AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

THE EFFECT OF THE LEHMAN BROTHERS BANKRUPTCY ON STATE AND LOCAL GOVERNMENTS

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

MAY 5, 2009

Printed for the use of the Committee on Financial Services

Serial No. 111–26

U.S. GOVERNMENT PRINTING OFFICE

51–585 PDF WASHINGTON : 2009

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

BARNEY FRANK, Massachusetts, *Chairman*

PAUL E. KANJORSKI, Pennsylvania
MAXINE WATERS, California
CAROLYN B. MALONEY, New York
LUIS V. GUTIERREZ, Illinois
NYDIA M. VELÁZQUEZ, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
DENNIS MOORE, Kansas
MICHAEL E. CAPUANO, Massachusetts
RUBÉN HINOJOSA, Texas
WM. LACY CLAY, Missouri
CAROLYN McCARTHY, New York
JOE BACA, California
STEPHEN F. LYNCH, Massachusetts
BRAD MILLER, North Carolina
DAVID SCOTT, Georgia
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
MELISSA L. BEAN, Illinois
GWEN MOORE, Wisconsin
PAUL W. HODES, New Hampshire
KEITH ELLISON, Minnesota
RON KLEIN, Florida
CHARLES A. WILSON, Ohio
ED PERLMUTTER, Colorado
JOE DONNELLY, Indiana
BILL FOSTER, Illinois
ANDRÉ CARSON, Indiana
JACKIE SPEIER, California
TRAVIS CHILDERS, Mississippi
WALT MINNICK, Idaho
JOHN ADLER, New Jersey
MARY JO KILROY, Ohio
STEVE DRIEHAUS, Ohio
SUZANNE KOSMAS, Florida
ALAN GRAYSON, Florida
JIM HIMES, Connecticut
GARY PETERS, Michigan
DAN MAFFEI, New York

SPENCER BACHUS, Alabama
MICHAEL N. CASTLE, Delaware
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
RON PAUL, Texas
DONALD A. MANZULLO, Illinois
WALTER B. JONES, JR., North Carolina
JUDY BIGGERT, Illinois
GARY G. MILLER, California
SHELLEY MOORE CAPITO, West Virginia
JEB HENSARLING, Texas
SCOTT GARRETT, New Jersey
J. GRESHAM BARRETT, South Carolina
JIM GERLACH, Pennsylvania
RANDY NEUGEBAUER, Texas
TOM PRICE, Georgia
PATRICK T. McHENRY, North Carolina
JOHN CAMPBELL, California
ADAM PUTNAM, Florida
MICHELE BACHMANN, Minnesota
KENNY MARCHANT, Texas
THADDEUS G. McCOTTER, Michigan
KEVIN McCARTHY, California
BILL POSEY, Florida
LYNN JENKINS, Kansas
CHRISTOPHER LEE, New York
ERIK PAULSEN, Minnesota
LEONARD LANCE, New Jersey

JEANNE M. ROSLANOWICK, *Staff Director and Chief Counsel*

CONTENTS

	Page
Hearing held on:	
May 5, 2009	1
Appendix:	
May 5, 2009	45

WITNESSES

TUESDAY, MAY 5, 2009

Eshoo, Hon. Anna G., a Representative in Congress from the State of California	9
Galatolo, Ron, Chancellor, San Mateo County Community College District	18
Gordon, Hon. Richard S., Supervisor, San Mateo County Board of Supervisors, California	19
Hullinghorst, Hon. Robert, Treasurer, Boulder County, Colorado	20
Rushing, Hon. Karen E., Clerk of the Circuit Court and County Comptroller, Sarasota County, Florida	17
Speier, Hon. Jackie, a Representative in Congress from the State of California	7
Street, Hon. Chriss W., Treasurer, Orange County, California	23
Thornberg, Christopher, Economist, Beacon Economics	21

APPENDIX

Prepared statements:	
Eshoo, Hon. Anna G.	46
Speier, Hon. Jackie	49
Church, Mark	53
Galatolo, Ron	56
Gordon, Hon. Richard S.	58
Hullinghorst, Hon. Robert	62
Rushing, Hon. Karen E.	64
Street, Hon. Chriss W.	66
Thornberg, Christopher	72

THE EFFECT OF THE LEHMAN BROTHERS BANKRUPTCY ON STATE AND LOCAL GOVERNMENTS

Tuesday, May 5, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:04 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Moore of Kansas, Clay, McCarthy of New York, Baca, Lynch, Scott, Green, Cleaver, Hodes, Ellison, Klein, Perlmutter, Donnelly, Carson, Speier, Kosmas; Bachus, Royce, Manzullo, Biggert, Hensarling, Garrett, Neugebauer, Price, Campbell, Posey, Jenkins, Paulsen, and Lance.

The CHAIRMAN. The hearing will come to order.

This hearing is called at the request of two Members of the House: one is a member of this committee, the gentlewoman from California, Ms. Speier; and the other is the gentlewoman from California, Ms. Eshoo. They share representation of San Mateo County, which was one of the victims of the collapse of Lehman Brothers and the inability of Lehman Brothers to make any payments on the debt it owed.

They made the entirely reasonable request that we begin the process of examining what we can do for public entities that have lost funding in these situations. We will get to the specific question of the Lehman Brothers failure. But there are a couple of points that I think this illustrates in a broader way that we want to talk about.

As is often the case, we find it I think easier to figure out what to do to prevent a recurrence of something unfortunate than to undo the consequences of it. This, to me, is a clear example of why there needs to be in the Federal Government the power to unwind nonbanks.

We have, through the FDIC, the power to deal with situations where a bank is unable to meet its obligations. We are in that situation because of deposit insurance. But it became clear last year that there are problems that occur when nonbanks are unable to meet their obligations.

Now there are several things we should be doing about that. One, I am confident that before the end of the year, we will have signed by the President legislation that makes it much less likely that these institutions will become indebted to the point where

they cannot pay off their debts. There are restrictions that should be imposed that are not now in existence to deal with that. But no system will be fail-safe. And therefore, there needs to be a method of genuine failure.

When banks fail, it is disruptive, but not to the degree that it is when nonbanks have failed. Wachovia, Washington Mutual, several banks failed. We had a mechanism in place for dealing with them. But the failure of nonbanks, we have had three different results that I can think of, none of them even close to satisfactory.

First came the failure of Lehman Brothers. When Lehman Brothers failed, the Bush Administration tried to find some way to deal with the indebtedness and was unable to do so. There had been a prior successful effort on their part, as they saw it, to do that with regard to Bear Stearns, and they got the Federal Reserve to pick up some of the obligation, although it feels it is well collateralized here, and they got JPMorgan Chase to take the rest. They could find no better institution ready to do that for Lehman Brothers.

There was some hope at the time that Barclays Bank would do it. There was some resistance, I am told, on behalf of the British authorities. At any rate, Lehman Brothers failed, and nobody stepped in. It was very soon the conviction of people in the Bush Administration that the failure of Lehman Brothers with no alleviation, no effort to pay off any of its creditors, was the single worst thing that happened in the economy in 2008 and moved from pretty bad to God-awful.

As a consequence, when AIG faced the same situation, the decision of the Bush Administration was to prevent any failure. So, whereas in Lehman Brothers, nobody got paid off; in AIG, the decision of the Bush Administration was to pay everybody off. That has also not been the best received decision in the history of the Republic.

Then we had the Merrill Lynch example, another nonbank that was failing. And there the Administration encouraged, in 2008, Bank of America to buy it, similar to what had been done with JPMorgan Chase and Bear Stearns.

Later in the year, last year, Bank of America discovered that Merrill Lynch was in worse shape than it had thought. So it indicated that it wanted to let it drop. Once again, the Bush Administration, having seen the cataclysmic effects in their minds of Lehman Brothers, said, no, you can't do that. So they—and this is now being debated—encouraged, insisted, cajoled, bribed, whatever because the TARP money was involved. At any rate, as a consequence of these discussions between the Bush Administration and Bank of America, Bank of America bought Merrill Lynch or continued with the purchase.

So we have had three approaches to failed nonbanks: Lehman Brothers, where nothing happened; AIG, where everything happened; and Merrill Lynch, which was Bank of America buying it. In no case did we receive a satisfactory outcome. That strongly argues to us later this year to have in place what Secretary Paulson had called for, what the Obama Administration calls for using the bankruptcy power under the Constitution to tailor a statute that empowers some combination of Federal authorities to resolve an institution, and that allows differential levels of payment.

We see this in the Chrysler bankruptcy. There will be an effort to, because it is bankruptcy, do that. But that does not resolve the problem for the current creditors, and that is what we would be talking about. So I do note that this underlines the importance of a method of resolving institutions, and we do have undeniably a situation where this public entity, San Mateo County, can say, gee, we made a terrible mistake. We invested with Lehman Brothers when it went bust. We should have done it with AIG, because if we had been AIG creditors, we would have gotten paid. It is only Lehman Brothers creditors that were not paid.

There is no principle of any sort that can justify that result, and our job is to try and see if it can be dealt with.

The gentleman from Alabama is now recognized for 4 minutes

Mr. BACHUS. I thank the chairman.

Mr. Chairman, you have pointed out what I think is obvious to everyone, and that is that the Federal Government, the regulators did take different approaches. They let Lehman fail. They did not in the case of AIG. And this created winners and losers. You have argued that the worst thing that the Federal Government did was to let Lehman fail.

The CHAIRMAN. If the gentleman would yield. I have made no such argument. I was quoting the Bush Administration. It was the Bush Administration, as I tried to make clear, the Bush Administration's conclusion that this was a terrible thing. I did not express an opinion.

Mr. BACHUS. I was thinking you were acknowledging that.

For any institution to fail, it is a bad thing. However, I think what was the worst thing, and you did point it out, is that there was one approach taken for AIG, and one approach taken for Lehman. And it certainly doesn't appear equitable or right.

However, I think the mistake was not that they should have bailed everybody out, but that they shouldn't have bailed anybody out.

I know some of the witnesses, it is predictable, and Congresswoman Eshoo, I have great respect for you.

And I can say, as a result of when you do something for one company and its bondholders and investors, you don't for another; it obviously creates an environment where someone steps up and says, why don't we make the municipal investors in Lehman whole?

But I think it was a mistake to intervene and make the AIG investors, people who had invested in that, whole, and I think it would be a mistake to do this in Lehman's case.

But I respect your opinion.

Bottom line, I think the American people are in a state of bailout fatigue. The U.S. Government has committed over $9 trillion to bailouts or interventions. And I think most American people want to know, when does it end? And while I do see the reasoning behind H.R. 467, you know, it just again commits the American taxpayer to yet another costly obligation, because it requires the Treasury Secretary to pay any municipality holding Lehman debt as of September 15, 2008, and I believe in the full face value of the bond. And that is an obligation that the taxpayers would have to take up.

The taxpayers have been, I think, saddled with too many obligations on investment decisions gone bad. And while I do see the unfairness of doing something for one and not the other, I personally am opposed to more taxpayer-funded guarantees and bailouts.

The municipalities did suffer considerable losses after the collapse of Lehman. I think, had we avoided the first intervention, we wouldn't be here today. And I think, had we not bailed out AIG, you wouldn't be here today with this bill.

As I said, and I am just going to close, I think that Lehman was really what we should have done, in that we should not have bailed out—we shouldn't have "too-big-to-fail." And we do need a resolution authority. We do need a systemic regulator.

But I think what we do with those is we have an orderly resolution and probably in bankruptcy or bankruptcy-like provision. And without any guarantee on the part of the taxpayers, I think that is the key, that we are not going to obligate the taxpayers, we are not going to have the government in the intervention business. And I am afraid that what this legislation would do, it would just be another step down the road that we shouldn't be on, not something that started with Lehman but something that I must oppose.

Thank you.

The CHAIRMAN. The gentleman from New Hampshire is recognized.

Mr. HODES. Thank you, Mr. Chairman.

And thanks for holding this very important hearing about the collapse of Lehman Brothers and its effect on State and local governments.

Many communities across the country, including in my home State of New Hampshire, of Nashua, Manchester, and others, have been very hard hit by the failure of our capital markets.

In February of this year, Mr. Chairman, we wrote a letter to Chairman Bernanke and Secretary Geithner asking them to provide assistance to States and localities that have been hurt by the economic downturn. Clearly, the inability to issue bonds has severely limited the ability for towns to raise capital in the ordinary course in order to fund the kinds of projects that they used to fund all the time: roads; sewers; and other public works.

As this hearing focusing on the impact of the Lehman Brothers collapse will no doubt demonstrate, further liquidity is needed for States and localities across the country. Many are still waiting for the short-term liquidity market to be active again. And hopefully, while we may debate interventionist or noninterventionist policies, while we make talk about whether it is AIG or Lehman Brothers that was the worst part of all this, it is up to us in Congress to find a way to help our community.

So I welcome my colleagues here today and look forward to discussing what solutions Congress can offer the American people.

Thank you, Mr. Chairman. I yield back.

The CHAIRMAN. The gentleman from California is recognized for 2 minutes.

Mr. ROYCE. Thank you, Mr. Chairman.

I would like to welcome Mr. Street from Orange County, California, who is going to be testifying on the second panel. By all accounts, I think Lehman Brothers was and is today a failed institu-

tion. The firm was very highly leveraged. It had significant exposure to the mortgage market, including the subprime sector. It had over $6 billion in subprime. It even owned a subprime mortgage originator, and institutions ignored those risks.

I am afraid we are moving away from personal and institutional responsibility on a massive scale. I voted against TARP because of this, and I have opposed other government bailouts because I am becoming increasingly concerned with the Federal Government's new role as savior of all things failed.

The Federal Government must get out of the business of picking winners and losers. There have been other municipalities that took significant losses on failed investments over the years without receiving government assistance. Orange County, California, took a hit in the 1990's, and a lesson was learned that it was a dangerous endeavor for county treasurers to use taxpayer funds to invest in products local governments do not understand.

I am afraid our incessant desire to reward those poor investment decisions will inevitably weaken, if not erase, market discipline. The strength of your ties to the Federal Government should not be more important than counterparty due diligence in your ability to make prudent investments. Unfortunately, Congress has repeatedly signaled the opposite in recent months.

I yield back the balance of my time, Mr. Chairman.

The CHAIRMAN. The gentleman from Texas, Mr. Hensarling, for 2 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman.

Bailouts beget bailouts which beget more bailouts. As Members of Congress, we have to ask ourselves the question, how many more bailouts can the taxpayers in future generations bear?

Last week an economic plan, a budget was adopted that will triple the national debt in 10 years, more debt in the next 10 years than in the previous 220, leading to a debt burden of $148,926 per household.

Now stocks are down. People have lost $11 trillion since the peak in the market, $11 trillion. Pension funds have lost. Charities have lost. Families have lost. Small businesses have lost, and yes, municipalities in State governments have lost as well.

The question I have, Mr. Chairman, is, who hasn't lost? And who isn't hurting in this economy? So if everyone who lost money in the market is to bail out everyone else who lost money in the market, are we truly better off? I think not.

How about the States and municipalities that lost money in Circuit City? Where is their bailout? How about the Washington State Investment Board that lost millions and millions in WaMu? Where is their bailout? How about the State of North Carolina State Pension Fund? They are down $17 billion. Where is their bailout? And a couple near and dear to my heart, small businesses in the Fifth District of Texas, United Rentals, Mineola Mercantile. They went out of business. Where is their bailout?

Once you absolve people of responsibility, you will beget more irresponsible behavior. We will also end up with firms that only invest in the largest firms that are perceived to be too-big-to-fail. This is a bad idea, and I do not believe we should go down this road for taxpayers and for future generations.

I yield back the balance of my time.

The CHAIRMAN. The gentleman from Georgia, Mr. Scott, for 2 minutes.

Mr. SCOTT. Thank you, Mr. Chairman.

I congratulate you on having this hearing. I think that the fundamental question we have before us now is, what do we do going forward that is in the best interest of the taxpayers?

Lehman Brothers in this situation presents us with a unique set of circumstances because, as a double whammy hit here on the taxpayers, as we know, when AIG was bailed out and others because of a "too-big-to-fail," Lehman was left out. And here is what happened. Millions of taxpayers' dollars were lost, but those dollars didn't just evaporate. They had been invested by cities and counties and State agencies, and many of these moneys were invested in a pool arrangement where millions were put into bond revenues for new construction projects at their new community colleges, at schools, community clinics, etc.

So the question now before us is, is it fair for these taxpayers who will be paying off the bonds for years to come to have nothing to show for it? And is there not some rationale for Treasury to be able to come in and be able, not to rescue Lehman now—that is off the books. The question is, is it proper for the Treasury Department to come in and rescue the taxpayers? I think that is the question before us today.

I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman from Georgia, Mr. Price, for 2 minutes.

Mr. PRICE. Thank you, Mr. Chairman.

It is extremely important for us to be discussing the Lehman Brothers bankruptcy in the context of the full committee. But I would also suggest and like to draw attention to the fact that we still haven't had a hearing on the collapse of Bear Stearns, which undeniably shaped the public expectations for the government bailout of Lehman Brothers.

On April 7, 2008, Ranking Member Bachus and 16 members of this committee sent a letter to the chairman requesting a hearing specifically on Bear Stearns, which has not yet occurred. We have not had a hearing focused specifically on the events that led to the Lehman bankruptcy, derivatives, or the SEC's now defunct Consolidated Supervised Entities Program, which supervised Lehman and the four other investment banks.

In the wake of Bear Stearns, and leading up to the bankruptcy of Lehman, many investors continued to purchase bonds or commercial paper issued by Lehman Brothers. In a normal functioning market, without suspicion of government backing or bailouts, investors would have likely been much more cautious, investing elsewhere and spreading their risk. Protecting risk seems to be the primary issue that has brought us here today.

Our Nation has a system that, though painful, works extremely well in times of great challenge. It is the bankruptcy system. And I would suggest that the Lehman bankruptcy actually unfolded relatively smoothly. While many would like to attribute this unprecedented event to the inadequacies of the bankruptcy system, the more accurate culprit is the government's unpredictable meddling

in the market. This certainly contributed more than any insufficiencies within the Bankruptcy Code.

The situation with Lehman Brothers, the government created an unreasonable expectation that led to increased economic turmoil. Part of getting this country back on track is getting the government out of the market and out of the business of eliminating risk. Investments involve risk and reward. If we take away all the risk, there will be no reward for anyone, no opportunity for anyone, and no reason to invest in the future. We should look at that.

The CHAIRMAN. The committee will now begin the hearing, and we will hear from our two colleagues.

First, we will hear from the committee member, the gentlewoman from California, Ms. Speier.

STATEMENT OF THE HONORABLE JACKIE SPEIER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Ms. SPEIER. Thank you, Mr. Chairman.

Thank you for convening this hearing today to examine the devastating impact of the failure of Lehman Brothers as it relates to State and local governments.

Although San Mateo County has been hit particularly hard, this is truly a national problem, and I want to underscore that, as you will hear from witnesses today from California, Colorado, and Florida. There are affected communities in at least 20 States, from Alaska to Washington to Massachusetts. Some of the losses are relatively small, but Minnesota lost more than $56 million. Missouri lost $50 million. Oregon lost $173 million. Washington lost $130 million, and Florida, already hit hard by two natural disasters and a recession, lost more than $465 million.

I would like, Mr. Chairman, to ask unanimous consent to enter testimony from some other affected entities.

The CHAIRMAN. Without objection, it will be made a part of the record.

Ms. SPEIER. At the beginning, let me just say that so much of our taxpayer money in TARP and the bailouts of AIG and others have gone to private institutions. We are asking here that taxpayer money go to taxpayers in these local jurisdictions.

So I would dispute what has been said by some that somehow it is taxpayer money being used again in a fashion that is inappropriate. This is actually money going back to the taxpayers.

As you know, Congresswoman Eshoo and I have both introduced a bill, H.R. 467, that would require the Treasury Department to repurchase certain Lehman investments held by these government entities at full face value using TARP funds. The Treasury Department asserts it still has $135 billion left in its TARP arsenal. It has used hundreds of billions of those taxpayer funds to bail out Wall Street. We are asking that a mere $1.7 billion of taxpayer money be provided to save Main Street.

As we all know, Lehman's was the only major investment bank the Federal Government did not prop up last September when Wall Street went into a free fall seemingly overnight. Bear Stearns, the first to be helped in being deemed too-big-to-fail, was half the size of Lehman Brothers. Negotiations the weekend of September 13th

between the Treasury, the Fed, Lehman Brothers, and Merrill Lynch resulted in Merrill, with Treasury's help, being acquired by Bank of America; Goldman Sachs and Morgan Stanley were each allowed to become bank holding companies. Lehman's then was allowed to go into bankruptcy, the largest bankruptcy in the history of this country.

In the words of Nobel Prize winner Paul Krugman, the decision to let Lehman fail was the event that basically brought the entire world's capital market down. The decision by the Treasury and the Fed to allow Lehman to fail was arbitrary and caught many taxpayer-funded agencies unprepared. They had watched the takeover of Countrywide by Bank of America and the bailout and takeover of Bear Stearns by JPMorgan and concluded, like many others, that since in those cases, note holders had been made whole, Lehman was unlikely to declare bankruptcy. But Secretary Paulson did not offer Lehman the same guarantees that it offered others. And if these local governments had chosen to sell their Lehman investments prior to maturity, they would have suffered a definite and substantial loss, negatively affecting the whole investment pool.

It is not like these government bodies were using taxpayer funds to speculate in the market. The public agencies were all talking about investing in Lehman corporate bonds and notes as part of a strict, safe, and conservative investment strategy. In fact, most of the debt instruments in question were highly rated right up until the moment of Lehman's collapse.

San Mateo County's pooled investment in Lehman's was rated A1 for the floating rate securities and A for its corporate bonds. That investment pool is prohibited under State law from investing in equities. And it is limited to conservative instruments, such as U.S. Treasury obligations, high-rated commercial paper, certificates of deposit, and the like.

Preservation of principal is of primary importance to minimize credit risk while recognizing and controlling market risk, matching maturities with capital expenditures and other planned outlays. Diversification plays a big role in that effort. San Mateo County only invested 5.9 percent of its pool in Lehman as part of its diversification strategy. It also holds similar investments with Morgan Stanley.

I believe that Treasury already has the power to do what we are asking. The language that Congresswoman Eshoo placed at ESA with the help of the chairman certainly instructs the Treasury Secretary to take into consideration the need to ensure stability for U.S. public instrumentalities, such as counties and cities, that may have suffered significant increased costs or losses in the current market turmoil. We requested that Secretary Paulson take such action last fall, and we have made the same request of Secretary Geithner in February, but have gotten no response.

There seems to be no limit to the amount of assistance we are willing to provide to the likes of AIG, Citigroup, Bank of America, and Goldman Sachs, let alone foreign interests which speculative derivative deals have been fully paid through the taxpayer-funded bailout of AIG. Goldman not only has been the beneficiary of $10 billion of TARP money directly, but it has gotten another $13 billion through its credit default swaps with AIG, all while it has re-

ported a $1.8 billion quarterly profit and is seeking to repay its $10 billion in TARP funds because it doesn't like the compensation strings that come with it.

If AIG had been forced to declare bankruptcy, the financial institutions like Goldman doing business with it would have wound up in court, just like San Mateo County has had to do with Lehman's, fighting to get pennies on the dollar for their claims. I say, let Goldman repay its bailout and use that money where it is really needed, in our local communities.

Restoring the value of these Lehman bonds is perhaps the fastest way to bring relief to communities across America, allowing them to pay their employees, maintain current levels of service, and immediately put shovels in the ground on already approved projects. Maybe in the grand scheme of things, $1.7 billion is just not seen as a big enough problem. To the local governments, school districts, sanitation and water districts, and the communities they serve across the country, these losses are devastating. How ironic that they should be left wishing they had invested in credit default swaps with AIG. If they had, we wouldn't be here today.

Thank you, Mr. Chairman.

[The prepared statement of Ms. Speier can be found on page 49 of the appendix.]

The CHAIRMAN. We will now turn to Congresswoman Eshoo.

But by way of introduction, I did want to share with people here a very important fact, which I learned from the publication CQ Today, and I call people's attention to page 12 where it says, when Representative Anna G. Eshoo was in high school in Connecticut, President Harry Truman gave her a ride home from school. It seemed to me that that information ought to be shared.

And we are glad that you made your way from Connecticut to California and are here today to represent your district. Please go forward.

STATEMENT OF THE HONORABLE ANNA G. ESHOO, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Ms. ESHOO. Thank you, Mr. Chairman, for that wonderful added note to you, to Ranking Member—

The CHAIRMAN. Was it the President himself or was it the Secret Service? Did the Secret Service drive, or did he drive?

Ms. ESHOO. No. He was sitting in the back seat of the car. There was very little security. Police officers on motorcycles in front of the car and behind it, flags on the car. And I was walking home from school. I was at a four-way stop and he said, "Where are you going, little girl?" And I said, "I am going home."

The CHAIRMAN. And no one told you not to take a ride from strangers at that time?

Ms. ESHOO. Well, it gave me confidence because there were police officers. And we all had the admonition from our mothers, but there were police officers on motorcycles and flags on the car. So he gave me a ride home. So thank you.

Thank you, Mr. Chairman, for calling this hearing.

To Ranking Member Bachus, to Mr. Neugebauer, and to all of the members and friends who are members of this committee, it is

very special for me to be here today to testify before you about a matter of really critical importance to local communities, not only from our shared San Mateo County in California, parts of our congressional district, but for local communities around the country.

I think the hearing is necessary so that any discussion concerning the financial losses of the public entity victims of the Lehman bankruptcy can be put into appropriate context.

Chairman Frank rightly called these public entities, "the unfair victims of this financial crisis."

On September 15, 2008, as Congresswoman Speier noted, after 150 years of continuous operation, Lehman Brothers declared bankruptcy. The Lehman bankruptcy was the largest in our Nation's history with nearly $700 billion in reported debt. And it is described as triggering an event for the resulting international financial crisis.

Following the collapse of Lehman, the Executive and the Legislative Branches of our government responded rapidly and aggressively in order to prevent any further failures of other major institutions by adopting the Emergency Economic Stabilization Act of 2008. As we all know, the Act was signed into law by President Bush on October 3rd of last year, and it created the Troubled Asset Relief Program (TARP).

It gave the Secretary of the Treasury both the authority and the responsibility to provide financial assistance to institutions through the purchase of "troubled assets" on such terms and conditions as may be appropriate.

In exercising this authority, the Secretary is required to take a number of factors into consideration, including, "the need to ensure stability for United States public instrumentalities, such as counties and cities, that may have suffered significant increased costs or losses in the current market turmoil." That is section 1037.

I proposed this language, and it was added to the bill with the support of the leadership and the assistance of the chairman of this committee, Chairman Frank, and his very able staff, as well as the support of Speaker Pelosi.

Since adoption of the Act, the Treasury Secretary committed to provide financial assistance in the approximate amount of $590 billion to more than 535 financial institutions. This assistance includes approximately $45 billion to Bank of America; $50 billion to Citigroup; $40 billion to insurance giant AIG; and $24.8 billion to automakers.

To date, no assistance under the Act has been provided to any United States public instrumentality. It has been said that some banks are too-big-to-fail. It can also be said that counties, school districts, and cities are too-small-to-be-noticed. Their losses represent one-quarter of 1 percent of TARP funding. The fact that TARP was intended to and should assist local public instrumentalities is clear.

Chairman Frank and I had a colloquy on the Floor of the House on January 15th of this year, and in response to my questions on the Floor, he reinforced that the Act is intended to provide financial assistance to local government entities which were significantly impacted by the Lehman bankruptcy; and that the Act expressly

provides authority for the Secretary of the Treasury to provide that kind of relief.

In fact, Mr. Chairman, I think you said it best when you indicated that it was important, "not simply to confirm that the authority is there but to say that we expect it to be used and to demand that if it is not used, we get a written explanation as to why not."

On November 8, 2008, I wrote to Secretary Paulson requesting that he exercise his authority under section 1037 of the Act to purchase the troubled assets held by local governments. He called me on November 21st, and reiterated his decision not to include local governments in the TARP.

On November 25, 2008, I wrote to the Presidential transition team spelling out the case and urging them to take action where the Bush Administration had not. I urged them to use the authority that was in the law.

On February 13th, together with Congresswoman Speier, we wrote to Secretary Geithner. Almost 30 of our House colleagues joined us. We again requested that he exercise the authority under the law. And I ask that these letters as well as our colloquy—

The CHAIRMAN. Without objection, they will all be made a part of the record.

Ms. ESHOO. Thank you.

The Treasury's decision to let Lehman fail is causing catastrophic losses to many localities, resulting in job losses, termination of ongoing construction projects, and elimination or reduction in critical services. Hospitals are reducing services and staff. Schools are laying-off teachers. Police and fire departments are reducing patrols and limiting services.

And what wrongs are these school districts, counties, and cities guilty of? They invested in highly rated conservative instruments in Lehman Brothers. That is the sin that they committed. And those are taxpayer dollars that should be put to work in our local communities gone when Lehman Brothers went down.

If we want our national economy to rebound, our local economies cannot be left behind. And this is not just a California problem. It includes public entities from Florida, Colorado, Arizona, Michigan, Massachusetts, Missouri, Oregon, Washington State, and the list goes on.

We need to return these dollars to them. We have a law that is clear. We have a case that is clear. What we need is clear, decisive action to right this wrong. Local taxpayers and communities should not have to tolerate losing their most basic services because the Federal Government allowed Lehman Brothers to go down.

Thank you, Mr. Chairman.

And thank you to all the members.

[The prepared statement of Ms. Eshoo can be found on page 46 of the appendix.]

The CHAIRMAN. I thank you.

Are there any questions from any members of the committee for the Members?

The gentleman from Illinois.

Mr. MANZULLO. Congresswoman Eshoo, before the TARP bill was passed, Lehman went under, and then Treasury—or the Fed

stepped in to infuse AIG. I am almost positive that the timing is correct on that.

The CHAIRMAN. The gentleman is correct. It was Lehman Brothers failing; AIG with money from the Fed; and then the TARP proposal.

Mr. MANZULLO. Okay. Thank you, Mr. Chairman.

And my understanding is that conversations actually went on between the Fed and Lehman.

Anything that you can add to that, Congresswoman Eshoo, as to why AIG was chosen and not Lehman Brothers?

Ms. ESHOO. Well, I think that is the $64,000 question.

In fact, when I spoke to Secretary Paulson on November 21st, I asked him that very question. I said, "Why did you allow Lehman to go down?" And he said, "That is a whole different conversation that we will have to have at another time." So he didn't offer any explanation for it.

Mr. MANZULLO. Of course.

The CHAIRMAN. We were in the position then of being informed, not consulted, until we came out with the TARP. The information I got at the time was that there was an effort. This always happens on weekends. We reached a point where I wanted to cut my phone wire on Friday afternoon because I was always getting bad news after the markets had closed for the weekend, and there was an effort, I believe, by the American Government to get Barclays Bank in England to take over Lehman Brothers, and the British authorities didn't think that was a great idea.

So there was an effort on the part of the Administration to try and find someone to take over Lehman. Apparently, you know, that is the information that I got.

It is the gentleman's time.

Mr. MANZULLO. I will yield of course.

Mr. GARRETT. Just to follow up with the chairman's comment, and if recollection serves, and correct me if I am wrong, I think part of the discussion with Barclays at that time was they were looking for the same thing as they saw with Bear Stearns; there has to be some kind of backstop on this. I think at the time the Fed said, no, we are not going to be the backstop. And of course, right after that, you had AIG where you had a huge backstop. There is the irony in it.

I will yield back.

The CHAIRMAN. It is clear Secretary Paulson and Chairman Bernanke were operating under enormous pressure. So I make no criticism of them.

They were partly influenced, frankly, by some criticism about Bear Stearns. So they didn't want—they were reluctant to intervene too much, and then they were reluctant not to intervene at all. But that was the answer—what I heard, frankly, on Sunday, I was called and said, we are hoping to get Barclays to do this, and then once Barclays said "no," there was nobody else.

Mr. MANZULLO. And the second question is—could I ask the chairman? He might know more than we do. Any idea as to the dividend that will be paid in bankruptcy on these bonds?

Ms. SPEIER. It is estimated that these jurisdictions will see anywhere from 7 to 20 cents on the dollar.

Mr. MANZULLO. Thank you.

The CHAIRMAN. Any further questions?

If not, the gentleman from New Hampshire, and then the gentleman from Colorado.

Mr. HODES. Congresswoman Eshoo, I note, in your written testimony, that you say on November 7th, you wrote to Secretary Paulson requesting that he exercise the authority that he clearly had to help municipalities. That is right?

Ms. ESHOO. Yes.

Mr. HODES. He called you back?

Ms. ESHOO. I spoke to him. He called me on, I believe, November 21st.

Mr. HODES. And you say that he reiterated his decision not to include local governments in the TARP.

Ms. ESHOO. He really was not interested in it.

Mr. HODES. Why? Did he tell you why?

Ms. ESHOO. I asked him why, and he said, "What I said stands."

Mr. HODES. But without any explanation?

Ms. ESHOO. Without any explanation, yes.

Mr. HODES. Later, in February, you wrote to Secretary Geithner with a number of Members of Congress, and you requested that he exercise his authority under TARP to help municipalities. Have you heard anything back from him?

Ms. ESHOO. Nothing in the mail pouch and no return phone calls.

Mr. HODES. Has anybody else from Treasury contacted you to talk about this?

Ms. ESHOO. No, not at all. As a matter of fact, I said it in my—I believe I said it in my testimony that, on the heels of the election, I wrote to the transition team to point out that this was something that needed to be dealt with; that it hadn't been dealt with by the previous Administration. I looked forward to working with them. And no response.

Mr. HODES. And setting aside for a moment the broader issues of the plight of our municipalities, just focussing on the Lehman collapse aspect, we are talking about $1.7 billion. Is that about—

Ms. ESHOO. Approximately that. It represents about one-quarter of 1 percent of all of the TARP funding.

Mr. HODES. And we know, at least according to Treasury, that there is $130 billion-plus still left in TARP, and nobody from Treasury has contacted you to talk about this issue?

Ms. ESHOO. Not yet. But I have remained hopeful.

Mr. HODES. Thank you.

Mr. Chairman, just before yielding back, I would like to hear from Treasury as to—I would like to get a response from them, and any effort that we can make on this committee to get Treasury to respond to this issue, I think, is really important.

Thank you. I yield back.

The CHAIRMAN. The gentleman from Colorado.

Mr. PERLMUTTER. Thank you, Mr. Chairman.

I want to compliment Congresswoman Speier on dealing with this issue. You were one of the first to raise this on the effect on local governments, whether they were hospital districts or school districts or whatever.

And I appreciate both of you taking this on.

We have a witness, Mr. Hullinghorst, who is our treasurer from Boulder County, who will be one of the panelists in the next group, and he is going to be speaking about some of the losses Colorado jurisdictions have suffered.

And to complicate it a little more, my question to you is—let me step back. There were indirect losses, too, by other government agencies in Colorado who had put a lot of money into a major money market with the reserve fund, and the primary fund, which invested all of its money—or a bunch of its money with Lehman Brothers, and then that has caused, as a secondary effect, losses to Colorado jurisdictions.

In your bill, do you deal just with direct investment in Lehman Brothers, or is there a potential for assistance to secondary losses?

Ms. SPEIER. The bill deals just directly with losses incurred because of the Lehman investments.

Mr. PERLMUTTER. And to my friend from Illinois, I think the testimony that we did hear in another committee about Lehman Brothers was that the Treasury had asked Mr. Fuld from really the time that Bear Stearns was merged on to look for a partner. And apparently, Lehman—at least the Treasury would say they tried to encourage a partnership earlier on in the year than when everything came down in September.

With that, I yield back.

The CHAIRMAN. The gentleman from New Jersey.

Mr. GARRETT. Just one closing question, I apologize. You know how it is; you come in and out of the hearings.

The CHAIRMAN. Sometimes even while you are sitting here, I find.

Mr. GARRETT. You are alluding to yourself, not to me?

The CHAIRMAN. Yes.

Mr. GARRETT. I will take a question that I assume that my colleague from Texas—I didn't hear his testimony. But I think I know what his testimony was. The question being, understanding the concerns that you have, and we have the same concerns in the State of New Jersey—I am from New Jersey, and you may know there is $118 million at question right now—is the old question of line drawing, and that is to say, if we do it for this class of investors, will we hear from other classes of investors? And to answer that question, sure, we will be hearing from seniors who have their pensions in this, or you will hear from unions that have pension funds, and businesses that have their pension funds or other seniors and retirees and the like. So how was that it you made the delineation that public institutions would get the bailout, but seniors and union workers and businesses would not?

Ms. SPEIER. The distinction that is being made is that these are taxpayer funds that were invested in A1 and A instrumentalities, both notes and bonds, and that these taxpayers should be repaid. We are not talking about investments made by individuals. We are talking only and exclusively about taxpayer funds invested for the purposes of holding onto money needed for the conducting of business and construction of projects. So that is the distinction we are making.

Ms. ESHOO. And the language is reflected in the TARP bill as such. Many don't realize that that language is now the law, and

it is very specific. It is section 1037. So these are public moneys that were—as I said, the only sin that the local governments and the school districts and the counties committed was to invest in highly conservative, highly rated instruments. And those tax dollars are gone, and the local jurisdictions are left holding the bag. So it is not about individuals, as Congresswoman Speier said.

Mr. GARRETT. You can both appreciate the fact that if all of this goes forward, that all of our offices probably will hear from individuals on this because they will say, okay, New Jersey's teacher pension fund, for example, now has been bailed out or the State union funds have been bailed out but my fund, meaning the union that I work in or my employment, is not bailed out. And so you can appreciate that is going to happen.

Ms. SPEIER. If I could, we specifically don't deal with pension funds. So it is not our intention to see pension funds reimbursed. It is only local jurisdictions that had money in these types of instrumentalities for purposes of operating local government or doing local construction.

Mr. GARRETT. Which is why that other area—all those other areas are going to come up. The other issue, of course, is the moral hazard that is being created here as far as—as the chairman brings up—

Ms. ESHOO. Did you say moral hazard?

Mr. GARRETT. Moral hazard going forward as far as the due diligence that is necessary that people should be making that, now in the future, they are looking to say, well, the Federal Government—well, at least for this class, not for pension funds and not for individuals, the government will step in and bail them out.

Now the State of New Jersey, somewhere on my desk here is a New York Times article with reference to the fact of who actually served in New Jersey—and I don't know any more about it than what is in the New York Times—about who actually served on the investment council who made the decisions. And coincidentally or not, three of the investment counselors were former Lehman employees and a wife of a Lehman employee. So I am sure there are all sorts of questions that people back in my home State are going to be asking—what sort of decisionmaking went into and what sort of due diligence was made in that case? And I guess that is the larger question going forward, is the proper due diligence—

Ms. ESHOO. I think it is a fair question. I have always adhered to the following, and that is that life is not tidy.

Let me say this, and that is that these were very conservative investments, and these public entities are required by law to spread out their portfolios and have a very safe place to hold the taxpayers' money. And they adhere to that. They were not high flyers. They were not high risk in any way, shape, or form. So they adhere to the law, to the laws that apply.

But it was singularly because of the big decision to let Lehman go down, and so that is why the language that became law passed a scrutiny test around here and the bill that Congresswoman Speier introduced, and I am proud to be an original cosponsor of, is very direct. And it is really quite surgical. I mean, it is very precise, and I am very pleased that we have been able to present the case to you today. You have asked very good questions.

The CHAIRMAN. The gentleman from Missouri.

Mr. CLEAVER. Thank you, Mr. Chairman.

Let me just commend Ms. Eshoo and Ms. Speier for introducing this legislation, bringing it to our attention.

As a former mayor, I can tell you that municipalities can only make safe investments, probably the safest investments of anybody who goes into the market. And that is why you will find mayors angry over the rating agencies because the corporations generally will get a more favorable rating than the municipalities, and we have not had a municipality go into default in almost 25 years.

The other reason that I appreciate you bringing this up is that municipalities have been devastated. There is a dramatic difference between what you are talking about and somebody coming up, saying, well, we want to be in line next.

Everybody in here lives in a city. Everybody in here lives in a municipality. And the municipalities are hamstrung now. They can't do revenue bonds because of the foreclosures, because when you have foreclosures, you are beginning to slice on the tax base, the municipal tax base. And so you can't do revenue bonds. The only thing you can do right now is to watch your infrastructure crumble.

And I am hoping that we can do something to rescue these cities because if we don't, we are going to find that—well, first of all, I mean, cities don't have a Fed. There is no municipal Fed where they can print money. So there is nothing they can do except wait this thing out and then try to make a comeback, and they are going to be further behind. I was trying to find a question here. Am I right?

Ms. SPEIER. You are right.

Ms. ESHOO. You are right. You are 100 percent right.

Mr. CLEAVER. Thank you.

The CHAIRMAN. I thank the witnesses.

We will now move to our next panel.

I am going to recognize the gentleman from Colorado, who wanted to make an introduction of one of the witnesses.

Mr. PERLMUTTER. Thank you, Mr. Chairman.

I would like to introduce my friend Bob Hullinghorst, who is the treasurer of Boulder County. He and his wife Vicky Lee have been friends of mine for many, many years. He has experience in the private sector as a cash manager, has dealt with financial issues his whole life, and is now treasurer of the county.

I don't represent Boulder County. I am just south of that. But its experience is the same as many other jurisdictions across the country. And I think Bob will be a good witness to describe the safe kinds of deposits they made, yet now have lost substantial money that is hurting all sorts of things.

So with that, I would just offer him as one of our witnesses.

The CHAIRMAN. Thank you.

And we will now begin.

We will just go in order with Karen Rushing, who is clerk of the Circuit Court and county comptroller of Sarasota County, Florida.

Any material that any witnesses wish to submit will, with unanimous consent, be submitted, so there is no need to ask for that.

You can present your oral testimony, and anything you want to accompany it will be made a part of the record.

STATEMENT OF THE HONORABLE KAREN E. RUSHING, CLERK OF THE CIRCUIT COURT AND COUNTY COMPTROLLER, SARASOTA COUNTY, FLORIDA

Ms. RUSHING. Thank you, Mr. Chairman, for the opportunity to address you and the committee today.

I am here to ask you for your assistance and support. As you will hear and have heard, State and local governments are faced with significant problems caused by the decision to allow Lehman Brothers to collapse. The money collected in the form of taxes and fees by the State and local governments is invested daily in highly rated quality investments with the objective of preservation of principal and adequate liquidity for paying daily obligations.

The rules governing investments are generally proscribed by law and in Sarasota County in particular. In addition to State law requirements, there is a local ordinance that describes the limitations and objectives of the investment policy. The objectives are the preservation of principal, and adequate liquidity through the purchase of highly rated investment instruments.

The collapse of Lehman Brothers caused highly rated debt instruments with adequate liquidity to become virtually worthless. Now the reason governments purchased bonds rather than equities is, with a buy-and-hold practice, a bond purchaser knows that, after the time of maturity of a bond, you will receive your principal and interest back.

The turn of events that directly affected the ability of governments to deliver services that are aimed at protecting the health and welfare of those we serve was caused by the failure of Lehman Brothers. Florida in particular is navigating very difficult times. High job loss, high foreclosure rate, a housing crash, and an insurance crisis are all affecting our ability to withstand the consequences of the collapse of Lehman Brothers.

It is my understanding that the current rules governing TARP provide for assisting State and local governments.

My written testimony outlines the services in Sarasota County that have been cut and the jobs that have been lost directly related to the Lehman Brothers collapse.

Although I am not prepared today to speak to the specific nuances regarding the losses in Florida State government and the local cities, I do want you to know that the problem is not unique to Sarasota County in Florida, that it is affecting all of our levels of government, and your assistance is requested.

Mr. Chairman, thank you for the time you have devoted to this hearing, and we appreciate your attention.

[The prepared statement of Ms. Rushing can be found on page 64 of the appendix.]

The CHAIRMAN. Next, and I apologize if I mispronounce it, Mr. Ron Galatolo, the chancellor of the San Mateo County Community College District.

STATEMENT OF RON GALATOLO, CHANCELLOR, SAN MATEO COUNTY COMMUNITY COLLEGE DISTRICT

Mr. GALATOLO. That is correct, Mr. Chairman. Chairman Frank, Ranking Member Bachus, and members of the committee, my name is Ron Galatolo. I am the chancellor for the San Mateo County Community College District and I am also a certified public accountant. Thank you also for adding my written testimony as part of the record.

What I would like to share with you today are the consequences that we have experienced, both the academic programs and services that we have at our colleges, as well as the financial hardship as a result of the Lehman collapse.

Our district has three colleges, and it sits equal distance between San Francisco and San Jose on the peninsula, and we serve about 45,000 students there a year. It is a fairly large institution, and many think of community colleges as a locale that essentially serve the needs of students who want to transfer to the university. And I will tell you that actually a large portion, and a part of our core mission, is to provide occupational skills, including dislocated workers for reentry into the workforce.

Our county's unemployment is the highest it has been in decades. At a time when unemployment is the highest in decades is actually when our unemployed workers need to come in to us and retrain and prepare themselves for the jobs they want to attain in our county.

Our loss as a result of the Lehman collapse was significant and exacerbated by the multibillion-dollar financial crisis we face right now in the State of California. When our Lehman instruments became worthless, they essentially wiped out operating reserves. Subsequently, when our State reduced our operating revenue, we had no viable option other than to reduce teachers and support staff, along with elimination of programs and services, again at a time when our community needs us most.

More specifically, last year we experienced about a 10 percent reduction to our budget and anticipate another 8 percent to our operating budget again this year. When all is said and done, we may have to shed the equivalent of about 11 percent of our full-time faculty and staff, with a devastating effect to teaching and learning at our 3 colleges.

When all is said and done, we have to abandon many construction projects slated to renovate our three colleges, causing a destimulus to our local economy. And based on our calculations, we actually found there may be as many as 400 construction jobs that are lost as a result of this.

By this inaction, we are simply taking the shovel out of the ground on these shovel-ready projects and causing a domino effect on the local economy; again, a destimulus to our county.

We are not alone and, through no fault of our own, we invested in what we believed and trusted to be highly rated, low-risk investments. Many schools, colleges and universities are in similar predicament to ours. To paraphrase Chairman Frank and Congresswoman Speier, if we invested in AIG, let's say, a guaranteed investment contract as opposed to invested in these highly rated, low-risk Lehman securities, we would not be before you today ask-

ing for your help. I feel it is highly inequitable to use TARP funding to shore up banks and to bail out failing corporations but fail to protect agencies' taxpayer dollars, such as ours and the others who are testifying before you here today.

I think it is important to note again something Congresswoman Speier said, and that is when you look at what we are asking for here, it is about $1.7 billion nationwide. When that is the numerator over the denominator, $700 billion is less than one-quarter of 1 percent of the TARP funding that is available for these types of activities. Thank you for your willingness to listen today.

[The prepared statement of Mr. Galatolo can be found on page 56 of the appendix.]

The CHAIRMAN. Next, we will hear from Richard Gordon, a supervisor on the San Mateo Board of Supervisors.

STATEMENT OF THE HONORABLE RICHARD S. GORDON, SUPERVISOR, SAN MATEO COUNTY BOARD OF SUPERVISORS, CALIFORNIA

Mr. GORDON. Chairman Frank, Ranking Member Bachus, and members of the committee, thank you for this opportunity to testify and to place my written comments in the record. My name is Rich Gordon and I am a member of San Mateo County Board of Supervisors.

And Mr. Chairman, in full disclosure, I want to note that at on at least one occasion, I have ridden in a car with Congresswoman Anna Eshoo. I want to thank Jackie Speier and also Senator Feinstein who, along with Chairman Frank, have highlighted the national implications of the Lehman Brothers bankruptcy on local governments and communities.

In excess of 200 jurisdictions in over 21 States lost $1.7 billion when Lehman was allowed to fail. The first question you might ask is, why were local government funds invested with Lehman? Why were these investments made? Local governments pay as we go. We have to meet payroll every 2 weeks. Yet our income is not on that same kind of regular stream. Our property tax payments may come in twice a year, or quarterly. Our State income tax payments often come once a year. Sales and use taxes come on a varying cycle. So our expenses are regular, but our income is not. And so we bank our income and we bank it for the purpose of managing our cash flow. When we actually do these investments, we will look to earn a modest interest, which often covers the difference between the current tax receipts and future expenditures, which are impacted by inflation. So it allows us to use those tax dollars in a way that stays even.

Such investments are a common practice across the country. These investments are governed by State and local policy. Policies are usually fairly similar and fairly simple: to protect principal; use safe investments; and diversify your portfolio.

In California 11 years ago, when the County of Orange made some risky investments and ended up in bankruptcy, State law was changed. In fact in California, we have a very tight system regarding where local governments can make their investments.

So the funds are invested to protect principal, and the goal is not to generate wild profits. In San Mateo County, our average rate of

return over the last 5 years on our pool of funds is 3.7 percent. These are safe investments. The securities and corporate bonds were A-1 and A, and our funds are diversified, which is one of the reasons that we were in Lehman. Actually a significant portion of our funds were in Treasurys or Federal agencies' securities, and Lehman represented 5.9 percent of our funds.

These are local tax dollars used for operational purposes. As you have heard, they fund construction projects to build classrooms, they pay for teachers, they allow us to employ our public safety personnel.

In San Mateo County, the absence of these funds will definitely impact highway projects, because the Transportation Fund Authority had money invested in this pool. Our schools are impacted and funds for our county hospital have clearly have been impacted. Our impacts are similar across the United States. And so the question might well be: Why use TARP? Most simply, because it is in the law.

As clarified in colloquy between Chairman Frank and Congresswoman Eshoo in January, one of the purposes of TARP is to help local governments, especially those impacted by the decision to allow Lehman to collapse. TARP has helped our private industries; it should also help our local communities. This translates directly into jobs at the local level, and we seek your help in seeing that the law is implemented to assist local governments that were injured and became the victims of the collapse of Lehman Brothers.

[The prepared statement of Mr. Gordon can be found on page 58 of the appendix. The prepared statement of Mr. Mark Church, president of the San Mateo County Board of Supervisors, can be found on page 53.]

Mr. MOORE OF KANSAS. [presiding] Thank you, Mr. Gordon.

Mr. Hullinghorst?

STATEMENT OF THE HONORABLE ROBERT HULLINGHORST, TREASURER, BOULDER COUNTY, COLORADO

Mr. HULLINGHORST. Thank you. And Chairman Frank and honorable members of the committee, I would really like to thank you very much for this opportunity to explain why H.R. 467 is very important to my county and to the taxpayers of 61 other governments in Colorado.

First, I would like to thank Congressman Perlmutter for those kind words, and to tell him from my wife, this is the last day of the session in Colorado; I know you miss it. She told me that she is sure she is having a lot more fun than you are. And since we have known Congressman Perlmutter's father since we came to Colorado, I am sure he rode in our car with us when he was 10 years old.

My name is Bob Hullinghorst, and I am the treasurer of Boulder County. We are located about 30 miles from Denver. Most of you know where that is. And we are the home of the University of Colorado. Someday we may even have a football team.

We have a population of about 300,000. In my statement, I point out how safely we try to invest these funds, and how important it is that somehow we be able to recover the write-offs that we have had to take. It has cost these governments in Colorado $5 million.

And in the case of Boulder County, we have had to write off $700,000.

Now the State legislature that my wife sits on just reduced the allocation for community health centers, who serve 10 percent of our population, the poorest of the poor. They have had to reduce that allocation by a million-and-a-half dollars. This $700,000 equates to roughly 20 nurses. That is absolutely critical to us in a county of our size.

I want to go a little off my statement and point out that Colorado and most of the other States in the Union have very strict investment statutes. I brought along the 15 pages of explanation of our investment statutes and I am going to offer it for the record. And in that, I won't go into detail or try to bring you up-to-date, but I do understand that your staff and some members of the committee think that there is a moral hazard here because we are investing imprudently. If I do, I have a chance to go to jail. So I try to be very, very careful about how I invest.

As a matter of fact, our legislation focuses around the prudent man standard, investments made pursuant to this statute must be made in accordance with a prudent man (person) standard. This requirement states that fiduciaries, such as officials and custodians who make investments or deposits for local governments, are obligated to exercise the judgment and care under the circumstances then prevailing, which men or women of prudence, discretion, and intelligence exercise in the management of the property of another. In other words, we are required by law to treat our taxpayers' funds as a sacred obligation to us, and we try to do that as best we can.

The investments that we made in Colorado by these 62 governments here, governments like Clear Creek County, a small county along I–70: the city of Fruita, a small town over by Grand Junction; the town of Kersey, a town that is populated mostly by people who grow grain for this country. The people in these towns rely on pooled investment trusts in order to be able to invest their money safely.

I had the pleasure of being one of the organizers of a pooled investment trust, and I can tell you from our experience that we did everything that we could to try to make sure that those funds were safe.

So I just want to thank the committee for having this hearing and considering the support of H.R. 467. Thank you.

[The prepared statement of Mr. Hullinghorst can be found on page 62 of the appendix.]

Mr. MOORE OF KANSAS. Thank you Mr. Hullinghorst.

Next, Mr. Thornberg of Beacon Economics.

STATEMENT OF CHRISTOPHER THORNBERG, ECONOMIST, BEACON ECONOMICS

Mr. THORNBERG. Mr. Chairman, committee members, San Mateo County's public agencies lost approximately $155 million in investments due to the bankruptcy of Lehman. These are today's losses, these were not securities and pension funds or other long-run securities. This money was being parked in Lehman in what was identified as highly rated liquid securities, until needed for their pri-

mary purpose, the near-term funding of schools, local infrastructure projects including transport, public transport, and new prisons, and of course the ongoing operation of local economy, including local government schools and so on.

I was asked by San Mateo County to calculate the economic damage that has been created by these financial losses. My results are such—these financial losses mean the loss of approximately 1,660 local jobs, approximately one-half of 1 percent of the county's overall employment base. It will suffer an overall loss of $216 million in output in the local economy, including $100 million in worker income. Not to mention, of course, the major delays in the completion of projects necessary for the growth of the economy.

These losses are intensifying an already grim economic situation in the State of California. Our employment in San Mateo County has risen from under 4 percent to over 8 percent. For the State overall, it is about 11 percent, with little sign of abatement.

San Mateo County, as we have heard, is not alone in suffering such losses. These losses, of course, stretch across the United States from Florida to Colorado into California. It is worth knowing that in recent months, the Federal Government has aggressively responded to the economic crisis by working to offset the problems by a variety of actions. These efforts include large financial infusions into the banking sector to keep our lending markets operational, expanding the money supply to keep interest rates low, and embarking upon a variety of fiscal spending initiatives to expand aggregate demand, including tax cuts, rebates, and direct spending on a variety of local projects.

In this last category, a substantial amount of funding has been put aside to offset the problems that State and local governments have been suffering due to a precipitous decline in tax revenues being seen across the United States. To allow State and local spending to shrink rapidly will only exacerbate the current economic problems and delay economic recovery that much further.

When the primary criticism of this spending program has been the time lag involved, the task of finding what you might call shovel-ready projects that meet certain criteria is challenging even at the best of times. And here we have one of the simplest solutions. These are not shovel-ready projects, these are shovel-stopped projects.

I would offer that by backfilling the financial losses being suffered by these local governments as a result of Lehman bankruptcy, the Federal Government really moves to accomplish two very important goals.

First is an almost immediate fiscal impact upon the economy. These are funds that will be directly translated into economic output and economic jobs to help sustain the economy through this tough time. As much as I appreciate the issues of moral hazard as an economist, it all works to level the playing field; because, in many ways, there was a critical policy decision that bailed out Bear Stearns and bailed out AIG and bailed out Merrill Lynch, yet allowed Lehman to fail. Why do we punish those local governments who made simply the unwise decision of choosing the one bank that was allowed to fail? Thank you very much.

[The prepared statement of Mr. Thornberg can be found on page 72 of the appendix.]

Mr. MOORE OF KANSAS. Mr. Street?

STATEMENT OF THE HONORABLE CHRISS W. STREET, TREASURER, ORANGE COUNTY, CALIFORNIA

Mr. STREET. Chairman Frank and honorable members of the committee, I am Chriss Street, Orange County Treasurer. Together, as we tackle the challenges that confront the Nation and navigate the financial sinkholes that have created uncertainty and instability, it is important to remember that each and every one of our actions will have consequences both intended and unintended, anticipated and unforeseen.

Whatever we do, it should be reasoned and rational. I, more than most, understand what the local officials who are testifying here today are facing: angry constituents; an uncertain future; and the paralyzing fear of facing a seemingly insurmountable fiscal black hole.

Fifteen years ago, bad investments forced Orange County, California into bankruptcy. In one of the Nation's most affluent communities, taxpayers remain on the hook for $1 billion of bankruptcy debt. I stood in the shoes of these local leaders. But as a result of directly facing these challenges, Orange County came together to solve the problems and overcome the obstacles that financial collapse posed. Labor and management, conservatives and liberals, businesses and unions, the entire community, pulled together and solved our problems without government intervening to cover our investment losses.

Today, because of compromise and teamwork, Orange County holds the prestigious AAAM rating from Standard & Poor's, the highest rating in the Nation, and is the only county in America to have achieved this recognition.

The pleas that you hear today are heart-wrenching but the actions these people are asking you to take are nonetheless wrong. We, as State and locally elected officials, must live with the intended and unintended consequences of our decisions. If we do not live with the decision and accept those consequences, we are shirking our responsibility as leaders. We must not look to someone else to blame for our current condition or solve our current problems.

Bailouts will not instill the virtue of fiscal responsibility at the local level. A bailout simply masks the problems and permits leaders to avoid the consequences of financial mismanagement. We must meet today's challenges today, not push them down the road to our children.

And what are the known and unknown consequences if we cover municipal losses? Realistically, just how much more debt can the United States of America assume without threatening the AAA full faith and credit of our Nation? If the cost of the Federal Government for issuing debt increases dramatically due to a downgrade in our credit rating, all the assumptions upon which the anticipated recovery are based will be rendered irrelevant and moot.

In the last few weeks alone, the 10-year Treasury bond yields, despite billions of dollars of Fed purchases, have climbed to 3.2 percent. That is a 25 percent increase in a very short period of time.

Rising obligations reinforce the market's concerns about the solvency of the debt of the United States of America. To add billions more in commitments could be the tipping point that crushes the fragile and embryonic recovery.

If we are going to shelter local leaders from consequences of their investment in Lehman Brothers, how can we stop there? Why not reimburse cities and counties for the mistaken bond and stock investments in Chrysler, General Motors, AIG, Washington Mutual, and others? And why stop at government entities? Why shouldn't we cover the losses of our own citizens who have seen their 401(k)s decimated and retirement dreams destroyed by the economic tsunami. How do we determine which constituencies merit a government bailout?

When we create laws, no matter our good intentions, to exempt individuals from the consequences of their actions, we eliminate responsibility and promote irresponsibility. Bailouts, no matter how lofty the original goal, encourage bad behavior. Pain, however uncomfortable and difficult, is part of the healing process. From experience, I can say that living through it and managing short-term pain gave Orange County the resolve and fortitude to bring about financial rehabilitation and community healing.

I caution you as our Nation's leaders to be deliberate in evaluating the legislation before you today and mindful of potential unintended consequences. I urge you to vote "no" on this legislation.

[The prepared statement of Mr. Street can be found on page 66 of the appendix.]

The CHAIRMAN. I have one question, We have some municipal finance officials here. This actually flipped. This hearing was going to be laid over—we were going to have a hearing on the whole question of municipal bonds.

Let me ask—Moody's, for instance, recently issued a statement for a general downgrading of municipal bonds. Let me ask particularly those in the municipal finance area, are you satisfied with the current rating system as it affects municipal bonds? Mr. Hullinghorst?

Mr. HULLINGHORST. Mr. Chairman, as a matter of fact, Boulder County is planning on going into the municipal market in about 15 days, and we anticipate getting a fairly good rate. This is an interesting revenue issue that is based upon our actually creating a special district, and residents of the district will be able to use municipal bond financing to get solar installations on their house, based on legislation that has been passed by our State legislature and is authorized under congressional act. So it is a very, very tricky issue, and we anticipate still being able to do it and get good rates. And I hope we do, because I am going to be the county treasurer collecting the income to pay those bonds.

The CHAIRMAN. Mr. Street?

Mr. STREET. I can say Moody's is just really a guideline; we use it as a tool in our investments. And of course, as our county, we have come all the way back up to a double A rating. So, no system is perfect. I have great respect for the efforts of Moody's, but I think when you look at the challenges we face, Moody's is a good tool.

The CHAIRMAN. Anyone else who is in the—those are the treasurers.

Mr. Bachus.

Mr. BACHUS. Thank you. Let me say this: These did appear to be safe investments. I understand there was some indication that Lehman was in trouble, but Bear had been bailed out at that time.

There is a section that Ms. Eshoo added to the TARP bill and I think, Chairman Frank, you engaged here in a colloquy which added, as one of the purposes of TARP, the need to ensure stability for U.S. public instrument penalties, such as counties and cities that may have suffered significantly increased cost or losses in the current market turmoil. I can certainly see how that fits your description.

I am wondering, though, as Mr. Street said, there are a lot of other entities, with WaMu dead and others. Has anyone made an estimate of what those total? If you add WaMu and some of these other failures, what we are talking about? Mr. Thornberg, do you know?

Mr. THORNBERG. I don't have a specific number on that, sir. I think the key point here is—again, I want to focus. These were short-run funds, not long-run investments for pension funds. In most of these cases, these are funds that are tied to spending that is going to occur within the next 12 to 24 months as opposed to over the next 20 or 30 years.

Again, I want to emphasize that the problem suffered by many of these local governments is due specifically to choosing Lehman as opposed to Bear or Merrill. That can't be underestimated.

In the context of Orange County, I don't believe the failure, the bankruptcy of Orange County, has any relevance in this particular situation; because in the case of Orange County, there were very specific investments made in very, very, risky products and that county individually suffered as a result of that. That was not the sort of a situation that was common across many places.

Mr. BACHUS. I see. I do appreciate your testimony. And these were, I guess, like liquid cash accounts I guess, which were highly rated. When we passed that bill, obviously the government had various options as to what they were going to do with the money. And as we have all witnessed, most of it has gone to a few large corporations, and then they have even distinguished between financial companies and car companies, so they are certainly making a lot of judgment calls.

I think in fairness to all, I don't know that there is anybody on this panel who could justify the decisions they have made. I know these do cause real problems for your candidates. And I, for one, know that you have availed yourself of your Members of Congress, and I think that is part of the democratic system. In the case of your Representatives, they have apparently—at least in the law, they have set up a provision which at least makes you eligible, so you do have grounds for your request. Thank you.

The CHAIRMAN. The gentleman from Kansas.

Mr. MOORE OF KANSAS. As over 5 million Americans have lost their jobs, and thousands of people have lost their homes, and our economy struggles through this recession, our local and State gov-

ernments are dealing with large budget deficits where painful choices have to be made.

Today, we are focused on State and local governments that were adversely affected when Lehman Brothers declared bankruptcy, but I am curious how widespread the problem is.

A list of local agencies that had investments with Lehman Brothers does not appear to list any city or county governments in Kansas. I would like to ask the county officials here, starting with Ms. Rushing, why did you decide to invest in Lehman Brothers in the first place? And were you able to recoup any of your losses in bankruptcies? And I would ask the same question of the other county officials.

Ms. RUSHING. Sarasota County has a portfolio of about $900 million, and the objective is to have a well-diversified portfolio. We were invested in mortgages in Fannie Mae and Freddie Mac. Thank goodness, those agencies were taken care of. The decision was to have a well-diversified portfolio with highly rated instruments with very little risk. That was the objective. And we have taken an unrealized loss on our accounting books, but we have not sold those instruments, so have the bonds still. And so we don't have a realized loss, unless we sell them, and of course we are holding them right now, trying to determine what to do next.

Mr. GORDON. Congressman, in San Mateo County, by law we are first of all required to diversify. So we had the maximum amount in Treasurys and Federal agency securities. The Lehman represented 5.9 percent of our pooled fund, a very small amount, actually, in terms of the total amount invested. But it was also exceedingly safe. We are not allowed to invest in equities, and we have to choose conservative instruments, by law. We had floating rate securities in Lehman that were rated A-1 and we had one corporate bond that was rated A.

In Bankruptcy Court, where we are at the moment, we are told that anywhere from 7 cents to perhaps 15 cents on the dollar. The result of Bankruptcy Court will not be known to us for many months. And so we believe and continue to believe that the law that was implemented providing for TARP does provide for mechanism for local governments.

Mr. MOORE OF KANSAS. Mr. Hullinghorst?

Mr. HULLINGHORST. Yes. Boulder County invested through a State pool. The State pool purchased the Lehman commercial paper, roughly 5 months before the bankruptcy. It was a 6-month paper. It was basically due to mature and pay within the week after bankruptcy. When it was purchased by the pool, it was a 1P1 paper, which is as good as you can get. And the underlying credit of Lehman Brothers at that time was A or AA. So it was an extremely safe investment in a pooled investment.

Now, I can tell you from experience that if you don't have pooled investments around the country, and there are a total of 151 of them authorized and regulated in 45 different States and they invest over $200 billion—probably closer to $300 billion before the Lehman Brothers bankruptcy—if you don't provide an avenue for liquidity in these State pools, they will probably cease to exist. At least one of the things that is certain, they will never buy anymore commercial paper, and that will not help.

The commercial paper market is so incredibly important to this country because, thanks to people in the Wharton School and whatever, that is the avenue that corporations are using to provide their working capital. And the bankruptcy of Lehman, the reason it is so critical is it cut the heart out of the commercial paper market. So your providing this support to us is one indication that the government understands how important this market is.

Mr. MOORE OF KANSAS. Mr. Street?

Mr. STREET. Orange County manages about $7 billion of cash, about three-quarters of those securities are in government securities. We have an investment policy statement. We did not own Lehman Brothers.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman. I think my time is up, so I yield back.

The CHAIRMAN. The gentleman from Texas.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. One of the questions I was going to ask the group, I notice that you had diversified portfolios and you had minimums and maximums that you can allocate. Isn't that the whole purpose, though, of the mixing and blending and pooling is that if there is a bobble in the portfolio, you don't have all of your eggs in one basket. And so if there is an event like this where there is a default, then have you not exposed your entire investment portfolio to that?

The question I would have for Mrs. Rushing is, what percentage of Lehman assets did you say you had in yours?

Ms. RUSHING. It is a little less than 5 percent.

Mr. NEUGEBAUER. A little less than 5 percent. That was an A-rated paper; is that correct?

Ms. RUSHING. Yes.

Mr. NEUGEBAUER. Is there any reason you didn't pick double A or some triple A, other alternatives in your portfolio?

Ms. RUSHING. Well, we did. And this particular investment was purchased through our investment advisor through our banking arrangement.

Mr. NEUGEBAUER. Who was your investment advisor?

Ms. RUSHING. Wachovia.

Mr. NEUGEBAUER. So you had opportunities. You could have invested in double A and triple A investments. Why would you choose the A-rated over the double A and triple A?

Ms. RUSHING. It was just a part of the diversified portfolio.

Mr. NEUGEBAUER. But if you could buy triple A, why would you buy an A?

Ms. RUSHING. The only response I can give you is that the portfolio was diversified, that we had commercial paper, that we had mortgages—as I said, Fannie Mae, Freddie Mac—and there was some portion of the portfolio that included corporate debt that was highly rated.

Mr. NEUGEBAUER. Thank you.

Mr. Hullinghorst?

Mr. HULLINGHORST. I know it is a hard name.

Mr. NEUGEBAUER. Mine is kind of hard too.

Mr. HULLINGHORST. It took my wife 3 years to learn how to spell Bob.

There are two points that I would like to make in response to your question. There are very few issues rated triple A that are available among the United States corporations, unless you go to governments. And there are very few short-term governments except for Treasurys. And in some markets you don't get anything in investing in Treasurys.

Now, the second point I would like to make is that the reason for the State pools in large part is to allow small municipalities to buy anything. You cannot go to Wall Street or to a representative in a brokerage firm and get any sort of a price if you only have $50- to $100,000 to invest at any one time. And so these State pools are there to provide smaller entities, or even entities like myself, who are buying smaller increments to get in at a decent rate in a well-managed pool.

If you really want to see a debacle, you will not support the State pools and you will leave investing up to all of these little entities.

I came to Washington a little over a year ago to try to talk to some of our congressional delegation and to the SEC about what I call criminalizing the sale of illegal investments to local officials. There was no interest at that time. I think there might be a little more interest now. But what I found was that, in fact, the SEC had the authority through their examination process to make sure that their brokerage firms were not treating us as qualified investors. Most governmental investors in any place in the country need to be treated as investors whose interests need to be protected. Almost every one of us is covered by State legislation that we are not allowed to go beyond. But we could not get a single brokerage firm—in my case, we could not get a single brokerage firm on Wall Street to sign an agreement that they would only sell us investments that qualified under our State law. Thank you.

Mr. NEUGEBAUER. My time is up.

The CHAIRMAN. Does the gentleman yield? The hearing that this was switched with, because of some concern on the part of the Administration—they couldn't make it today. We will have that hearing on May 17th. It is a package of bills, one of which would call for the registration of finance providers. We do not, as members of this committee, have the jurisdiction to criminalize, because that is under the jurisdiction of the Judiciary Committee. But we do have a bill that would propose a fiduciary standard for advisors. Obviously, that will be up to the committee. So we will be dealing with that subject to the extent that it is our jurisdiction. Criminal jurisdiction is, of course, with the Judiciary Committee.

Mr. BACHUS. That pay-for-play and things of that nature?

The CHAIRMAN. Yes, I think that would be covered by that. Yes, exactly. So it is, I think, directly relevant. We will have a hearing on that on the 17th of May.

Mr. BACHUS. Mr. Hullinghorst, I think you wife is going to have the whole football team meet you at the airport.

The CHAIRMAN. The gentleman from Missouri.

Mr. CLAY. Thank you, Mr. Chairman. Thank you for holding this hearing. In Missouri, as in many other States across the country, we have had adverse impacts because of the collapse of Lehman Brothers. I am also concerned that TARP funds have been denied from local governments, although provisions were made in the leg-

islation for this. I also noted that in Representative Eshoo's statement that she mentions Missouri as a State that has public entities with problems.

I will start with Mr. Hullinghorst, and anyone else can chime in, do you think H.R. 467 will have enough teeth, if it is to pass, to effect a change in the present thrust of TARP funds? Will this be sufficient to restore these local entities to where they would have been financially?

Mr. HULLINGHORST. Thank you for the question, Congressman. The legislation as it is written, I believe, will help cover 95 percent of the problem. Just during these discussions over the last 2 days, I have been made aware of the fact that there are State pools who invested in money market funds.

The TARP money has been used to bail out the money market funds. You are probably familiar with Prime. The trouble is that Prime was given money, was bailed out; but in fact, cause of the way it was bailed out by the previous Administration, the moneys haven't flowed through. There is a substantial amount that is being reserved.

Now, most of the losses in those money market funds like Prime were losses because of Lehman Brothers. And so it is probably important to look at how this legislation can get the public pooled money that is in those money market funds extracted. So that is my answer, is that I think that this will solve 95 percent of the problem. And I am sure that a modification could help the other pooled investment trusts that have experienced losses because of the commercial money market.

Mr. CLAY. Thank you for that.

Anyone else on the panel?

Mr. GORDON. If I could, thank you Congressman. We believe that local government could be made whole now if the Secretary of the Treasury would implement the language that is in TARP. What H.R. 467 does is direct him to do that, but we think he has the capacity now. In either case, there is a capacity to make local governments whole through either of these venues.

Mr. CLAY. Thank you.

Mr. Street, you mentioned personal responsibility in your comments about, I guess, 401(k)s, and maybe you can elaborate more. I don't know how an individual with a 401(k) could have been more responsible as far as the hit they took. When you look at, on average, that the 401(k)s lost about 30 percent, what is your response to that? I mean, they really were victims when you think about it.

Mr. STREET. I agree the losses are just heart-wrenching, I think the challenge of this bill is how do you separate a poor person who lost money in their 401(k) from a government entity who lost money in their short-term investments? It is how do you make that decision and how do you pick the winner and the loser in this game of allocation?

Mr. CLAY. Priority-wise, should we go back and try to make those individuals whole who were really banking on those 401(k)s as far as retirement? And some are already retired who have lost a significant amount of the value of those 401(k)s. Do we first go after them to make them whole?

Mr. STREET. You have a challenge here as our leaders to make these kind of decisions. For me, I would be concerned that if you make one small decision, you would make a second and a third. I am just very afraid that someday, on the front page of the Wall Street Journal, we will see, "United States of America downgraded to double A."

Mr. CLAY. Thank you, I yield back.

Mr. THORNBERG. If I may make a comment on that. The losses in the financials across-the-board are enormous, there is no doubt about it. And in many ways, the reason for that is if you looked at the trend over the last 20 years in the U.S. economy, you saw an amazing appreciation in asset classes across the board: real estate, commercial real estate, all sorts of different types of funds. The levels were unrealistic and now those levels are collapsing back.

There is very little that can be done about that. We can't create wealth where wealth didn't exist in the first place. The issue here I think before us is a little different, and that has to do with the fact that the local governments are being forced to curtail current spending as a result of these short-run financial losses. That is exacerbating the business cycle. I don't think we need to look at this as making someone whole or someone not. We should view this more as part of the fiscal stimulus package to help and turn the economy around.

When you think San Mateo County has to stop construction on buildings at a community college, on a public transit project, on this jail, these have all created a loss of jobs and a loss of incomes at a time when we as a Nation cannot afford these losses. And so excuse me—

The CHAIRMAN. Just one thing. I would just say personally, if it comes to the point where they downgrade U.S. paper to double A, and the interest we have to pay goes up accordingly, I want to announce now I will be a heavy buyer, because the likelihood that this body would ever walk out with default is so negligible. I hope that day never comes, but if it does, I will make money off it personally.

The gentleman from California.

Mr. ROYCE. Thank you, Mr. Chairman. I want to thank Mr. Street and ask him a question. I made the observation that Lehman was highly leveraged; it had a significant exposure to the mortgage market. I think it was as late as 2008 that it had $6 billion in subprime exposure, and it even owned a subprime originator, B&C Mortgage.

You know Orange County as I remember, I think it was about 1994, and I think you were around there at that time, Orange County took a hit. And I think a lesson was learned that it was a dangerous, dangerous endeavor for a county treasurer to use taxpayer funds to invest in products that the local governments did not understand. And maybe you can tell us and discuss the extent to which the county took responsibility for those losses and what did the county do to restructure during that period?

Mr. STREET. I think the first thing we did to restructure was work closely with our staff and closely with all the community leaders. It was a very difficult time at first with people, lots of recrimi-

nations. Fortunately, we got over that and down to the issues of really dealing with reality. We worked together. We tried to use efficiency. Unfortunately, there were some layoffs, but over time we were able to bring back our credit rating and bring back our community.

Mr. ROYCE. Also one of the things that changed was a policy from taking risk to one that was far more prudent.

Mr. STREET. That is correct.

Mr. ROYCE. What do you believe the impact on market discipline will be if Congress awards these municipalities TARP funding, thereby making them whole on the investments on the bankruptcy of Lehman Brothers?

Mr. STREET. I am concerned, quite frankly. It encourages people to take that little bit extra risk and little bit extra yield, and the results you see today are quite challenging.

Mr. ROYCE. Several of our municipalities across the country lost money on Washington Mutual. Should Congress make these municipalities whole as well? And where should we draw the line, then, if we start down that road?

Mr. STREET. Congressman Royce, I think you ought to set the line where it is right now, that we have to take personal responsibility, and that is what I am encouraging the committee to do today.

Mr. ROYCE. Maybe you could discuss a little bit some observations you have about market discipline and the role it would play. Going back to 1994, back to the decision-making process and the treasurer's office back far before you were treasurer of the county; maybe some of the observations about why those risks were taken at that time.

Mr. STREET. I think it was a challenging time in government. In 1993, as many will remember, there was a real estate recession and times were hard. I think people were trying just a little bit harder and the treasurer had been very successful for a long period of time doing just a little bit more, and he tried just a little bit more, and finally one day we missed payroll.

Mr. ROYCE. Yes, it was very highly leveraged derivatives, actually, at the time.

Mr. STREET. Correct. He was leveraged about 6:1. In fact, I think one of the greatest shocks to Wall Street was the fact that Orange County was highly rated. We were double A at the time. What Bob Citron, our treasurer, was doing was very transparent. People knew what he was doing, Wall Street knew what he was doing, and one day the whole house of cards came down.

Mr. ROYCE. Now, you saw the investments, the $6 billion in subprime exposure by Lehman; you saw the fact that they owned a subprime mortgage originator, B&C Mortgage. Is there a reason specifically why Orange County was not, after its experience in 1994, not investing in Lehman or not utilizing Lehman in 2008?

Mr. STREET. We have an in-house research capability. We also use this tool, Standard & Poors and Moody's, and we chose not to have Lehman Brothers on our investment list.

Mr. ROYCE. Thank you, Mr. Street.

Ms. SPEIER. [presiding] I am going to take you down memory lane with Mr. Citron a little bit. If I recall correctly, in 1994 there

was $7.6 billion that was invested in Orange County for about 200 municipalities in special districts; is that right, Mr. Street?

Mr. STREET. About 7.6 billion, I believe, is about right. He had a portfolio of about $26 billion. It was essentially leveraged up from that point.

Ms. SPEIER. If I recall correctly, the investments that were being made in Orange County would not be defined as prudent; is that correct?

Mr. STREET. In fact, most of it would be defined as extremely prudent as far as the instrument he bought. He bought 5-year U.S. Government agencies. He simply leveraged them. He had some number of derivatives, but 90 percent of Mr. Citron's investment philosophy was leverage.

Ms. SPEIER. Well, he did invest in derivatives and inverse and floaters; is that not true?

Mr. STREET. A number of them, yes, about $4 billion worth.

Ms. SPEIER. And you heard testimony that none of these jurisdictions have invested in derivatives or inverse floaters; is that correct?

Mr. STREET. That is correct.

Ms. SPEIER. So you are really trying to suggest that their prudent activity was liked to Mr. Citron's very imprudent investment policies.

Mr. STREET. I can only speak for Orange County.

Ms. SPEIER. Well, I know. But you have attempted to establish that somehow what happened to Orange County should happen to these jurisdiction, when in fact they didn't engage in anything like derivatives or inverse floaters. And furthermore, as I understand it, he was so hooked on the fact that he was getting 12 percent interest and that about 35 percent of the revenues for Orange County at the time were coming from interest made on these very speculative instruments, that he went out and borrowed money, did he not?

Mr. STREET. That is correct.

Ms. SPEIER. So he borrowed money to invest it. So for every dollar he borrowed, he was attempting to make $2 in an investment; is that correct?

Mr. STREET. I don't know the return at $2. I remember that he was making about 8 percent on his investments. He was buying instruments that yield at about 4½ percent and leveraged them to an 8 percent yield.

Ms. SPEIER. As you heard from testimony here today by these various local communities and jurisdictions, they weren't playing the market; they were taking their money and what was the equivalent of putting it in a savings account to be used, appropriately, to build buildings, to make payroll. It was not being used in any way that can be likened to what Mr. Citron was doing in Orange County, correct?

Mr. STREET. I have in no way said that the investments that were made here were the challenge. The challenge today is that the bill that is before you, I think, would set a bad precedent and, in fact, be dangerous to the financial markets.

Mr. ROYCE. Would the gentlelady yield?

Ms. SPEIER. I am not a gentleman, but I will be happy to.

Mr. ROYCE. I said gentlelady. Excuse me, ma'am.

You know, I think the point he was making here, you made the point it was a savings account that they were invested in. No, they weren't investing in a savings account. They were investing in a highly leveraged institution that was Lehman Brothers, just as Orange County was highly leveraged in 1994. And what we are talking about in terms of market discipline is getting county treasurers away from the concept of leveraging and investing in these institutions that are so highly leveraged. I thought that was one of the underlying themes here, so I just—

Ms. SPEIER. Would the gentleman yield?

Mr. ROYCE. Yes.

Ms. SPEIER. I did listen to his entire testimony, and my interpretation was that he was suggesting that if Orange County made some bad mistakes and they kind of swallowed hard and dealt with it, then these jurisdictions should do the same thing.

The only point I was trying to make is that it was very different, what was happening in Orange County, than in these specific jurisdictions.

Mr. ROYCE. And I understand that point. But in both cases we are dealing with leverage. And that is, I think, the take-away or the theme that he was trying to leave us with. But I thank the gentlelady for yielding.

Ms. SPEIER. All right.

Mr. Street, if I could, I would just like to ask you one other series of questions. And that is, based on what you have said, I would interpret that you would not have supported the TARP funding; is that correct?

Mr. STREET. I think that once you started to bail out Bear Stearns that it was only a matter of time before people would take more risk and people would say things are too-big-to-fail, and then you would have the situation we are dealing with today.

Ms. SPEIER. I guess you didn't answer my question. Would you have supported the TARP measure? Did you support it? Do you support it?

Mr. STREET. I think that there needed to be some form of standby guarantee within the Fed. Is the TARP the correct measure? That was really your decision.

Ms. SPEIER. So you, then, would not be opposed to having TARP moneys being spent to bail out Wall Street companies, but you have an objection to having TARP moneys used to bail out local jurisdictions; is that correct?

Mr. STREET. I think that we are talking here about really replacing lost dollars. If that is what TARP money is going to be used for, I think it would be a mistake.

Ms. SPEIER. You don't think the money has been used to help AIG and that we are possibly not going to see any of that money come back, or with some of the money we have given to Chrysler?

Mr. STREET. I think those are the tough decisions you have to make every day, and clearly those decisions keep coming.

Ms. SPEIER. All right, thank you.

Mr. Thornberg, I have one question for you. You indicated that there were probably about 1,700 jobs lost in San Mateo, about 1,658 jobs lost in San Mateo County as a result of the money that

had been invested in Lehman. If you would extrapolate for the $1.7 billion that has been lost by jurisdictions across this country, how many jobs do you think have been lost as a result of Lehman's being allowed to failed?

Mr. THORNBERG. It would be, of course, just a rough estimate, but probably something on the order of 20- to 25,000 jobs in total.

Ms. SPEIER. Thank you.

Mr. Lance from New Jersey.

Mr. LANCE. Thank you very much, Madam Chairwoman. Good morning to you all.

I find this a very interesting issue, and as I view the testimony, the State of New Jersey where I live may be in a similar situation to the State of California. And I will direct my questions to Mr. Street, but certainly there are other experts on the panel as well.

In the State of California, is there a requirement, constitutionally, that the State budget has to be balanced each year; and can debt be issued for the general operating portions of the State budget? Would you know that, sir?

Mr. STREET. There is a requirement, constitutionally, that the State has a balanced budget. Certain debt can be issued as revenue anticipation notes to smooth out cash flow—

Mr. LANCE. I am not concerned about that, but those are merely short-term obligations. I am talking about the length of the budget year.

Mr. STREET. My understanding is it is illegal to basically borrow money for operating outside the current fiscal year.

Mr. LANCE. Your testimony indicates that issuance of debt by California, as I understand your testimony, has increased a yield from 4 percent to 6 percent in the last several months. Am I reading your testimony correctly?

Mr. STREET. That is correct. From the start of the year, I think we started out at about 2 percent for short-term money and went to 4 percent. Now the last issuance is longer-term money; it is 6.2 percent, I believe.

Mr. LANCE. We issued debt in New Jersey over the last decade for the general operating portions of our State budget, over my strong objection; I was the minority leader in the State Senate before I came here. And a constitutional amendment was passed last November in New Jersey, under my authorship, to prohibit that in the future, because it has been so devastating to our State. If you are not able to issue debt for the general operating portions of the budget, is it your understanding, sir, that the general operating portions of your State budget are exclusively funded through ongoing revenues?

Mr. STREET. Well, that is correct. Currently, the State of California faces an inability even to sell short-term cash-flow instruments and is anticipating selling what are called revenue anticipation—

Mr. LANCE. I see that in your testimony, yes.

Mr. STREET. But these are really PAYGO. So California is approaching PAYGO.

Mr. LANCE. And am I reading your testimony right, sir, that there is going to be a ballot initiative sometime later this month regarding increasing taxes in California?

Mr. STREET. That is right. There are six ballot initiatives, I believe, four of which I think have revenue that would add about $6 billion or $7 billion a year. Those four revenue initiatives are currently failing in polls quite heavily.

Mr. LANCE. I see. Thank you.

This is certainly reminiscent of what is occurring in New Jersey. We rely on an income tax that, in turn, relies on upper-income New Jerseyans. You indicate in your testimony that 40 percent of your State income tax is derived from the top 1 percent of filers. That is also true in New Jersey. We have a gross income tax, not an adjusted gross income tax, with very few deductions. And I would be interested, and perhaps I will ask the nonpartisan office here, to analyze the similarities between California and New Jersey. I am struck by them in your testimony.

I know this is not the main purpose of today's hearing, Madam Chairwoman, but certainly it has piqued my interest.

I yield back the balance of my time. Thank you, Madam Chairwoman.

Ms. SPEIER. Thank you.

The gentleman from Texas, Mr. Green?

Mr. GREEN. Thank you, Madam Chairwoman.

And I thank the witnesses for testifying, as well.

Mr. Street, I thank you for your line of logic, and I would like to pursue it, if I may. Given your line of logic, would you have allowed Bear Stearns to fail?

Mr. STREET. Yes, I would.

Mr. GREEN. Would you have allowed AIG to fail?

Mr. STREET. I think that AIG is probably a function of what happened with Bear Stearns.

Mr. GREEN. May I take it that your answer is "yes?"

Mr. STREET. Yes.

Mr. GREEN. Would you have allowed Chrysler to fail?

Mr. STREET. Chrysler failed once before. It got a loan. I think it is currently failed and in bankruptcy, and we will see how it goes.

Mr. GREEN. May I take it that your answer would be "yes?"

Mr. STREET. Perhaps.

Mr. GREEN. Would you allow GM to fail?

Mr. STREET. I think GM is going to come back as a very strong company, and I think it is going to go into bankruptcy.

Mr. GREEN. Would you allow the banks that received the equity capital from the TARP—we purchased equity positions; would you have purchased those equity positions?

Mr. STREET. Would I have accepted that the Federal Government should put money to back the banks?

Mr. GREEN. Yes.

Mr. STREET. I would accept that the Federal Government should put money to back the banks.

Mr. GREEN. The backing of the banks with the funds is not something that we traditionally do. We have the FDIC, but what we are doing with TARP is in addition to FDIC. Do you agree?

Mr. STREET. It is going to a new level, yes.

Mr. GREEN. Just for my edification, what world do you see, had you allowed all of the things that you would allow to take place, how do you see the world today if these things had occurred?

Mr. STREET. I wrote an article, along with David Evans, in Bloomberg magazine in July of 2007, which outlined all of the problems that we are facing in the real estate markets—

Mr. GREEN. Because my time is somewhat limited, please, I don't mean to be rude, but tell me about the world that you would see today. What would unemployment be like in this world today, had we pursued your line of logic?

Mr. STREET. I think if we would have had failures and then rehabilitations through bankruptcy we would be back in a better shape today.

Mr. GREEN. Let's talk about today, and we are talking about over the last year now all of these events were occurring. So are you of the opinion that unemployment would be lower today and that we would be better off today, had we allowed the failure of Bear Stearns, AIG, possibly Chrysler and GM? We did invest in them. Are you of the opinion that we would be better off?

Mr. STREET. I believe that if we had let Bear Stearns fail of its own actions, we would be better off today and have less unemployment.

Mr. GREEN. But not just—you see, we are not talking about one; we are talking about a number of entities. Let's put them all in the equation. If we had allowed all of the things to occur that could have occurred but for action, are you of the opinion we would be better off?

Mr. STREET. Yes.

Mr. GREEN. Now, let's talk about something else, Mr. Street. You asked, how do we pick winners and losers? I assume, Mr. Street, that you don't pave all of your streets in Orange County at one time. That is a fair statement, I assume.

Mr. STREET. Yes.

Mr. GREEN. And, Mr. Street, if you don't pave all of your streets at one time, somebody picks winners and losers.

Mr. STREET. Yes.

Mr. GREEN. That is the job, sometimes, of government. It is not a nice thing to have to do; no one relishes having to do it. But there are times when you have to make hard decisions, very difficult decisions, and you do the best that you can. You may not get it right, you may not be perfect. But you do what you can, the best that you can, to be of assistance.

Final question: All of these persons with you are here because there is a law that they are trying to cause us to implement as they see it appropriately. Had there been a law at the time Orange County found itself in this dilemma that connoted Orange County could receive some assistance, would you have pursued receiving that assistance from the Federal Government?

Mr. STREET. No.

Mr. GREEN. You would have simply allowed Orange County to do as it has done and not made a bid for Orange County to benefit from what the law says Orange County may have been entitled to?

Mr. STREET. Yes.

Mr. GREEN. I thank you very much.

And I yield back the balance of my time.

Ms. SPEIER. The gentleman from California, Mr. Campbell?

Mr. CAMPBELL. Thank you, Madam Chairwoman.

Mr. Street, when Bob Citron, the former treasurer of Orange County, did what he did, he was trying to increase the yield and increase return to the County of Orange, was he not?

Mr. STREET. That is correct.

Mr. CAMPBELL. So he was chasing yield, let's call it.

Mr. STREET. He had a strategy to maximize.

Mr. CAMPBELL. And because of the failure of those things, the County of Orange went bankrupt, correct?

Mr. STREET. That is correct.

Mr. CAMPBELL. Okay.

And, Ms. Rushing or Mr. Galatolo, could either of you have invested in something that was a higher-rated bond but gave a lower yield instead of Lehman Brothers at the time?

Ms. RUSHING. Absolutely.

Mr. GALATOLO. In my situation, actually, I am required by law to invest in the county commingled fund, so the answer is no.

Mr. CAMPBELL. You are required by law to invest in what?

Mr. GALATOLO. Yes, the proceeds that we receive from our general obligation bonds as well as all our property taxes in addition to the State apportionment goes into the county commingled fund, and, by law, it is invested on our behalf.

Mr. CAMPBELL. You are required to invest in Lehman Brothers?

Mr. GALATOLO. We are required to invest in the county commingled fund, in the San Mateo County commingled fund.

Mr. CAMPBELL. Oh, all right. Then I should be asking the question of who made the investment in the county commingled fund, I guess.

Is that you, Mr. Gordon?

Mr. GORDON. The county treasurer made that choice.

Mr. CAMPBELL. Okay. But he could have invested in Treasury bills and had a lower yield.

Mr. GORDON. We were invested in Treasury bills.

Mr. CAMPBELL. But he could have invested it all in Treasury bills.

Mr. GORDON. But there are diversification rules in the State of California. We were actually maximum on our Treasuries. So—

Mr. CAMPBELL. But you could have invested in other things that gave a lower yield and a higher return and still met the diversification rules.

Mr. GORDON. No—

Mr. CAMPBELL. The point I am trying to make, which I am sure you can all get, is that—well, let me ask, are either of your counties in danger of going bankrupt purely and strictly because of the Lehman failure?

Mr. GORDON. No, we are not in danger of going bankrupt. And, you know, the State law—

Mr. CAMPBELL. Ms. Rushing?

Ms. RUSHING. To your question, no.

But I want to make sure I didn't misunderstand your prior question. I thought you asked me if I could have invested in instruments with higher yields.

Mr. CAMPBELL. No, lower yield. Lower yield, but higher rating.

Ms. RUSHING. Okay. So then I would take, yes, I would—

Mr. CAMPBELL. Would you have invested in Treasury bills instead of that?

Ms. RUSHING. We were.

Mr. CAMPBELL. Could you have invested the Lehman money in Treasury bills instead?

Ms. RUSHING. Well, we have diversification limits.

Mr. CAMPBELL. The point here is quite clear. Mr. Citron was chasing yield. Now, he did it to an extreme degree, such that the County of Orange failed and went bankrupt because he was chasing yield.

The point I am simply trying to make is that you guys were chasing yield, too. There is nothing the matter with that. There is nothing wrong with that. But with yield comes risk. And if there is no downside to that risk, then we all chase as much yield as we can.

And so I would say, Madam Chairwoman, that although the County of Orange is not equivalent because these people aren't facing bankruptcy and the County of Orange was, that there is an equivalency in the fact of chasing yield.

Ms. SPEIER. Would the gentleman yield?

Mr. CAMPBELL. I will if you will give me a second, so I don't run out of time. But go ahead.

Ms. SPEIER. Let us ask the treasurer from Orange whether or not they are invested in Merrill, which was bailed out.

The point here is that everyone else was bailed out and Lehman was not.

Mr. CAMPBELL. Okay, reclaiming my time, Madam Chairwoman, I go to the next question, which is, why are you all more worthy of having your investment in Lehman than a pension fund that someone is counting on for retirement who invested in Lehman, or an individual who is living on a fixed income and this was part of their fixed income and they now will have to completely change their lifestyle, or some mutual fund that invested for a vast amount of investors in Lehman?

Why are you more worthy than any of those? And so, if we are going to bail out people who invested in Lehman, why not bail out everybody who invested in Lehman?

Anyone can answer.

Ms. RUSHING. I think we are here today because your regulations allow for State and local governments to participate in the TARP program. And that is why we are here today, asking for your assistance.

Mr. CAMPBELL. But then, shouldn't anyone who made this same—other people in the private sector, obviously, made this same investment and have suffered the same loss. Shouldn't they also have an opportunity to recover their loss?

Mr. GALATOLO. With all due respect, Congressman, I think it is important to denote a very important difference here. And that is that, when you are talking about the retirement funds, these are moneys that will be invested for a long period of time, actually have the time to potentially recover. The money that we lost in our school district, actually, we lost immediately. And it went to our operating fund, so it immediately cut right into our ability to pay our faculty and staff. So it resulted in lost—

Mr. CAMPBELL. Well, except that most retirement funds are paying out to people who are retired currently, and they hold some for—you have some balance. And I realize my time is up. But you have some balance of investments that you are carrying at all times.

Mr. GALATOLO. Retirement funds, too, obviously have a very large investment pool. And when they are paying out, they are paying out of a very small fraction of that investment pool at any one point in time.

The money that we had actually went directly to paying faculty salaries, staff salaries, and operating expenses. And not being able to do that means that we have to eliminate positions immediately, which really causes a destimulating effect.

Ms. SPEIER. Mr. Campbell, I would like to answer your question. And I think the difference is really quite clear. The difference is these are taxpayer entities, and we want taxpayer money to be returned to these taxpayer entities.

Some of the references you made are to individuals, and we are not interested here in making individuals whole. We want to make the local jurisdictions whole that are the beneficiaries of the taxpayer money anyway.

Mr. CAMPBELL. Would the gentlelady yield?

Ms. SPEIER. Yes.

Mr. CAMPBELL. Taxpayers are individuals, as well.

Ms. SPEIER. I understand that. But this—you asked the question about pension funds and others who invested in Lehman. And my point is that we want to make those who were taxpayer entities, local jurisdictions, be able to be made whole with TARP money that all these other jurisdictions were beneficiaries of.

Mr. CAMPBELL. If the gentlelady would yield, I just don't see the distinction between—I mean, I understand a public entity has taxpayers, but pensions—which are individuals—pensions has retirees, who are individuals; mutual funds have investors, who are individuals. The impact on those individuals is as severe, relatively, as it would be on municipalities. And I just think it is unfair to do one and not the other.

Ms. SPEIER. All right.

The gentleman from Missouri, Mr. Cleaver?

Mr. CLEAVER. Thank you, Madam Chairwoman.

Whew. I just need to editorially say that we approved, in this committee, toxic asset removal. We were going to take all the bad assets out of the markets so that people would feel comfortable. We went home and found out that the money for toxic asset removal was given to banks. And so I have some irritation over the fact that, in the language of the bill, we say that we can help municipalities. Now, we took the money, gave it to banks.

Most of the people in America believe that Congress voted to give money to the banks. When I go home and do town hall meetings, people want to know, why did you vote to give money to the banks? I never voted to give money to the banks. I voted to give them to municipalities. And, as a former mayor, I understand that is something that is desperately needed.

And I am going to calm down.

What I also need to raise—Mr. Street, would you read the last paragraph of your statement? The statement that we have here is different than what you were reading. Or maybe you were just speaking off the cuff.

Mr. STREET. On my written submission? You are asking me to read the statement?

Mr. CLEAVER. The last paragraph of your statement.

Mr. STREET. "I caution you, as our national leaders, to be deliberate in evaluating the legislation before you today and mindful of potentially unintended consequences. And I urge you to vote 'no' on this legislation."

Mr. CLEAVER. Okay. And I guess the paragraph earlier, you said that—well, "the consequences of your behavior and the"—you said "the bad behavior." It may have been in the previous paragraph.

Mr. STREET. Would you like me to read that paragraph?

Mr. CLEAVER. Yes.

Mr. STREET. "When we create laws, no matter how good our intentions, that exempt individuals from the consequences of their actions, we eliminate responsibility and promote irresponsibility."

Mr. CLEAVER. Okay.

Mr. STREET. "Bailouts, no matter how lofty the original goal—"

Mr. CLEAVER. I got it. Thank you, thank you.

I was trying to figure out how that related to the municipalities, the counties.

Ms. SPEIER. Do you have an answer, Mr. Street?

Mr. STREET. Is that a question, how this relates—

Mr. CLEAVER. You say, is that a question? I am going to try it again. Let's see. How does that relate to the counties? How does that relate to the conversation?

Mr. STREET. It is very challenging, being from Orange County and suffered this pain, and I know their pain. On the other hand, Orange County worked out its challenges without a bailout, without an intervention.

Mr. CLEAVER. Excuse me, sir. Excuse me. Okay, thank you.

How does what you say—I am going to try to say this really clearly, because I know I am confusing you. How does what you just read impact or relate to the counties, the municipalities?

Mr. STREET. If you bail out certain investors in Lehman, you are going to have to bail out others. And you are going to have to bail out lots of them.

Mr. CLEAVER. Madam Chairwoman, I surrender.

Ms. SPEIER. Mrs. Biggert from Illinois?

Mrs. BIGGERT. Thank you, Madam Chairwoman.

I would yield to the gentleman from California, Mr. Campbell.

Mr. CAMPBELL. I thank the gentlelady for yielding.

Just a couple more questions or points.

The original TARP money, what was happening at the time was a systemic risk, that if various of these institutions failed, the belief which—in fact, I was late to this hearing because I was questioning Mr. Bernanke, the Chairman of the Federal Reserve, in the Joint Economic Committee. And I asked him, you know, what were we on the verge of? And he said we were on the verge of a financial calamity, which could have resulted in thousands of bank failures

and literally would have touched every segment of the economy, at every level, if we didn't do that. That is his feeling, his opinion.

Is there an opinion that somehow there is some systemic risk here if we do not reimburse municipalities for their investment in Lehman Brothers?

Mr. Thornberg, do you want to take a crack at that one?

Mr. THORNBERG. You mean is there going to be some sort of cascade effect that will bring down the entire State of California? No, absolutely not.

Mr. CAMPBELL. How about a cascade effect that brings down anything else?

Mr. THORNBERG. Well, again, we are in a situation, of course, where consumers have been pulling back dramatically on spending, which is creating a lot of turmoil inside the economy. To allow State and local governments to also pull back dramatically on spending creates an even more vicious cycle.

Mr. CAMPBELL. Okay. But, in theory, any use of TARP funds to a private entity or a public entity that results in an activity that creates jobs could do the same thing, correct?

Mr. THORNBERG. Absolutely. I agree with that.

But let me also make the point that, I mean, one of the advantages of using TARP money for this particular situation is that, for example, you can immediately put people back to work because these are shovel stop projects. I mean, so this would have one of the most immediate impacts.

One of my largest concerns about some of the spending bills, it is just that most of the spending takes place next year, when it is not going to be relevant anymore.

Mr. CAMPBELL. Right, but, I mean, clearly—all right, I understand. And, I mean, I disagree, in that I think in the private sector—and you and I have talked for years. There is a bigger multiplier effect in the private sector, isn't there?

Mr. THORNBERG. Well, I mean, obviously, much of this money would go to the private sector. Don't forget, like, for example, the construction projects, that is private sector. A lot of this money would go to external contractors.

Mr. CAMPBELL. Okay, but we don't know necessarily where it will go. But there is no systemic issue here.

Mr. THORNBERG. No.

Mr. CAMPBELL. So it is really not akin to TARP, I mean, to the original purpose of the original TARP.

Mr. THORNBERG. No.

Mr. CAMPBELL. The last thing is why—and if this question has been asked, I apologize. But if a municipality adjacent to any of yours, or whatever, has Chrysler debt or General Motors, which was pretty highly rated at one time, or WaMu or whatever, why should only Lehman investors be carved out, versus all of the other failures that have happened or are yet to occur?

Mr. THORNBERG. I will just weigh in very quickly on that.

Again, I think one of the primary points that I tried to make in my presentation was that the money we are talking about is strictly short-run investments; that long-run investments should not be covered under this in any way, shape, or form.

Mr. CAMPBELL. Well, I mean, I am just talking about the bonds.

Mr. THORNBERG. Well, but these are all short-run bonds used for current expenditures. These were not long-run bonds wrapped up in pension funds or anything like that. Those should not be part of this process.

Mr. CAMPBELL. Okay. Suppose someone was invested in something overnight or invested in 30 days, whatever, invested in something short-run for one of these other institutions, one of these other bonds that has failed.

Okay. All right. I will yield back the balance of my time to the gentlelady from Illinois. Thank you very much.

Mrs. BIGGERT. Thank you.

I yield back.

Ms. SPEIER. The gentleman from Colorado, Mr. Perlmutter?

Mr. PERLMUTTER. Thank you.

And I appreciate the conversation and Mr. Campbell's points and some of the remarks that you have made, Mr. Street, but let's just start from square one.

Orange County filed Chapter 9. That is, like, one in a million counties that file Chapter 9, correct?

Mr. STREET. There have been other counties that have filed Chapter 9 or are about to file Chapter 9.

Mr. PERLMUTTER. But Orange County, back in the 1990's, was the only county to file Chapter 9, wasn't it?

Mr. STREET. I believe so.

Mr. PERLMUTTER. Okay. And Chapter 9 is a bankruptcy, very unusual bankruptcy for a governmental entity, correct?

Mr. STREET. Yes.

Mr. PERLMUTTER. Okay. So that is how Orange County dealt with its financial problems, is it filed bankruptcy.

Mr. STREET. Yes.

Mr. PERLMUTTER. It didn't get a bailout, but it utilized the laws of the United States to file bankruptcy. So it made a lot of very bad investment decisions. And Mr. Campbell is right. You compare yield and risk, and the riskier you get, maybe the higher yield you get and the more trouble you might get into. And Orange County got into a lot of trouble. Other counties didn't get into trouble, at that time.

Mr. STREET. There were a lot of counties that got into trouble, a lot of cities. You just didn't hear it in the form of bankruptcies—

Mr. PERLMUTTER. I am a bankruptcy lawyer. I did Chapter—I didn't do Chapter 9's, because we didn't have Chapter 9's going in Colorado. But I am aware of Orange County. And, really, that was the only one—that was the signature bankruptcy in the 1990's, for sure, and in this decade too. And so, to use that as the highlight of comparison to these other folks who invested in, more or less, money markets with a company that had a high rating from a rating agency is absolutely ridiculous.

So I do appreciate the comments that you made after that, about the fact you have to watch every nickel, because at this time in our Nation's history, every county and every individual and every government has to watch how it is doing. So those points are well-taken.

But, you know, as a lousy pun, to compare Orange County to these other counties and districts is like comparing apples and or-

anges; it just doesn't really apply. Your point about watching money closely now is correct.

I think where I have a real problem with what Mr. Campbell was saying—he says, well, to California, "If you don't get your share of TARP money, will the system fall apart? If not, then you are not systemic." We provided TARP money because, across the system, everybody needed assistance. We certainly helped the banks; now, why aren't we helping Main Street?

You can't have an objection to that, can you, sir?

Mr. STREET. I think that if you pass this bill, you will encourage risk in the future. People will see the bailout as allowing them to take greater amounts of risk and—

Mr. PERLMUTTER. You don't think we have already encouraged that by assisting the banks?

Mr. STREET. I think there has been a lot of punishment taken out on some of the executives of the bank, and I think America actually applauds that.

Mr. PERLMUTTER. Let me ask you this, and then I will turn it over to the other panelists.

Mr. Hullinghorst described the purpose of investments in something like a Lehman Brothers or other things. And I am sure Orange County had investments in some other companies, and Merrill Lynch or Citibank or JPMorgan Chase. The purpose was to also bolster commercial paper lending. Everything is connected to everything else in the financial sector. That certainly is something we have found.

Now, do you object to taxpayer money coming in through local governments being used to assist with commercial paper?

Mr. STREET. Taxpayer money coming in to bail out local governments' commercial paper? Absolutely.

Mr. PERLMUTTER. Okay. Do you object to local governments' taxpayer money, their own taxes, being used to purchase commercial paper that then goes to assist businesses across the country?

Mr. STREET. I think they have investment policy statements, and they pursue those investment policies.

Mr. PERLMUTTER. Did you hear any of these individuals state that they were outside of their investment policies or the laws of their State?

Mr. STREET. I did not.

Mr. PERLMUTTER. Okay.

Mr. Hullinghorst, what if you were all to pull back from, you know, buying highly rated paper that then is used for—your funds are used to assist other businesses across the country?

Mr. HULLINGHORST. The amount of investment in commercial paper by governments is probably less than 10 percent, maybe 20 percent of our entire portfolio. I would have to be speculating on that. But there is at least $200 billion to $300 billion invested in pools, pooled investment funds.

And so that is roughly $30 billion. It is not going to kill the commercial paper market, but we are in the commercial paper market because there are specific maturity dates that we need to meet. Sometimes those maturity dates aren't available in other paper, and commercial paper that is A1/P1 rated is supposed to have a maturity that you can count on.

There are two things that are going to happen if we continue down this road and don't support municipal governments.

One is already happening, and that is that people are pulling out of the pooled investment funds all over the country. One in Colorado has already failed because of its Lehman investments because it broke the buck. It wasn't a bad investment pool; it is just that, by the rules of the game, if you have more than a $1 loss in a pooled investment fund, you close the doors and you liquidate.

There is another pool in Colorado that—

Mr. PERLMUTTER. My time is up, but I appreciate your comments.

And I guess I am the last person, so I would yield back.

Ms. SPEIER. Thank you.

Ladies and gentlemen, this brings to a close our hearing today. I want to thank the panelists for providing us with such great testimony.

I want to thank all of you who joined who are staff to these jurisdictions, who came the long distance to be here today. Will all those who are the support to those who are at the table like to stand up so we can say, "thank you," as well, for your great participation.

I would also like to clarify that the municipal finance hearing will be on May 21st, not on May 17th, as earlier mentioned. So May 21st will be the hearing on municipal finance.

And, at this time, the committee stands adjourned.

[Whereupon, at 12:28 p.m., the hearing was adjourned.]

A P P E N D I X

May 5, 2009

Statement of the Honorable Anna G. Eshoo
House Committee on Financial Services
Hearing on *The Effect of the Lehman Brothers Bankruptcy on State and Local Governments*
May 5, 2009

Chairman Frank, Ranking Member Bachus, and Members of the Committee, thank you for the opportunity to speak to you today about a matter of critical importance to local communities across the country.

This hearing is necessary so that any discussion concerning the financial losses of the public entity victims of the Lehman bankruptcy can be put into appropriate context. Chairman Frank rightly called these public entities the "unfair victims of this financial crisis."

On September 15, 2008 -- after 150 years of continuous operation -- Lehman Brothers declared bankruptcy. The Lehman bankruptcy was the largest in U.S. history, with nearly $700 billion in reported debt, and it is described as a triggering event for the resulting international financial crisis. Following the collapse of Lehman, the Executive and Legislative branches of our government responded rapidly and aggressively in order to prevent any further failures of other major institutions by adopting the Emergency Economic Stabilization Act of 2008.

The Act, signed into law by President Bush on October 3, 2008, created the Troubled Assets Relief Program ("TARP") and gave the Secretary of the Treasury both the authority and the responsibility to provide financial assistance to institutions through the purchase of "troubled assets," on such terms and conditions as may be appropriate. (Sections 101 and 102).

In exercising this authority, the Secretary is required to take a number of factors into consideration, including "the need to ensure stability for United States public instrumentalities, such as counties and cities, that may have suffered significant increased costs or losses in the current market turmoil". (Section 103(7).) I proposed this language and it was added to the bill with the support and assistance of Chairman Frank and his staff, as well as Speaker Pelosi.

Since adoption of the Act, the Treasury Secretary committed to provide financial assistance in the approximate amount of $590 billion to more than 535 financial institutions. This assistance includes approximately $45 billion to the Bank of America, $50 billion to Citigroup, $40 billion to insurance giant AIG and $24.8 billion to automakers. To date, however, no assistance under the Act has been provided to any United States public instrumentality. It's been said that some banks are too big to fail. It can also be said that counties, school districts and cities are too small to be noticed. Their losses represent ¼ of 1% of TARP funding.

The fact that TARP was intended to, and should, assist local public instrumentalities is clear. This fact was further confirmed on January 15, 2009, when Chairman Frank, in response to my questions on the Floor of the House of Representatives, reinforced that the Act is intended to provide financial assistance to local governmental entities which were significantly impacted by the Lehman bankruptcy and that the Act expressly provides authority for the Secretary of the Treasury to provide relief to municipalities.

In fact, Mr. Chairman, I think you said it best when you indicated that it was important "not simply to confirm that the authority is there but to say that we expect it to be used and to *demand* that if it is not used, we get a written explanation as to why not."

On November 7, 2008, I wrote to Secretary Paulson, requesting that he exercise his authority under Section 103(7) of the *Emergency Stabilization At of 2008*, to purchase the troubled assets held by local governments. He called me on November 21st and reiterated his decision not to include local governments in the TARP.

On Novermber 25, 2008, I wrote to the Presidential Transition Team, spelling out the case and the authority under the TARP law, and the lack of action on the part of the previous Administration. I strongly urged the new Administration to use its authority to protect taxpayer funds and purchase the troubled assets of local governments.

On February 13, 2009, I wrote to Secretary Geithner and was joined by 26 House Colleagues requesting that he exercise his authority under TARP to purchase the troubled assets held by local governments.

I ask that these letters, as well as a November 21, 2008 analysis I requested of the Congressional Research Service on the Authority of the Secretary of the Treasury under the *Economic Stabilization Act*, and a copy of the January 14, 2009, colloquy between Chairman Frank and myself be included in the hearing Record.

The Treasury's decision to let Lehman Fail is causing catastrophic losses to many localities, resulting in job losses, termination of ongoing construction projects, and elimination or reduction in critical services. Hospitals are reducing services and staff. Schools are laying off teachers. Police and fire departments are reducing patrols and limiting services.

And what 'wrongs' are these school districts, counties and cities 'guilty' of? Investing in highly rated instruments in Lehman Brothers.

If we want our national economy to rebound, our local economies cannot be left behind. This is not just a California problem. It includes public entities from Florida, Colorado, Arizona, Michigan, Massachusetts, Missouri, Oregon and Washington State. And the list goes on.

Local public entities should be able to recover some of the dollars lost. To date, Lehman Brothers is the only financial institution that was allowed to collapse and our schools,

public safety, and social services will suffer if we don't return these dollars back to our local governments.

We have a law which is clear.
We have a case that is clear.

What we need is clear, decisive action to right this wrong. Local taxpayers and communities should not have to tolerate losing their most basic services because Lehman Brothers was allowed to go down.

Statement of the Honorable Jackie Speier
House Committee on Financial Services
Hearing on the Effect of the Lehman Brothers Bankruptcy on State and Local Governments
May 5, 2009

Chairman Frank, Ranking member Bachus, and colleagues:

I thank you for convening this hearing today to examine the devastating impact the failure of Lehman Brothers has had on state and local governments and other publicly funded entities. Although my district has been hit particularly hard, this truly is a national problem, as you will hear from the witnesses today from California, Colorado and Florida. There are affected communities in at least 20 states, from Alaska to Washington to Massachusetts. Some of the losses are relatively small—only $18 in Tennessee as far as we can tell—but Minnesota lost more than $56 million, Missouri lost $50 million, Oregon lost $173 million, and Arizona lost $61 million. You will hear from one of today's witnesses that Florida, already hurt hard by natural disasters and the recession, lost more than $465 million.

I would like to ask for unanimous consent to enter testimony from some other affected entities into the record.

As you know, Ms. Eshoo and I have introduced a bill—HR 467—that would require the Treasury Department to repurchase certain Lehman investments held by these government entities at full face value using TARP funds. The Treasury Department asserts it still has more than $135 billion left in its TARP arsenal. It has used hundreds of billions of those taxpayer funds to save Wall Street. We are

asking that it use just $1.7 billion of those taxpayer provided funds to save Main Street.

Lets be clear. Lehman is the only major investment bank the federal government did not prop up last September when Wall Street went into freefall, seemingly overnight. Bear Stearns, the first to be helped - and deemed "too big to fail", was half the size of Lehman Brothers. Negotiations the weekend of September 13 between the Treasury, the Fed, Lehman Brothers and Merrill Lynch resulted in Merrill - with Treasury's help - being acquired by Bank of America. Goldman Sachs and Morgan Stanley were each allowed to become bank holding companies. Lehman then was allowed to go into bankruptcy—the largest in our history. In the words of Nobel Prize winner Paul Krugman, the decision to let Lehman fail was the event that "basically brought the entire world capital market down."

The decision by the Treasury and Fed to allow Lehman to fail was arbitrary and caught many taxpayer-funded agencies unprepared. They had watched the takeover of Countrywide by Bank of America and the bailout and takeover of Bear Stearns by JP Morgan and concluded, like many others, that since in those cases noteholders had been made whole, Lehman was unlikely to declare bankruptcy. But Secretary Paulson did not offer Lehman the same guarantees it had offered the others. And if these local governments had chosen to sell their Lehman investments prior to maturity, they would have suffered a definite and substantial loss, negatively affecting the whole investment pool.

It is not like these government bodies were using taxpayer funds to speculate in the market. The public agencies we are talking about invested in Lehman corporate bonds and notes as part of a strict, safe and conservative investment strategy. In fact, most of the debt instruments in question were highly-rated right up until the

moment of Lehman's collapse. San Mateo County's pooled investments in Lehman were rated A-1 for its "floating rate" securities and A for its corporate bond. That investment Pool is prohibited under state law from investing in equities, and is limited to conservative instruments such as US Treasury obligations, highly rated commercial paper, certificates of deposit and the like. Preservation of principal is of primary importance—to minimize credit risk while recognizing and controlling market risk, matching maturities with capital expenditures and other planned outlays. Diversification plays a big role in that effort. San Mateo County only invested 5.9% of its pool in Lehman as part of its diversification strategy. It also holds similar investments with Morgan Stanley.

These local governments provide critical services and programs that every American family and business relies on to protect public safety, provide healthcare services, respond to emergencies and educate our children. Given our current economic situation, these services are more essential than ever, and the local governments providing them are already struggling with greater demand for services and declining tax revenues to fund them. These losses represent hundreds of jobs lost for construction, teachers, public safety, healthcare, and other services, and class rooms, fire stations, jails and other projects that will halt or never get started.

I believe the Treasury already has the power to do what we are asking. Section 103 of the Emergency Economic Stabilization Act, that we passed last Fall, instructs the Treasury Secretary to take into consideration "the need to ensure stability for United States public instrumentalities, such as counties and cities that may have suffered significant increased costs or losses in the current market turmoil." We requested that Secretary Paulson take such action last Fall, and we

have made the same request of Secretary Geithner in February, but have gotten no response.

There seems to be no limit to the amount of assistance we are willing to provide to the likes of AIG, Citigroup, Bank of America, and Goldman Sachs, let alone the foreign interests whose speculative derivative deals have been fully paid through the taxpayer-funded bailout of AIG. Goldman not only has been the beneficiary of $10 billion of TARP money directly, but it has gotten another $13 billion through its credit default swaps with AIG. All while it reported a $1. 8 billion quarterly profit and is seeking to repay its $10 billion in TARP funds because it doesn't like the compensation strings that come with it. If AIG had been forced to declare bankruptcy, the financial institutions like Goldman doing business with it would have wound up in court, just like San Mateo County has had to do with Lehman, fighting to get pennies on the dollar for their claims. I say let Goldman repay its bailout and use that money where it is really needed—our local communities.

Restoring the value of these Lehman Bonds is perhaps the fastest way to bring relief to communities across America, allowing them to pay their employees, maintain current levels of service and immediately put shovels in the ground on already approved projects.

Maybe in the grand scheme of things $1.7 billion is just not seen as a big enough problem. To the local governments, school districts, sanitation and water districts and the communities they serve, these losses are devastating. How ironic that they should be left wishing they had invested in credit default swaps with AIG—if they had we wouldn't have to be here today.

Board of Supervisors

BOARD OF SUPERVISORS
MARK CHURCH
CAROLE GROOM
RICHARD S. GORDON
ROSE JACOBS GIBSON
ADRIENNE TISSIER

DAVID S. BOESCH
COUNTY MANAGER
CLERK OF THE BOARD

COUNTY OF SAN MATEO

COUNTY GOVERNMENT CENTER • REDWOOD CITY • CALIFORNIA 94063-1655 (650) 363-4653
WEB PAGE ADDRESS: http://www.co.sanmateo.ca.us FAX: (650) 599-1027

WRITTEN TESTIMONY OF SUPERVISOR MARK CHURCH
PRESIDENT, SAN MATEO COUNTY BOARD OF SUPERVISORS
COUNTY OF SAN MATEO, CALIFORNIA

HEARING OF THE HOUSE FINANCIAL SERVICES COMMITTEE
ON THE EFFECT OF THE LEHMAN BROTHERS BANKRUPTCY ON STATE AND LOCAL GOVERNMENTS
MAY 5, 2009

Chairman Frank, Ranking Member Bachus, and Members of the Committee:

I thank the Committee for the opportunity to submit this written statement on an issue of utmost importance to local public agencies throughout the United States.

I currently serve as President of the Board of Supervisors of the County of San Mateo, a county of 735,000 located in the San Francisco Bay Area. Together with Supervisor Richard Gordon, who is present to testify in person today, I serve on our Board's Financial and Operations Committee. As everyone here today knows, the collapse of Lehman Brothers Holdings, Inc. on September 15, 2008, triggered a sudden and unprecedented failure of the international financial system, the fallout from which will seriously impact individuals, businesses, and state and local governments for many years to come. Since that collapse, the reaction and response of the United States Government has been swift and comprehensive, with hundreds of billions of dollars directly infused into financial institutions and other businesses, with the goal, among others, of ensuring that no other institutions suffer the fate of Lehman. The first major federal program adopted to address the financial collapse was the Emergency Economic Stabilization Act of 2008 (the "Act"), which created the Troubled Assets Relief Program (TARP), administered by the Secretary of the Treasury.

The Act provides, among other things that, when making decisions as to the use of TARP funding, the Secretary of the Treasury shall consider:

> " . . . the need to ensure stability for United States public instrumentalities, such as counties and cities, that may have suffered significant increased costs or losses in the current market turmoil;" (H.R. 1424, section 103(7))

Unquestionably, countless public instrumentalities have suffered significant costs and losses in the current market turmoil. To date, public instrumentalities have suffered losses exceeding $1.67 billion. While as of April 7, 2009, $590 billion has been authorized and distributed under TARP, no TARP assistance has been provided to public agencies. These losses were suffered despite the fact that state and local governments are generally required, by law, to purchase only the most conservative instruments, such as those offered by Lehman.

We join our colleagues from other states, each of whom have suffered specific substantial losses as a result of the collapse and bankruptcy of Lehman, to demonstrate that assistance to public instrumentalities directly harmed by this failure is not only appropriate, but will pay dividends in the future which, while difficult to directly quantify, are nonetheless real.

Why should those public entities that suffered losses as a result of the Lehman collapse receive consideration under TARP while other public agencies may not? There is no question that public agencies at every level throughout the country are suffering due to the dramatic loss of state and local funding revenues resulting from depressed property and sales taxes, as well as other revenue streams normally driven by a robust economy. The County of San Mateo, as well as all other public agencies that suffered losses as a result of the Lehman bankruptcies, will suffer in the same way that all other agencies will suffer for many years to come, and no assistance under TARP will alter that reality. But those public agencies that carried investments with Lehman have experienced a separate and quantifiable loss above and beyond that generally suffered by their fellow public agencies because a decision was made in September 2008 not to provide support to Lehman, but to let it fail. As a result of this failure and the ensuing decision by the Congress and Executive Branch that allowing similar failures was an unacceptable option, institutions that might otherwise have gone the way of Lehman instead survive, and their public agency investors have avoided the fate visited on Lehman public agency investors.

To place the relief sought by the many public entities who have suffered losses as a result of the Lehman bankruptcy into context, it is helpful to understand how and why local public funds are invested and the raw numbers in terms of operating and capital funds that simply disappeared on September 15, 2008. Our County's experience provides a telling example of the impact to public entities nationwide. As allowed by California state law, the County Treasurer operates an investment pool that invests surplus monies of 25 school districts, 15 cities within the County, and numerous other public agencies that provide public services within the County. The purpose of the pool is not to "make a profit", but to preserve public monies and to manage them such that ongoing cash flow needs are met and that idle funds do not lose value against inflation. As required by state law, the types of investments allowed are limited to conservative investment vehicles that must meet certain minimum credit standards. Historically, the County Treasurer has

invested the bulk of the monies in the pool in treasuries or instruments issued by federal agencies, and a lesser amount in high quality bonds and other conservative debt instruments issued by financial and other corporate institutions with solid histories and high credit ratings. Lehman fell into the latter category and, as of September 15, 2008, approximately 5.9% of the pool's assets were invested in A-rated floating rate notes and bonds issued by Lehman. Immediately before the bankruptcy, these investments had a par value of approximately $155 million; immediately after September 15th, as a result of the decision to allow Lehman to fail, these same investments were virtually worthless.

How has the Lehman failure specifically affected San Mateo County, and the cities, school districts, transportation agencies, and other local public instrumentalities which provide the myriad services that the citizens of the County rely on? The distinguished local agency panelists appearing at your hearing today will no doubt explain in detail what these lost dollars mean in terms of lowered educational expectations and curtailed services. In San Mateo County alone, the impact includes a $25 million loss to the Transportation Authority, which will adversely impact plans to electrify the Caltrain Peninsula commuter rail service and road construction and reconstruction projects; a $40 million loss to schools which will result in layoffs of critical teaching staff, as well as cause a delay in (if not cancellation of) needed educational facilities; and a nearly $37 million loss to sorely needed County health, social service and law enforcement programs.

What has San Mateo County done in response to the Lehman losses? The County has taken all steps within its power to mitigate the severe financial blow resulting from the Lehman collapse. As have so many of the public agencies who invested in Lehman, we have filed a claim in bankruptcy; these proceedings are still in the early stages, and based on estimates provided by bankruptcy counsel, may last another 18 months to two years, with limited recovery in the range of 20 cents on the dollar to be expected. We have filed a lawsuit against officials of Lehman and against its auditors, Ernst and Young, which will likely take years to resolve with the outcome unknown. And we immediately embarked on a comprehensive review of the County's investment policy, which has already resulted in a determination by an outside financial consultant that County pool assets have been, and continue to be, invested conservatively in a manner consistent with the overriding objective of preservation of principal.

On behalf of the San Mateo Board of Supervisors, the many agencies throughout the County who provide countless services on the public's behalf, and the citizens of the County, we respectfully request your consideration of financial assistance to public agencies directly harmed by the collapse of Lehman Brothers. I again thank you for the opportunity to submit these written remarks.

SAN MATEO COUNTY
COMMUNITY COLLEGE DISTRICT

Canada College, Redwood City
College of San Mateo, San Mateo
Skyline College, San Bruno

Office of the Chancellor

TESTIMONY OF RON GALATOLO, CHANCELLOR OF THE SAN MATEO COUNTY COMMUNITY COLLEGE DISTRICT (CA) BEFORE THE HOUSE COMMITTEE ON FINANCIAL SERVICES
HEARING ON "THE EFFECT OF THE LEHMAN BROTHERS BANKRUPTCY ON STATE AND LOCAL GOVERNMENTS"
MAY 5, 2009

Chairman Frank, Ranking Member Bachus, and Members of the Committee:

Thank you for inviting me to testify on the effect of the Lehman Brothers Bankruptcy on state and local governments. My name is Ron Galatolo and I am the Chancellor of the San Mateo County Community College District. Below is a summary of my remarks here today:

- I was formerly a Certified Public Accountant with KPMG Peat Marwick
- Given my professional background I will address the academic consequence as well as the fiscal impact to the district's operating budget as a result of the Lehman bankruptcy.
- The district has three colleges located within the boundary of San Mateo County and serves approximately 45,000 students per year and; in addition to preparing students for transfer to universities, a large portion of the institution's core mission is to provide occupational skills including retraining and preparing dislocated workers for re-entry into the workforce.
- By holding these troubled Lehman assets, the immediate loss consumed most of the district's operating reserves and substantially reduced the amount of resources set aside for capital renovation at our three colleges.
- Overall, we have suffered about a 10% reduction to our budget and are forecasting as much as another 8% reduction in the coming year.
- As a result of our reserves being eliminated by the Lehman bankruptcy, we have no viable option other than to immediately reduce our teachers and support staff in addition to shrinking our academic programs and services.
- When all is said and done, we may have to shed the equivalent of as much as 11% of our full-time workforce. Again, that will directly affect our ability to meet the academic and occupational needs of our community who rely on us to prepare them for local jobs.
- When all is said and done, we will have to abandon many of our construction projects slated to renovate our three aging colleges. By our calculations, this could negatively impact as much as 400 construction jobs... causing a "de-stimulus" to our local economy.
- We are not alone and through no fault of our own... many schools, colleges and universities have experienced similar economic hardship as a result of the Lehman bankruptcy. We are a "labor intensive industry" who invested in what we believed and trusted were very low risk, high quality investments and, ironically, to paraphrase Congresswoman Speier, if we had invested in AIG instead of Lehman... we would not be here today asking for your help.
- I feel that it's highly inequitable to use TARP funding to shore-up banks and cover bad mortgages, but fail to protect agencies' taxpayer dollars such as ours and the others who are testifying before you today.

Ronald D. Galatolo

Experience: *Chancellor* – San Mateo County Community College District

Executive Vice-Chancellor – San Mateo County Community College District
(Chief Financial and Operating Officer)

Controller – Foothill-De Anza Community College District

Adjunct Faculty: Accounting Program – Foothill College
Government Program – Golden Gate University

Certified Public Accountant/Consultant – KPMG Peat Marwick

Education: San Francisco State University, EMBA
San Jose State University, Business Administration

Credentials: Certified Public Accountant (California)
California Community College Instructor Credential
Past President – Administrative Management Association
Member – American Institute of Certified Public Accountants
Member – California Society of Certified Public Accountants

Served on several boards including:
ACE Commissioner – Adult Learning & Educational Credentials,
San Mateo County Community Colleges Foundation – Ex Officio Board Member
Peninsula Policy Partnership of San Mateo County – Board Member
Daytop California – Board Member
San Mateo County Schools Insurance Group – Board Member
Statewide Association of Community Colleges – Board Member
Bay Area Community College Joint Powers Authority – Officer
HOPE (Housing our People Effectively) Leadership Committee
East Palo Alto Community Transportation Plan
Workforce Investment Board, San Mateo County

TESTIMONY OF RICHARD S. GORDON
MEMBER, SAN MATEO COUNTY BOARD OF SUPERVISORS
COUNTY OF SAN MATEO, CALIFORNIA

HEARING OF THE HOUSE COMMITTEE ON FINANCIAL SERVICES
ON THE EFFECT OF THE LEHMAN BROTHERS BANKRUPTCY ON STATE AND LOCAL GOVERNMENTS"
MAY 5, 2009

Chairman Frank, Ranking Member Bachus, and Members of the Committee:

Thank you for inviting me to testify on the effect of the Lehman Brothers Bankruptcy on state and local governments. My name is Richard Gordon and I am a member of the Board of Supervisors of the County of San Mateo. San Mateo County is a county of approximately 735,000 located in the San Francisco Bay Area. Together with my fellow Board member Mark Church, who has submitted written testimony to the Committee, I serve on our Board's Finance and Operations Committee.

I also would like to specially thank our representatives in Congress, Jackie Speier and Anna Eshoo as well as Senator Diane Feinstein, who -- together with Chairman Frank -- have highlighted the national implications of the Lehman bankruptcy on local governments and communities across this country. With their encouragement, our county staff has connected with a national network of public instrumentalities that has collectively lost 1.7 billion dollars of investments in commercial bonds and similar conservative debt instruments as a result of the Lehman collapse. So, clearly the issues being discussed today are of great importance to local governments and communities.

General Description of Impact:
As a direct result of the Lehman bankruptcy, public instrumentalities across the United States suffered an immediate loss of monies that were invested in Lehman bonds and other securities. As I mentioned earlier, these losses, which have impacted hundreds of public instrumentalities across the United States, are presently estimated to total $1.7 billion.

The Unique Position of Public Instrumentalities:
Public instrumentalities at the state and local level are unique in that, as a rule, we are fully funded by the taxpayers. Although the exact restrictions will vary from state to state, as a general matter, state constitutional and statutory constraints require local governments to operate on a "pay as you go" basis, with strict limitations on the revenue that can be generated on a yearly basis.

The revenues raised by public instrumentalities are for the direct benefit of constituents, in the form of services (*e.g.*, teachers, police services, public works services) or capital improvements (*e.g.*, classrooms, roads, sewer facilities).

Typically, this revenue is not collected on a steady ongoing basis. In many states, for example, property taxes are collected twice a year. As a result, the ongoing operations of our schools, counties, and other local public entities require careful management of cash flow (*e.g.*, to pay salaries) and state laws generally place strict limitations on the ways that public funds may be invested. Unlike the private sector, the overriding investment objective for public funds is the preservation of capital rather than gain.

In California, for example, treasury pool investments are restricted to high quality debt instruments, including federal agency instruments, high-grade commercial paper, corporate bonds and similar investments. Returns are relatively low, consistent with the conservative nature of the investment allowed, and are largely intended to keep pace with inflation. Treasury pool portfolios are managed to hold investments to maturity so that return of principal is assured.

By way of example, as of September 15, 2008, our County's Pool held conservative financial instruments bought through Lehman representing about 5.9 percent of the par value of all pooled assets. These investments included safe "floating rate" securities and one corporate bond. The floating rate securities, as required by law and County investment policy, were rated "A-1" at purchase, and the corporate bond was rated "A" at purchase.

In my county, the Treasury Pool's investment history reflects the conservative nature of the Pool's investment strategy. The Pool's average gross return on investment for the last 5 years, for example, was 3.68 percent. Because of the conservative investment strategies required by state law, and our County's Investment Policy, investments only make a return sufficient to keep up with inflation, so that these public funds will not "lose ground" against the general economy. In other words, the Pool is not run for the purpose of turning a profit.

When asked the question: "Why would a municipality invest in Lehman Brothers in the first place?" therefore, it is important to recognize some key principles: First, in light of the constraints placed on local treasury pool investments regarding the rating of the issuing entity, limits on the percentage of the pool that could be invested in any one entity, limits on the types of investments that could be purchased -- as well as the liquidity needs of pool participants -- Lehman corporate bonds were one of the few investments that the public instrumentalities could make. Second, it should be recognized that local governments as a general matter are prohibited from purchasing equities. In other words, the Lehman securities purchased were conservative investments in bonds and corporate notes, not speculative purchases of Lehman stock. Finally, as evidenced by the hundreds of billion dollars of other investments in Lehman that are being sorted out through the bankruptcy process, it is clear that, up until the date that Lehman filed for bankruptcy, public entities were not alone in the conclusion that Lehman investments, if not sound, were certainly not a clear liability.

As a result of the Lehman bankruptcy, 15 cities, numerous special districts, and 24 school districts -- all of whom had placed taxpayer funds into the Treasury Pool -- suffered an

unexpected and devastating financial hit. These losses have been substantial and have resulted in the direct loss of services and the delay or cancellation of needed capital improvements. The losses include the loss of many jobs, including teachers, police officers, fire fighters, health care workers and construction workers.

Losses in our county alone, for example, include:

- $25 million in San Mateo County Transit Authority funds that will stall planned electrification of the Caltrain Peninsula Commuter Rail Service;

- $40 million in K-12 school operating funds, that includes teacher salaries, educational materials, books and facility construction and maintenance;

- $36.7 million of the County of San Mateo operating funds that support such activities as San Mateo Medical Center (public hospital), affordable housing development, parks, childcare, In-Home Support Services for the elderly and disabled, law enforcement, and construction of sorely-needed correctional facilities; and

- $12.3 million in special district operating funds including the Bay Area Air Quality District, and numerous sanitation and flood control districts.

Statewide and nationwide, the impact described above is not unique:

- Cities, counties, and local agencies in Arizona have sustained losses exceeding $40 million;

- Cities, counties, and local agencies in Florida have sustained losses exceeding $400 million;

- The State of Oregon's investment pool sustained losses of approximately $170 million; and

- In addition, schools, special districts, local agencies, and state governments in Alaska, Massachusetts, Michigan, Minnesota, New Jersey, New Mexico, Pennsylvania, and Washington have also lost hundreds of millions of taxpayer dollars as a result of the decision to allow Lehman to collapse.

The Direct Benefit of Assisting Lehman-Impacted Public Instrumentalities

Some may wonder: "If TARP funds are used to assist public instrumentalities who suffered Lehman losses, won't this open the floodgates to scores of requests from other public and private investors who have suffered losses as a result of the downturn in the economy?"

On behalf of the affected public instrumentalities, I respectfully submit that the answer is "No."

As set forth in the Emergency Economic Stabilization Act of 2008 itself, and as clarified in the colloquy between Chairman Frank and Representative Eshoo in January, one of the purposes of TARP is to assist local governments, especially those that were impacted by the decision to allow Lehman to collapse. While the use of TARP to capitalize banks, financial institutions, and other industries is undoubtedly important and necessary to bring our national economy back to health, by providing TARP funds to make local governments whole for Lehman losses will yield a direct and immediate benefit to local economies.

Because the TARP monies would be directed towards local public entities, the use of such funds will be transparent and the benefits will be quantifiable. Such funds will directly support our local schools, police, fire districts, libraries, hospitals and job training efforts. Taxpayers will be able to clearly identify the number of jobs created, the number of buildings constructed, and the number of constituents directly served as a result of the use of TARP funds in this manner.

L:\CLIENT\ADMIN\PAO - Treasurer\Congressional Hearings\Richard Gordon Testimony v4.doc

TESTIMONY OF ROBERT HULLINGHORST, TREASURER OF BOULDER COUNTY, COLORADO, BEFORE THE HOUSE COMMITTEE ON FINANCIAL SERVICES HEARING ON "THE EFFECT OF THE LEHMAN BROTHERS BANKRUPTCY ON STATE AND LOCAL GOVERNMENTS"
MAY 5, 2009

Chairman Frank, honorable members of the Committee, thank you for this opportunity to explain why HR 467 is very important to my County and the taxpayers of 61 other governments in Colorado.

I am Bob Hullinghorst, Treasurer of Boulder County. We are located 30 miles northwest of Denver and are the home of the University of Colorado. We have a population of about 300,000.

For over a decade, Colorado has been well served by three pooled investment trusts regulated by our Division of Securities. They have been required by law to operate by federal money market standards, and Standard and Poors has rated them AAAm.

During this past year, my county and 61 other local governments, have had to write off $5 million plus interest because our pool, Colorado Diversified Trust, had invested part of its assets in highly rated commercial paper issued by Lehman Brothers.

Ours was not a speculative investment. We are not yield hogs. My county and these other governments were relying on a regulatory environment that includes numerous federal agencies as well as our own state securities commission. We should not have been taking risks with taxpayers' dollars. We did not think we were.

Boulder County was forced to write off $700,000 because of the Lehman Brothers commercial paper in the Colorado Diversified Trust pool. Just to give you some perspective, this is almost half of the $1,500,000 our state legislature just cut from Boulder County's portion of the appropriation for Community Health Centers serving

about 10% of our population—the poor and unemployed. This could mean 20 nurses or 25,000 flu shots.

Today, I ask you approve HR 467 and direct TARP funds to acquire Lehman Brothers commercial paper. If you do, you will not be rewarding imprudent local government officials. You will be directing federal taxpayer dollars that will be used quickly and spent effectively to fill a very big gap that was primarily the result of a regulatory failure in our federal financial oversight.

KAREN E. RUSHING
Clerk of the Circuit Court and County Comptroller

Sarasota County

2000 Main Street • P.O. Box 3079 • Sarasota, FL 34230-3079 • Phone: 941-861-7400 • www.sarasotaclerk.com

STATEMENT OF THE SARASOTA COUNTY
CLERK OF THE CIRCUIT COURT AND COUNTY COMPTROLLER
THE EFFECT OF THE LEHMAN BROTHERS BANKRUPTCY ON
STATE AND LOCAL GOVERNMENTS
HOUSE FINANCIAL SERVICES COMMITTEE
TUESDAY, MAY 5, 2009 AT 10:00AM

Mr. Chairman and members of the committee, thank you very much for the opportunity to submit this statement for the record for the hearing on the effect the Lehman Brothers' bankruptcy has had on state and local governments.

The Secretary of the Treasury has the authority to purchase "troubled assets" as defined within the Emergency Economic Stabilization Act of 2008 (the "ACT"). The purpose of my testimony today is to:

1. Respectfully encourage Treasury Secretary Tim Geithner to designate a portion of the $700 billion Troubled Asset Relief Program (TARP) to purchase the troubled assets of Lehman Brothers Holding, Inc., held by many cities, states, and local governments, like the State of Florida, its cities and Sarasota County.

2. Request your support for HR467, Equitable Treatment of State and Local Governments Act of 2009.

It is my understanding that as of this date, the Treasury Secretary has not yet exercised his authority to purchase the troubled assets from state and local governments, and the adoption of HR467 will require the purchase of bonds and other debt instruments issued by Lehman Brothers Holdings, Inc.

Florida's weakened economic activity, high unemployment rate, reduced revenue, declining property values and record high foreclosures *(FL ranks in top four in the nation)*, and insurance crisis has resulted in an extreme economic crisis for the State of Florida, and weakens our ability to withstand losses caused by the failure of Lehman Brothers. It is important to note that for those states and local governments that rely heavily on development-related revenue and sales tax, like Florida, the impact is even greater due to the severe decline in home construction and spending.

The decision to treat Lehman Brothers' financial situation differently than other failing financial institutions resulted in devastating consequences on state and local governments. The State of Florida was holding over $300M and Sarasota County was holding $40M in Lehman bonds at the time Lehman filed for bankruptcy. Our economic analysis indicates

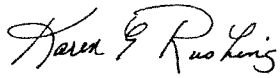
that for every $10M of losses, the estimated impact to the local economy is approximately 95 jobs, and $12.7M in total economic output.
The direct impact of this investment loss has had a negative consequence for several key areas of community service: health and human services, public safety, emergency services and courts.

Listed below is a sample of the effect caused by the bonds purchased by Sarasota County Government:

- Inability to build, equip and staff a new fire station which would expand ambulance coverage in the eastern part of Sarasota County
- Reduced operating budgets for the county transit authority (non-state and federal funding component)
  - 45 buses with fixed route service
  - 2.6 million annual riders
- Inability to build and equip two new libraries
  - 2 locations
- Reduced operating budgets for the county's library system
  - 8 locations
- Inability to construct new parks
  - 11 parks
- Reduced operating budgets for Pretrial Services
  - Pretrial Services provides a vital role by ensuring violent offenders are identified, so appropriate decisions concerning their release or detention can be made. Reductions in this program are likely to increase the jail population, and accelerate the need to construct a new jail facility.

I ask for your support to assist state and local governments, by ensuring they are placed in the same position they would have been in, had the Secretary of the Treasury and the Board of Governors of the Federal Reserve System provided emergency financial assistance to Lehman Brothers Holdings Inc.

Mr. Chairman, thank you very much for calling this hearing, and providing me the opportunity to submit this statement for the record.



Karen E. Rushing
Clerk of the Circuit Court and County Comptroller
Sarasota County, FL

FROM THE OFFICE OF
CHRISS W. STREET
ORANGE COUNTY TREASURER

DANGER OF GUARANTEEING CALIFORNIA DEBT

In the next two months, the State of California intends to bring $15 billion in Tax & Revenue Anticipation Notes (TRANS) to the public marketplace. Due to the recent multiple downgrades of California's credit rating and deteriorating economic fundamentals, the State fears there may be no appetite to purchase new California debt. The purpose of this financing is to bridge the State's cash flow needs beyond July 2009. To enhance the offering's credit worthiness, the State is asking the US Congress to take the unprecedented step of backing the sovereign debt of the State of California with the Full Faith & Credit of the United States. There is a substantial risk that the AAA credit rating enjoyed by the United States would be cut if the US Government took this action.

EXTERNAL ECONOMIC ENVIRONMENT

The United States is in the midst of a severe recession, which began in 2007 and is expected to run through the end of 2009. The sectors of the economy most severely impacted by the recession continue to be real estate and finance. Considering California was at the National forefront of both sectors for the last decade, it is logical that the current contraction will have a disproportionately negative impact on the State.

The large monetary and fiscal intervention by the US Federal Government has cushioned the initial shock of the contraction and created a favorable basis for a moderate recovery of GDP next year. Nonetheless, it will probably be at least another 5 years for the real estate and financial sector to become positive generators of growth. Absent any structural change to the California economy, the State should anticipate a slower recovery than the US in general.

INTERNAL ECONOMIC ENVIRONMENT

For 35 years California has led the United States in GDP growth, job creation and standard of living. During these golden years, the State taxed, borrowed and spent itself into an increasingly uncompetitive economic position. Today California has the highest tax rates, second highest unemployment rate, highest total unemployed, lowest credit rating, highest fiscal deficit and least attractive business environment of any state in the Nation.

11 Civic Center Plaza · Santa Ana, CA 92702 · 714-834-7625

Although California leads the Country in net migration out of the State, it continues to enact new anti-business laws and environmental mandates. The increasingly negative business climate and punitive consumer tax structure contributes to the State's increasing deficits. Because the State has historically been able to borrow its way out of cash flow shortfalls, there has been no pressure to change this broken model.

PROPOSITION 13

The State of California has historically relied on taxing real property and income to fund its operations. In 1978, a taxpayer revolt resulted in the passage of Proposition 13, which limited the increase on assessed valuations of existing properties to 2% annually. Consequently, the State increasingly relied on income tax, especially capital gains taxes, to fund budget growth.

The broad decline in real estate prices from 1990-97 predictably resulted in a significant drop in revenue for California. One of the biggest victims of the recession was the County of Orange. The County maintained its spending levels, even as revenue contracted, by increasing its reliance on speculative short-term investment earnings. Although the investments helped cover costs in the short run, the scheme ultimately proved to be a disaster and the County was forced into bankruptcy. When the County's efforts to raise sales taxes were rebuffed by voters, operations were restructured to be more efficient. In spite of a 20% revenue reduction, services continued largely uninterrupted and at a level which met all legal requirements.

CAPITAL GAINS FROM STOCKS AND REAL ESTATE

From 1997-2001 Silicon Valley was the center of the universe. Capital gains taxes, a byproduct of soaring internet stock prices, filled California's coffers. The newly created wealth resulted in higher consumer spending, increased auto sales and record revenues for California. It also fueled a dramatic expansion of government programs.

When revenues fell off a cliff in fiscal year 2001-2002, the Governor and California Legislature sought to create new taxes to fill the budget short fall. Working together, they increased the marginal tax rates on high-income earners and tripled the vehicle license fee (VLF) for all car owners. The combination of progressive and regressive taxes, were wildly unpopular and led to another taxpayer revolt. The Governor was recalled, the VLF tax was rescinded and legislation was passed that permitted $10 billion of long term borrowing to plug a current year deficit.

For the next 5 years, consumer spending and car sales accelerated, while real estate capital gains exploded. The spike in tax revenue allowed the State Legislature to increase spending at twice the compounded growth of the State GDP.

THE END OF CAPITAL GAINS

Spurring the growth of the California budget was the State's phenomenally large capital gains tax base. The top one percent of earners generates 40% of the states revenues; 250,000 people have been doing the heavy lifting for a state with a population around 36 million.

From 1994 to 2007, this top-heavy tax system flourished as virtually every class of investment vehicle, including stocks, residential real estate, commercial real estate, commodities, art, collectibles, oil, gold and US Government bonds participated in a bull market. During this period of economic expansion, the state was collecting roughly $25 billion in capital gains driven taxes.

Since the middle of 2008, most investments have declined precipitously in value. The losses associated with all investments have created tax-loss carry forwards that will offset about 80% of any capital gains tax liabilities for the next 5 years.

TAX AND SPEND

In late 2008 the California State Controller's and Treasurer's offices began warning that worsening economy would inevitably result in significantly diminished revenues. The Legislature responded to this grim outlook by increasing regressive State taxes, expanding State employee head-count and passing new business restrictions. In order for the Legislature's budgetary house of cards to stand, voters must approve a series of new taxes when they go to the polls May 19. The Legislature's tax, borrow and spend initiatives will fail, according to all recent polling data.

STATE REVENUE CASH FLOW

The State of California's cash flow balances rise and fall annually on a predictable cycle. Consumer sales and new model car sales generate very large sales tax and VLF revenue at the end of the calendar year. Tax revenues are paid to schools and other beneficiaries in January and reserves thus hit a low point in February.

Income and property tax collections begin in March and the State's reserves hit their annual high point in April. Reserves then decrease each month until they hit their annual low point in September.

To smooth cash flows availability, Federal Law permits the State to sell TRANS with maturities up to 210 days, or until sufficient revenue is collected to match spending activity. If the State does not have the resources to pay beneficiaries of State spending on a timely basis, the Legislature may delay the distribution of apportionments to beneficiaries.

WARRANTS AND RAWS

If the State is unable to borrow money to meet their obligations, the State Controller can issue unsecured warrants, which are IOUs to vendors. The State can also sell Registered Anticipation Warrants (RAWs), which are promises to pay on a daily priority basis as cash flow is available. It is a felony for the State Controller to fail to pay RAWS as cash becomes available. RAWs would be extraordinarily attractive to investors because their priority is criminally protected against non-payment; default is not an option!

The RAWs that were issued in the last 30 years were met with strong ratings and exceptionally strong investor demand. The State has resisted issuing RAWs in the past, because RAWs require fiscal discipline; as revenue is collected cash must be immediately paid out to creditors.

Moody's and S&P have both assigned an A rating to the State of California. Given that TRANS are sold to money market funds that require a minimum rating of AA, there currently is no market for California TRANs. Issuing RAWs appears to be the only way for the State to meet its cash flow needs.

COMPROMISE TAX INCREASE

In late February 2009, the California State Legislature signed a "compromise" State Budget that substantially increased taxes, and placed tax and borrowing measures on the May 19th ballot. Although the State is required to annually pass a balanced budget with a $2 billion reserve, most State financial officers' estimate the budget will be billions in the red, even if all the initiatives passed.

Furthermore, the current budget curiously assumes that property taxes will continue to increase at 5%, while most County Treasurers forecast their collections to be flat or negative this year and down an additional 5% next year. The California Legislative Analyst March 2009 forecast is enclosed.

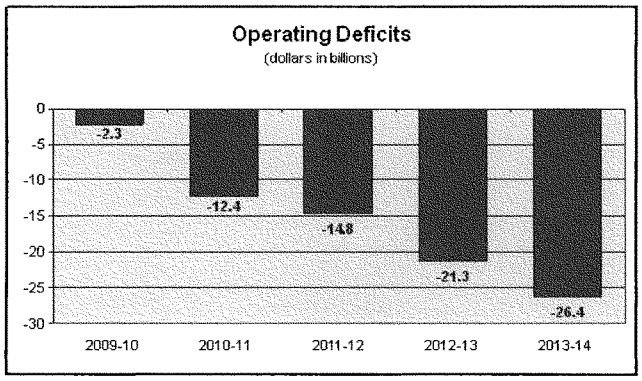
CALIFORNIA STATE DEBT ISSUANCE

The Treasurer of the State of California has sold $10 billion of bonds so far this year. Bonds issued at the beginning of the year yielded 4%, but this most recent offering saw rates with yields up to 6%; a 200 basis point increase in just a couple months!

California now has approximately $60 billion of debt outstanding. The vast majority of the bond sales have been to individuals. Each sale of bonds included financial projections regarding the State budget that appear to have been incorrect, or unreasonably hopeful, at the time of issuance

Further borrowing by the State of California, will make higher taxes a necessity. If the Legislature fails to keep spending in line with State revenues, California risks defaulting on their bonds. The March 2009 pro forma published by the California State Legislative Analysts Office

(LAO) estimates that the State of California would face a new $2 billion operating shortfall for Fiscal 2009-10 and a $76 billion of annual deficits over the next 5 years (exhibit below).



These projections may be extraordinarily optimistic. The LOA's forecast assumes that all the revenue generating in initiatives on the May 19th ballot pass and that assessed property values continue to rise. As of today the ballot initiatives are trailing badly in the polls and property values continue to decline

ADDITIONAL BUDGET RISKS

No commercial bank or insurance company is currently willing to provide credit enhancement to increase the rating of the State of California. The common response from lenders is that California appears to be heading for further downgrades. Lenders are concerned that exposure to California debt may drag down their own credit rating.

ISSUANCE OF RAWS

There is a substantial pool of buyers for California State Revenue Anticipation Warrants. The interest rate cost to issue RAWs would be more favorable than that of recent debt offering. The only impediment is that the State Legislature fully understands issuing RAWS would legally require fiscal discipline.

US Government Guarantee of California Debt

Providing US Federal guarantees for the State of California substantially increases the RISK of the United States losing its AAA Sovereign Debt rating. Furthermore, US guarantees of California State debt would have a material adverse effect on the ability of all other municipality and state borrowers to fund, due to a "crowding out" effect; interest rates would soar for non-Federal-guaranteed debt. The United States government will inevitably become the lender of "last resort" for all government entities in California and across the United States as the contagion devastates other government issuers.

If the US government decides to aid California, it should buy RAWs, not guarantee the State's debt. RAWs will insure that all investors get paid on time. Purchasing RAWs give the US government an avenue to aid California, without establishing a precedent that could destroy the US government's credit worthiness.

BEACON ECONOMICS

STATEMENT

Committee Members,

San Mateo County's public agencies lost $155 million in investments in Lehman Brothers Holdings, Inc as a result of that institution's bankruptcy. These are today's losses. These were not securities in a pension fund or other long run investment. This money was being parked in Lehman in what were identified as highly-rated liquid securities until needed for their primary purpose—the near term funding of schools, local infrastructure projects including public transport and new prisons, and ongoing operations of the local economy.

In real terms, these financial losses mean the loss of 1,658 local jobs, approximately one half of one percent of the County's employment base. It will suffer an overall loss of $216 million in output within the local economy including $100 million in income for local workers and major delays in the completion of projects necessary for the growth of the economy. These losses are intensifying an already grim economic situation. Unemployment in the county has risen from under 4% to over 8% in the past year, with little sign of abatement.

San Mateo County is not alone in suffering such losses. Many local governments have been hit by financial losses due to investments at Lehman. Estimating the overall scope of the economic damage being generated as a result of the loss of public funds is beyond the scope of our report. However it is worth noting that Lehman had over $600 billion in total debt at the time of its bankruptcy. In other words the scope of these public losses are surely considerably larger that the $155 million being suffered by local agencies in San Mateo County.

The Federal Government in recent months has aggressively responded to the financial crisis by working to offset the problems through a variety of actions. These efforts include large financial infusions into the banking sector to keep our lending markets operational, expanding the money supply to keep interest rates low and embarking upon a variety of fiscal spending initiatives to expand aggregate demand, including tax cuts and rebates and direct spending on a variety of local projects.

In this last category a substantial amount of funding has been put aside to offset the problems that state and local governments have been suffering due to the precipitous decline in tax

revenues. To allow state and local spending to shrink rapidly will only exacerbate the current economic situation and delay recovery that much further. One of the primary criticisms of this program is the time lag involved in these programs. The task of finding 'shovel ready' projects that meet certain criteria is challenging at the best of times. Yet here is one of the simplest solutions to this issue. These are not shovel ready projects—these are shovel stopped projects.

By backfilling the financial losses being suffered by local governments as a result of the Lehman Bankruptcy the Federal government can accomplish two important goals.

- An almost immediate fiscal impact on the economy by funding local public projects that were already underway, or almost underway when Lehman failed; and,
- Leveling the playing field to offset the critical policy decision to prevent the bankruptcies of Bear Stearns and Merrill Lynch (and therefore rescue their public investors) but not Lehman Brothers.

Thank you,

Christopher Thornberg

O