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Testifying on Behalf of
The United States Conference of Mayors

Before the
United States House of Representatives
Financial Service Committee

Hearing on

Legislative Proposals to Improve the Efficiency and Oversight of Municipal Finance

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Mr. Chairman first let me thank you, Ranking Member Bachus and all of the members of this distinguished committee for holding this hearing to focus national attention on one of the most critical problems facing the nation's cities. I am Tom Leppert, Mayor of Dallas and Chairman of the U.S. Conference of Mayors Metro Economies Committee, which monitors tax and finance issues and recommends policy on legislative and regulatory proposals that affect local governments. Today I am pleased to appear on behalf of the nation's mayors to offer comments on pending legislation that has been introduced to assist state and local governments gain better access to the credit market.

Before I get started, I want to commend you Mr. Chairman for the leadership you have demonstrated in responding to the problems municipalities are experiencing in accessing the credit market. We appreciate you coming to speak to Mayors about the impact of the economic crisis on cities earlier this year at our winter meeting and thank you for introducing legislation, which you discussed with us, that would address some of the concerns we raised then about the municipal bond crisis and the capacity of local governments to secure needed financing.

<u>Impact of the Economic Crisis on Local Access to the Credit Market</u>

For more than a year, state and local governments have suffered from the global economic credit crisis. According to BNY Mellon Asset Management, 2009 municipal bond issues are expected to decrease 12 percent, or $48 billion, a decrease comparable to eliminating all federal highway and transit spending for one year. Our citizens and taxpayers are the ones who have suffered the consequences. Many capital improvement projects across the nation – both large and small - have been halted due to the lack of affordable access to the market and the inability of states and local governments to issue bonds. At a time when communities are confronting decreased revenue and growing unemployment, local governments have increasingly been unable to access the capital markets due to prohibitive borrowing costs. Local government actions are not to blame for this credit crunch, which has arisen solely as a result of the global financial crisis.

This has a significant impact on our economy at a time we need to create jobs and economic activity, this lack of liquidity is holding back key projects that could have an enormous impact on our local and national economy. Indeed, opening up the municipal bond market could be a major stimulus to the economy. This would have the additional advantage of creating a significant economic stimulus without a Federal outlay of funds. By increasing the support of the municipal bond markets, we will see many projects move forward, creating thousands of jobs.

In Dallas, we have several major projects we would move forward with if the municipal markets return to a more “normal state.” Cities and States across the country are in the same position. We have also put several public works projects on hold until the bond market conditions improve. These include the substantial water and sewer infrastructure construction and improvements to Love Field that are mandated by law. We would like to proceed with these projects in order to put people back to work locally and take advantage of reduced construction costs. These are just a few of the many projects on hold in Dallas and many other cities across our nation waiting on market conditions to improve.

While we sincerely appreciate all the help from Congress and the Administration to create jobs, the legislation you have introduced will improve state and local access to capital markets and help us create far more jobs much more quickly as capital improvement projects that are currently on hold receive financing at reasonable interest rates. Indeed, your legislation would allow local governments with strong ratings to move forward and leverage the significant infrastructure assistance provided earlier this year by the American Recovery and Reinvestment Act. Other issuers, especially small issuers who may not have a credit rating or whose credit rating is low (BBB or A) would also benefit. They have been unable to obtain the bond insurance or credit enhancement they need to secure investors for their debt and issue bonds at affordable interest rates.

There are also other issuers who frequent the variable rate market for short-term debt purposes. That market all but shut down last year and has been slow to recover, leaving many governments, especially larger ones, without access to finance tools that they have depended on for years. Adding insult to injury, many governments that issue short-term, variable-rate debt secure that debt with a letter of credit (LOC) or a liquidity facility to help attract investors to these products. The number of LOC's and standby purchase agreement providers has decreased, and those providing those services are charging much higher premiums. Municipal Market Advisors estimate that liquidity premiums have grown by 10 times the magnitude from 2008 to 2009, which is a price level that has not been part of this market in recent history.

. That is why the four legislative proposals being discussed today are so vital to repairing our market and helping governments improve their communities by building and repairing schools, firehouses, highways and water systems. It is also worth mentioning that unlike the federal government, local governments do not have the luxury of carrying a deficit. By law, they are required to balance their budget every year. For many, the only way to provide vital infrastructure is through the issuance of bonds, which has been a viable way of financing critical infrastructure projects for more than 100 years.

According to Thomas Doe, CEO of MMA Advisors, with fixed-rate yields having risen to extraordinary heights, many state and local issuers chose to table the majority of their planned primary market loans, waiting for conditions to improve. Smaller, lower-rated, and riskier credit issuers may have, at least temporarily, been unable to access capital. But large states and cities were always able to raise money. Their decisions were based on price. MMA estimates that, in 2008, more than $100 billion of planned new-money infrastructure projects were delayed, the majority of that occurred in the fourth quarter.

I am certain that the market experts in the next panel will elaborate more on these numbers, and there is no denying the fact that this market stands to greatly benefit from the legislation that you have introduced. Now that I have provided a brief overview of some of the key problems local governments are facing, I'd like to discuss very briefly each of the pending proposals and how we think they would address those problems.

The Municipal Bond Fairness Act (Global Ratings)

The Municipal Bond Fairness Act would require credit rating agencies to rate municipal securities on the same scale as corporate securities and take into account default statistics and the ability to repay debts, which we expect would give investors a more accurate portrayal of the low risk of municipal securities compared to their corporate counterparts. Mr. Chairman, this is a change that's long over due. We believe this will better ensure equality in the rating system and will spur increased investment in municipal bonds. Ensuring that rating agencies use uniform and accurate credit ratings for all securities will lower borrowing costs and make it easier for new investors to participate in the municipal securities market. The Conference of Mayors fully supports this legislation, as we have in the past.

Under the current system, the three major credit ratings agencies operate two separate but incomparable ratings systems – one for corporate securities and one for municipal securities. Although municipal issuers have shown historical default rates that are a fraction of similarly or more highly-rated corporate bonds, the ratings on municipal bonds remain widely dispersed across the investment grade municipal scale.

Traditionally, issuers have been forced to rely on bond insurers (who were rated AAA on the corporate rating scale) to satisfy both investor regulatory requirements and a growing demand on the part of both institutional buyers and unsophisticated retail investors, who may not understand the difference between rating scales. This set of double standards has hurt issuers, who may have paid unnecessary fees for bond insurance premiums, and it adds to the hardships that issuers face in the current marketplace.

The double standard also has caused state and local governments to pay for unnecessary bond insurance and/or have more debt issuance costs than similarly rated corporate bond issuers. For example, according to an April 21 Bloomberg News story, the AAA-rated University of

Virginia paid more when issuing $250 million for 30 year taxable Build America Bonds than a company that issued taxable bonds on the same day, yet rated five levels lower - 6.22 percent for UVA versus 6.125 percent for the corporation. This is a recent apples-to apples comparison of the higher costs state and local governments have had to endure over the years due to the inability of the rating agencies to fairly and equally rate debt issuers of all types so that investors can know the true risks associated with various securities. The creation of an equitable credit rating system would help issuers and investors alike.

Governmental bonds, either pledged with the full faith and credit of the government or governmental revenue bonds, have a nearly zero rate of default as shown in the chart below. This should be better reflected in the ratings of governmental issuers. Your bill would also assure consistent debt ratings among local governments and improve the transparency of the rating process. These actions can only strengthen public finance.

Rating Categories	Cumulative Historic Default Rates			
	Moody's		S&P	
	Munis	Corps	Munis	Corps
Aaa/AAA	0.00%	0.52%	0.00%	0.60%
Aa/AA	0.06%	0.52%	0.00%	1.50%
A/A	0.03%	1.29%	0.23%	2.91%
Baa/BBB	0.13%	4.64%	0.32%	10.29%
Ba/BB	2.65%	19.12%	1.74%	29.93%
B/B	11.86%	43.34%	8.48%	53.72%
Caa-C/CCC-C	16.58%	69.18%	44.81%	69.19%
Investment Grade	0.07%	2.09%	0.20%	4.14%
Non-Invest Grade	4.29%	31.37%	7.37%	42.35%
All	0.10%	9.70%	0.29%	12.98%

Source: Moody's and S&P

Moody's: Average cumulative 10-Year default rate between 1970-2006

S&P Municipals: Average cumulative 19-year default rate between 1986-2006

S&P Corporates: Average cumulative 15-year default rate between 1981-2005

Source: MMA Advisors

Municipal Bond Insurance Enhancement Act (Reinsurance)

There is no question Mr. Chairman, we believe the Municipal Bond Insurance Enhancement Act would help increase the capacity of municipal bond insurers to insure new risks and thereby make it easier for issuers, particularly small issuers, to borrow in the capital markets. Again, the Conference of Mayors fully supports this proposal. While many governments could be aided by an improved bond rating system, some governments, especially smaller ones, still need bond insurance. As has been frequently cited, nearly half of all municipal credits were insured until 2006. Often the issuer chose to obtain bond insurance in order to receive an AAA rating on the issuance, which lowered interest rate costs for the bonds at a savings greater than the cost of insurance.

This system has caused confusion for investors. When a bond insurer is downgraded, the issuance itself is downgraded. Even though the state and local government credits themselves are not downgraded when this happens, the issuer is required to file a material event. This is an example how the bad practices of the private sector hurt state and local governments.

The following examples illustrate the problems brought on by downgrades of bond insurers.

Example 1: Small issuers cannot afford to issue debt

A large state pool issues debt for plain vanilla fixed-rate debt for mainly local governments. Currently, there is a list of about 10 to12 or more small issuers that need to issue debt that cannot due to lack of credit enhancement. Their projects, mostly infrastructure, are on hold. The size of these issues ranges from about $3 million to $20 million. They cannot issue debt without credit enhancement as they are below AA ratings, and there is neither a viable nor affordable bond insurer option. A federal guarantee, subsidy or reinsurance as provided in the pending legislation, would be greatly beneficial to the municipal market, specifically for smaller issuers. The problem within the small issuer fixed rate market has not been as widely known as the variable rate issues due to the size of the entities. The smaller issuer is not in the market as frequent and many have just put their projects on hold. However, these needs will become more demanding in the upcoming months.

Example 2: The Loss of Aaa Rated Bond Insurers Leaves a Hole in Issuing tax Increment Bonds

A city uses tax increment financing to provide funding for a wide-range of economic development and transportation infrastructure projects within the City. These projects create high-paying jobs both in the short run (construction) and the long run (infrastructure for business development). The ratings on the city's tax increment bonds tend to fall in the mid to lower "A" category. Bonds of this rating category have historically benefitted from bond insurance. In addition, the complex state property tax system through which tax increment revenues are generated requires investors to devote substantial time and energy to understanding the credit behind the bonds. The credit review and insurance qualification function performed by the bond insurers allowed investors to look through the complexities of the credit and to rely on the presumed financing strength of the insurer. For these reasons, the availability of affordable bond insurance has been a critical element in the city's ability to access the public debt markets for these types of bonds. In addition, the inability to obtain a debt service reserve surety policy from a bond insurer in lieu of a cash funded reserve has reduced the amount of bond proceeds that the city is able to direct toward job creating investments.

Municipal Bond Liquidity Enhancement Act (Liquidity Provider)

Issuers of short-term debt have been most acutely affected by the credit market crisis. Governments purchase letters of credit or secure a liquidity provider in order to achieve lower borrowing costs than would be possible if they offered securities through their own credit. However, they have faced a double whammy as the markets have frozen and most liquidity providers have either ceased to exist over the past six months or have stopped providing these services.

The short-term markets have been specifically hurt throughout the global credit crisis. Auction Rate Securities (ARS) have ceased to exist, yet many government issuers are still left holding ARS paper and are paying dearly for the evaporation of this market. Mr. Chairman the legislation you have introduced to create a federal liquidity facility for outstanding variable rate demand notes would greatly help this sector of the market. It would fill the vacuum created by the absence of private sector providers and provide the Treasury Department authority to purchase these notes so that issuers do not have to continue to pay enormous amounts every time these products must be remarketed, saving local governments a tremendous amount of money.

According to MMA, approximately $50 billion in municipal ARS and $10 billion to $30 billion in variable rate demand obligations lack consistent money market fund acceptance and there are billions of cash flow borrowing needs that would this legislation would assist. Issuers across the nation have told us they are experiencing difficulty obtaining letters of credit that were due in recent months. For example:

- A large transit authority recently noticed the number of liquidity providers has shriveled dramatically over the past year. In 2005 they received 18 bidders to provide liquidity for a double A credit, a sharp contrast to 2009 when they only received two bids.
- A large Midwestern city has locked into a liquidity facility for its variable rate debt through 2012, at an annual average of 20 or less basis points. The city is concerned about finding a replacement facility in 2012, or sooner if the current bank providing the facility is downgraded, as the costs could skyrocket to 75 basis points.
- Three cities in Connecticut illustrate the problems facing others in the nation. One city with an A/A3/A credit rating had an existing variable rate debt insured by Ambac. When the issue became bank bonds in 2008, the city needed to refinance and unwind the swap. The swap termination cost on the bonds was $7.2 million. The city received a three-year letter of credit for 55 basis points. Another city with a A/A3/A rating terminated a forward-starting swap at a cost of $450,000 in March due to its inability to obtain a letter of credit. The city solicited a $12 million letter of credit from 13 bank providers and received a single bid at 125 basis points annually with an additional 30 basis points due as an upfront fee. The bidder also requested other banking relationships as a part of the deal. As a result, the city was forced to issue fixed rate bonds when it would have been advantageous to keep swap in place and issue variable rate bonds. Another Connecticut city, with a BBB+/Baa1/BBB+ rating, attempted to obtain a letter of credit for a $100 million taxable pension obligation bond issue. The city received an initial bid of 85 basis points for a three-year commitment; however, the provider's national credit committee was unable to

approve the credit due to a desire to have a broader banking relationship. As a result, the city was unable to take the proceeds from a bond issuance to increase its pension liability funded ratio, which is a top rating concern by the rating agencies. The city currently needs a reasonably priced letter of credit to achieve the savings a pension obligation bond issuance would provide.

Municipal Financial Advisors Regulation Act

While the USCM does not have specific policy supporting the regulation of financial advisors to state and local governments and requiring them to register with the SEC, we understand and are supportive of the intent to protect issuers, and place financial advisors on the same regulatory playing field as the broker dealer community. This bill is yet another step in restoring investor confidence in municipal debt.

In summary Mr. Chairman the municipal bond market is experiencing a severe liquidity shortfall, due in large part to the global credit crisis. Because of the high costs associated with issuing municipal bonds, many local governments around the nation have placed many infrastructure projects on hold until market conditions improve. As a result of, thousands of short-term and permanent jobs have been placed on hold as well. This situation can change as soon as financing of these projects at reasonable interest rates can be secured. We believe the legislation that you have introduced will significantly assist in improving market conditions and increasing local government access to credit at reasonable rates, allowing cities to be full partners in efforts to renew our nation's infrastructure, revitalize our economy and create jobs. The U.S. Conference of Mayors expresses its support for your continued efforts to assist state and local governments and the municipal bond market. The four pieces of legislation discussed today will go far towards helping my city and thousands of other cities across the nation. The nation's mayors stand ready to assist you in any way we can in securing their passage.