



**Association of
Oregon Counties**

February 15, 2010

To: AOC Legislative Committee

From: Community Development Steering Committee; Ann Hanus

Re: Support for National League of Cities Proposal for Nonprofit Mutual Bond Insurance Company

Requested Action: Support the National League of Cities Proposal for a Nonprofit Mutual Bond Insurance Company to be funded by Congress in the Jobs Bill

Discussion: In May 2009, the National League of Cities (NLC) issued a business plan for a new, nonprofit mutual bond insurance company to bring stability to the municipal bond market. Throughout 2008 and 2009, the market was devastated by the downgrades of existing municipal bond insurance companies. Before the insurance crisis, 50 percent of the market was insured. In 2009, approximately 10 percent was insured. Only one bond insurer remains active in the business today.

The goals of the new company are to (1) provide market access to infrequent and lower-rated borrowers with credit enhancement, (2) improve the salability and marketability of these borrowers' debt, (3) save municipal bond issuers billions of dollars in interest costs and, most importantly, (4) get projects funded and jobs created. The provision of a federal loan to provide start-up capital for this new insurer will re-energize the municipal bond market and accelerate and sustain federal recovery efforts.

Small Federal Investment Supports Large Number of Projects: NLC seeks an interest-free \$3.0 billion loan to provide the capital needed to start-up the company and \$2.0 billion of call capital from the Treasury to support growth in future years. The Treasury will be fully repaid within 10 years. Over the 10-year period, NLC estimates that up to \$890 billion in projects can be insured. This is a highly leveraged federal investment.

Issuers are Denied Market Access: The tax-exempt bond market seems to be doing surprisingly well if market volume and borrowing costs are the barometers. Taxable municipal bond issues skyrocketed in 2009 because of the new Build America Bonds program. Borrowing costs for tax-exempt issuers are at or near 40-year historic lows due to a decline in supply and strong

demand by investors seeking quality. However, it is not a robust market for small, infrequent, and lower-rated issuers.

In December 2009, Barclays Capital reported that tax-exempt bond issuance by local governments for the previous three months declined by 50 percent when compared to the average annual issuance during that time period from 2003 to 2007. Bond pools that issue on behalf of small governments and individual governmental issuers have not issued debt because of the lack of affordable bond insurance and letters of credit. For example, six bond pools that are members of NLC and which typically issue more than \$1.0 billion annually to finance local projects have been shut out of the market for two years. Projects financed by bond pools include community centers, water and sewer projects, parks, schools, city halls, and other infrastructure projects.

Lack of Insurance is Costly: Reuters recently provided an example of the increased borrowing costs paid by low-rated borrowers. In 2007, before the insurance crisis, a triple-B issuer selling a 10-year bond paid 25 basis points (one-fourth of a percent) more than a triple-A borrower. At the end of 2009, that same issuer paid 142 basis points more. A hefty penalty is paid by issuers needing insurance.

Other Insurance Options are Unavailable: The NLC solution is needed because the commercial insurance model is outmoded. New entrants have not been able to obtain the ratings and capital they need to enter the business. Private equity investors are not willing to support a mutual insurance company because they cannot find the kinds of economic returns or the forms of participation they require in a company mutual company. Mutual insurance companies are successful, stable, and policyholder-focused company structures that have been used in other lines of insurance since insurance began centuries ago.

Alternative Credit Enhancement Mechanisms are Limited: Letters of credit, which are guarantees of payment issued by commercial banks and other institutions, are either not available or are unaffordable. NLC's bond pool members faced price increases of 200 and 300 percent for letters of credit. The federal government has not passed legislation providing reinsurance for existing insurers, who are unable to sell new policies. State credit enhancement programs have limited capacity; typically they only provide support to school issuers; and they rely on the strength of the state's credit rating, which may not be strong.

Risk to Federal Treasury is Low: The risk to the U.S. Treasury is exceedingly remote because of historically low default rates on the bonds eligible for insurance. When defaults do occur, borrowers recover their losses almost 100 percent of the time. Also, the proposed financial model is very conservative. The insurance will only be available to governmental issuers, borrowers will be carefully evaluated before receiving insurance, administrative and overhead costs will be lower than those experienced by commercial insurers, issuers will pay premiums to obtain the insurance, the company will be a tax-exempt organization, and the amount of capital available to pay investors (the capitalization ratio) will be significantly greater than the ratio used prior to 2008.

Help is Available to Launch the New Company Rapidly: There is an abundance of highly skilled talent available to start the company because of the closure and layoffs at other companies. The New York State Insurance Department is committed to expediting the licensing process and rating agencies have not identified problems with the business concept.

New Insurer Needs Market Acceptance: Borrowers have signaled strong interest in doing business with a bond insurer that is owned by the governments and is not a profit-making entity. Investors distrust the traditional bond insurance industry after the recent downgrades. NLC is not one of these legacy insurers.

Taxpayers Will Benefit: Taxpayers will benefit from the additional capacity that more competition in the bond insurance industry will provide. More expensive projects translate into higher taxes or fewer local services. The ability to reduce borrowing costs by 1.0 percent on billions of dollars of bonds that are outstanding for up to 30 years means billions of dollars of savings each year.

New Insurer Supports National Interest: During times of economic crisis, it is in the national interest to help state and local governments reduce borrowing costs, move forward with important projects, avoid unnecessary budget cuts, and rebuild the nation's infrastructure.

This proposal was discussed with both the Oregon State Treasurer's Office and the Oregon Business Development Department debt specialists and they agreed that this proposal could be very beneficial to municipalities.

PUBLIC LANDS
COMMUNITY DEVELOPMENT

PROPOSED RESOLUTION on the Small Business Administration (SBA) Historically Underutilized Business Zone (HUBZone) Program Contracting Disparities

Issue: Support a resolution to urge federal agencies to adhere to the goal of using the HUBZone Program for 3% of total dollar value of prime contracts and not overly rely on the HUBZone program at the expense of other small business set-aside programs; and further to urge simplification and streamlining of data entry and the process to become certified for SBA small business programs.

Background: The HUBZone Empowerment Contracting program was enacted into law as part of the Small Business Reauthorization Act of 1997 to provide for federal contracting assistance to qualified HUB Zone small businesses.

This SBA program gives preferential federal contract bidding to small businesses that are located in qualified counties that are defined a “non-metropolitan county” (as defined in section 143(k)(2)(B) of the IRS Code) with a median household income of less than 80 percent of the state median household income or with an unemployment rate of not less than 140 percent of the statewide or U.S. average. Federally recognized Indian reservations and qualified census tracts are also included in the program.

As unemployment rates have ratcheted up, so has the benchmark for being qualified as a HUBZone. For example, despite Oregon’s high unemployment rate of 11 %, above the national rate of 10%, not all counties qualify for the program. Consequently, even counties with high unemployment rates above the national average do not qualify for the program because it must be at least 140% of the national unemployment average.

Further contributing to the problems of local small business has been the over-reliance by some federal agencies on using the HUBZone program compared to other Small Business programs. For example, most Forest Service Regions have surpassed the 3 % national goal with at least five regions exceeding 25 percent of their total dollar value of prime contracts. This results in an inequity for businesses across Oregon when bidding on contracts even within their own county and a distortion in the market place because it is forcing businesses to relocate or lose contracts. Contractors bidding for wildland firefighting contracts and construction contractors have been especially impacted.

Small businesses have also faced difficulties in becoming certified for small business programs and entering their data into the SBA’s Central Contractor Registration (CCR) data base. Simplifying and streamlining the data entry and certification process would make it easier for small businesses to qualify and become certified for the various SBA programs and increase the chances of success to be awarded contracts.

COMMUNITY DEVELOPMENT

PROPOSED RESOLUTION ON Eligibility of Community Action Programs for Community Development Block Grant Funding

Issue: Support a federal statutory change so that Community Action Programs are presumed to serve principally low and moderate income persons as determined by HUD in order to apply for and receive Community Development Block Grant (CDBG) Funding.

Background:

The Housing and Urban Development Department (HUD) has specific language which presumes people in categories such as abused children, battered spouses, elderly persons, severely disabled adults, homeless persons, illiterate adults, persons living with AIDS, and migrant farm workers to be principally low and moderate income persons as determined by HUD.

According to Section 202 of the Economic Opportunity Act of 1964, "Community Action Program" is defined as a program which provides services, assistance, and other activities of sufficient scope and size to give promise of progress toward elimination of poverty or a cause or causes of poverty through developing employment opportunities, improving human performance, motivation, and productivity, or bettering the conditions under which people live, learn and work.

While Community Action Programs serve many of these individuals, CDBG applicants for projects that include Community Action Programs face onerous requirements to analyze demographic data and survey participants separately to meet low income standards. This creates barriers and higher costs in order to apply for and receive CDBG funding to serve low income individuals.

Adding Community Action Programs to the list of those categories presumed to serve low and moderate incomes will eliminate a barrier, reduce costs, and streamline the application's process.