REFUND TRANSIT COALITION

Riding the Gravy Train

How Wall Street Is Bankrupting Our Public Transit Agencies by Profiteering off of Toxic Swap Deals

June 2012

Refund Transit Coalition *is a group of transit advocates, workers and supporters dedicating to exposing that big banks on Wall Street are gouging transit agencies and the governments that fund them for more than half a billion dollars each year through toxic deals known as interest rate swaps. The coalition calls on banks to renegotiate these toxic interest rate swap deals immediately to stop the bilking of taxpayers and free much needed resources for our local transit agencies and governments.*

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EXECUTIVE SUMMARY

Across the country, the state and local budget crises have hit public transit agencies very hard. As public officials try to cope with record revenue shortfalls caused by the economic crisis created by the banks, public transit is on the chopping block. In city after city, transit riders are facing fare hikes and service cuts. But while riders are forced to bear the costs of solving transit agencies' budget problems, the big banks on Wall Street are gouging many of these same agencies and the governments that fund them for **more than half a billion dollars** each year through toxic deals known as interest rate swaps.

OFF THE RAILS.

Wall Street banks sold these swap deals to state and local governments and transit agencies as a way to save money and lower borrowing costs. However, when the banks crashed the economy in 2008, the federal government aggressively drove down interest rates as part of the bank bailout. These artificially low interest rates have changed the math on these deals, and governments and agencies are now losing millions of dollars every year as a result. The banks are reaping a windfall at taxpayers' and riders' expense, and it is a direct result of the bailout-era interest rates.

THROWING RIDERS UNDER THE BUS.

We have identified a dozen places around the country where banks have entered into toxic swap deals directly with transit agencies or with the governments that provide substantial funding to them: Baton Rouge, Boston, Charlotte, Chicago, Detroit, Los Angeles, New Jersey, New York, Philadelphia, the San Francisco Bay Area, San Jose, and Washington, DC. In these 12 places alone, **banks are overcharging taxpayers and riders $529 million a year**.

JUMPING THE TURNSTILE.

Furthermore, there have been widespread reports recently that several banks may have been colluding to manipulate interest rates downward, causing governments and agencies to lose even more money on these deals. Global financial regulators have opened investigations into this issue, and the City of Baltimore is the lead plaintiff in a federal class-action lawsuit claiming that municipalities' losses on these swap deals were magnified as a result of this alleged manipulation. This alleged fraud could have cost just the transit agencies and governments covered in this report more than **$92 million**.

PULLING THE EMERGENCY BRAKE.

Banks need to renegotiate these deals with our governments and transit agencies to save taxpayers and riders millions of dollars each year. Across the country, in places like Massachusetts, Pennsylvania, Los Angeles, and Oakland, state and local officials have called on public entities to renegotiate or get out of these swap deals. Furthermore, there are already examples of places where banks have agreed to renegotiate swaps with public bodies to save taxpayers money, so we know that this can be done.

GETTING BACK ON TRACK.

Our public officials are faced with difficult choices as they try to fill vast budget holes that grow bigger by the day as the Great Recession wears on. But it is a mistake to balance those budgets on the backs of transit riders and taxpayers, while bleeding away millions of dollars a year to the same banks that caused the economic crisis. It is time to get our priorities in order. We cannot keep robbing working families to pay the rich bankers on Wall Street. We need to make banks renegotiate these toxic interest rate swap deals to save taxpayers and riders more than half a billion dollars annually.

RIDING THE GRAVY TRAIN

***Tamika Williams** is a mother and a disabled bus rider, who often relies on AC Transit in East Bay, CA to get around. "I often find myself waiting extra-long periods of time for the bus and there is no bench or shelter near my neighborhood bus stop to relax. I try to call ahead to find out what time the bus will be there but they are often wrong. Then I found out the information operators for AC Transit don't even live in my city or my state because of all the budget cuts they have all been outsourced. We need our bus service restored."*

An investment in public transit is an investment in the American people. Millions of Americans rely on buses and trains to get to work and school every day. Local businesses depend on customers who use public transportation to get to their shops. Public transit creates jobs, protects the environment, and improves our quality of life. Every dollar invested in public transportation generates $4 in economic benefits.[1] According to the American Public Transportation Association (APTA), public transit boosts state and local tax revenues by up to 16%, and a $20 million investment in building and running public transportation systems creates 900 jobs.[2]

However, public transit is under attack. Across the country, the state and local budget crises have hit public transit agencies very hard. As public officials try to cope with record revenue shortfalls caused by the economic crisis created by the banks, public transit is on the chopping block. As a result, nearly 80% of transit agencies have been forced to slash services or raise fares in order to make ends meet since the beginning of the recession, balancing their budgets on the backs of riders.[3] This impacts all riders, but it has a particularly devastating impact on students, seniors, people with disabilities, and low-income riders, who often do not have other means of transportation.

While riders are forced to bear the costs of solving transit agencies' budget problems, the big banks on Wall Street are gouging many of these same agencies and the governments that fund them for $529 million each year. Transit agencies from Boston to Los Angeles are stuck in toxic deals known as interest rate swaps. Cash-strapped agencies have already seen their state funding get slashed because of budget shortfalls caused by the economic crisis that these banks created. As they struggle to figure out how to pay to keep the buses running and the trains moving, they are forced to send mountains of cash to Wall Street as a result of these swap deals. That money could instead pay for expanded service, discounted fares for students and seniors, new buses, long overdue repairs, and thousands of good jobs that our economy so desperately needs.

When the banks were on the brink of collapse in 2008, we bailed them out with our taxpayer dollars. In all, we made **$15 trillion** available to the financial sector through various taxpayer-funded bailout and backstop programs.[4] Now those same banks are squeezing us for more than half a billion dollars a year. Our bus fares are going up because our transit agencies cannot make ends meet. We need to take an extra half hour to get to work because the trains no longer run as often. People with disabilities have to rely on others to get around town because their bus routes have been eliminated. Our kids need to find new ways to get to school because their student

discounts no longer apply. Those among us who can least afford it are being forced to bear the costs of the agencies' budget crunch, while the banks make off with our millions.

The banks that caused the economic crisis that is strangling state and local budgets need to do their part to fix the problem they created. Banks like Bank of America, JPMorgan Chase, Goldman Sachs, and Wells Fargo need to renegotiate these toxic swap deals with our transit agencies to save riders millions of dollars each year.

OFF THE RAILS

All state and local governmental units, including transit agencies, pay for long-term projects by borrowing money. They typically do this by issuing bonds, which have to be paid back over time with interest. Transit agencies regularly issue bonds for major construction projects like laying the track on a new train line and for capital expenditures like buying new buses. As with mortgages, there are two general categories of bonds: conventional, fixed-rate bonds that have a set interest rate that remains constant over the life of the bonds, and variable-rate bonds that have a floating interest rate that can go up or down depending on fluctuations in the market. Variable-rate bonds are like adjustable-rate mortgages—one can typically get a lower interest rate on the front end, but there is always the risk that rates will shoot up later and the payments on the bonds will skyrocket.

When governments and transit agencies issued variable-rate bonds, banks offered them a deal. The banks said that if the agencies would pay them a steady, fixed interest rate, then the banks would pay them back a variable rate that they could use to pay the interest on the bonds. Banks sold these deals as insurance policies that would let taxpayers lock in lower interest rates without having to worry about rates shooting up in the future. However, these deals were actually more of a gamble than an insurance policy. If variable

FIGURE 1: The Structure of an Interest Rate Swap Deal

rates fell really low, then they could actually end up costing agencies millions of dollars. That is exactly what happened when the banks crashed the economy in 2008.

As part of the banking industry bailout in the fall of 2008, the federal government aggressively drove down interest rates to near zero to spur economic recovery and help the banks get back on their feet.[5] This let banks borrow money from the federal government practically for free.[6] These record low interest rates have had an unintended consequence that has proven very costly for taxpayers. Because the banks' variable-rate payments on swap deals are linked to prevailing interest rates in the market, their swap payments have plummeted to near zero. However, governments and transit agencies are still locked into substantially higher fixed rates and cannot refinance into lower rates unless they pay the banks hefty termination penalties. **As a result, taxpayers are typically stuck paying 3% to 6% interest on these deals, but they get back less than 0.5% from the banks. The banks get to pocket the difference as profit, which adds up to billions of dollars each year.**[7]

The banks are profiteering off the low bailout rates. The federal government slashed rates to get the economy going again by encouraging banks to lend to homeowners, small businesses, cities, states, and public agencies.[8] Instead of passing the savings onto the taxpayers who bailed them out, the banks are taking advantage of our generosity by gouging us on these toxic deals. Figure 2 shows how changes in the Federal Reserve's Federal Funds Rate coincided with increases in the Southeastern Pennsylvania Transportation Authority's (SEPTA) swap deals.

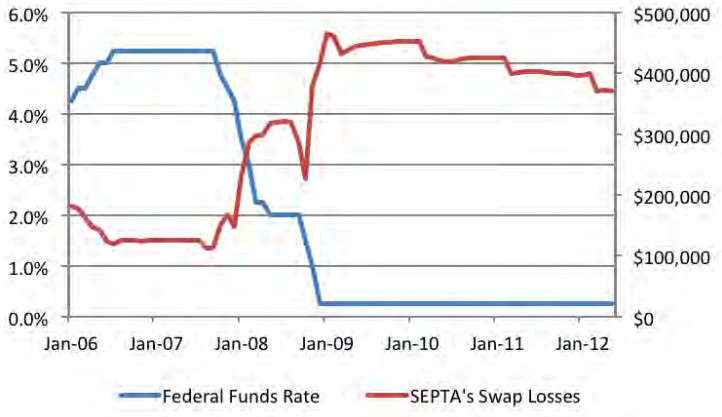

FIGURE 2: The Federal Funds Rate vs. SEPTA's Monthly Swap Losses to Bank of America[9]

Nationally, researchers have identified approximately 1,100 toxic swap deals at more than 100 different governmental units, including transit agencies. Together, taxpayers are losing more than $2.5 billion a year on these 1,100 deals alone.[10] This is just the tip of the iceberg and there are likely hundreds of other interest rate swap deals out there that have not yet been analyzed.

THROWING RIDERS UNDER THE BUS

Across the country, transit agencies are losing hundreds of millions of dollars as a result of these toxic swap deals. We have identified a dozen places around the country where banks have entered into toxic swap deals directly with transit agencies or with the state/local governmental units that provide substantial funding to them. In those 12 places alone, banks are overcharging taxpayers and riders $529 million a year.[15]

NATIONAL PUBLIC TRANSIT RIDER PROFILE[16]

- Median annual earnings for transit riders in the country: $30,501
- Percentage of riders making below $25,000 annually: 43%
- Percentage of riders who are people of color: 60%
- Percentage of riders without a car: 37%

Governments and public agencies entered into interest rate swaps because at the time they issued the related variable-rate debt, the cost of a conventional fixed-rate bond would have been even higher. Many of these deals seemed to make sense at the time they were initiated because interest rates were never expected to fall as low as they have. However, these deals carried hidden risks. In 2009, Pennsylvania Auditor General Jack Wagner wrote, "The majority of entities handling swaps in the public arena don't understand them, which is putting public money at risk."[11] He said these deals amount to "gambling with taxpayer money."[12]

A key part of the problem was that many of the governments and agencies that entered into these deals did not understand the risks. The banks that sold them these swaps were not legally required to act in their best interest in giving them advice.[13] Moreover, because interest rate swaps are structured as a zero-sum game, where taxpayers' loss is the banks' profit, there is a major conflict of interest for the banks. The Dodd-Frank Act includes provisions to tackle this conflict of interest problem, but when the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) wrote regulations to implement the law they, watered it down so much that the problem continues to persist.[14]

Metro Area	Public Entity/Agency with Swap	Annual Swap Losses	Banks/Swap Counterparties	Related Transit Agency
Baton Rouge	City of Baton Rouge & Parish of East Baton Rouge	$13.3 million	Bank of America, Citigroup Deutsche Bank	Capital Area Transit System (CATS)
Boston	Massachusetts Bay Transportation Authority (MBTA)	$25.8 million	Deutsche Bank JPMorgan Chase Morgan Stanley. UBS	Massachusetts Bay Transportation Authority (MBTA)
Charlotte	City of Charlotte	$19.4 million	Bank of America Wells Fargo	Charlotte Area Transit System (CATS)
Chicago	State of Illinois	$88.2 million	AIG, Bank of America BNY Mellon, Citigroup Deutsche Bank Goldman Sachs JPMorgan Chase Loop Capital Morgan Stanley Wells Fargo	Chicago Transit Authority (CTA)
Detroit	City of Detroit	$54.0 million	Citigroup JPMorgan Chase Loop Capital Morgan Stanley SBS Financial, UBS	Detroit Department of Transportation (DDOT)
Los Angeles	Los Angeles County Metropolitan Transportation Authority (LACMTA)	$19.6 million	Bank of Montreal Deutsche Bank Goldman Sachs Wells Fargo	Los Angeles County Metropolitan Transportation Authority (LACMTA)
New Jersey	State of New Jersey	$83.2 million	Bank of America Bank of Montreal Citigroup Goldman Sachs Morgan Stanley Natixis, UBS Wells Fargo	New Jersey Transit
New York City	Metropolitan Transportation Authority (MTA)	$113.9 million	AIG, Ambac BNP Paribas, Citigroup JPMorgan Chase Morgan Stanley, UBS	Metropolitan Transportation Authority (MTA)
Philadelphia	Southeastern Pennsylvania Transportation Authority (SEPTA) and City of Philadelphia	$39.0 million	Bank of America Citigroup JPMorgan Chase, RBC	Southeastern Pennsylvania Transportation Authority (SEPTA)
San Francisco Bay Area	Metropolitan Transportation Commission (MTC)	$48.1 million	Ambac, Bank of America BNY Mellon, Citigroup Goldman Sachs JPMorgan Chase Morgan Stanley	Metropolitan Transportation Commission (MTC)
San Jose	Santa Clara Valley Transportation Authority (VTA)	$13.0 million	Bank of America, Citigroup Goldman Sachs Morgan Stanley	Santa Clara Valley Transportation Authority (VTA)
Washington, DC	District of Columbia	$11.1 million	JPMorgan Chase Morgan Stanley Wells Fargo	Washington Metropolitan Area Transit Authority (WMATA)
TOTAL		**$528.6 MILLION**		

FIGURE 3: Transit Agencies & State/Local Government's Annual Losses on Swap Deals

BATON ROUGE

EAST BATON ROUGE PARISH PUBLIC TRANSIT RIDER PROFILE[17]

Median annual earnings for transit riders in the parish:	$14,106
Percentage of riders making below $25,000 annually:	78%
Percentage of riders who are African-American:	64%
Percentage of riders without a car:	50%

The Capital Area Transit System (CATS) is the regional transit authority serving the Baton Rouge metropolitan region.[18] Despite serving the second largest metropolitan area in Louisiana, CATS has no independent funding stream.[19] The system has been in continual crisis and it was estimated that CATS would have run out of funding in July of this year.[20] Service has been terrible with average wait times between buses of more than an hour and rides averaging nearly two and a half hours;[21] yet riders contributed nearly twice as much to the system in fares than comparable cities. The 50% of public transit riders in East Baton Rouge Parish that do not have a car have no choice but to put up with paying more for less. This past April, voters approved a ten-year $10.6 million ($1.06 million per year) property tax to fund the system.[22]

This new tax on residents would not be needed if the City of Baton Rouge and East Baton Rouge Parish renegotiates its toxic swap agreements with Bank of America, Citigroup, and Deutsche Bank. CATS relies on the city/parish government for a significant portion of its budget, and in 2012, it only received a little more than half the funding it requested from the local government.[23] A fraction of the $13.3 million that taxpayers are sending Wall Street every year would be enough to fund CATS without raising taxes on Baton Rouge homeowners.[24]

BOSTON

CITY OF BOSTON PUBLIC TRANSIT RIDER PROFILE[25]

Median annual earnings for transit riders in the city:	$31,114
Percentage of riders making below $25,000 annually:	40%
Percentage of riders who are people of color:	51%
Percentage of riders without a car:	39%

The Massachusetts Bay Transportation Authority (MBTA, or the T) operates the nation's fifth largest regional transit system, serving 175 cities and towns in Massachusetts[26] that cover about 70 percent of the state's population.[27] The T provides over 370 million trips per year, including more than 2 million trips on the RIDE—the paratransit service for riders with disabilities.[28] Fifty-five percent of all work trips into Boston rely on the T.[29]

The T may be the fifth-largest system in the U.S., but according to its *Fare and Service Change Information Booklet*, it has "the highest debt burden of any U.S. transit agency."[30] Just about every dollar the T collects in fares goes to pay down the debt.[31] This crushing debt burden has helped contribute to a FY 2013 deficit of $160 million.[32] In order to plug the hole in the budget this year, the T approved an average fare increase of 23%. Riders with disabilities and seniors, however, face draconian and disproportionate hikes of up to 150% and 87.5%, respectively. The T expects these hikes to lead to a reduction of more than 242,000 trips on the RIDE.[33] That's nearly a quarter-million trips that riders with disabilities won't be taking to get to the doctor, the pharmacist and the supermarket.

Wall Street banks have swooped in to take advantage of a financially desperate transit agency—and its riders—by roping the T into risky interest rate swap deals. The T is losing about $26 million a year on five toxic swaps still outstanding with Deutsche Bank, JPMorgan Chase and UBS.[34] Over the next two decades the T will lose another $254 million on these swaps.[35] Meanwhile, the T expects to save $12.6 million—about half what it's paying to the banks each year—by hiking fares on riders with disabilities up to 150%.[36] In other words, the just half of the T's payments on these toxic swap deals would be enough to reverse these fare hikes.

Swaps are not a new problem for the T. In 2008 the Massachusetts Auditor found that, from July 2000 through December 2005 alone, the T had actually increased its debt service costs by $55 million through a number of harmful swap deals.[37] In other words, the T was losing money on these deals even before the economic crisis hit. Since then the T has lost hundreds of millions more.[38] Meanwhile, the riders who can least afford it have been forced to pay for these deals with astronomical fare hikes.

CHARLOTTE

CITY OF CHARLOTTE PUBLIC TRANSIT RIDER PROFILE[39]

Median annual earnings for transit riders in the city:	$19,749
Percentage of riders making below $25,000 annually:	60%
Percentage of riders who are people of color:	79%
Percentage of riders without a car:	41%

The Charlotte Area Transit System (CATS) is managed by the City of Charlotte's Public Transit Department.[40] The city contributes over $18 million annually to the system, but CATS's principal source of funding comes from a half-cent sales tax.[41] Since the economic recession, sales tax revenues have plummeted, and to make up for the shortfall CATS has raised fares on buses and light rail three times in the past four years with another increase proposed.[42] These fare hikes have a devastating impact on Charlotte transit riders, 60% of whom make less than $25,000 a year and more than 40% of whom are dependent on public transit to get around.[43] The pending increase is expected to garner $2.5 million additional revenue, an amount that could easily be covered by the $19.4 million that Charlotte is dishing out annually in swap payments to Bank of America and Wells Fargo.[44]

CHICAGO

CITY OF CHICAGO PUBLIC TRANSIT RIDER PROFILE[45]

Median annual earnings for transit riders in the city:	$29,408
Percentage of riders making below $25,000 annually:	34%
Percentage of riders who are people of color:	58%
Percentage of riders without a car:	36%

1.6 million people ride the Chicago Transit Authority's (CTA) buses and trains every weekday, making it the second largest public transit system in the country. One in six transit riders in Chicago makes less than $10,000 annually and 58% are people of color. The CTA relies on the State of Illinois for a significant portion of its public funding, and in the past state budget gaps have resulted in funding shortfalls for the transit agency.

In March 2012, CTA Chief Financial Officer Lois Scott said that the agency may need to "evaluate other sources of financing" as it looks to fund future projects. One such option that she mentioned was distance-based pricing, which refers to a fare structure that would charge higher fares based on distance traveled. This would disparately impact low-income residents who are more dependent on public transit and have been pushed to the outer parts of the city, away from Downtown, as a result of gentrification.

Instead of making low-income communities pay for the CTA's much-needed infrastructure projects, officials should look to the State of Illinois's interest rate swap deals for a solution. Illinois loses $88.2 million a year on these deals. While the state is forced to slash funding to public agencies like the CTA, it is forced to ship millions every year to Bank of America, JPMorgan Chase, Wells Fargo, Goldman Sachs, Citigroup, Morgan Stanley, AIG, Deutsche Bank, Bank of New York Mellon, and Loop Capital. The state will pay these banks $1.2 billion between now and 2033, when the last of these deals is set to expire. State and local officials should not force the CTA to balance its budget on the backs of low-income Chicagoans when they are sending the banks on Wall Street millions of dollars in free money every year.

Don Buckley *lost his job driving a Chicago Transit Authority bus over two years ago and has been looking for work ever since, even as bus drivers around the country are being laid off.*

Buckley, his two daughters and his fiancée had to move into the basement of his mother's house, delay his marriage, and he has spent all his savings. "I was the kind of person who put away for a rainy day. It's flooding now."

Buckley is still looking for work, but decent-paying jobs do not exist. "I was living the American dream — my version of the American dream. Then it crumbled. You get used to having things and then they take them away, and you realize how lucky you were."

DETROIT

CITY OF DETROIT PUBLIC TRANSIT RIDER PROFILE[53]

Median annual earnings for transit riders in the city:	$11,956
Percentage of riders making below $25,000 annually:	76%
Percentage of riders who are African-American:	90%
Percentage of riders without a car:	55%

The City of Detroit was brought to the brink of bankruptcy in 2009 when its swap deals blew up. When the city's credit rating was downgraded, UBS and other banks threatened to terminate the city's swap deals and demanded $400 million in penalties, which the city did not have.[54] Detroit was able to renegotiate its deals with the banks to save some money, but as a result, it has to make a "$4.2 million monthly payment to the banks before a single cent can go to schools, transportation, and other critical services," according to *BusinessWeek*.[55] As a result of the city's budget pinch, it was forced to make drastic cuts to public transit, eliminating bus routes, delaying equipment repairs, and laying off workers. Wait times at buses increased as much as 33% in some areas as a result of service cuts.[56]

Since 2008, Detroit has been able to take out offsetting swaps on six of its original deals, under which banks return part of the fixed rate paid by the city.[57] Even after all of these renegotiations, the city is still losing $54.0 million a year on its swap deals, exacerbating its budget crisis.[58] Detroit's swaps are with Citigroup, JPMorgan Chase, Loop Capital, Morgan Stanley, SBS Financial, and UBS.[59] This has taken a big toll on the city's public transit system, which is run by the Detroit Department of Transportation (DDOT). The mayor announced plans to put the DDOT under private management in November 2011,[60] and then in February 2012, DDOT announced plans to eliminate overnight bus service altogether.[61] The median annual earnings for Detroit transit riders are just $11,956. 76% of DDOT public transit riders make less than $25,000 a year and 55% of do not have a car and so are dependent on public transit to get to work.[62] By cutting public transit, the city has shifted the costs of these toxic swap deals to those who can least afford it.

LOS ANGELES

LOS ANGELES COUNTY PUBLIC TRANSIT RIDER PROFILE[63]

Median annual earnings for transit riders in the county:	$15,969
Percentage of riders making below $25,000 annually:	71%
Percentage of riders who are people of color:	87%
Percentage of riders without a car:	30%

The Los Angeles County Metropolitan Transportation Authority (LACMTA or L.A. Metro) is the fourth largest transit system in the country, servicing 1.4 million riders daily.[64] Since 2007 L.A. Metro has raised

fares for single rides and passes between 20% and 100%, while at the same time reducing bus service by 12%.[65] Low-income communities and communities of color are most heavily impacted by these cuts. 87% of Los Angeles County bus riders are people of color, and nearly three-fourths make less than $25,000 annually.[66] Riders' median income is just below $16,000.[67] After a yearlong investigation, the Federal Transit Administration recently found that L.A. Metro's service cuts failed to comply with federal civil rights requirements to assess potential discriminatory impacts in service changes.[68]

L.A. Metro's most recent service cuts were geared to save the agency $23 million annually. That is only slightly more than the $19.6 million the transit authority is paying Wall Street banks annually on its toxic swap deals.[69] The four banks pocketing these millions are Wells Fargo, Goldman Sachs, Deutsche Bank and the Bank of Montreal, which operates as BMO Harris in the US.[70] Figure 4 below lists the details of each of LACMTA's five outstanding interest rate swaps. For many low-income commuters in Los Angeles, service cuts mean they are forced to take multiple buses and pay multiple transfer fares because their direct bus service has been eliminated.[71] So while the Wall Street banks continue to enrich themselves, Los Angeles commuters are faced with longer commutes and increasing costs.

Notional Value	LACMTA's Fixed Rate	Bank's Variable Rate Formula	Bank's Variable Rate as of 5/2/2012	Net Swap Rate as of 5/2/2012	Annual Losses on Swap	Bank Counterparty
$86.2 M	3.501%	64% of 1-mo. LIBOR	0.154%	-3.347%	$2.9 M	Bank of Montreal
$130.0 M	3.373%	63% of 1-mo. LIBOR	0.151%	-3.222%	$4.2 M	Bank of Montreal
$130.1 M	3.358%	63% of 1-mo. LIBOR	0.151%	-3.207%	$4.2 M	Deutsche Bank
$89.6 M	3.392%	68% of 1-mo. LIBOR	0.163%	-3.229%	$2.9 M	Goldman Sachs
$166.5 M	3.454%	68% of 1-mo. LIBOR	0.163%	-3.291%	$5.5 M	Wells Fargo
TOTAL					**$19.6 M**	

FIGURE 4: The Details of LACMTA's Swap Deals[72]

NEW JERSEY

STATE OF NEW JERSEY PUBLIC TRANSIT RIDER PROFILE[73]

Median annual earnings for transit riders in the state:	$45,894
Percentage of riders making below $25,000 annually:	32%
Percentage of riders who are people of color:	61%
Percentage of riders without a car:	25%

Over the last couple of years, New Jersey Transit has had to raise fares, cut service, and increase wait times for its 900,000 riders in order to make ends meet. In 2010, NJ Transit instituted the highest fare hike in its history—25%—and cut 32 trains and three buses in order to fill a revenue shortfall caused in part by a $33 million reduction in state subsidies.[74] David Peter Alan, an attorney from South Orange, New Jersey who is unable to drive due to a disability, said about the cuts, "This is an absolute nightmare for all transit riders, and it must have been done with either intentional malice or reckless disregard for the mobility of people who don't have automobiles."[75]

Even as the State of New Jersey slashed $33 million from NJ Transit, it was forking over $83.2 million a year to Wall Street firms like Goldman Sachs, Bank of America, Citigroup, Morgan Stanley, Wells Fargo, UBS, Royal Bank of Canada, Natixis, Bank of Montreal, and Deutsche Bank.[76] The state's payments on these toxic swap deals would have been more than enough to restore the state's funding to NJ TRANSIT and help fix the agency's budget woes. Instead, New Jersey was forced to shift the cost to transit riders.

For Willemina Melrose, a 61-year-old grandmother of five who has been blind since her mid-30s, the MBTA's RIDE service is literally a lifeline. She uses the RIDE to run errands, and to get to twice-weekly exercise classes her doctor has recommended to help manage her diabetes. Melrose is unemployed, and her only source of income is Social Security disability checks. Her fares are scheduled to double starting July 1, from $20 to $40 a week. "Either there's gonna be a lot of appointments I'm not gonna make or I just have to cut my grocery shopping down — and I'm a diabetic and the doctors want you to eat properly," Melrose told NPR. She sees the draconian fare hikes as fundamentally unjust, telling the MBTA board: "I was working when minimum wage was $1.85, OK? So I have put into the system full force, and this is the thanks I get? It's not right."

NEW YORK

NEW YORK CITY METRO AREA PUBLIC TRANSIT RIDER PROFILE[77]

Median annual earnings for transit riders in the area:	$37,186
Percentage of riders making below $25,000 annually:	34%
Percentage of riders who are people of color:	64%
Percentage of riders without a car:	51%

The New York Metropolitan Transportation Authority (MTA) has active interest rate swaps with JPMorgan Chase, Citigroup, UBS, AIG, Morgan Stanley, BNP Paribas, and Ambac that cost the MTA

$113.9 million annually.[78] Another swap deal is set to be activated this November that will cost the MTA an additional add $1.5 million a year on top of what it is already losing.[79]

As of August 2011, the MTA had lost $658 million on these swap deals since they first went into effect. These payments contributed to the drag on the MTA's budget that in 2010 led it to lay off more than 1,000 MTA workers in New York City and eliminate 749 other positions. [80] Additionally, MTA service cuts that year – which included subway and bus service cuts as well as the reduction of cleaning services – were part of the largest service reduction package in decades. [81] Riders were forced to pay a 7.5% fare increase in 2011 and are scheduled to face two more 7.5% fare increases in 2013 and 2015. [82] More than a third of New York area riders make less than $25,000 a year even though they live in one of the most expensive cities in the world, home to many of the bankers who are profiteering off these deals at MTA riders' expense. Ironically, many of those bankers are themselves MTA riders who take the subway to work every day.

The graph below shows how JPMorgan Chase, BNP Paribas North America, Inc., and UBS AG have benefited from just one of the MTA's swap deals following the 2008 economic crash forced interest rates to artificially low levels. Every time the red line was below the blue, the MTA lost money. As the graph illustrates, the MTA's losses increased significantly after the Federal Reserve slashed interest rates in the aftermath of the financial crash in the fall of 2008.

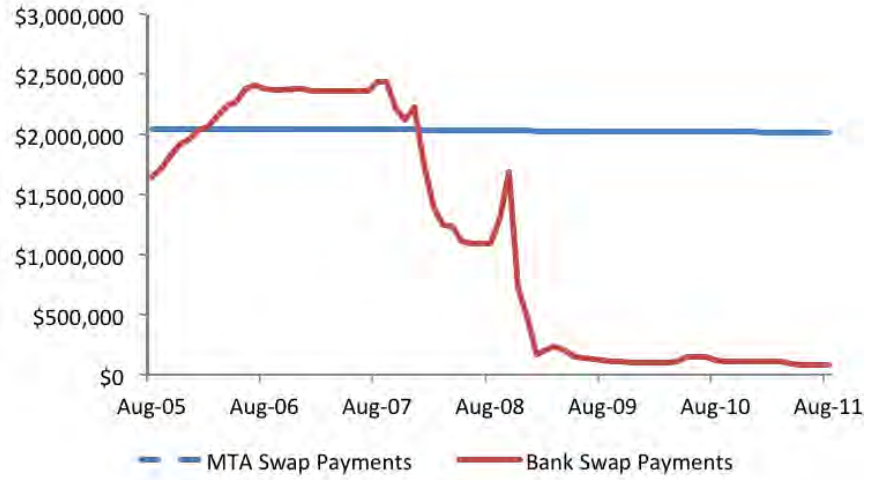

FIGURE 5: Monthly Payments on MTA's 2005B Swap Deals[83]

PHILADELPHIA

CITY OF PHILADELPHIA PUBLIC TRANSIT RIDER PROFILE84

Median annual earnings for transit riders in the city:	$25,806
Percentage of riders making below $25,000 annually:	48%
Percentage of riders who are people of color:	69%
Percentage of riders without a car:	43%

The Philadelphia area's transit system is called the Southeastern Pennsylvania Transportation Authority (SEPTA). SEPTA is an independent agency, but part of its funding comes from the City of Philadelphia.[85] Both SEPTA and the city have interest rate swaps that together are costing them nearly $40 million a year. SEPTA is losing $4.0 million a year on its swap to Bank of America,[86] while Philadelphia's toxic swap deals with Bank of America, Citigroup, JPMorgan Chase, and the Royal Bank of Canada are costing the city $35.0 million every year.[87] Furthermore, the city already paid at least $34.0 million in penalties to Wells Fargo, Bank of America, Citigroup, and JPMorgan Chase to terminate some of these bad swap deals in 2010.[88]

These hefty payments to Wall Street come at the expense of riders and taxpayers. One out of every six dollars in SEPTA's FY 2013 capital budget goes to debt service, which includes interest rate swap payments.[89] For the last three years, SEPTA has been forced to trim its capital budget by 25% due to funding shortfalls. According to its budget proposal for FY 2013, these reduced funding levels will "severely hamper SEPTA's ability to bring the system to a state of good repair and will curtail the Authority's ability to advance system improvements."[90] Dozens of critical improvement projects have to be postponed indefinitely or scrapped altogether, including critical overhauls, bridge repairs, electrical substations, and station renovations.[91] This will cost the city jobs and it will severely affect SEPTA's quality of service and the long-term sustainability of the system impacting Philadelphians for years to come.

***Andrea Bell**, a student living in Oakland, CA, who commutes to San Francisco for school on the bus and BART subway, has seen the impact of service cuts firsthand. "There is a bus that stops near my house that I never get to use. The service cuts made that line almost inexistent for me! It only runs from 6:30am to 9am and 3pm to 7pm. Therefore I have to walk half a mile to another bus line to get across town to catch the Bart. My 15-minute bus ride just turned into about an hour overnight from the service cuts. And I still have to catch Bart to San Francisco barely making it on time for class. It's very upsetting that the simplest trip is a serious hassle every day! I'm a college student and I can't afford to pay more money for less bus service!"*

SAN FRANCISCO/OAKLAND BAY AREA

BAY AREA PUBLIC TRANSIT RIDER PROFILE[92]

Median annual earnings for transit riders in the area:	$43,181
Percentage of riders making below $25,000 annually:	33%
Percentage of riders who are people of color:	58%
Percentage of riders without a car:	24%

The Metropolitan Transportation Commission (MTC) is responsible for long-range planning and many funding decisions for public transit in the nine-county Bay Area region. It oversees local operators like MUNI

in San Francisco and Alameda County Transit (AC Transit) in Oakland and the East Bay. The MTC is losing $48.1 million a year on its swap deals with Ambac, Bank of America, JPMorgan Chase, Goldman Sachs, Citigroup, Bank of New York Mellon, Morgan Stanley, and Ambac.[93] It is stuck in most of these deals until 2036 or later. By the MTC's own estimates, these deals will cost more an additional $1.3 billion over the remaining life of these swaps.[94]

But while the MTC is forced to send millions to Wall Street, transit riders are feeling the squeeze. Facing historic budget deficits between 2008 and 2010, nearly every single bus operator cut service and raised fares, reducing transit affordability, reliability and in some cases eliminating bus lines altogether. Some operators cut as much as 50% of service, of which little has been restored. Across the Bay Area, 8% of all bus service was cut.[95] These cuts have left entire communities stranded. One in four transit riders in the Bay Area does not have a car and is dependent on public transit to get around.[96] Ridership has fallen dramatically as a result of the cuts, averaging 55,000 fewer trips taken each day. It would cost an estimated $72.5 million to restore the lost service with fixed route bus transit.[97]

FIGURE 6: Bus Service Cuts on MTC Operators (2006-2011)[98]

SAN JOSE

SANTA CLARA COUNTY PUBLIC TRANSIT RIDER PROFILE[99]

Median annual earnings for transit riders in the county:	$26,969
Percentage of riders making below $25,000 annually:	48%
Percentage of riders who are people of color:	70%
Percentage of riders without a car:	14%

The Valley Transportation Authority (VTA) is the transit operator in Santa Clara County, California. It is part of the larger Bay Area Metropolitan Transportation Commission (MTC) system and serves San Jose and the South Bay. Faced with budget deficits, the VTA has been forced to cut back on 4% of its bus service over the past five years.[100] These cuts hit low-income communities and communities of color the hardest. Nearly half of transit riders in Santa Clara County make less than $25,000 per year, and 70% of them are people of color.[101] One out of seven riders depends on the VTA as the only mode of transportation.[102] It would cost an estimated $7.5 million annually to reverse these cuts and restore service to the levels from five years ago.

The VTA pays twice that amount to Wall Street banks on its toxic swap deals. The VTA is losing $13 million annually on its swap deals with four banks: Bank of America, Citigroup, Goldman Sachs, and Morgan Stanley.[103] Figure 7 below looks at the VTA's swap deal in connection with the Measure A 2008A bonds. The graph shows that the deal made sense through the end of 2007, but that once the federal government started driving down interest rates in 2008, the VTA's losses skyrocketed.

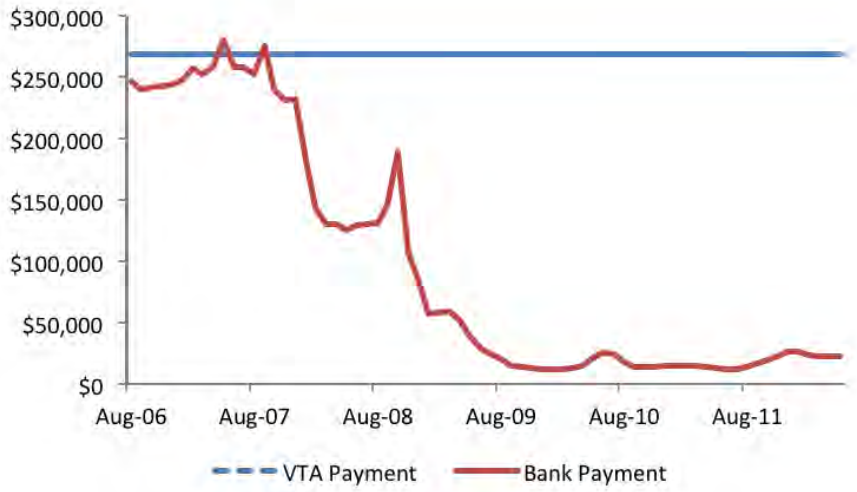

FIGURE 7: Monthly Payments on VTA's Measure A 2008A Swap Deal104

Through May 2012, Bank of America, Citigroup, Goldman Sachs, and Morgan Stanley have sucked $51 million out of the VTA's budget, forcing the agency to shift the costs to riders. Unless these four banks agree to renegotiate these deals, the VTA could lose another $224 million on these swaps through 2036 if current interest rates hold.[105] That is money that would be better spent restoring bus service to South Bay riders for the next 30 years.

WASHINGTON, DC

WASHINGTON, DC METRO AREA PUBLIC TRANSIT RIDER PROFI

Median annual earnings for transit riders in the area:	$46,867
Percentage of riders making below $25,000 annually:	29%
Percentage of riders who are people of color:	60%
Percentage of riders without a car:	24%

The Washington Metropolitan Area Transit Authority (WMATA, or the Metro) services the nation's capital, and surrounding suburbs of Maryland and Virginia, with an average ridership of 1.4 million daily.[107] In 2010, the Metro's board approved the largest fare increase in the system's history with increases ranging from 20% to 33% on bus and rail lines.[108] People who pay in cash, which tend to be lower income riders, were hit with the highest increases.[109] Overall, people of color account for 60% of DC transit riders; and nearly a third of DC area workers using the transit system earned less than $25,000 a year.[110] This year, riders are facing additional increases that average 5%.[111]

While DC transit riders have faced repeated fare hikes, the District is making $11.1 million in annual swap payments to JPMorgan Chase, Morgan Stanley and Wells Fargo, three of the nation's largest banks.[112] The Metro is dependent on District coffers for part of its funding. Together the CEOs of these three banks took home $56 million in compensation in 2011,[113] which could have covered more than half of $109 million DC riders paid in fare increases last year.[114]

JUMPING THE TURNSTILE

As mentioned above, transit agencies' and state and local governments' losses on these deals are a function of the difference between the high fixed rates governments and agencies pay to the banks and the much lower variable rates they get in return. The variable rates are tied to an interest rate index—most commonly, the London Interbank Offered Rate (LIBOR) index. The lower the value of LIBOR, the lower the variable rates received by the governments and the greater their losses on swaps. In recent months there have been widespread reports that several banks—including six that held swaps covered in this report—may have been colluding to manipulate LIBOR downward. This alleged fraud could have cost just the transit agencies and governments covered in this report more than $92 million. Dozens of other governments and agencies not covered in this report may have suffered losses in the billions.

The British Bankers Association, which oversees LIBOR, has called it "the world's most important number."[115] LIBOR is the basis for interest rates on most consumer loans, including credit cards, car loans, student loans and adjustable-rate mortgages. It also serves as the benchmark rate for a global derivatives market worth $360 trillion, of which interest rate swaps constitute the largest single segment. Over 60% of state and local government swaps in the United States use a LIBOR-based variable rate. A change in LIBOR of just one one-hundredth of a percentage point can mean tens of billions of dollars in bank profits.

Financial regulators and law enforcement authorities in the U.S., the U.K., Europe, Japan and Canada have launched investigations into the alleged collusive manipulation of LIBOR on the parts of certain major banks.[116] The U.S. Department of Justice is conducting a criminal probe into this alleged fraud.[117] Several traders have been fired or put on leave from these banks as a result.[118] Fortune magazine is calling it "the Wall Street multibillion-dollar scandal no one is talking about."[119]

In addition to these investigations, there have been a number of lawsuits brought in U.S. federal court over alleged LIBOR manipulation. The City of Baltimore is the lead plaintiff in a federal class-action suit claiming that the banks colluded to manipulate LIBOR downward from August 2007 through May 2010. As a result, the suit claims, Baltimore suffered magnified losses on its interest rate swap deals.[120]

From August 2007 through May 2010, all the transit agencies and governments included in this report held swaps that are based on LIBOR. All told, they may have overpaid the banks more than **$92 million** because of the banks' alleged fraud.[121]

Metro Area	Public Entity/Agency with Swap	Losses Caused by Alleged Fraud
Baton Rouge	City of Baton Rouge & Parish of East Baton Rouge	$0.8 million
Boston	Massachusetts Bay Transportation Authority (MBTA)	$2.1 million
Charlotte	City of Charlotte	$2.0 million
Chicago	State of Illinois	$5.8 million
Detroit	City of Detroit	$9.7 million
Los Angeles	Los Angeles County Metropolitan Transportation Authority (LACMTA)	$4.9 million
New Jersey	State of New Jersey	$14.1 million
New York City	Metropolitan Transportation Authority (MTA)	$16.9 million
Philadelphia	City of Philadelphia	$12.0 million
Philadelphia	Southeastern Pennsylvania Transportation Authority (SEPTA)	$1.6 million
San Francisco Bay Area	Metropolitan Transportation Commission (MTC)	$17.1 million
San Jose	Santa Clara Valley Transportation Authority (VTA)	$1.9 million
Washington, DC	District of Columbia	$3.7 million
TOTAL		**$92.6 million**

FIGURE 8: Transit Agencies and State/Local Governments' Losses Caused by Alleged LIBOR Fraud

Nineteen banks are being sued and/or have been named in the various investigations. Six of the largest ones served as counterparties on swaps covered in this report from August 2007 through May 2010 (indicated in **bold**):

- **Bank of America**
- Bank of Tokyo-Mitsubishi UFJ
- Barclays
- **Citigroup**
- Credit Suisse
- **Deutsche Bank**
- HBOS (part of Lloyds)
- HSBC
- **JPMorgan Chase**
- Lloyds
- Mizuho Financial Group
- Rabobank
- **Royal Bank of Canada**
- Royal Bank of Scotland
- Société Générale
- Sumitomo Mitsui
- Norinchukin Bank
- **UBS**
- WestLB

PULLING THE EMERGENCY BRAKE

Banks are pocketing more than half a billion dollars every year off of taxpayers and riders through these toxic swap deals. The only reason they are able to take home their hundreds of millions is that they crashed the economy and taxpayers bailed them out by slashing interest rates and by giving them direct cash infusions. Now these same banks are profiteering off the bailout and using those low rates to make a killing at our expense.

Interest rate swap deals are supposed to be structured so that both sides break even in the long run. Sometimes the bank will pay more and sometimes the agency will, but in the long view, it is supposed to balance out. However, as Figures 5 and 7 show, these deals have become so one-sided since the bailout that it is nearly impossible for public agencies to recover their losses. Furthermore, the Federal Reserve announced in January 2012 that it would keep interest rates near zero until at least late 2014,[127] which will prolong the losses on these swaps. And as if the bailout rates were not low enough already, it appears that banks may have illegally colluded to drive rates down further still, exacerbating the pain caused by these deals.

We are stuck in pre-bailout deals with post-bailout interest rates. Banks must agree to renegotiate these swaps with the current, post-bailout interest rate environment in mind, so that these

This LIBOR manipulation scandal is nothing new. It is part of a larger pattern of unethical and potentially illegal behavior on Wall Street:

- Last year, Jefferson County, Alabama was forced to file bankruptcy because of a JPMorgan Chase swap deal that resulted in local officials going to jail and the bank paying $722 million in fines.[122] Bankers paid millions in bribes to county officials and their friends to secure county business. According to *Bloomberg*, JPMorgan Chase employee "Charles LeCroy said the key to landing bond deals in Jefferson County, Alabama was finding out whom to pay off."[123] When these deals blew up, the county went bankrupt.
- The U.S. Department of Justice and Attorneys General in several states are investigating whether banks illegally conspired to rig bids on municipal derivatives known as guaranteed investment contracts (GICs). *Bloomberg* noted in 2010, "Many of the same bankers and advisers who sold public officials interest-rate swap deals that backfired for taxpayers are now subjects of the criminal antitrust investigation involving GICs."[124] Bank of America and JPMorgan Chase have paid $137 million and $211 million respectively to settle the charges.[125] Bank of America even admitted to criminal antitrust behavior in exchange for leniency from the Department of Justice.[126]

deals make sense again. When the banks were hemorrhaging money in the fall of 2008, we bailed them out. Now it is time for the banks to fulfill their obligation of using the bailout to rebuild the economy by voluntarily renegotiating these deals without assessing agencies penalties or termination fees.

Across the country, there is a chorus of officials calling on public entities to renegotiate or get out of these swap deals:

- In 2008, A. Joseph DeNucci, then the **Massachusetts** State Auditor, recommended that the MBTA "[c]onsider discontinuing its participation in this highly speculative interest rate derivatives market." [128]

- In 2009, **Pennsylvania** Auditor General Jack Wagner called on school districts and local governments in the state to get out of their swaps.[129]

- In 2010, the **Los Angeles** City Council unanimously passed a resolution calling on its finance department staff to renegotiate its swaps with Bank of New York Mellon and Dexia Financial.[130]
- Several members of the **Oakland** City Council have called on Goldman Sachs to renegotiate its swap with the city.[131] In an op-ed she coauthored in April 2012, Oakland City Councilmember Rebecca Kaplan wrote, "The City of Oakland will continue to negotiate—and will take whatever action is necessary—to terminate this 'deal.'"[132]

In the corporate world, banks renegotiate deals all the time because of changes in circumstances. No bank can deny that there has been a change in circumstances. After all, it was the banks' own recklessness and unsound business practices that are responsible for the change. Furthermore, banks have already agreed to renegotiate swap deals in a number of places:

- The City of **Richmond**, CA was losing $6 million a year on its swaps with the Royal Bank of Canada. The city got the bank to agree to renegotiate the terms of the deals, and saved $5 million a year on its swaps.[133]

- The City of **Detroit** has actually already cut deals with banks to save money on six of its swaps. While it did not renegotiate its swaps in the traditional sense, Detroit got banks to take out offsetting swaps on six of its deals in which the banks pay the city back a portion of its fixed rate. Detroit is saving $25 million a year through these offsetting swaps, although it continues to lose another $54 million annually on its other swaps.[134]

- The Asian Art Museum of **San Francisco**, a public-private partnership with the City and County of San Francisco, was on the verge of bankruptcy in December 2010 due to its financial deals with JPMorgan Chase, which included an interest rate swap and a letter of credit. A letter of credit is essentially another form of bond insurance that public agencies are often required to carry on their variable-rate debt. After month long negotiations, the bank agreed to a deal that saved the museum $40 million, terminated the swap without penalties, refinanced the debt into a lower-cost fixed-rate bond, and ultimately let the museum avoid bankruptcy.[135]

Furthermore, Goldman Sachs has agreed to enter into negotiations with the City of Oakland over its swap deal,[136] which is costing the city $4 million annually. According to Peralta Community College Trustee Cy Gulassa, the Bay Area school is in discussions with Morgan Stanley regarding its swaps.[137] We have seen time and again that banks can and do voluntarily agree to renegotiate these deals.

GETTING BACK ON TRACK

*Detroit bus driver **Rudolph Markoe** expressed the frustration of Detroit bus riders with the endless rounds of cutbacks to bus service. "The cuts we're seeing today are a continuation of a long round of cuts. At the most recent public hearing (about the service cuts), some people were in tears, fearing for their ability to get to and from their jobs - in fact many people have lost their jobs. But you never really get feedback from the school kids. They have to catch the bus in the morning and after school, they never come to the hearings, but the cuts affects them. There's a sense of hopelessness, that there's nothing they can do about it anymore."*

Our public officials are faced with difficult choices as they try to fill vast budget holes that grow bigger by the day as the Great Recession wears on. But it is a mistake to balance those budgets on the backs of transit riders and taxpayers, while bleeding away millions of dollars a year to the same banks that caused the economic crisis.

Public transit is critical to our economic and environmental sustainability. Buses and trains get workers to their jobs, customers to shops, and students to schools. For millions of low-income families, seniors, and people with disabilities, public transit is the only means of transportation available to them. Transit expansion and improvements also create construction jobs and help improve the quality of our air and fight climate change by reducing carbon emissions caused by traffic congestion. Investments in public transit literally move America forward.

Swap payments to the banks, on the other hand, take us in the wrong direction. Banks use their profits to lobby against laws that aim to curb their abuses, to create and inflate the next economic bubble, to find ways to avoid paying their fair share in taxes, and to pay out billions of dollars in bonuses. Nearly 40 cents of every dollar that big Wall Street banks take in go straight towards bankers' bonus and compensation pools, helping deepen the income inequality between the 99% and the 1% in this country.[138] That means that more than $200 million of the half a billion dollars that transit agencies and the governments that fund them are paying banks on these toxic swap deals will go straight towards banker pay. That is a direct transfer of wealth from taxpayers and riders to the bankers that crashed our economy.

It is time to get our priorities in order. We cannot keep robbing working families to pay the rich bankers on Wall Street. We need to make banks renegotiate these toxic interest rate swap deals to save taxpayers and riders more than half a billion dollars annually. This would be a first and important step in renegotiating our state and local governments' relationship with Wall Street and getting our economy back on track.

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