOA recommends that the Fed allow for a broad definition for the use of proceeds that correlates to the varied economic crises of communities.

Pricing and term sheet considerations. The Fed's MLF announcement provided few details on how notes will be priced. Because the policy objective of the MLF is to provide opportunity for liquidly in the public sector, we encourage the Fed to develop pricing structures that won't exclude an issuer from other sources of capital. In other words, notes offered by the facility should be priced as close as possible to market norms with commonly used benchmarks.[4] Without such structures, issuer participation will likely be dampened.

Disclosure considerations. GFOA has a suite of best practices about issuer disclosure, and the debt committee recently published considerations for issuer disclosures during COVID-19.[5] To significantly streamline participation in the program, the Fed should use the disclosure regime currently in place, and GFOA has asked that disclosures not extend beyond what issuers are required to provide based on their continuing disclosure agreements. GFOA also urged the Fed to allow issuers to satisfy program term compliance with representations rather than submitting financial or other documents. Disclosure considerations will also depend on other details of this facility: Will DTC be involved with issuance? Will secondary market trading possibilities exist?

Cost and administration of issuance. GFOA understands the substantial efforts and costs of issuing debt in the public markets. Additionally, issuers will likely assume similar costs when accessing the MLF. We therefore asked the Fed to consider guidance that additional costs of issuance can be paid from the proceeds of borrowing.

ANDREW HARRER/BLOOMBERG VIA GETTY IMAGES

Jerome Powell, chairman of the U.S. Federal Reserve, speaks during a virtual news conference on April 29, 2020. Federal Reserve officials restated their pledge to hold the benchmark interest rate near zero and will keep buying bonds, judging that the coronavirus pandemic "poses considerable risks to the economic outlook over the medium term."

The debt committee recognizes the Federal Reserve's considerable efforts to launch and maintain the MLF, which will provide much-needed immediate assistance in critical areas. This facility goes a long way toward accomplishing the policy objective of ensuring sufficient liquidity in the public sector. But the debt committee's work is not yet finished! We are very much aware that through the CARES Act, Congress directed the Federal Reserve and the Treasury to use a portion of the $454 billion for the Treasury's Exchange Stabilization Fund to serve the financing needs of state and local governments. It is our hope that the Fed will continue to monitor the stability MLF provides, together with a stable municipal bond market and financial institutions that provide affordable solutions. Together, this federal-state-local partnership, financial institution and capital markets solution will help turn the tide on the state of the pandemic.

1 FAQs: Municipal Liquidity Facility, Federal Reserve Bank of New York, April 27, 2020.
2 Municipal Liquidity Facility, Federal Reserve, April 9, 2020.,
3 CARES Act, P.L. 116-136, Section 4003(a).
4 For example, see Thomson Reuters Municipal Market Data, Municipal Market Analytics, Bloomberg BVAL Muni Benchmark, Municipal Bond Information Services, Intercontinental Exchange, the Treasury curve, or others.
5 "GFOA Debt Committee Releases Urgent Member Guidance for COVID-19 Debt Service and Disclosures," GFOA debt committee (gfoa.org).

COMMITTEE ON RETIREMENT AND BENEFITS ADMINISTRATION WORKS ON UPDATES AND NEW RESOURCES

With the January 2020 GFOA Winter Meeting behind them, members of the Committee on Retirement and Benefits Administration (CORBA) work groups moved right into their ongoing efforts. They have been focusing on the following: updating GFOA's "Securities Class Action Litigation" best practice and "Deferred Retirement Option Plans" advisory; drafting a proposed advisory on in-kind asset transfers; and updating a resource on public employee retirement system comprehensive annual financial reports.

Generally, there are a number of reasons for reviewing an existing GFOA best practice or advisory. For example, circumstances or conditions might have changed since the document was initially developed. Or sometimes, we learn more from governments that have implemented measures in response to the conditions a best practice or advisory addresses, leading GFOA to take a stronger stance.

While in Washington, D.C., for their annual January meeting, CORBA members received an update from each working group to hear how their respective projects were progressing. In return, work groups were able to field questions and receive feedback from other committee members.

This committee update will focus on two of the projects CORBA members continue to work on, and what the committee will potentially be working on despite the new norm the pandemic has forced on us—that is, not being able to meet in person at the GFOA annual conference in May.

Advisory on Deferred Retirement Option Plans (DROP). Last approved by the GFOA Executive Board in 2005, this advisory recommends that governments exercise extreme caution in considering DROP plans.

While DROP plan features can vary significantly, they generally result in a lump-sum payout that supplements an employee's pension. DROP plans allow employees who would otherwise retire in a defined benefit plan to continue working. Rather than continuing to accrue credit for service and compensation, a certain sum is credited to a separate account under the government's retirement plan. Typically, the employee participating in the DROP plan receives the money in the account, including an agreed-upon interest amount, in a lump sum when they retire.

Exercise extreme caution in considering DROP plans.

Before this advisory was issued, many governments implemented DROP plans to achieve a variety of financial and human resource management goals; however, concerns over the use of DROP plans grew as some governments incurred costs that were substantially higher than anticipated due to factors like unfavorable plan design and faulty investment return assumptions.

Proposed advisory on in-kind asset transfers to public pension plans. Over the years, public pension plans have made adjustments that could include changes in plan design or financing. These efforts increased in the years following the Great Recession, but an interesting conversation, carried out on different platforms over the years, raises the notion that there could be a more direct relationship between infrastructure/assets and public pension funds. For example, several federal legislative proposals have sought to provide a mechanism for public pension funds to directly capitalize a national infrastructure bank, which in turn would be used to provide loans for major infrastructure projects. Another possibility is directly transferring an asset to a pension fund as a potential solution to mitigate plan liabilities and boost asset levels. This conversation will likely continue, as our nation's infrastructure needs a great deal of investment and pension funds will experience more funding challenges, especially given the impact on financial markets due to the coronavirus outbreak.

The CORBA work group will focus on the latter scenario, where a jurisdiction is considering an in-kind asset transfer to its pension fund. To be clear, this practice, while often discussed, is currently not widely in use. But recent, specific case examples are drawing increased press exposure (and providing part of CORBA's motivation to explore the topic).

Currently, the work group is trying to answer three types of questions. First, what are the potential asset types, and do their implications differ? Second, what are the considerations and risks from a pension plan's perspective? Finally, what are the considerations and risks for the government transferring the asset?

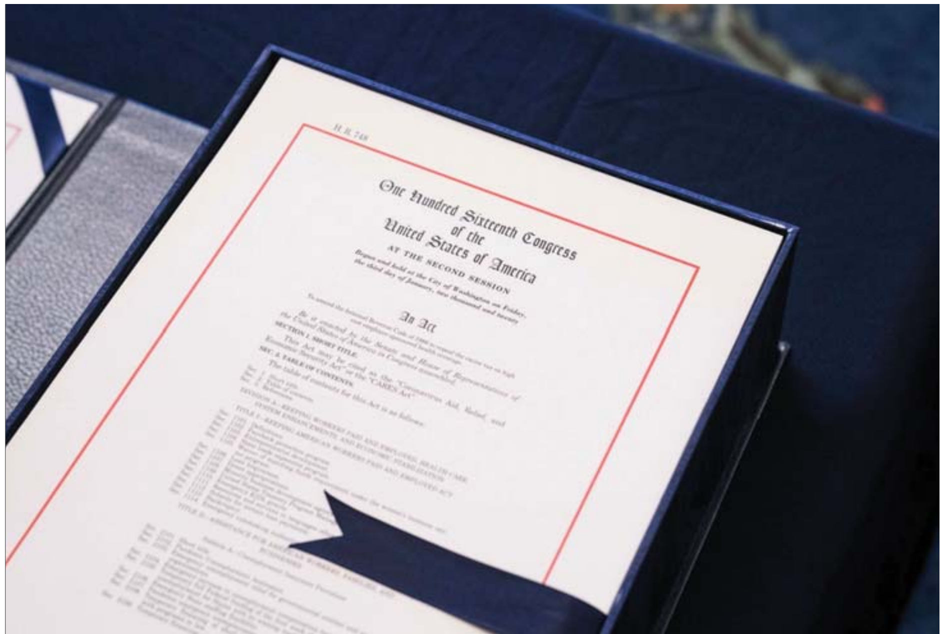
The question about asset types seemed to be answered with some certainty, in part because the initial case examples provided some ideas. The different types seem to also generally fall into specific categories that include physical assets, the dedication of a future revenue stream, and a combination of the two where there is a transfer of a physical asset that provides a revenue stream. Initial discussions among committee members led to some consensus that the type of asset could certainly drive the discussion about the remaining categories of questions.

Committee members have had robust discussions while trying to answer the questions raised by the other two types of questions, which has led to more unanswered questions. For one, it is unclear that governments (other than large, sophisticated entities) have the existing expertise to carry out such a transaction for either a pension plan or government looking to transfer an asset. And regardless of the expertise available, would the entities involved potentially be at odds when it comes to the valuation of the asset? The entities may agree or disagree on obtaining an independent valuation of the asset, for example. And what capacity and expertise would be needed to manage the asset? If it weren't managed internally, what would the costs and risks be if a third party were used to manage the asset? Each question leads to another, and entities would likely have different answers.

Conclusions

The committee held a virtual meeting in lieu of its annual meeting in May to provide an opportunity for members to provide feedback to and hear back from some of the work groups. CORBA still plans to forge ahead with the work groups and potentially have some guidance ready in time for the September GFOA Executive Board meeting. In the months ahead, committee members will continue to engage each other virtually to share observations or experiences as we continue to monitor the economic impact of current public health crises.

***Emily Swenson Brock** is the director of GFOA's Federal Liaison Center.*



SARAH SILBIGER/BLOOMBERG VIA GETTY IMAGES

A copy of H.R. 748, Coronavirus Aid, Relief, and Economic Security (CARES) Act, sits on a table before a signing ceremony at the U.S. Capitol in Washington, D.C., on March 27, 2020.

FEDERAL UPDATE

COVID-19 Stimulus Efforts and Resources

BY EMILY SWENSON BROCK

COVID-19 has put states, local governments, and numerous state and local authorities on the front lines of our emergency response efforts, be they health care, public safety, or ensuring that vital utilities remain online. GFOA remains committed to working with Congress and the Trump administration to develop and implement solutions that address the widespread impact of this unprecedented public health and economic crisis. We encourage our members to do the same.

CONGRESSIONAL STIMULUS EFFORTS IN MARCH 2020

The Families First Coronavirus Relief Act. The Families First Coronavirus Relief Act (FFCRA), drafted in the House of Representatives and signed into law on March 18, expands employer requirements for Family and Medical Leave Act leave and emergency paid sick leave due to the coronavirus pandemic. It also provides a refundable tax credit to certain employers that provide this extended benefit. The tax credit is intended to offset the increased costs of expanded requirements included in the FFCRA.

Unfortunately, under the FFCRA, only private-sector employers are eligible for the payroll tax credit; public-sector employers are specifically prohibited from receiving it. GFOA and other public-sector organizations expressed opposition to the provision and have been advocating for Congress to address this problem in any subsequent relief legislation. Given the uncertain timing of a fourth coronavirus relief package, state and local groups welcomed bipartisan and bicameral efforts to introduce stand-alone legislation that would repeal the language in the FFCRA and make public employers eligible for the credit.

This exclusion amounts to an unfunded mandate at a time when state and local governments are already facing fiscal challenges from their coronavirus pandemic response efforts. GFOA urges members to reach out to their senators and representatives and ask them to support the effort to restore parity between public- and private-sector employers by co-sponsoring this legislation.

The Coronavirus Aid, Relief, and Economic Security Act. The Senate acted swiftly to enact the $2.3 trillion Coronavirus Aid, Relief, and Economic Security Act (CARES) on March 27. The provisions include the following:

- A $454 billion Economic Stabilization Fund that permits the U.S. Treasury to "purchase obligations (of states, local governments, instrumentalities, and their political subdivisions) or other interests in secondary markets or otherwise," thus permitting the Federal Reserve to participate as an institutional investor in securities that mature in more than six months. This fund also provides loans and loan guarantees to small businesses.
- $150 billion in direct aid specifically for COVID-19-related expenses incurred by states, tribal governments, territories, and local governments with populations of more than 500,000. There is no direct language on aid to local governments with smaller populations. The inspector general of the Treasury is charged with conducting oversight of receipt and distribution.
- $130 billion in grants to healthcare providers to provide reimbursements and to supplement lost revenue for hospitals.
- $30.9 billion to help schools respond to coronavirus-related school closures, including $13.5 billion for elementary and secondary education formula funding directly to states. Higher education would receive $14.3 billion.

Direct funding for the frontline expenses and for the health and sustainability of our financial and capital markets remains our paramount concern.

- $45 billion for the Federal Emergency Management Agency. The funds are intended to help state and local efforts, including medical response and purchasing protective equipment. The breakdown includes: $200 million for shelter, food and services; $100 million in grants to firefighters for protective equipment, supplies, and reimbursements; and $100 million for enhanced sanitation at airport security checkpoints and other airport costs.
- $100 million for correctional officer overtime, personal protective equipment and supplies, and inmate medical care and supplies. Another $850 million is designated for state and local law enforcement and jails through a grant program.
- $25 billion for transit providers through Federal Transit Administration (FTA) Transit Infrastructure Grants to states and local governments across the country for operating and capital expenses. Funding will be distributed using existing FTA formulas.
- $10 billion to maintain operations at our nation's airports, which are facing a record drop in passengers. Airport Improvement Program funds will be distributed by formula according to the Federal Aviation Administration.

While the aid enacted so far in FFCRA and the CARES Act provides much-needed support for the public sector in responding to this crisis, it should be viewed as a beginning and not an end. State and local governments will experience continuing difficulties and lingering effects that could last well into next year and beyond.

Direct funding for the frontline expenses and for the health and sustainability of our financial and capital markets remains our paramount concern. The nation relies on municipal bonds because they can be used to immediately finance critical projects that support our nation's infrastructure needs and enable state and local governments to manage their budgetary issues while protecting the economy during this crisis.

THE NEXT RESPONSE PACKAGE

Additional direct funding. As a fourth response package for the COVID-19 crisis is considered, we are urging Congress to provide additional direct funding, in particular to local governments of all sizes, that will give governments maximum flexibility to be nimble

CAROLINE BREHMAN/CQ-ROLL CALL, INC VIA GETTY IMAGES

House Speaker Nancy Pelosi of California signs the bill for the Coronavirus Aid, Relief, a nd Economic Security (CARES) Act, after it passed in the House in Washington on Friday, March 27, 2020.

in their responses to this quickly changing landscape.

A recent GFOA survey found that states and local governments expect to experience dramatic constraints on budgets in waves because of increased COVID-19 expenditures. Several sources of local government tax revenues, like sales tax and hospitality taxes, will be completely lost because of stay-at-home orders. There is no one single revenue stream that every state and local government relies on. Delayed receipt of vital revenues from income and property taxes resulting from delayed tax filing deadlines compounds this challenge. It is crucial that state and local governments be eligible to use additional funding for lost revenues.

Enhancing and modernizing the muni market. GFOA is also urging Congress to include provisions to enhance and modernize the municipal bond market. Doing so would strengthen municipal bonds, a proven, efficient, and low-cost financing tool used to manage budgets and to fund critical infrastructure investments.

Provisions of this kind would free up scarce resources for states and localities while also stimulating investments needed to keep our economy growing. A number of legislative provisions enacted during previous crises have demonstrated their effectiveness. As for the immediate need, GFOA asked that the next response package include the following:

- **Restore advance refunding of tax-exempt bonds (H.R. 2772).** Restoring the ability of governments and other qualifying entities to advance-refund tax-exempt municipal bonds would free up billions of dollars that governments and nonprofits could spend on other projects. Responding to a pandemic requires strengthening the infrastructure network that underpins communities and institutions. GFOA is asking Congress to restore advance refunding, which would provide immediate debt service savings and near-term debt relief for taxpayers, which can be put to public works and safety purposes. This would be immensely helpful for planning and budgeting purposes for public organizations like hospitals, which are first-line responders during this crisis.
- **Increase access to capital for small borrowers (H.R. 3967).** Increasing the bank borrowing limit from $10 million to $30 million and having it apply at the borrower level would allow thousands of small local governments and nonprofit hospitals and healthcare systems to access low-cost capital for immediate project needs.
- **Restore and expand the use of direct-pay bonds.** Restoring and expanding the use of direct-pay bonds, and ending their exposure to sequestration, would immediately create an attractive investment option globally while funding thousands of state and local projects, especially while the municipal bond market is recovering from the initial effects of the pandemic.

Other measures that will provide greater liquidity and help relieve pressure on budgets and working capital challenges include the following:

- Pass legislation directing the Treasury to permit tax-exempt, long-term cash flow borrowing, with sizing based on potential deficits (rather than having to demonstrate actual deficits of a certain size) and clearly permitting pandemic expenses under the extraordinary working capital exception of Treasury Regulation Section 1.148-6(d)(3)(ii)(B). This relief would address severe cash flow difficulties and uncertain revenue streams. It should also mean no retesting for deficit financings for at least 10.5 years after issuance, to help states and local governments handle unanticipated and difficult-to-predict cash flow issues.

- Reinstate a stable net asset value to money market mutual funds (H.R. 4492). This legislation will provide significant relief to state and local governments that depend on the municipal debt markets to finance the facilities, resources, and infrastructure needed to protect our citizens from the pandemic by encouraging greater investment in money market mutual funds.

GFOA urges more expediency and clarification on several of the provisions regarding the Federal Reserve that have already been enacted into law in the previous relief packages.

The stability of our $3.8 trillion municipal bond market is crucial during this crisis, as state and local governments and the municipal bond market provide critical support for the infrastructure needed to care for and support our citizens.

GFOA appreciates the Federal Reserve's actions, with the Treasury's support, to intermediate in the short-term municipal market and to provide needed cash flow support to states and municipalities—which are facing tax collection delays and strains on revenue sources—through the Municipal Liquidity Fund (see the Debt Committee's response to the Municipal Liquidity Fund term sheet1). These needed actions support an important but relatively small component (approximately five percent) of the current market. To further support the needs of state and local governments, the Federal Reserve needs to create a facility or facilities to purchase medium- and long-term municipal securities that are publicly issued in the secondary market and directly from issuers. Congress could further weigh in to ensure that smaller governments and utilities and other political subdivisions will have access to funds from the facility.

Section 4003 of the CARES Act also states that the Federal Reserve may purchase bonds in the secondary market. GFOA urges Congress to call on the Federal Reserve to make these purchases, which will help reinvigorate the municipal bond market and provide access to capital for all municipal issuers. By doing so, the Federal Reserve will help banks shed some of their holdings, freeing up their capacity to underwrite and purchase new municipal securities issuances.

A critical component of getting through this crisis lies in federal, state, and local governments working together in partnership.

GFOA has also urged Congress to restore parity between private- and public-sector employers, as far as eligibility for tax credits to alleviate the costs of emergency paid leave provisions included in the FFCRA. State and local governments collectively employ millions of individuals, many of whom are responsible for providing the services that are now in high demand. GFOA was immediately concerned with, and opposed to, prohibiting public employers from eligibility for the tax credits, as detailed in Sections 7001(e)(4) and 7003(e)(4) of the FFCRA. Another finding from the GFOA survey noted earlier is that a majority of respondents identified staff overtime and staff sick leave as unanticipated expenses that could be particularly high in the near term because of the pandemic. This new requirement is a large expense and an unfunded mandate imposed at a time when state and local governments are already strained because of reduced tax revenues.

CONCLUSIONS

While the full impact of the COVID-19 pandemic on the economy is uncertain, we know that a critical component of getting through this crisis lies in federal, state, and local governments working together in partnership.

GFOA also thanks our members for their outreach, which helped to make the CARES Act a reality. Stimulus efforts probably are not over, and we are ready to help advance additional relief packages to address the pandemic's widespread effects. As your advocate in Washington, D.C., we are always happy to provide you with the resources you need to make this critical outreach.

***Emily Swenson Brock** is the director of GFOA's Federal Liaison Center.*

[1] "Federal Reserve Board announces an expansion of the scope and duration of the Municipal Liquidity Facility," the Federal Reserve, April 27, 2020.