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Fed boosts its credit supports to "11", with the help of the Treasury

- **The Fed took a number of substantial measures today to bolster the flow of credit to the business sector and to state and local governments. Among other things, today's actions expand the list of assets it will purchase under various programs to include munis, corporate bond ETFs (both investment grade and high yield). It also expanded the list of securities that can be pledged under TALF to include commercial MBS and collateralized loan obligations (CLOs).**
- **Today's actions create a $500bn Municipal Liquidity Facility to help manage cash flow stresses for state and local governments; new liquidity facilities that will purchase loans originated by financial institutions under the Small Business Administration's Paycheck Protection and Main Street Lending programs; and measures to expand the scope and size of the PMCCF, SMCCF and TALF programs.**
- **Today's measures come on top of the unprecedented measures that the Fed has taken in recent weeks to improve market functioning and to fulfill its role as lender of last resort. Taken together, these additional measures could facilitate up to $2.3trn in lending for the US economy, all targeted at sectors with acute funding needs. The Fed's lending would expand its balance sheet by a similar magnitude.**
- **These programs make generous use of the Section 13(3) authority under the Federal Reserve Act (which requires "unusual and exigent circumstances"). Almost all the programs were established with the approval of the Treasury Secretary, and leverage funding provided under the CARES Act passed in late March.**

Once again, the Fed's has acted forcefully to fulfill its role as lender of last resort for the US economy, stepping in with additional facilities targeted toward sectors of the US economy that are experiencing exceptionally strong credit demand, including main street businesses, the corporate sector, and state and local governments. Most of these facilities will be operated as special purpose vehicles (SPVs) funded with equity provided under the $2.2trn CARES Act that was passed in late March. The measures are broadly in line with many of the wide-ranging additional steps we had envisioned in *Thinking Macro: New crisis, new solutions: Liquidity support is not enough*.

Financing of PPP Loans originated by banks: Following through on its promise from earlier this week, the Fed finally provided details about how it will be supporting the lending programs of the Small Business Administration (SBA) established under the CARES Act. The first of these measures will be support the Paycheck Protection Program (PPP) by creating a new PPP Liquidity Facility (PPPLF) that will extend non-recourse loans to all institutions that originate qualifying loans to small businesses, taking the government-guaranteed PPP loans as collateral. Funding will be provided at a rate of 35bp, and will be available until September 30, 2020, unless otherwise extended. With the pace of loan issuance under the PPP currently at a trickle, the hope is that the Fed's support will help open the lending spigot at banks, which could slow the aggressive pace of layoffs seen in recent weeks.

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Purchasing loans originated under the Main Street Lending Program: The Fed will also help fund up to $600bn in loans to small and medium-sized business originated under the SBA’s Main Street Lending Program. To operate the program, the Fed will create two new facilities that will lend to a single SPV backstopped by a $75bn equity investment from the Treasury: The Main Street New Loan Facility (MSNLF) and the Main Street Expanded Loan Facility. Both will purchase a participating interest in qualifying loans originated by eligible lenders (insured depository institutions, US bank holding companies, and US savings and loan institutions), with lenders retaining a 5% stake. These loans are restricted to businesses with no more than 10,000 employees or up to $2.5bn in 2019 revenue. Among other requirements, eligible loans must be unsecured with a term of four years, issued after April 8, with interest and amortization deferred for one year, and have no prepayment penalty.

Funding help for state and local governments: With fallout from the COVID-19 outbreak putting substantial stresses on revenues and expenditures of state and local governments, the Fed stepped in today with a new facility to help fund the shortfall on favourable terms. A new Municipal Liquidity Facility has been created that will offer up to $500bn in lending, on a recourse basis, to states, counties with more than two million residents, and municipalities with at least one million residents. However, only one issuer is eligible per state, city, or county. State issuers can direct funding to smaller governmental entities. The facility will also be operated as a SPV, with a backstop of $35bn in equity from the Treasury funded using the CARES Act. The list of securities eligible for purchase is limited to notes that mature within 24 months of issuance, including tax anticipation notes, tax and revenue anticipation notes, and bond anticipation notes. Although eligible issuers are restricted to aggregate funding of no more than 20% of its revenue (both own account and from utilities) in the 2017 fiscal year, states may request additional funding to allocate to political subdivisions that are not directly eligible for the facility. Pricing will be based on the issuer’s credit rating at the time of purchase, plus a 10bp origination fee, with notes callable by the issuer at par. The facility is currently scheduled to cease its purchases by September 30, 2020.

Expansion of the TALF: The Term Asset Backed Lending Facility (TALF) introduced two weeks ago is designed to provide liquidity to the ABS market. In this program, all US companies holding newly issued ABS will be able to borrow money from the Fed on a non-recourse basis for up to 3y. Loans can be prepaid. As with the other Fed programs, the TALF will have an equity investment provided by the Treasury from money funded by the CARES Act. Although the Fed restricted the size of the program to $100bn as announced earlier, it has expanded the program to include legacy commercial mortgage backed securities and CLOs. All other ABS in the program must be newly issued after March 23, 2020. The TALF will charge a 10bp administration fee and loan rates will be based on the weighted average life of the assets underlying the security. In an effort to stimulate small business lending, the program will accept SBA pool certificates and development company participation certificates – at lower rates than the general ABS collateral.

More details about existing corporate credit facilities: The Fed has added more detail about its previously established Primary and Secondary Corporate Credit Facilities (PMCCF and SMCCF). It has defined the potential program size – $750bn ($500bn in the PMCCF and $250bn in the SMCCF). The PMCCF will still buy investment grade corporate debt from issuers; however, like the CPFF, it will purchase debt that was downgraded (to BB-) after March 22. Similarly, the program includes syndicated loans. Maturities are limited to 4y or shorter. Purchases will be limited to 25% of an issue. Issuers are limited to 130% of the maximum debt they had outstanding between March 22, 2019, and March 22, 2020. Interestingly, this appears to apply across all tenors of a borrower’s outstanding debt, not just what it had maturing within 4y. This expands the ability of issuers to roll over any maturing debt they have coming due between now and the end of September into the Fed’s program. The SMCCF will buy investment grade corporate bonds in the secondary market.

When the program was announced two weeks ago it included shares in investment grade corporate bond ETFs. Today, it expanded these purchases to include high yield ETFs. These and the secondary market corporate bond purchases will be at market prices.

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