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ENERGY & ENVIRONMENT

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BUDGET & FINANCE

MOTION

On an annual basis, the City of Los Angeles does hundreds of millions of dollars in business with Wall Street banks for investment management, debt management, and banking services. The purpose of these financial services is to help fund public services and finance public improvement projects such as street and storm drain repairs, and to pay for construction of public facilities, including police and fire stations and other neighborhood service facilities.

On March 25, 2014, the Fix LA Coalition released a report, entitled "*No Small Fees*," that documents a growing body of evidence suggesting that these banks have engaged in predatory lending practices when providing municipal financing to cities and government agencies through the transaction of deals, such as issuance of debt, that carry high fees, high interest rates, unnecessarily high-risk and complex structures to the benefit of the financial institutions. The Fix LA Coalition report shows that while the City of Los Angeles faces ongoing financial problems and cuts to its public services, Wall Street has profited by costing the City more than $200 Million last year in fees and payments, not including interest or principal. While these arrangements should all be studied in an effort to explore solutions to end any predatory practices, one such transaction cries out for immediate attention. It is called an interest rate swap.

The City entered into an interest rate swap deal with NY Mellon Bank and Dexia in 2006. In 1988, the City issued a Wastewater System Revenue Bond to fund capital improvements to the sewer system. In an effort to take advantage of lower interest rates that existed at the time, these bonds were refinanced in 2006 from a fixed rate to a variable rate. Variable rate bonds are like adjustable-rate mortgages. They can save the City money in the short run, but there is always the risk of spiking interest rates down the line. In order to protect itself against this type of risk, the City entered into "interest rate swap" agreements with NY Mellon and Dexia. In one particular interest rate swap, the City agreed to pay NY Mellon and Dexia a steady fixed interest rate of 3.34%, and NY Mellon and Dexia agreed to pay the City a variable rate that the City could use to pay the interest on the bonds.

Unfortunately, this deal soured in 2008 when the economy crashed, Wall Street banks were implicated, and the bottom fell out of interest rates when the Federal Reserve intervened by cutting interest rates to near zero as a means to give banks access to cheap money. The crash, and the subsequent and prolonged cuts to interest rates, were unforeseeable events that radically changed the basic assumptions upon which these swap deals were based. Instead of saving money by entering into this swap deal, the City found itself locked into a fixed rate substantially above market rate while NY Mellon and Dexia were able to take advantage of variable interest rates that were kept artificially low by the Fed. As a result, NY Mellon Bank and Dexia have been and will be able to pocket the difference of $4.8 million a year. To add insult to injury, NY Mellon and Dexia want the City to pay $24 Million more to let the City out of this bad deal. NY Mellon and Dexia have been unfairly profiting millions of dollars every year at the expense of the City since the banks crashed the economy in 2008.

Based on how the interest rate swap transaction was structured, one could assume that NY Mellon Bank and Dexia entered into this interest rate swap agreement with the City with the intent, and in a good faith effort to save the City money. As stated in a 2006 City report on the

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swap agreements, the agreement was estimated to save the City $3.7 million per year through 2028. Instead, the current swap is costing the City $4.8 million per year and since 2008, NY Mellon and Dexia have unfairly profited over $65 million.

This same situation occurred in 2012 when the City was forced to pay $26.1 Million in order to terminate another swap deal with NY Mellon and Dexia. If the City does nothing on this existing swap, we stand to lose an additional $69 million at current interest rates because we are locked into the swap deal through 2028. In order to uphold its fiduciary duty to the taxpayers of Los Angeles, the City has no other reasonable or fair option than to call on NY Mellon and Dexia to renegotiate or terminate the deal without incurring any fees.

The City of Los Angeles, together with its airport, seaport, utilities, and pension funds control $106 billion that flows through financial institutions. The City should use its financial and economic power to demand better deals from Wall Street, so it can invest more in local communities.

I THEREFORE MOVE that the City Council call on NY Mellon Bank as well as Dexia to renegotiate or terminate the interest rate swap deals associated with the Wastewater System Bonds with no additional fees to save taxpayers millions of dollars every year, and call on NY Mellon Bank and Dexia to return the unfair profits and termination payments since 2008, estimated to have cost the City up to $65 million. Office of Finance staff, along with the CAO and the CLA, and any other appropriate departments, should report back to Budget and Finance Committee in 30 days on the progress of negotiations.

I FURTHER MOVE that if NY Mellon and Dexia are unwilling to renegotiate or terminate this swap deal at no cost to the City, that the City Council consider terminating any current business with these banks and excluding NY Mellon and Dexia from all future business with the City.

PRESENTED BY: ______________________
PAUL KORETZ
Councilmember, 5th District

SECONDED BY: ______________________