PATRICK DOWD

MEMBER OF COUNCIL, CITY OF PITTSBURGH

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On March 3, 2009, I attended my first Finance Committee meeting as a member of the Board of Directors for the Pittsburgh Water and Sewer Authority. At that time, I learned first-hand of the state of the Authority's 2008 Revenue Bonds Series A, B, C, D. These are often referred to as the Authority's variable rate bond swap deal. I was deeply distressed by what I learned and have spent the last six days reading almost 2,000 pages of documents associated with this deal.

This is one of the most opaque and complicated things I have ever tried to understand. When you're spending public money, it shouldn't be so hard. Based on what I learned at the meeting and what I have read subsequently, I feel an urgent need to air the situation so that the citizens of Pittsburgh understand what is going on and so we can find a solution to this looming crisis.

In 2008, the Authority sold $320 million worth of variable rate bonds, which means they sold bonds at high risk.

To dampen down that risk, the Authority contracted with Wall Street firms to provide what is technically called a "liquidity facility." You and I might call it an insurance policy against the wild swings in the interest rate market.

The Authority has been informed by Dexia, the largest provider of that so-called liquidity facility that they will not renew the contract before the expiration date of June 11, 2009. In simple terms, that means the Authority will lose that insurance policy.

The Authority has also been told by JP Morgan, a smaller provider of that so-called liquidity facility, and an original underwriter and a remarketer of the bonds, that they will only agree to provide the entire insurance policy for an outrageous fee increase of 150 basis points which is up from 25 basis points: a six-fold increase for the same service.

If an alternate provider cannot be found by late May, the Authority will be forced to choose between very bad options. If an alternate provider cannot be found at all, it could cost each rate payers the equivalent of $3,800.

This is disgraceful and a complete failure of fiduciary responsibility.

Those who want to defend the deal will say that it looked good at the time the Authority entered into it. Nothing could be further from the truth. The Authority entered into this risky transaction in the spring of 2008 as the municipal bond insurance market was experiencing heavy turmoil. Well in advance of this deal the water authority in Jefferson County, Alabama was in crisis and making national headlines. Closer to home, at exactly this point in time,

Committee on Intergovernmental Affairs
510 City-County Building • Pittsburgh, Pennsylvania 15219
412-255-2140 • Fax: 412-255-2419
www.city.pittsburgh.pa.us

people were calling into question the variable rate bond swap deal executed by the Erie School District. The same exact firms involved in those deals constructed this deal.

This is not a question of bad timing. It is a perfect example of reckless decision-making.

Let's also not forget that at the time the Authority entered into this deal the City of Pittsburgh stood as a distressed municipality. The Director of Finance for the City of Pittsburgh, Scott Kunka, was the Treasurer of the Authority and sat on the Authority's Finance Committee. He was the largest proponent of this transaction, but he should have known better. The Act 47 Recovery Plan, which is the document guiding the City of Pittsburgh's finances at this time, notes that distressed municipalities are forbidden by law from engaging in SWAP transactions. It further states that "such techniques should be used with <u>extreme caution</u> and … <u>such transactions should not be undertaken lightly without a proper understanding of risk.</u>"

That the ICA and Act 47 team allowed this transaction to take place demonstrates their complete failure at oversight. The ICA and Act 47 were obviously asleep at the switch.

This administration has exposed the PWSA ratepayers to unconscionable levels of risk. Just exactly how much risk is hard to say because the transaction is so difficult to unravel. For that reason, I demand that the Pittsburgh Water and Sewer Authority hire an independent and credentialed third-party auditor. By independent, I mean someone who is not connected in any way to either the transaction or the parties of the transaction. This third-party auditor should provide a simple statement – in plain English – so that the citizens can understand three things:

a. What exactly are the full terms of this deal?
b. What exactly are all the risks?
c. When exactly do these risks occur?

The independent, credentialed, third-party auditor should also tell the citizens how to get out of this situation. Finally, I demand a full public disclosure of the report and an honest and open discussion of our options. For too long now, this administration and the Authority has sought to keep us in the dark. They must come clean with the unbelievable risk to which they have exposed the ratepayers and disclose their plans for dealing with it.

Let me now just try to walk you through this transaction. What I have found is shocking.

Slide 1: PWSA: A Public Entity
Slide 2: Risk: Who Owns It"
Slide 3: Transaction Basics
Slide 4: Loser: Pittsburgh Ratepayers
Slide 5: What Are the Risks?
Slide 6: How Does This Deal Work?!
Slide 7: Ratepayer Share of Wall Street Indebtedness
Slide 8: Winners: Hand-Picked Firms
Slide 9: Churning for Fees?
Slide 10: Cost of this Transaction
Slide 11: Call to Action
Attachment A: Letter from Dexia Credit Local
Attachment B: Schedule C (Fee Schedule) from Closing Statements
Attachment C: Page 82 from the Act 47 Recovery Plan for the City of Pittsburgh