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**Municipal Bonds**

**Sunsetting the Municipal Liquidity Facility may be negative for muni market**

**Boston** - The US Treasury has communicated that the Municipal Liquidity Facility (MLF) will not be extended beyond December 31, 2020. Let's look at the impact of this announcement on the municipal bond market.

**Volatile market calmed despite limited use**

Created as part of the Coronavirus Aid, Relief, and Economic Security (CARES) Act passed in late March 2020, the MLF was intended to provide \$500 billion in lending capacity to certain cities, states, counties and revenue bond issuers. We believe the presence of the MLF helped to calm the volatile muni market during the COVID-driven downturn in early 2020.

To date, we have observed little impact on the municipal market from the announced termination of the MLF at the end of this year. One reason is that the MLF has barely been used thus far, and we expect it was unlikely to be used significantly in 2021. In fact, since its inception, only two municipal issuers have tapped the MLF:

1. State of Illinois drew down \$1.2 billion from the MLF in June 2020 (and is expected to draw down an additional \$2 billion before the MLF expires at year-end)
2. Metropolitan Transportation Agency of New York (MTA) drew down \$450 million in August 2020 (and is expected to draw down an additional \$2.9 billion before the MLF expires at year-end)

The \$1.65 billion that has been borrowed through the MLF equates to just over 3% of the MLF's \$500 billion capacity.

**Muni market functioning well**

Another reason for the limited impact is that the municipal market is currently functioning very well, as technicals remain positive. Fund flows into the muni market have totaled \$31 billion year to date in 2020, which has helped to offset the robust bond issuance of \$414 billion through October — a 23% increase from 2019.

To cite one recent example of the market's health, consider the successful pricing of \$3.7 billion in bonds by the State of New Jersey. Just one month ago, this state was exploring tapping the MLF for deficit financing, but instead was able to issue bonds at a true interest cost below 1.95%, as the bond deal was significantly oversubscribed and traded up substantially in the secondary market.

**Muni credit proving resilient but MLF still useful**

Finally, municipal credit has proved to be resilient in 2020. In the spring of 2020,



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many forecasts estimated that state revenues could decline by 15% to 20% through fiscal year 2022. However, on a year-to-date basis through September, state revenues have declined just 1% compared to 2019. State revenues are highly correlated with GDP, and therefore could fall as the economy continues to grapple with COVID-related stresses.

The strength in tax receipts year to date in 2020 has been positive for state credit and the municipal market overall. Nevertheless, we believe that sunseting the MLF may be negative for muni bonds, as it had provided a backstop for stressed issuer, and helped heal the market from bouts of illiquidity this past spring.

**Bottom line:** While the MLF may not be needed in today's strong market, its absence could accelerate a future sell-off stemming from a mutual fund outflow cycle or a headline-grabbing municipal default. The Biden administration could just re-instate the programs, but funding would need to be approved by a divided Congress, which has proven to be no easy task.

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