TESTIMONY

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Economic Recovery, Job Creation and Investment In America

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Chairman Rangel, Ranking Member McCrery and Members of the Committee, thank you for the opportunity to appear before you today. I am Timothy Firestine, Chief Administrative Officer of Montgomery County, Maryland. With respect to the critical role state and local governments serve in creating American jobs, this hearing could not come at a better time. The turmoil in the capital markets has had a particularly acute affect on the municipal bond markets and, as a result, state and local governments are facing very real economic hardships.

I have spoken to many government officials around the country and like the other distinguished gentlemen at the table, the current fiscal climate facing local and state governments is the most challenging that I have seen throughout my career. At a time when communities are faced with skyrocketing foreclosures, decreased tax revenues, growing unemployment, and the increased demand for services that comes with these problems, states, counties, cities, and small towns, have been frozen out of the capital markets, for days and weeks at a time, or are faced with borrowing costs that are prohibitively high. Without reasonable access to the capital markets, local governments are struggling to provide ESSENTIAL services to the general public. For example, the inability to access short-term financing is affecting our ability to purchase replacement firetrucks and purchase new transit buses or rail cars at a time when ridership is growing.

Problems in some sectors of the capital markets, like the market for certain mortgage-related securities, are related to a rise in defaults and losses for investors. By contrast, states' and local governments' difficulty accessing capital is due not to an increase in downgrades or defaults but to the global liquidity crisis. The retreat of banks and other financial institutions from the municipal bond market has caused an astronomical increase in borrowing costs. In addition to borrowing long-term for capital projects, state and local governments issue short-term debt for a variety of reasons, such as to bridge the gap between the payment of regular expenses and the collection of taxes. In the current environment, local governments who issue short-term debt with interest rates that adjust on a daily or weekly basis saw their borrowing costs increase from less than 2% to upwards of 9-10%. Some issuers were completely unable to find buyers for their short-term bonds, which increased borrowing costs even further. And there are no signs of a quick recovery. In fact, recently Montgomery County put out an RFP for a liquidity provider on a pending transportation financing transaction and we received no bids. We have never seen anything like this, and are very concerned with the layers of disruption in our market, and the likelihood of a very long recovery period.

Currently there is approximately $2.7 trillion in outstanding tax-exempt bonds. Last year, 12,600 municipal securities were issued, totaling $487 Billion. $58 Billion of that was in the short-term market, and $429 Billion in the long-term. According to the Regional Bond Dealers Association and based on data from the Federal Reserve, yields on long-term municipal bonds in 2007 averaged around 4.40 percent. By mid-October 2008 that rate had jumped to over 6 percent. A key measure of the health of the municipal bond market is the ratio of yields on long-term municipal bonds to that on Treasury securities. In normal conditions, that ratio is in the neighborhood of 85 percent. In recent weeks it has been as high as 140 percent for some issues. Municipal bond rates have jumped dramatically not because of a decline in the credit quality of municipal borrowers, as a majority of this debt is issued by governments and is backed by the full faith and credit of the entity or a dedicated revenue stream, but because of the disruption of the capital markets. Furthermore, since mid-September nearly $20 billion of new municipal borrowing have had to be postponed because of the challenging market. Capital projects that would have created jobs and provided enhanced services for citizens have been put on hold. Higher interest rates for municipal borrowers have a negative effect on the amount of debt a government can afford, which will dampen rather than stimulate the economy.

While state and local governments are suffering the effects of the current credit crisis, it is important to note that the general problems in the municipal market are NOT due to any fundamental problems with the underlying credits or state and local governments themselves. Municipal securities are one of the safest investments available, second only to Treasuries with a default rate of less than one tenth of one percent – and virtually zero for strictly governmental bonds. A perfect storm of bond insurance downgrades, the subprime mortgage crisis, the resulting global liquidity crisis and lack of confidence in the financial systems, has hit state and local governments, causing significant disruption in our market, with no clear path to a quick recovery.

The *Emergency Economic Stabilization Act* passed by Congress last month will provide a significant injection of capital into the market, and flexibility for the Treasury and Federal Reserve to begin rebuilding the country's financial system. However, aside from the inclusion of tax-exempt money market mutual funds in the Treasury's temporary guaranty program for money market funds, virtually no direct relief or accommodations have been made for issuers of tax-exempt bonds. Repeatedly, the Federal Reserve has commented that its Commercial Paper Financing Facility would NOT be extended to include tax-exempt commercial paper or other short term debt instruments, and the Treasury has indicated that the ability to purchase 'challenged assets' under TARP would not be extended to tax-exempt securities.

What that means is that while local governments have not contributed to the problems of the credit crisis and continue to serve as the first responders between citizens and government, we are not receiving help, while the institutions and sectors of our economy who recklessly chose to gamble with 'cheap money' are being assisted. Bottom line – even governments like Montgomery County, which is rated AAA, is and will be paying the price due to both the fallout in the capital markets and the federal government's lack of attention to our sector. Thus, it will be more expensive for governments to provide public safety programs, schools, roads, firehouses, libraries, public hospitals, and other services that the public relies upon, or these services will need to be reduced. Furthermore, as many governments are rated A under the current (and broken) credit rating system, those governments will have an even more difficult time than others accessing the market, especially since the bond insurance and credit enhancement markets are damaged, and investors are demanding AA or AAA paper.

In a quest to stimulate the economy, create jobs and help state and local governments, Congress could act to infuse capital in the municipal securities market in order for governments to begin vital infrastructure projects. In Montgomery County alone, we have capital projects ready to go, but because of the uncertainty in the market, some of these projects may come to a halt. An infusion of capital would allow many governments to begin the projects that they had planned.

What can Congress do that would be helpful to state and local governments? Again, the ideas expressed by this panel are all worth noting and must be taken seriously by Congress in order to help local and state governments during the economic downturn. However, one of the most important action items Congress could undertake in order to stimulate the economy and create jobs would be to ensure that state and local governments have regular access to the capital markets in an economical fashion. One suggestion would be to have the Treasury and the Federal Reserve extend their authority under TARP and the CPFF to ensure that the capital markets are open to state and local governments, and that there are buyers for floundering short-term debt. Treasury and the Federal Reserve have already exercised broad authority under TARP, and clarifying that they have authority to assist state and local governments would allow them to provide immediate assistance. Without dictating exactly how to execute this, there are certainly many ways to create an opening in the markets for tax-exempt debt and help those entities who are especially being hurt by this unfortunate market dynamic. Furthermore, the Treasury and Federal Reserve and other federal government agencies should create a special task force to address the problems state and local governments are facing and determine ways to assist counties, towns and states as they try to maintain their footing during this economic downturn.

Congress and the Treasury could also act to lift burdensome tax code requirements on corporations and property and casualty insurers that limit the amount of tax-exempt bonds that they can purchase. The current limits and regulations stifle demand and are woefully out of date. Simply raising these limits would allow for these sectors to purchase more tax-exempt securities, which would be a win-win for all parties. To that point, Congressman Neal of this Committee, together with Financial Services Committee Chairman Barney Frank, introduced legislation this summer that would encourage banks to directly hold municipal securities. In 1986 Congress eliminated the deduction banks and financial institutions could take for carrying and purchasing tax-exempt bonds. This took away nearly all incentives for banks to purchase municipal bonds, which was a significant blow to state and local governments, as banks were a major purchaser of our securities prior to 1986. The only allowable interest deduction left in place is for banks to carry bonds from governments that do not issue more than $10 million per year. H.R. 6333 not only addresses the new purchasing power for banks to purchase all types municipal securities – as was the case prior to 1986, but it also raises the bank qualified debt limit to $30 million. Raising the bank qualified limit will allow smaller governments to directly place their issuances with banks, and avoid many of the costly expenses associated with issuing debt in the general market.

Other actions Congress could take that would help the tax-exempt securities market and state and local governments, include:

- Passing legislation (H.R. 6308) that calls for the SEC to use its authority and have the rating agencies use comparable ratings for all securities, which will better reflect the soundness – and significantly lower level of defaults – of municipal securities. Many governments would likely see their ratings upgraded if comparable scales are used, possibly leading to lower debt issuance costs.

- Governments will need to refinance debt in the months and years ahead as the markets calm, thus Congress should grant an additional – and targeted and temporary – advanced refunding opportunity to governments, similar to what was provided in the aftermath of September 11 and Katrina.

- Eliminating the AMT penalty that exists on some tax-exempt bonds, should also be considered, similar to the legislation Congress passed earlier this year that eliminated the AMT penalty for housing bonds.

Providing direct funding and eliminating unfunded mandates are specific ways Congress could act to help state and local governments. But, access to the capital markets, should also be an integral part of assistance, and one that would directly create new jobs and stimulate the economy. I hope that the Committee will take this matter into consideration as it creates a new stimulus plan this year – and other legislative efforts in the next Congress. Furthermore, it is essential for the federal government to partner with state and local governments on a variety of issues facing our country, and specifically how to recover from these challenging economic times.

Mr. Chairman and members of the Committee, thank you again for the opportunity to appear before you and I look forward to answering any of your questions.