

**Testimony of
J. Ben Watkins, Director of Bond Finance, State of Florida**

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**U.S. House of Representatives
Committee on Financial Services
*Legislative Proposals to Improve the Efficiency and Oversight of Municipal Finance***

Mr. Chairman, Ranking Member Bachus, and members of the Committee, on behalf of the Government Finance Officers Association* (GFOA), thank you for the opportunity to join you today to discuss legislative proposals to improve the efficiency and oversight of the municipal bond market.

I am Ben Watkins, Director of the Division of Bond Finance for the State of Florida, a position I have held since 1995. As Director, I am responsible for administering the bonding programs for the state's departments of education, transportation, environmental protection and management services, Board of Regents, Florida Turnpike System, the Florida Hurricane Catastrophe Fund and the State Comptroller's Equipment Financing Program. The state currently has approximately \$25 billion in outstanding debt and typically issues around \$2.5 billion a year with 15 to 20 transactions. As a frequent issuer, I have direct experience with the crisis in the municipal bond market and have managed the state's debt portfolio and market activities to prevent the disruption of our capital programs and other vital public services.

Florida's story is much like many other states and localities across the country. The crisis in the municipal bond market results from the systemic problems in the broader capital markets. The demise of the major bond insurers and the lack of adequate liquidity providers, have compounded the problems of the frozen credit markets and have hit state and local governments especially hard. That is why having this hearing today is so important to all of our constituents. Discussing these issues will provide a better awareness of the problems in the municipal market so that adequate solutions can be formulated and state and local governments can return to the credit markets with confidence.

While the funds provided to state and local governments in the American Recovery and Reinvestment Act (ARRA) are helping state and local governments mitigate the effects of this recession, they are not a panacea. As we all know, state budgets continue to experience a considerable strain because of declining revenues and increasing demand for countercyclical public services. The problem is, of course, compounded by the profound disruption in the municipal marketplace, affecting even the most creditworthy governments. Unfortunately, neither the Federal Reserve nor the Department of the Treasury has provided any meaningful solutions to problems confronting state and local governments in our market. State and local governments need access to a properly functioning credit market to finance critical infrastructure such as roads, schools, water and sewer projects, affordable housing and healthcare, and in some cases to fund operations.

The passage of the Housing and Economic Recovery Act (HERA) last year and the recent passage of the ARRA provide state and local governments with new bond instruments and tax credit tools to help them deliver necessary public services and capital investments. Without stable sources for affordable capital, however, state agencies and departments and localities – in particular those that do not access credit markets on a regular basis – may not be able to use these new policy tools to their fullest intent.

It is important to note that the credit crisis has not just constricted access to capital but also has increased interest-rate costs for those issuers that can access the markets. The legislative proposals being discussed today could go far to tackle these fundamental problems.

The effects of the broader financial crisis on municipal markets have been most acute in the short-term markets for variable-rate demand obligations (VRDOs), auction-rate securities (ARS) and commercial paper (CP). Issuers continue to face interest rate resets on these instruments, sometimes into double-digits, which is atypical for these products. Probably the most severe market disruption occurred with ARSs, as these credits have been decimated by the credit crisis and some issuers, especially large governments, still have auction rate securities outstanding and are paying very high interest rates. This is due to the fact that there are very limited liquidity facilities available which are necessary to support these debt instruments or to restructure the ARSs into VRDOs or fixed rate obligations. Additionally, there is very limited bond insurance available to convert ARSs or VRDOs into long-term fixed rate debt.

As a result of these problems, state and local governments are faced with increased interest costs and accelerated amortization of debt. This has exacerbated already strained budget problems for most state and local governments, affecting state services to taxpayers and preventing many infrastructure projects from moving forward.

It has been a volatile time for the long-term fixed rate market as well, and one I have never seen in my 20+ years of public finance experience or was expected by anyone I have come across in the field. Large and frequent issuers, which are the states with simple credit structures such as general obligation bonds, have had access to credit but have also struggled with these market conditions. However, the majority of the country's debt issuers, which are smaller, less frequent issuers or issuers with lower credit ratings have been shut-out of the market altogether. This is in large part due to the lack of bond insurance or other credit enhancement. Although it is worth noting Mr. Chairman, that your leadership and that of Congressman Kanjorski to ensure passage of the Housing and Economic Recovery Act, made possible federal home loan bank support for bank letters of credit which has become an important tool for issuers since its enactment.

Given all of these adverse conditions – declining state and local revenues, increased demands on scarce public dollars for basic needs, higher debt maintenance costs, and decreased access to short- and long-term debt markets - many jurisdictions have had to delay or halt infrastructure projects that are vital to economic development and, generally, would contribute to a broader economic turnaround. This is why your attention

to these issues is so important and why I am pleased that this committee is not ignoring such an important segment of the nation's credit markets. Once state and local governments are able to affordably and efficiently return to the market, governments will be able to provide the essential infrastructure and services that our communities deserve.

I have only highlighted the problems that governments are facing today, and there are many here who will give a more thorough explanation of the market dynamics and problems that have occurred since late 2007. There is a wealth of data, graphs, percentages, and so forth, to clearly portray what has been and is occurring. But, just as important, is the stark evidence of how this data translates to real problems in our communities. For example, in Florida:

- The \$200 million Everglades variable rate bonds, which normally had rates from 2 to 3 percent, reset at 8 percent.
- Bond insurance has not been available for the State's Environmental Bond Program for land conservation and Lottery Bond Program for school construction.
- Recently, letter of credit provider rates from the Sunshine State Bond Pool have more than tripled.
- Miami-Dade County was unable to find a liquidity provider for its \$475 million capital program.
- The Jacksonville Utility CP program has not been able to reset their rates and has had to halt construction on many of its projects.

- A \$50 million road construction project expected to spur growth and development in Collier County, Fla., has been shelved as a result of the illiquidity in the commercial paper market. The road would link Ava Maria University, located in the eastern part of Collier County, to Interstate 75 and the urban area of the county. It was scheduled to be funded with tax-exempt commercial paper and was expected to spur the growth and development of both the university and the surrounding suburban area in both Collier and Lee Counties. Without financing from tax-exempt commercial paper, this project may be moved out several years, and the lost benefits will never be recaptured.

As these anecdotes show, and as Mayor Leppert has also described, state and local governments are facing some of the most extraordinary challenges ever, and the need for solutions is profound. The legislative proposals for enhanced bond insurance and liquidity enhancement being discussed today could go a long way to help state and local governments.

Uniform Credit Ratings - *The Municipal Bond Fairness Act*

Credit ratings that are uniform for both the taxable and tax-exempt markets are more important now than ever before. Especially with the tremendous growth in taxable municipal bonds, due in large part to the new Build America Bonds program, it is essential for investors to have an apples-to-apples comparison on credit quality for municipal and corporate securities. The GFOA continues to support this legislation as it has in the past and believes it will help many governments, especially smaller, lower-

rated governments sell debt at more affordable rates and save taxpayers money. The organization agrees Mr. Chairman, with your assessment that the credit rating system can be improved and should be based on default rates and the ability to repay debts. The Municipal Bond Fairness Act, by not authorizing NRSRO status to rating agencies until they incorporate uniform ratings for corporate and municipal securities, is an important step forward. GFOA applauds your leadership on this issue.

Federal Reinsurance Program – *The Municipal Bond Insurance Enhancement Act*

There would be value in some form of assistance to obtaining affordable bond insurance for the municipal bond market. Prior to the financial crisis, over 50 percent of all municipal bonds were sold with bond insurance. However, as all four major bond insurers are no longer viable, the new issue market has suffered. In fact, I have seen that currently only one bond insurer is writing insurance for new issues; they are very selective on credits they will insure, and such insurance comes at a very high price. While the need for bond insurance, in general, is one that the market and the issuer community need to address, there is likely to always be a need for bond insurance, especially for smaller and lower-rated issuers who are effectively shut out of credit markets today. Supporting some form of municipal bond insurance, as is outlined in the Municipal Bond Insurance Enhancement Act, would help address the problems governments currently face with market access and will lower the cost of borrowing for governments.

It should be noted that the Act calls for \$50 billion in coverage, and it is important to clarify that that amount is not a true exposure to the federal government, unlike other programs it has recently enacted to assist failing financial institutions. Due to the minimal risk associated with municipal securities, it is highly unlikely that the federal government would lose money by establishing such a facility.

Furthermore, Congress and the Treasury may also wish to review additional ideas to assist with the bond insurance market, including the National League of Cities' proposal for an Issuers Mutual Bond Assurance Company.

Federal Liquidity Enhancement Program – *The Municipal Bond Liquidity Enhancement Act*

As noted above, the variable rate debt market has been riddled with problems for over a year, and no complete solution has been able to help all of the governments that remain in this market. Liquidity providers (letter of credit and standby purchase agreement providers) have left the market or are charging significantly higher rates than issuers can tolerate. The Municipal Bond Liquidity Enhancement Act, which would allow the Federal Reserve to fund new liquidity facilities, would greatly help governments with outstanding variable rate obligations that need to be restructured, and also would aid in the restructuring auction rate securities. GFOA and many municipal market participants believe that the Federal Reserve and the Treasury currently have the power to assist this

market and state and local governments; however, the Act's specific call to create programs for these instruments is tremendously beneficial.

We also suggest that the Committee consider making the facility available prospectively and have it available for the commercial paper market.

Regulating Financial Advisors – The *Municipal Financial Advisors Regulation Act*

While the GFOA does not currently have a policy position on the regulation of financial advisors, we understand the reasons behind the proposal that would place these professionals under a similar regulatory regime as is currently the case for the broker/dealer community. The intent to prohibit fraud and deceptive practices and establishing a fiduciary responsibility to the issuer clients are supported by the GFOA and articulated in our various Best Practices.

I think it is important to emphasize one more point. You hear terms like bailout fatigue, and worse. It is important, I think, to note that these legislative proposals being discussed today are not about municipal bond issuers seeking a bailout. Indeed, our problems are part of the systemic problems that originated outside of our markets -- collateral damage, if you will. State and local issuers operate in the sunshine. We are accountable to our constituents. They rightly demand – and receive – transparency, caution, and thoughtfulness when sanctioning their government officials to issue debt in their name. The problems in the municipal marketplace are real, and these difficulties affect not just

state and local governments but also its citizens. Your willingness to address these problems is greatly appreciated.

Mr. Chairman, thank you again for the opportunity to speak with you and your continued support for state and local governments. I hope that this testimony and that of others, provides adequate information and insights to the problems in this market and that Congress, the Treasury, and the Federal Reserve will work with state and local governments and other market participants to improve the outlook for the municipal market.

* The Government Finance Officers Association, founded in 1906, represents over 17,500 state and local government finance officers from the United States and Canada. Our members include chief financial officers, budget directors, treasurers and other officials from city, county, and state governments. Our purpose is to enhance and promote the professional management of governments for the public benefit by identifying and developing financial policies and practices and promoting them through education, training and leadership.