

Gimme Some Credit!

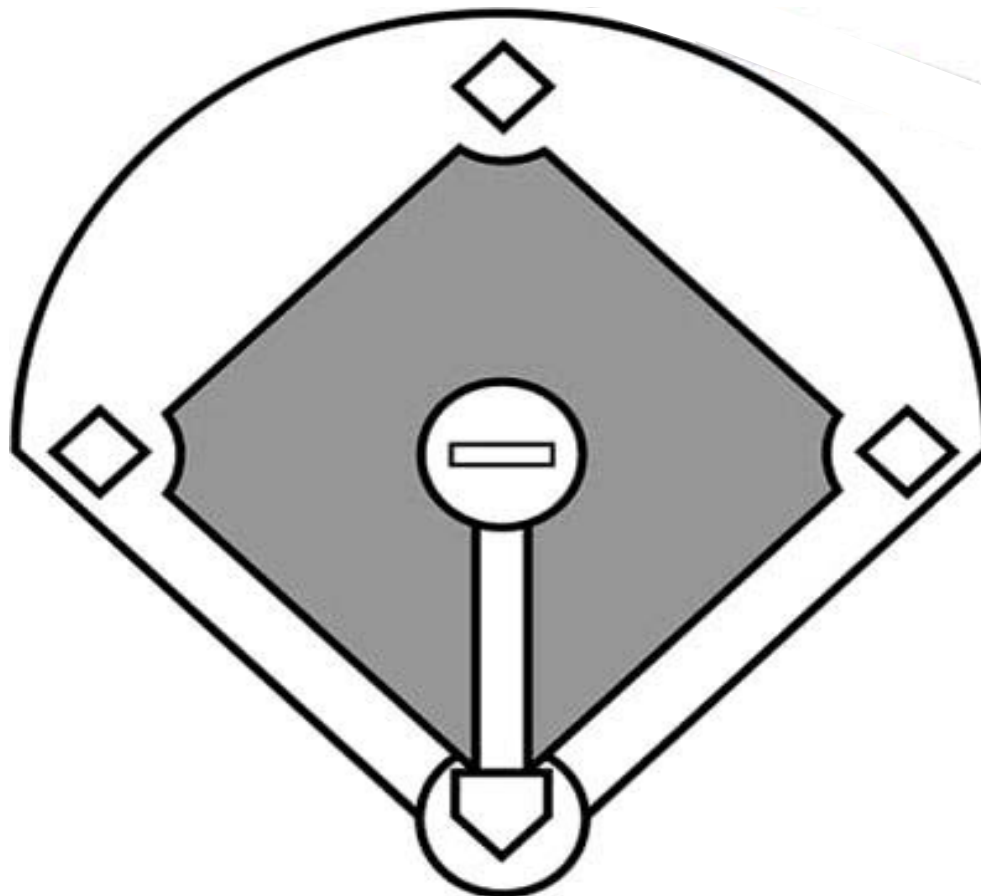
A Status Report on Credit Conditions
for State and Local Governments

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A Grand Slam of Financial Challenges

Rising Demand for Services

Pension Underfunding



Declining Tax Revenues

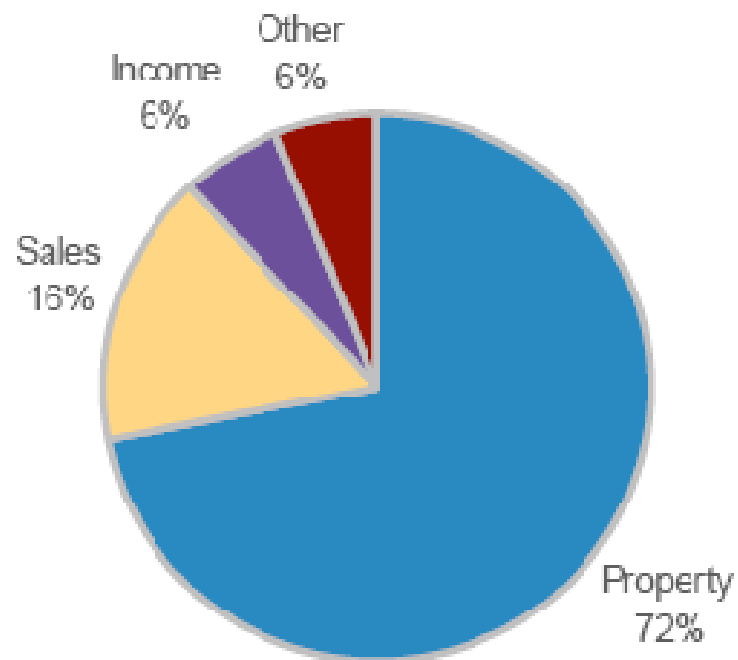
Expensive Credit

Impacts of the Recession

- Housing decline hampers property values, property taxes and transactions fees
- Consumption decline hampers sales tax receipts, especially for big ticket items
- Corporate cutbacks limit the tax base
- Stock market slump widens pension shortfalls
 - Role of alternative investments
- Demand for community services rises dramatically
- **Balanced budget requirements enforce procyclicality**

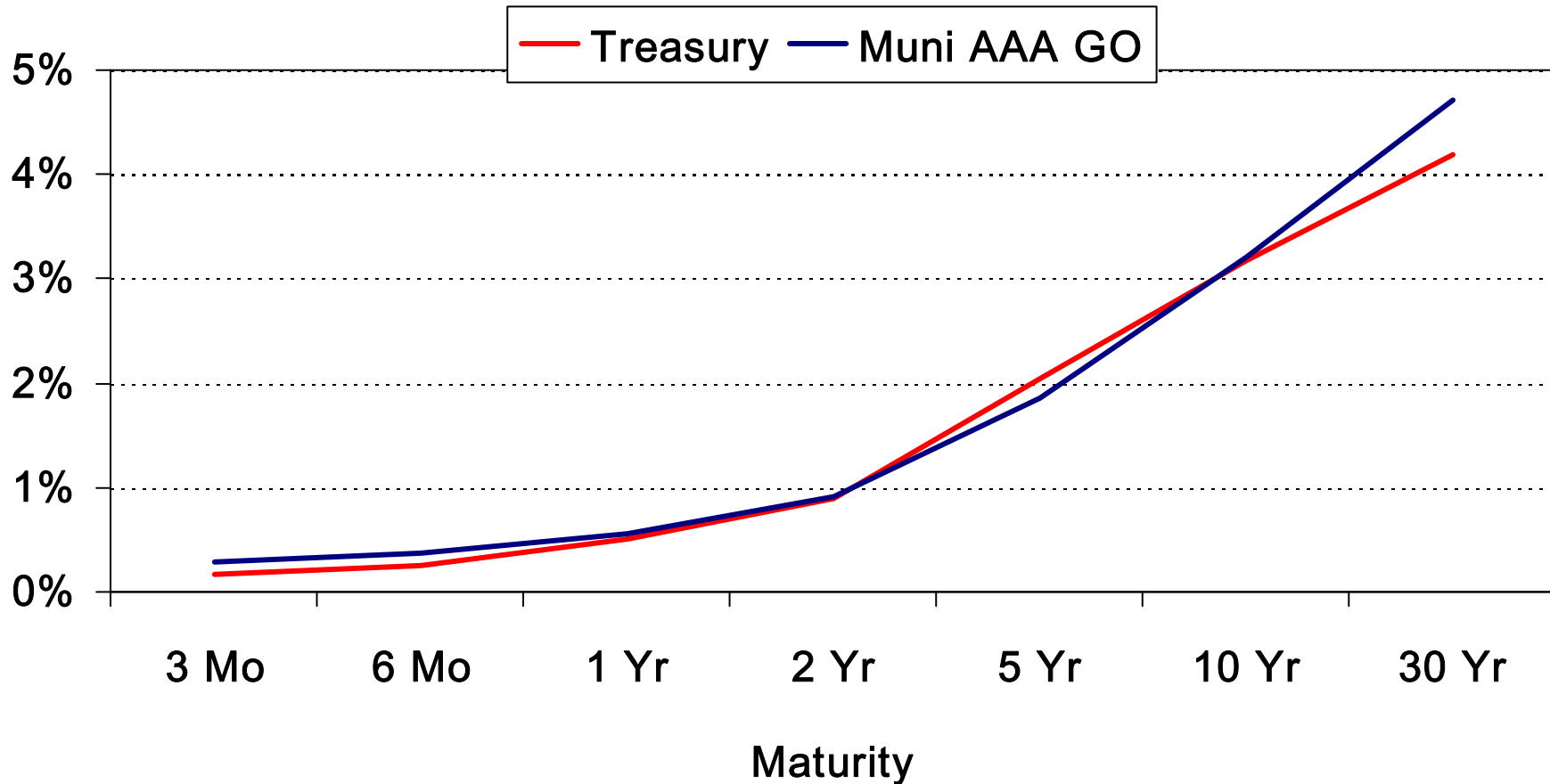
All About Housing?

Property Tax Comprises Majority of Local Government Tax Revenue

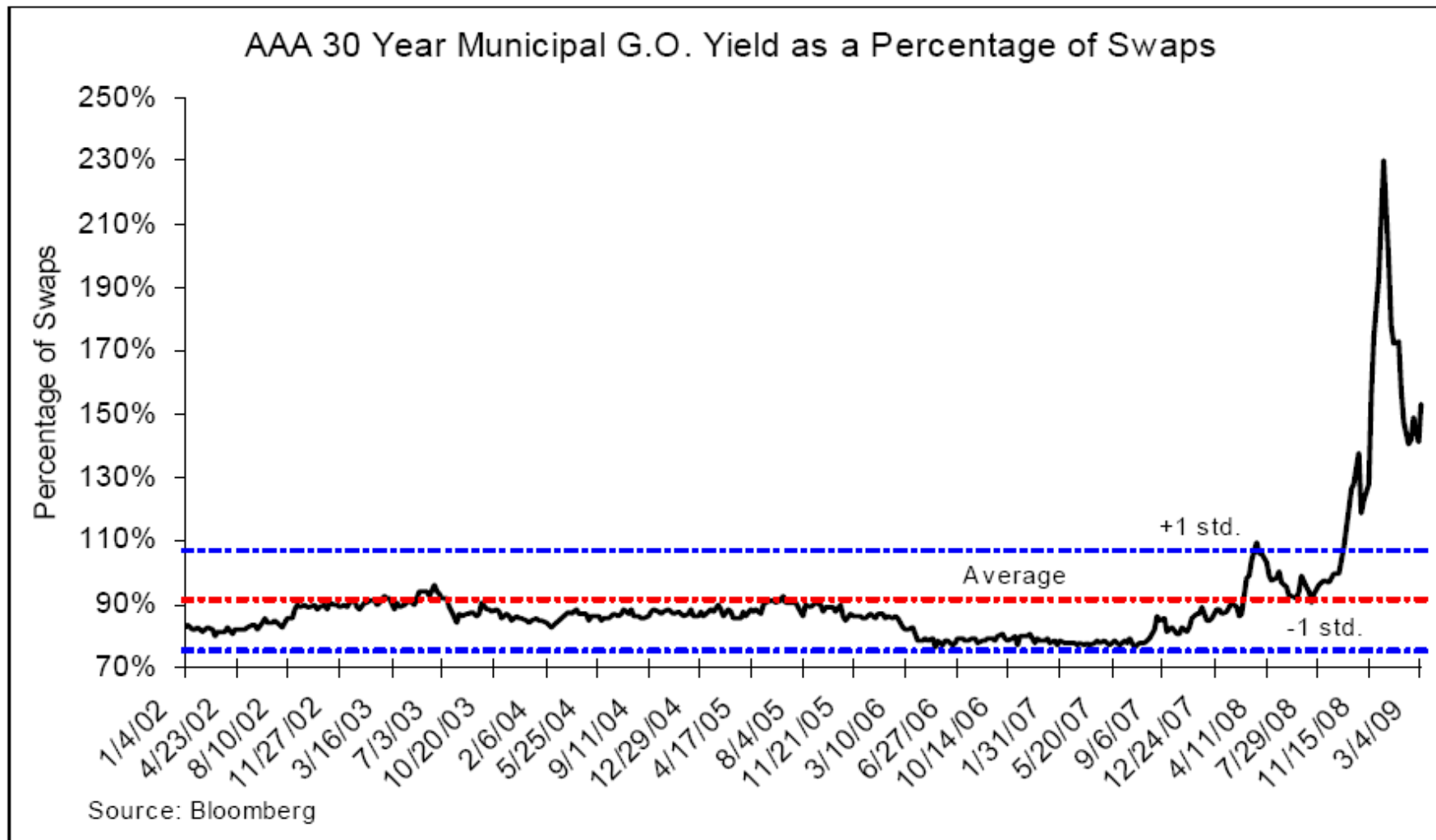


Source: US Census Bureau, State and Local Government Finances by Level of Government and by State: 2005-06

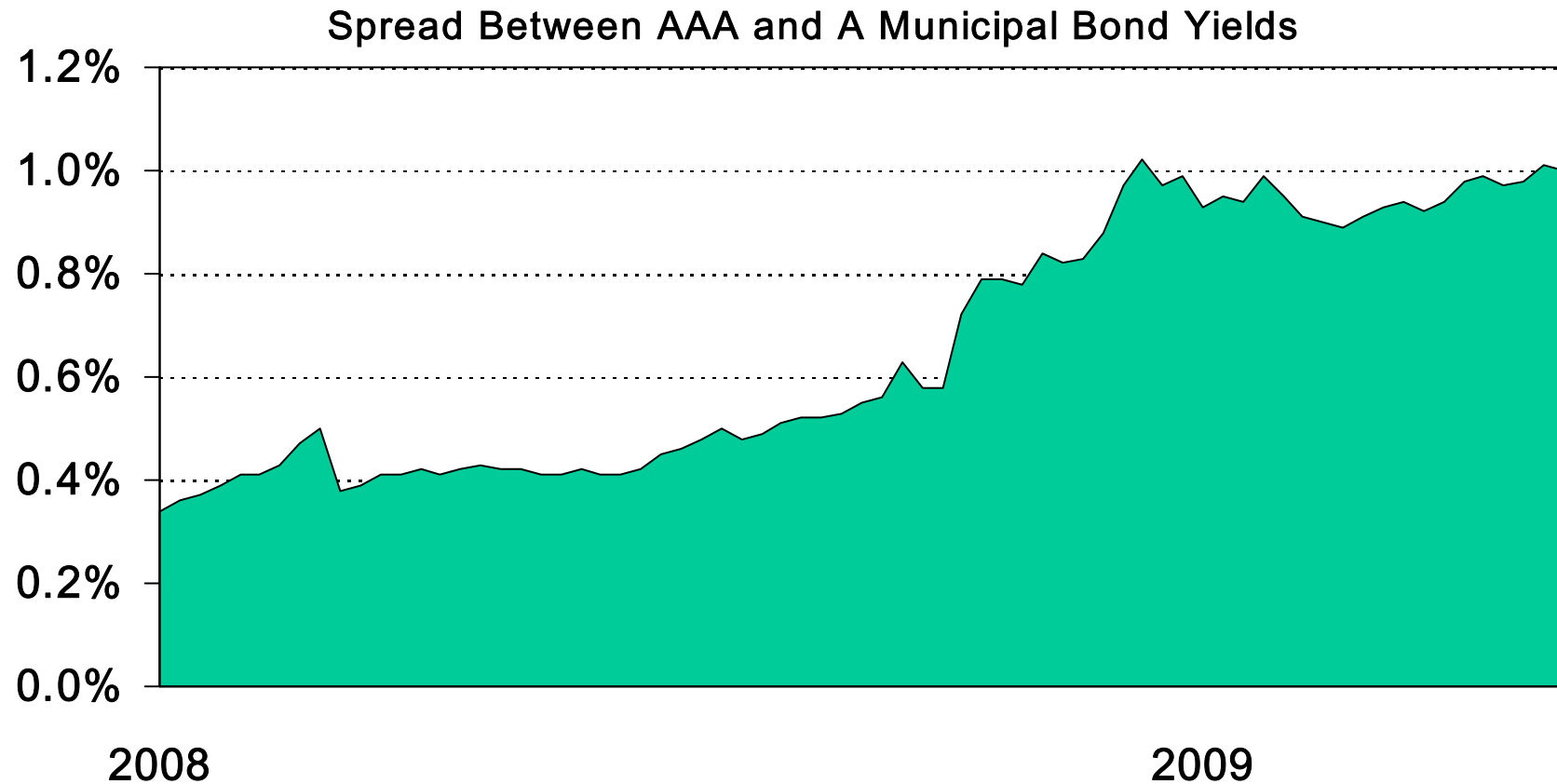
Current Yield Curves



A Reversal of the Norm



Flight to Quality

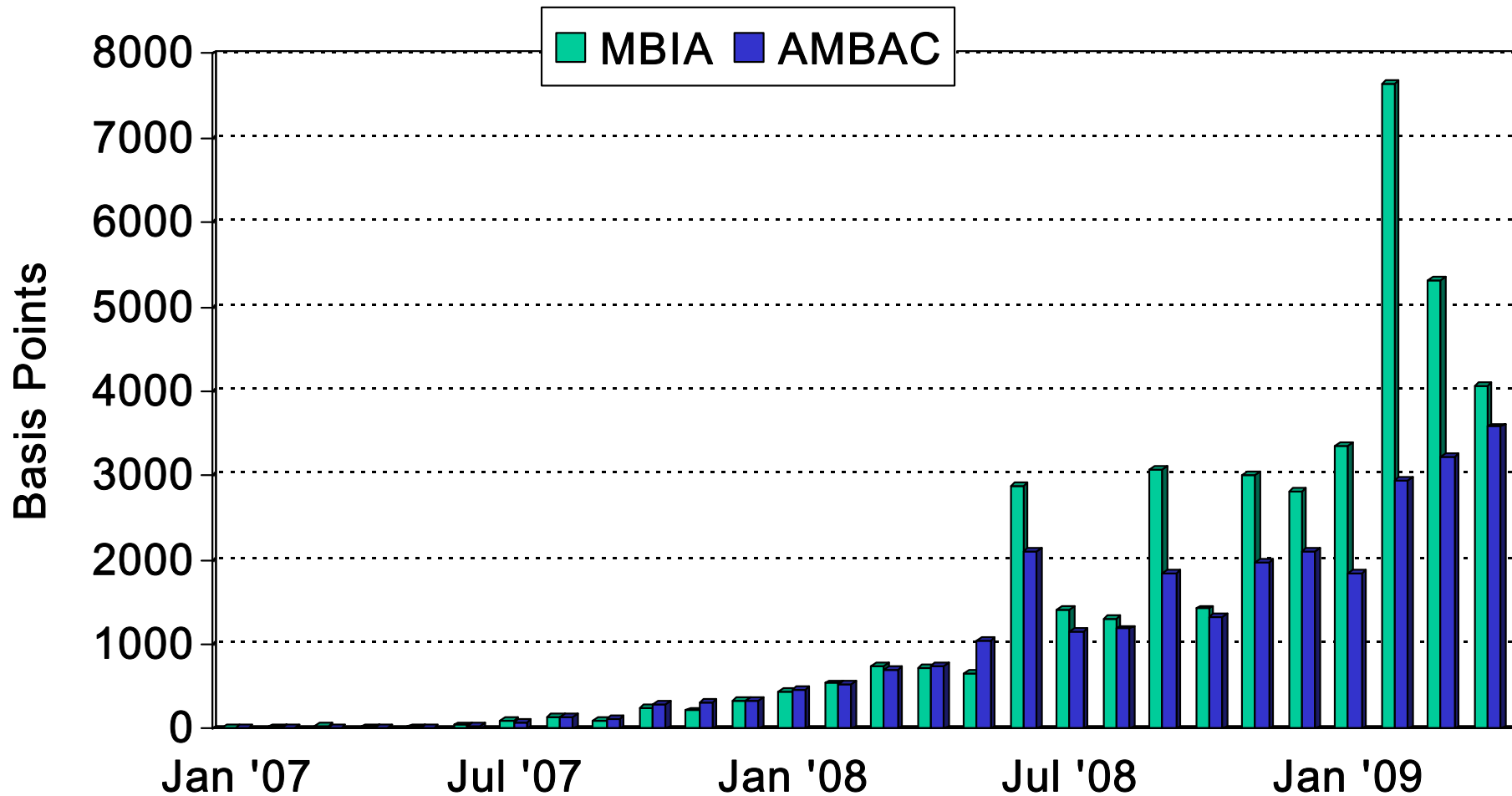


Reasons for the Reversal

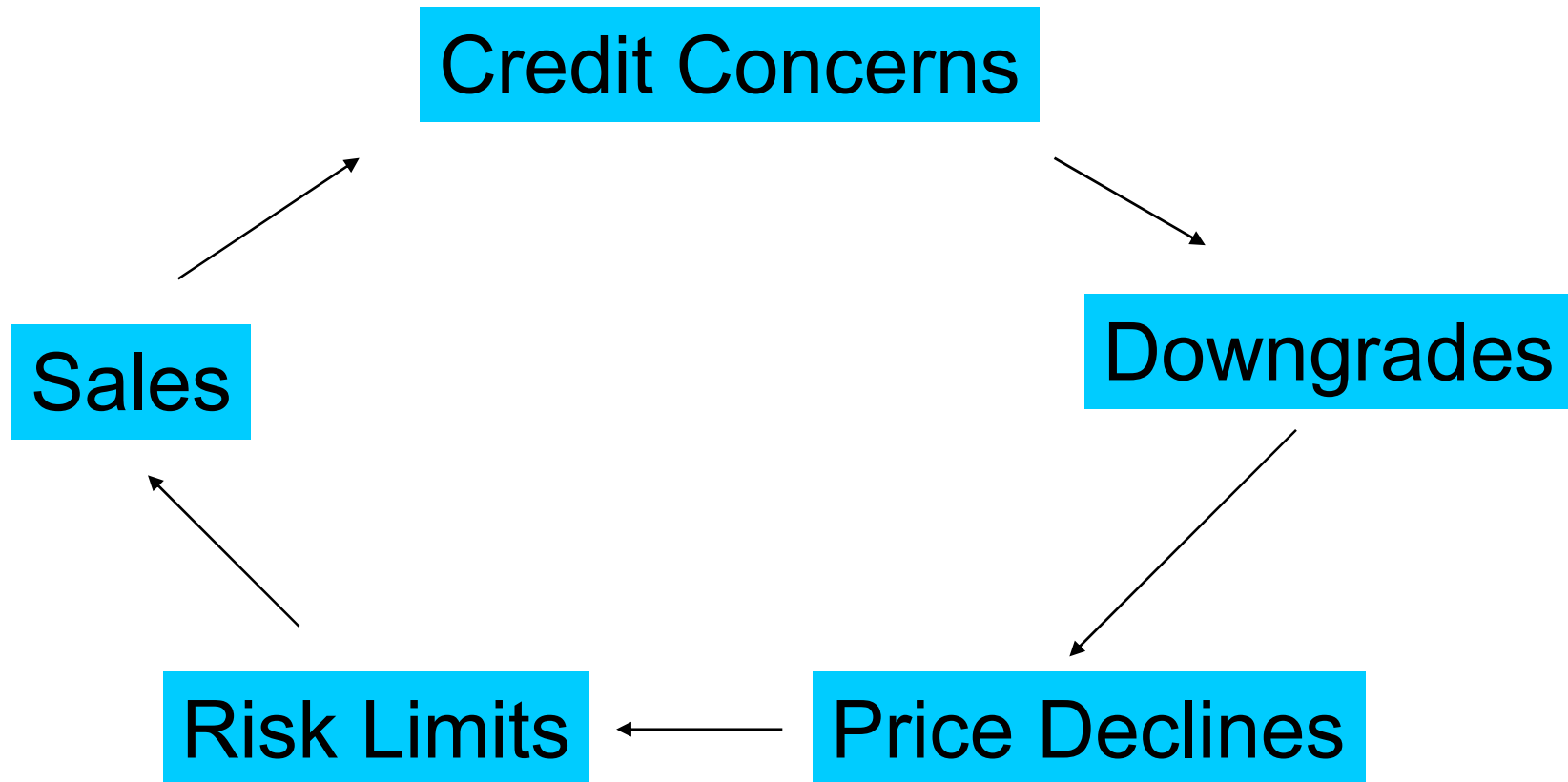
- Poor fiscal outlook
- General trend toward risk aversion
- Stress on collateral value and liquidity
- General concern over the integrity of ratings
- Instability of municipal bond insurers

Municipal Bond Insurers

Credit Default Swap Quotes



The Downward Spiral for Investors



- Models accelerate the process

Mark to Market Accounting

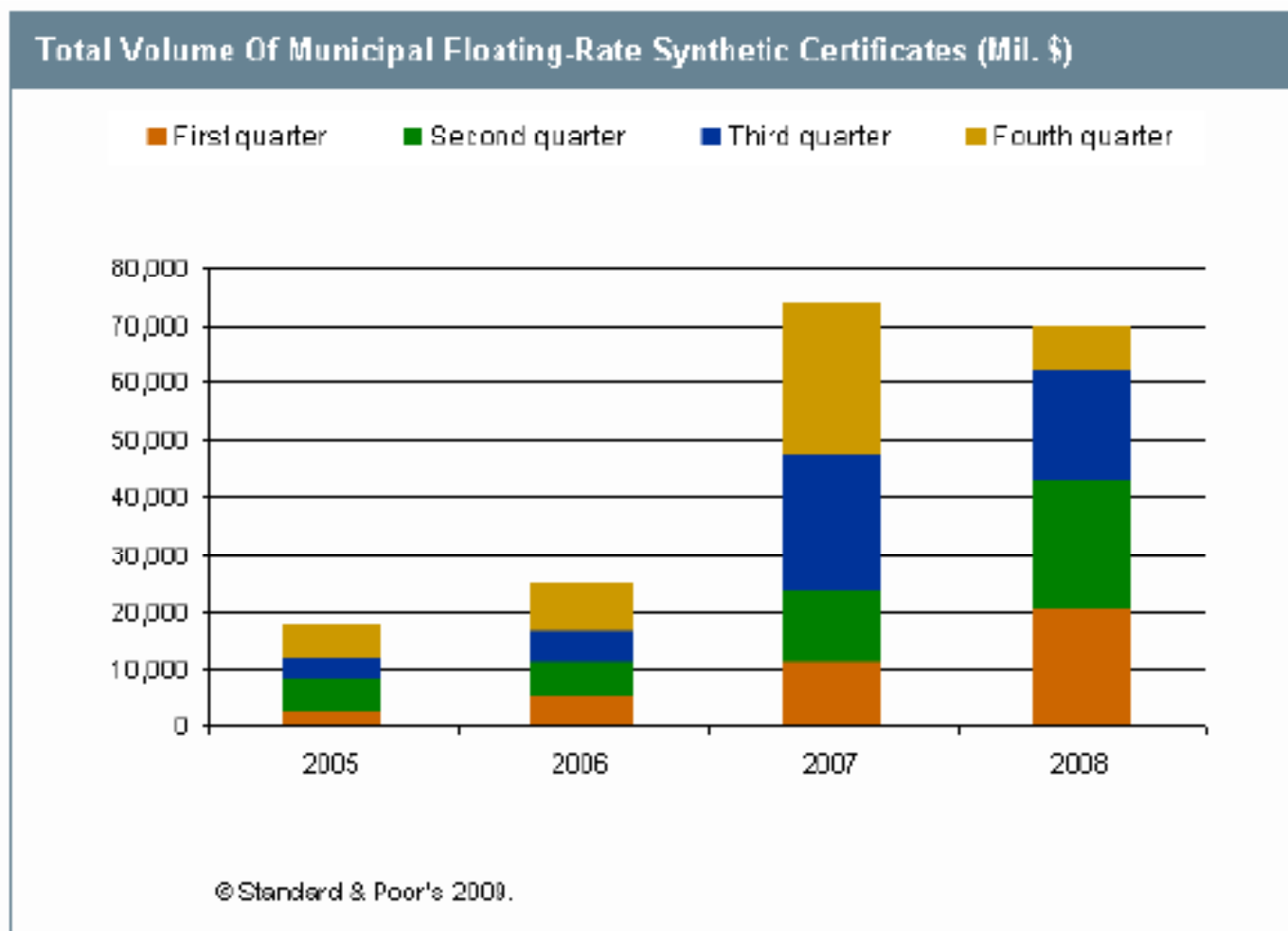
Pros

- Transparency: an external view of value
- Early warning signal
- The rule of thumb for securities markets (collateral)

Cons

- Performs poorly in illiquid environments
- Very pro-cyclical (on the way up, too)
- Not reflective of the way that all investors manage

The Rise of ARS, VRDNs, TOBs



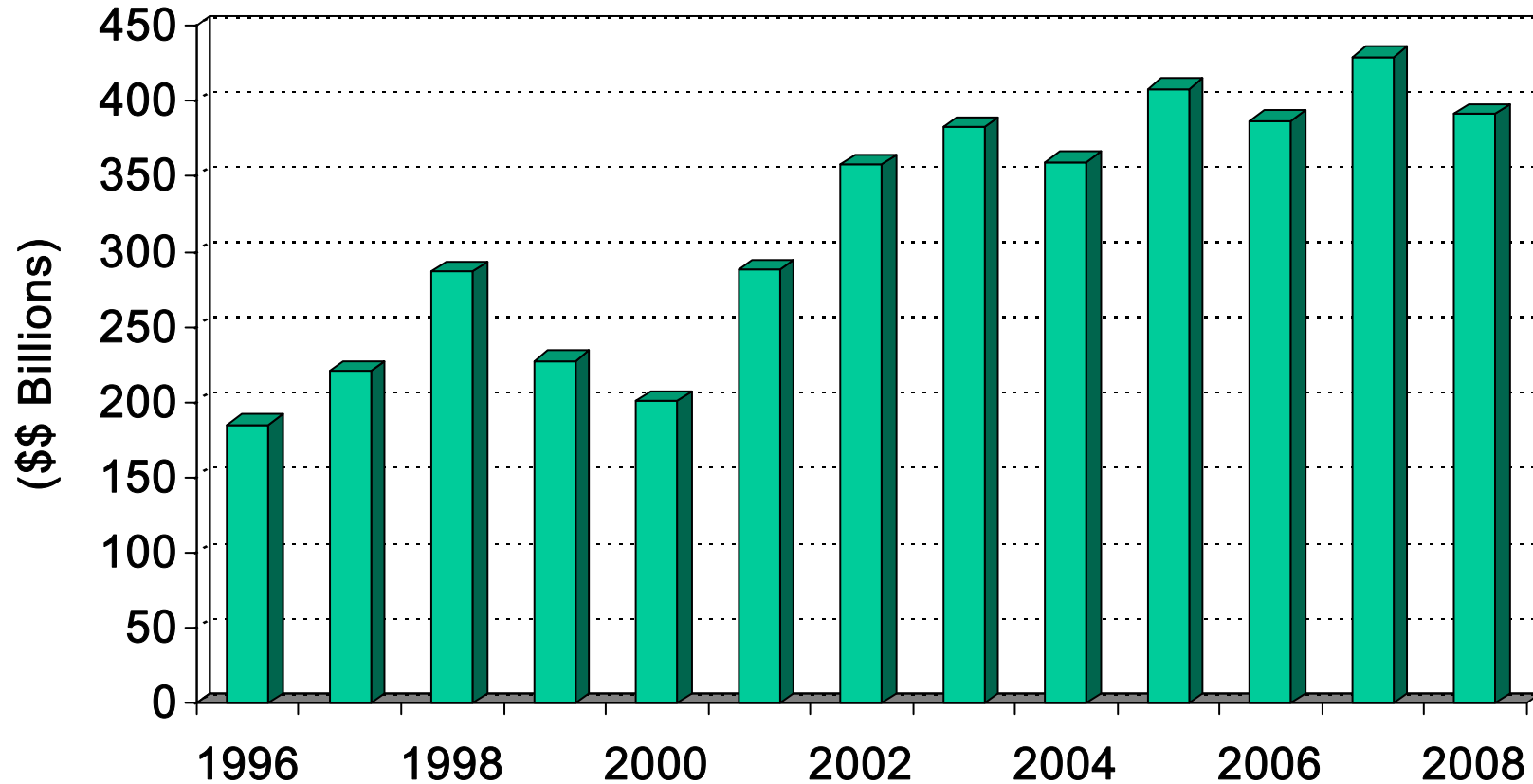
Short-Term Structured Products

- Issuers liked the combination of term liquidity and short-term costs
- Investors liked the combination of tax preference and short-term liquidity
- Sponsors liked the fees
- Ultimately, everyone was disappointed
 - Auctions failed
 - Issuer costs skyrocketed
 - Investors were locked in
 - Sponsors had to provide support to preserve reputation

Why No TALF?

- Securities are very heterogeneous
- Unclear resolution procedures
- Long maturities not consistent with desired exit strategies
- Providing a first-loss component
- State/local governments benefit directly from fiscal stimulus plan

Muni Bond Issuance



Not much dropoff for YTD 2009

Summary

- Municipal debt issues are getting done...
- ...but costs are significantly higher than they have been historically
- Shallow, heterogeneous markets play to investor fears about transparency
- Competition from other debt issues will be significant
- Other fixed income sectors may recover earlier