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House Aims To Help Munis

Letters Expected to Be Released Today

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By Andrew Ackerman

WASHINGTON - House lawmakers, in letters to federal regulators and legislation expected to be introduced today, are making a major push to help the municipal market, particularly for short-term instruments that issuers have struggled to sell.

Reps. Michael Capuano and House Financial Services Committee chairman Barney Frank, both Massachusetts Democrats, along with 25 other congressmen **sent a letter** to Federal Reserve chairman Ben Bernanke and Treasury Secretary Tim Geithner Friday calling for the establishment of a temporary backstop for the $500 billion variable rate demand obligation market as well as other short-term paper.

The lawmakers are echoing market participants' concerns about the lack of assistance for the muni market in the government's economic recovery program. They believe that the scarcity of banks willing to provide letters of credit or standby purchase agreements - which are standard for VRDOs - has made it difficult for many issuers to access the short end of the yield curve. By temporarily providing these products to muni issuers, the Fed would ensure smooth functioning of the short-term market until the banking crisis subsides, they said.

"A consensus has emerged among issuers, investors and dealers in the municipal bond markets that the Federal Reserve could provide immediate and dramatic assistance to the overall market by creating a temporary lending facility to create liquidity in the market for [VRDOs] and other short-term municipal debt instruments," they said in the one-page letter. "This is a limited market with low underlying credit risk and it is likely the mere presence of a federal financing backstop alone would bring investors back and limit the need for the Federal Reserve to actually purchase bonds."

In the last four months of 2008, states and localities borrowed 34% less than they did during the same period in 2007, "largely because borrowing rates in the municipal bond market were so high - if they could access the market at all," the lawmakers said.

"While conditions have improved somewhat, it is still difficult for many state and local governments to access the market at attractive terms," they said. "This is especially troubling since a great deal of state and local borrowing goes directly to finance construction projects that create desperately needed jobs."

In an interview Friday, Capuano said the proceeds from the short-term transactions the program would backstop would go "directly into creating jobs, mostly construction jobs." He stressed that the backstop "shouldn't cost the Fed one penny" because the presence of the backstop would ensure that VRDO remarketings are successful.

"The worst-case scenario is they just have to step up a little bit" if a VRDO remarketing failed, he said. But it is more likely the backstop "wouldn't cost anything but a couple hours of their time."

Meanwhile, freshman Rep. Gerald Connolly, D-Va., plans to introduce legislation today that would provide direct assistance to muni issuers. Specifically, his bill would require the Treasury secretary to establish a program to purchase municipal securities or issue Treasury securities backed by pools of munis, as well as to provide credit enhancement or guarantees for munis. The purchases would be conducted directly or through the Federal Financing Bank, which the Treasury oversees.

To ensure "the orderly and coordinated marketing" of federal purchases or guarantees on munis, the legislation would give the Treasury secretary the authority to approve the method, source, and timing of financing for all of the muni bonds that it purchases.

The bill also would formally authorize the Fed Board of Governors to establish a broad credit facility that could backstop short-term munis, though some lawmakers believe that the Fed already has that authority.

Connolly's bill comes as Frank's staff is drafting legislation that is expected to be introduced before the summer that would provide federal guarantees for general obligation bonds, some form of federal "reinsurance" of revenue bonds, as well as a backstop for the VRDO market.

It may also include a provision that would require the federal regulation of financial or investment advisers in the muni market that are not currently regulated as well as a provision that would effectively require credit rating agencies to rate municipal and other debt on the basis of default risk alone.

Congressional sources said that portions of Connolly's bill may eventually be written into Frank's more expansive legislation. But muni market participants said Friday that the two lawmakers appear to be considering different approaches to legislation helping the muni market: Connolly's planned bill would mandate an expansive new role for Treasury by requiring it to make purchases of muni bonds, while Frank's would favor a more indirect approach of authorizing commitments to purchase munis, without requirements to do so.