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Solutions to Governmental Unit Revenue Shortfalls

In the wake of COVID-19, many local governments find themselves facing unanticipated and potential revenue shortfalls due to business interruptions and postponed tax filing deadlines. To assist in addressing these shortfalls, this notice provides a high-level summary of several common tools available to local governments to address temporary cash flow issues as well as other revenue and expense matters. Some of the options discussed herein may not be available in every state or jurisdiction, and some states or jurisdictions may have additional tools available for local governments that are not included in this notice. The purpose of this notice is simply to serve as a resource for local government officials when discussing possible courses of action internally and with legal counsel and other advisors. The following topics will be discussed herein:

- [The Federal Reserve Municipal Liquidity Facility](#)
- [The CARES Act Coronavirus Relief Fund](#)
- [Traditional Bank Financing](#)
- [Tax Anticipation Notes \(TANs\) and Revenue Anticipation Notes \(RANs\)](#)
- [Refunding Outstanding Obligations](#)
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The Municipal Liquidity Facility

On April 9, 2020, in response to the COVID-19 pandemic, the Federal Reserve announced a Municipal Liquidity Facility to provide up to \$500 billion in loans to states, cities of greater than one million residents, and counties of greater than two million residents

to allow those states, cities and counties to purchase short-term notes from local governments to address cash flow troubles. On April 27, 2020, the Federal Reserve expanded the facility to cities of greater than 250,000 residents and counties of greater than 500,000 residents. The Federal Reserve has also stated its intention to provide further support, if necessary, to support local governments through the pandemic.

The Coronavirus Relief Fund

Under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, Congress established a Coronavirus Relief Fund (the “Fund”) of \$150 billion to provide payments for specified uses to state and certain local governments. Payments from the Fund may only be used to cover costs of the state and local government that are necessary expenditures incurred due to the public health emergency with respect to COVID-19 and not accounted for in the state or local government’s most recently approved budget as of March 27, 2020. Costs that are incurred “due to” COVID-19 include expenditures to allow the state or local government to respond directly to the emergency, such as by addressing medical or public health needs, as well as expenditures incurred to support those suffering from employment or business interruptions.^[1] However, funds may not be used to fill shortfalls in government revenue to cover expenditures that would not otherwise qualify under the Act.

Traditional Bank Financing

Some jurisdictions permit local governments to utilize traditional bank financing in the form of loans or lines of credit. Depending on the jurisdiction, the local government may be limited as to what the loan may be used to cover (e.g. working capital vs. debt service or lease rental payments) or the amount or term of the loan. Local governments with existing loans or lines of credit may also be able to renegotiate or refinance existing loans or credit lines, subject to applicable local government finance laws. However, any local government considering incurring or modifying any existing

traditional bank financing should be sure to understand the impact that may have on its outstanding debt obligations.

Tax Anticipation Notes (TANs) and Revenue Anticipation Notes (RANs)

TANs and RANs are short-term debt instruments used to cover current expenses and are pledged against tax or other revenues to be collected in less than a year. While they are typically used to account for routine revenue and expense timing issues, TANs and RANs may be an appropriate measure for local governments facing temporary shortfalls due to postponed income or property tax filing deadlines from COVID-19. Generally, TANs and RANs may not be issued in excess of the anticipated current deficit plus a reserve, so local governments facing longer-term cash flow difficulties may need to look towards some of the other options in this notice in conjunction with or as an alternative to TANs or RANs. Some state agencies may provide pooled financing opportunities related to TANS, RANS, or tax warrants, for local governments as well.

Refunding Outstanding Obligations

Local governments often refund outstanding tax-exempt and taxable obligations to extend maturity dates of obligations coming due or to take advantage of decreases in available interest rates to provide incremental future savings on debt service. Since the passing of the Tax Cuts and Jobs Act of 2017, tax-exempt “advance” refundings—i.e. refundings more than 90 days in advance of maturity or redemption—are no longer permitted, but taxable advance refundings are still allowed. Also, taxable refundings can later be refunded by tax-exempt bonds, and some taxable refundings can convert to tax-exempt status without having to issue new bonds. The public finance market has seen some recent volatility, but some refundings may still generate a savings to the local government.

Long-Term Working Capital Cash Flow Deficit Financing

Generally, proceeds of an issue can only be allocated to working capital expenditures, depending upon applicable law, when there are no other “available amounts” (i.e. the issuer is facing a working capital deficit). There is an exception to this rule for “extraordinary, nonrecurring items that are not customarily payable from current revenues, such as casualty losses or amounts in excess of reasonable insurance coverage.”^[2] Some issuers have posited that expenditures arising specifically from COVID-19 could qualify under this exception. However, if a local government has previously set aside funds to address this type of emergency, they may be required to expend those funds first before allocating any bond proceeds.

Drawing Cash Reserves

Local governments are typically required to have cash reserves equal or greater than the maximum annual debt service on the underlying obligations, however, some bond documents allow for a standing credit facility or similar evidence of liquidity in place of cash reserves, such as a debt service reserve surety. Depending on the terms in the bond documents, the local government may be able to substitute such an alternative reserve and draw on the cash reserves to pay for expenses consistent with the purposes of the issue. However, some surety providers have increased requirements and restrictions on policies or limited the policies on which they are offering.

Sales of Local Government-Owned Property

If a local government owns unused or underutilized property, it may be able to sell, lease, or sell and lease back such property to another public or private entity to provide a one-time cash infusion or

ongoing future cash flow.

Securitizing Intangible Assets

Most local governments own cash producing intangible assets such as delinquent taxes, fines, traffic tickets, and grants; or receive TIF, assessment or special charge revenue streams. Some governments may be able to borrow against the present value of these assets or sell such intangible assets to provide liquidity to meet current expenses and obligations. Care should be taken to check if the assets to be securitized are pledged to other debt or are otherwise subject to restrictions or prohibitions on the pledge thereof.

The methods discussed in this notice are by no means an exhaustive list of the tools or options available to local governments. At the same time, not every method discussed in this notice is applicable, available, or appropriate for every local government. As federal, state, and local governments continue to address the COVID-19 pandemic, further liquidity options may become available to local governments to address cash flow difficulties. All issuers, regardless of whether they currently face cash shortfalls, should have plans in place to respond quickly to further unanticipated budgetary needs resulting from COVID-19.

For more information on the potential effects of the COVID-19 pandemic on governmental unit's finances, [click here](#).

For more information, contact [Michael Brockman](#), David Rogers, [Amy Condaras](#), [Beau Zoeller](#), [Scott Krapf](#), [Stephen Sparks](#), or any attorney in Frost Brown Todd's [Public Finance](#) Practice Group

To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a [Coronavirus Response Team](#). Our attorneys are on hand to answer your questions and provide guidance on how to proactively prepare for and manage any coronavirus-related threats to your business operations and workforce.

[1] The Treasury Department has provided an expanded list of permissible expenses from the Fund at <https://home.treasury.gov/system/files/136/Coronavirus-Relief->

[Fund-Guidance-for-State-Territorial-Local-and-Tribal-Governments.pdf](#)

[2] Treasury Regulation 1.148-6(d)(3)(ii)(B).

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