

PUBLIC HEARING

before

THE NEW JERSEY TAX POLICY COMMITTEE
TASK FORCE F [PUBLIC CREDIT]

Held:
November 9, 1970
1100 Raymond Boulevard
Newark, New Jersey

MEMBERS OF TASK FORCE PRESENT:

John J. Magovern, Jr. [Chairman]
Assemblyman Hugo M. Pfaltz, Jr. [Vice Chairman]
Senator J. Edward Crabel
J. Richardson Dilworth
Edward A. Jesser, Jr.

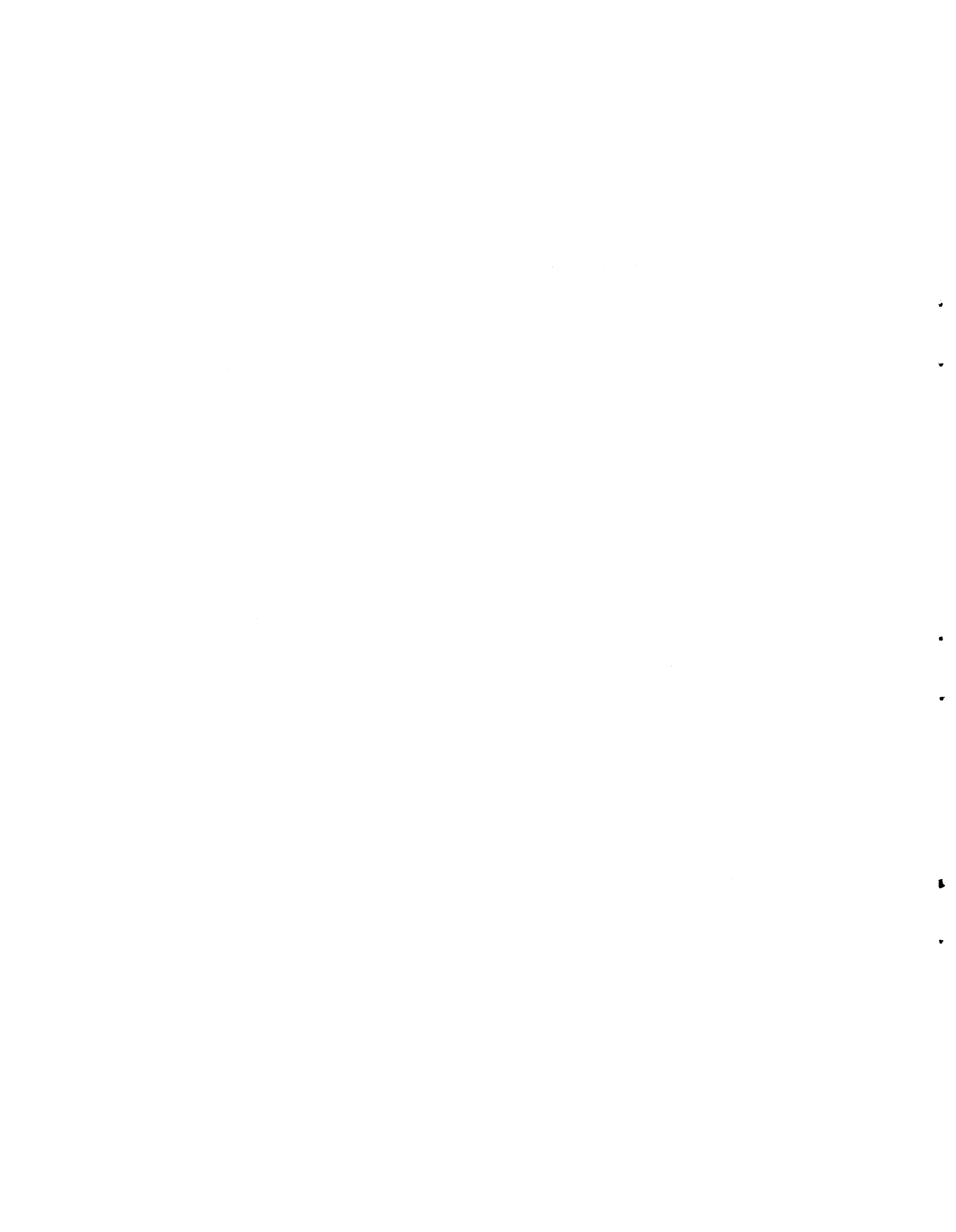
Also:

Dr. William Miller
Staff Director
Leonard Moak, Tax Consultant

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I N D E X

	<u>Page</u>
Arthur B. Mohor, Jr. Joseph F. Hughes Municipal Finance Officers Assoc.	2 & 87
John Carpenter Bache & Co.	14
Irving Dalin Tristram B. Johnson Foster Cooper Hornblower & Weeks - Hemphill Noyes	15 & 89
John K. Pfeiffer Standard & Poor's Corporation	37 & 98
David Breen Jack Rosenthal John J. Ryan Company	42 & 107
George T. Micholick New Jersey City Management Assoc.	61 & 116
Arthur Rochlin Tecott Jackson & Co.	73
Walter H. Stoll Fidelity Union Trust Company	79
Statement from:	
John T. McHugh, Township Manager Township of Willingboro, New Jersey	125
Kidder, Peabody & Co., Inc. New York, N.Y.	127



JOHN J. MAGOVERN, JR. [Chairman]: Gentlemen, this, as you are all aware because you are experts in the field, I believe, is Task Force F, which is concerned with Public Credit as part of the studies of the New Jersey Tax Policy Committee.

An agenda has been sent, I believe, to those who are prepared to testify. We have seven registrants and it would appear to be proper to take them in the order in which they are listed.

Although we have our names here, for those who are near-sighted or far-sighted or because of very poor printing by Mr. Dyke, I should perhaps introduce the individuals: Assemblyman Pfaltz on the far end, Mr. Dilworth, Dr. Miller, myself, John Magovern, Senator Crabel, Mr. Jesser, and Mr. Moak who is not a part of the Committee but who is an expert in this field.

The first witness to be heard would be Mrs. Crawford, but I do not see her here. She is from the Municipal Receivers, Tax Collectors and Treasurers Association of New Jersey. I don't know whether there would be anyone in her place or not.

MR. MOHOR: I am Mr. Mohor from the Township of East Brunswick. I am the President of the Municipal Finance Officers Association. I am representing both Associations.

MR. MAGOVERN: The Municipal Finance Officers Association, Mr. Mohor, was the next one registered. So if you would like to speak on behalf of both the Municipal Receivers and the Municipal Finance Officers Association, you may do so.

MR. MOHOR: Unfortunately, I told Mr. Dyke, I do not have a paper prepared. I didn't know about this meeting until late on Thursday. Since then though, I have tried to assemble my thoughts in as quick a time as I could. The main thing that concerns the Finance Officers is the rating.

MR. MAGOVERN: We have very excellent stenographers and competent people here so you needn't hesitate about a

paper. They will be able to take down what is said. But, please, first identify yourself by name. Would you be more comfortable sitting down over in the chair over here? And if you have anyone with you that you want to consult with, bring him along.

A R T H U R B. M O H O R, J R.: First of all, I will introduce myself. I am Arthur Mohor. I am the President of the Municipal Finance Officers Association of the State of New Jersey. I am also a member of the Municipal Receivers, Tax Collectors and Treasurers Association, of which Mrs. Ruth Crawford is the President. I am here in behalf of the Association, also as Director of Finance of the Township of East Brunswick, which is where I picked up some of these problems.

I do not know whether you gentlemen are aware of it, but in May of 1970 Moody's Investors Service and Standard and Poor for the year before had been requesting fees from each municipality when they were going to have a bond issue, which is something new, but certainly understandable. I have a letter I would like to read from Moody's: "Enclosed is a copy of our revised policy statement regarding fee ratings. Basically the intent is to charge each issuer when bonds are sold on or after May 15, 1970. Certainly credit reviews include not only the issuer's credit but other issuers, including separate school districts and other agencies up to the county level. Since the fee is payable only when bonds are sold, it may be that the fee is payable only once in several years by each issuer. This seems to most issuers a more reasonable approach rather than to charge for each issue as sold. The revision in our original policy took this situation in consideration. If we did not charge this way, it would seem inequitable to the issuer who pays when an issue is sold. Of course, the surveillance of ratings between sales which frequently are several years apart is maintained without any additional

charge. Each rating for a fee is good for at least a year or such longer period until the next sale. I hope you can appreciate the need for this approach."

This letter was written to me because in East Brunswick we had a school district that was sold last week and they had to pay Moody's a fee for having their bonds rated. However, the municipality is going to have a sale probably in February or March - at least it will be in the year 1971 - and we again must pay another fee for the township.

You know as well as I do in this brochure that we make up, the prospectus for bond sales, or the brochure for rating agencies, they include the same information: the percentage of taxes collected, the population, etc. It seems like dual work. However, this is between the municipalities of the State and Moody's and/or Standard and Poor.

What bothered the Association is the fact that not only do you have to get this rating - and I will read a telegram to you to show you just how important these ratings are, at least how our arms are a little bit bent. The municipality had a bond issue in August 1970 and on July 15th I received the following telegram from Standard and Poor, addressed to me, Arthur Mohor, Township Treasurer, Municipal Building, East Brunswick:

"We no longer rate municipal bonds on a voluntary basis, but only for a fee. Because we have not had a request to rate your issue selling July 27th, both the new issue and all outstanding bonds will now be considered as not rated. If you desire us to continue rating your obligations, we will be pleased to do so."

There is one other aspect of this rating problem and that is that it does not come cheap and I have something with me here on that. I am presenting problems here and I have one solution if you can bear with me a minute.

The fees to be effective are as follows: (The population of the borrowing unit is how they base it.) Zero to 50,000, the minimum fee is \$600. Now this is Moody's. Standard and Poor's

may be different and I do not have it with me. 50,000 to 100,000, \$850; 100,000 to 1,000,000, \$1100; and 1,000,000 and over, \$1350. Revenue issues - the minimum is \$850, the maximum is \$2500. The exact fee for revenue issues would be based on the amount of work involved in processing the issue.

The thing that concerns us is that a community like East Brunswick, or take some of the smaller communities in Middlesex County, Spotswood or Helmetta, they are going to get stuck for \$600 right off the bat if they come out with a small issue to rate these bonds. And they have to rate them because if they don't, as they told me in the telegram, your outstanding bonds are not going to be considered rated, even though they originally were rated four or five years before.

This brings me to the point that I want to make that I think that this central credit agency that has been talked about in the State is going to have to come into existence and we recommend that it be seriously considered so these small communities do not have to get their ratings. They can sell these to the State agency, assuming we have one, and then, of course, the bonds would be sold through the State agency, assuming they would probably have an A or a double A rating. This is something that finance officers have been talking about for a long time.

As long as these ratings were free, it didn't hurt a community too badly and you could go to these New York firms, namely, Moody's and Standard and Poor, and get a rating and come out with something that resembled a fair, honest rating. But for a town like mine that is going to have a small \$500 thousand or \$600 thousand issue to spend an additional \$600 or \$800 to have a rating, and you may have just had one two years before or less, seems to me a little bit outrageous as far as the fees are concerned, plus the fact that you are not getting a continuing rating either.

They will continue it for one year is what they are telling us. This has created a problem - I think a unique problem - and most of the New Jersey municipalities have enough troubles now trying to sell issues. We are all backed up, as you probably know, because the bond market has been so terrible in the last two and two and one-half years that most of us haven't sold any bonds. We have been putting them on the shelf and extending them to the full maximum period of time, which is now five years.

This is basically the one big point I wanted to make. I have a paragraph that I would like to read that was written by Mr. Arnold Rosenthal of Rosenthal and Attinger, Certified Public Accountants, and was used in a talk he made a year ago at the League of Municipalities Convention in Atlantic City:

"Why are the opinions of these two services so crucial?" He is saying this of Moody's and Standard and Poor. "It is because municipalities need so much new money for improvements of all kinds that a great many new municipal issues are coming on the market and investors have to rely on the analysis and ratings established by Moody's and Standard and Poor. In fact, the rating assigned to a municipality has a major bearing on the price it pays for the money when it has to borrow. Furthermore, the ratings carry even greater weight because Federal and State regulatory agencies use them as a guide to determine what kind of bonds banks and insurance companies will be permitted to hold in their portfolios. Therefore, a poor or low rating can limit the market for a municipality's bonds."

So you can see it is very important to have this rating. I am not saying we could do away with the ratings. We need them. But the way in which we are going about them now is not to the liking of people who work for municipalities. That is all I have to say.

MR. MAGOVERN: Would you just clarify for me and for the Committee just exactly how you feel that this State

approach that you have mentioned would work if it is done on the basis of rating charged against issues?

MR. MOHOR: My understanding of it the few times I have talked about it to James Alloway, the Director of the Division of Local Finance, and the Past Director, George Skillman, if it was handled right - as far as the details of how this will work, I don't know - but I feel instead of a small community coming out with a \$500 thousand issue and another one with a \$600 thousand issue, a State agency should lump this together and have a \$4 or \$5 million issue and possibly have a combined rating and it would be a State of New Jersey type of thing where you would probably get a double A rating or a triple A. You in turn would sell your bonds to this agency and this agency would sell the bonds through the State. That is my understanding of it. Now George Meholick is here. I am sure he can clarify the details on it. He represents the Municipal Managers and Administrators Association.

MR. MAGOVERN: For the sake of the record, I understand from your testimony that the basis for the charges made by both Moody and Standard and Poor is the same - not rating but the basis - that is, on the basis of issue.

MR. MOHOR: Right.

MR. MAGOVERN: Any member of the Committee have a question?

ASSEMBLYMAN PFALTZ: You mentioned that there would be a \$600 charge for a \$500 to \$600 thousand issue for your rating, which works out to about one-tenth of one per cent. I would like you to comment, if you would, on what kind of attorneys' fees you would pay for a similar type of rating? What is the effect of attorneys' fees on your loss of revenue that you can use in your municipality?

MR. MOHOR: Well, there are several other side issues in this charge. There is also the auditor's fee that comes into this rating because he has to come in and certify all of this and, of course, he is going to get a fee. The

bonding attorney's fee is one-half of one per cent of the total issue.

ASSEMBLYMAN PFALTZ: And that goes to a local attorney?

MR. MOHOR: No. That goes to the bonding attorney.

ASSEMBLYMAN PFALTZ: That goes to the New York bond counsel?

MR. MOHOR: Right.

ASSEMBLYMAN PFALTZ: One-half of one per cent?

MR. MOHOR: One-half of one per cent. Now depending upon the county you are in, because I have worked in Bergen and Essex and now Middlesex - in Middlesex County you never pay the fee directly to the New York bond counsel. This is another problem. You pay it directly to your own in-house attorney who in turn turns that much over to the bonding attorney.

MR. HUGHES: We don't do that.

ASSEMBLYMAN PFALTZ: I think that one-half of one per cent is about what you pay your in-house counsel, isn't it?

MR. MOHOR: No.

ASSEMBLYMAN PFALTZ: What do you pay to him?

MR. MOHOR: In Middlesex County, the Middlesex Bar Association minimum schedule of fees is 3 per cent of the first \$200,000; 2 per cent of the next \$500,000; and I think it is 1 per cent of excess to \$1,000,000; and 1/2 of 1 per cent excess over \$1,000,000.

ASSEMBLYMAN PFALTZ: That is the local attorneys' fees?

MR. MOHOR: That's right, in Middlesex County.

MR. HUGHES: Most of the work is usually done by the New York attorney.

MR. MAGOVERN: His fee, however, is in addition.

MR. HUGHES: And if there are bond anticipation notes issued prior to the main issue, then his fees will be increased according to the amount of work that he has to do to prepare for the bond anticipation note issue.

MR. MAGOVERN: Do you mean by that when you have bond anticipation notes outstanding for a period and then you have

a bond issue that picks up those notes, you use as a basis for the fee the double?

MR. HUGHES: Yes, or triple or quadruple, depending on how often you issue bond anticipation notes.

MR. JESSER: Mr. Chairman, may I ask a question?

MR. MAGOVERN: Yes, Mr. Jesser.

MR. JESSER: How much work does the New York bonding attorney do and how much work does the local attorney do in a municipal bond issue?

MR. MOHOR: As far as the New York bonding attorney is concerned, it is his opinion that you are really paying for. With regard to the notes, generally speaking in the dealings I have had with him, he renders an opinion, a certification of delivery, delivery certification paper. He usually makes up the notes if they are bond anticipation notes right in his office. I would say, as far as the work of the local attorney, it is very little on a bond anticipation note. Now on the actual bond sale, the bulk of the work is done through the Treasurer's Office and the Auditor. The prospectus is made up there. It is sent to the bonding attorney generally and he is the one that puts it out to the bond buyer and contacts the various and sundry prospective purchasers and he at the same time renders the final opinion on that bond sale. That is part of the front page of the prospectus. So it is his work and the auditor's work that is involved in the bond sale. The local attorney has very little to do with a bond sale.

MR. JESSER: He has very little to do with the bond anticipation notes also?

MR. MOHOR: That is correct.

MR. JESSER: Could you define "very little" because it is really the decision of the bonding attorney that enables the securities to be sold; isn't that right?

MR. MOHOR: That is correct.

MR. JESSER: Without his decision, you can't sell the security. So whether he has a great deal of work or not,

actually the responsibility of his firm is at stake.

MR. MOHOR: Right.

MR. JESSER: What actually does the local attorney do?

MR. MOHOR: After that original ordinance has been drawn and possibly amended, the local attorney has very little to do. I can't think of anything he has to do.

MR. JESSER: Is his reputation at stake?

MR. MOHOR: No, because generally speaking in a municipality they will have several ordinances. They will have five or six ordinances in a bond sale. They will combine these ordinances into a combining ordinance and even that is drawn up by the bonding attorney. It is not drawn up by the local attorney.

SENATOR CRABIEL: Sir, you indicated that you had experience in Bergen County. Do you know what the rates are in Bergen County?

MR. MOHOR: No, I don't. I worked for the City of Englewood for, I guess, three-quarters of a year, if I remember correctly, before I came to East Brunswick and I did not have too much dealings with the bonding attorney up there. My understanding is that their fees are more in line with what we had in Essex County; that is, the local attorney was paid on primarily a retainer basis and included in that was the drawing up of all ordinances, bonding or otherwise, all resolutions, and the only time that the local attorney would get extra fees would be for a court case and not involved in a bond sale or bond anticipation notes. That is unique to Middlesex County, which is the point that I was making.

ASSEMBLYMAN PFALTZ: I would just like to continue what you are discussing there. It seems to me you are complaining about a \$600 rating fee of Moody's, whereas this same bond issue would carry a \$17,000 fee to a local attorney, which to me from what you said and from the observations of this Committee is not earned in the sense that time is

expended proportionate to the fees received. Wouldn't that perhaps be a more helpful focus for saving municipal funds?

MR. MOHOR: Absolutely. This is kind of a ticklish situation, but I had that as a comment and I didn't know whether this would be brought up by other people or not. But the bond market today is problem enough without adding fantastic fees for the attorneys as well as this extra 6 - and in the case of East Brunswick it is 8.50 - it's not 6 - and any little bit all helps. The bonding attorney's fees have been going on for years. This is not all over the State though according to my understanding. I have talked to some of the finance directors in the southern part of the State and they don't seem to have this problem. Middlesex County does. Mr. Hughes is from Middlesex County, the Township of Edison, and I am from East Brunswick. I know in Essex County when I was treasurer and controller up in Cedar Grove for seven years, we had no problem up there. In other words, the local attorney did not have this fee schedule and he did not charge the towns for this. It would be just whatever his time was that he was involved in a court case or possibly a trip to New York or something like that that he would bill the town a minimum amount of money. It is definitely in Middlesex County. Now where else it is, I don't know because I haven't been all over the State. But I have not heard of it being involved in Cape May or Atlantic Counties or in Essex. I can't speak of the other counties.

SENATOR CRABIEL: If you think the fee is excessive, why do you pay it?

MR. MOHOR: Well, unfortunately, finance directors, you know, if it is in the budget and if it is added and subtracted right, this is about where our jurisdiction runs. We can recommend it not be paid. But if the council says, pay it, it is paid. Calling a spade a spade, this is the way it works.

MR. MILLER: Except for the fee part of it that you have discussed, do you find that the rating services are otherwise satisfactory from your point of view?

MR. MOHOR: Yes. I think they are very fair. Presented with the proper data, they seem to come up -- I have been over there now four times in the last five years, I guess, and every time I have been treated fair and square. I have no objections to the way I have been treated.

MR. MILLER: Aside from your own experience, do you find that the members of the Municipal Finance Officers Association generally are aware of the importance of furnishing what you call the proper data to the rating services?

MR. MOHOR: Absolutely.

MR. MAGOVERN: In your statement, you mentioned the postponement of the issuance of bonds for the extended period, now five years. You didn't comment on it and you needn't now if you don't care to. But do you have any thoughts with respect to limitations of that kind on the issuance of bonds? The five-year period is now the most extensive available.

MR. MOHOR: No. As a matter of fact, I teach Municipal Finance Management in Rutgers University and what I teach and what the law is are two different things. My own personal opinion is that five years is too long because I think we have a problem of procrastination. Because the only way to beat the bond market is to put them out on the market when it is time to put them out. If you keep the five years, you may say why not make it seven or ten. I don't think this is the answer. I think that three was sufficient and I think we all had our problems. I don't think we are going to see a 3 or 4 per cent bond issue in the next few years. I think the way to lick the whole problem is, when the bonds are due, sell them and get them out on the market. As a matter of fact, I could have issued in October or August of this past year a million and a half and I chose to issue only \$660 or \$662 thousand, I think it was, and if I had known

what I know now, it should have been the whole million and a half - but the typical problem is of procrastination.

MR. MAGOVERN: Any other member of the Committee have a question?

MR. MOAK: May I ask to whom do you sell your bond anticipation notes and what is the general procedure?

MR. MOHOR: The answer to this is summed up by the amount. If it is a small amount - when I say "small," I mean where a local bank can pick it up. This grey line between small and large seems to be somewhere between \$200 thousand and half a million. When you have three-quarters of a million or a million and a half and your local bank won't pick it up, you will have to go through Bache and Company or one of the firms in New York City usually to pick that much up. Does that answer your question?

MR. MOAK: How is the rate determined?

MR. MOHOR: Speaking for most of the finance officers, we usually take quotes. In other words, when you find your local bank can't pick it up either through their own portfolio or to work it through their bank, then you generally get quotes from these New York concerns, Salomon Brothers and Hutzler, Bache and Company, and you make some phone calls or write some letters and get some quotes back. You tell them you are going to have some bond anticipation notes you want to sell and you get their rate.

MR. JESSER: Do you anticipate the rate that the bank would charge would be considerably below the rate that you might get from New York?

MR. MOHOR: Absolutely. It always is.

MR. HUGHES: That is providing the bank can handle it.

MR. MOAK: What is the reason for that?

MR. HUGHES: A million dollars is difficult for most banks to handle.

MR. MOHOR: Generally speaking it is because if they loan you the money, they have to work and, if they loan you, say, half a million dollars, you don't take the whole half

a million out of their bank. It just stays right in their bank. As far as cash loss is concerned, they are not going to lose it right away because you are going to draw on it as you need it. This is one of the reasons they can come out with a lesser rate because it is not a full impact. Sure over the next six months they are going to lose \$500 thousand, but it is staggered. I think this is the only answer I can give you.

MR. MOAK: Getting back to this matter of selling bonds, do you feel that we would all be better off if you went into the market when you needed the money instead of trying to guess what the market is going to be and defer the sale? In other words, over a period of ten or twenty years, you would hit the peak in the market, you would hit the bottom, and you would average out.

MR. MOHOR: That's correct.

MR. MOAK: It is better to do that than defer it and pile it up and then be forced, if you are reaching the five-year maximum, to go into the market at a very adverse time with a very large issue?

MR. MOHOR: Yes, because you see you don't often accept those bids. In other words, if you prepare a bond sale for next Friday and when the rates come in, you don't like any of the rates - you just feel that you are getting the well-known shaft and you say, "This is not the best rate that I can get," - you recommend then that the council turn all these bids down. They will turn it down. Then you can go again three weeks later. What I am saying is that you don't have to stand there and whatever they give you, take. But the idea of putting these bonds on the shelf and sitting because the law allows you to sit is not the answer either.

MR. MAGOVERN: Any other questions? [No response.] Thank you very much, Mr. Mohor. We appreciate your appearing here.

Mr. Haiback of Kidder - Peabody is the next person listed.

MR. RUTLEDGE: Al is not here. He couldn't make it. Mr. Carpenter and I came. Mr. Carpenter is from Bache and Company. You could ask him if he wants to say anything.

MR. MAGOVERN: Mr. Carpenter?

J O H N C A R P E N T E R: I think I would just rather listen today. We were rather surprised -- There are several gentlemen here that are in the bond business in the State of New Jersey. As a matter of fact, I think almost every firm that operates in New Jersey is represented. The only thing I would like to say is we didn't hear about this until Friday afternoon and I think we would have liked to testify at the hearing representing people in the bond business, in the actual selling end of the business.

I, myself, am not personally prepared to testify today because I don't understand the whole significance of the hearing. I just got this Friday afternoon. I hope at future hearings representatives of the business can also know about these things and be represented on their side.

I don't know whether it is proper, Mr. Chairman, but there might be some other gentlemen here who would like to say something. Is that proper?

MR. MAGOVERN: Yes. If they wish to testify, we will be glad to add them to the list. But I don't think we can necessarily interrupt those who have registered. I don't anticipate that we would be unduly delayed, but we would welcome any witness who wishes to testify and appear. We will add them to the list and I will call them when we finish the registered list of witnesses.

SENATOR CRABIEL: This gentleman could file a formal statement with us if he wants.

MR. MAGOVERN: Senator Crabiel suggest that it may be that you would want to file some sort of a statement with us in lieu of testifying today since you were pressed for time and I regret that you didn't get the notice or we didn't send it to you in time. But you could file a statement and you may

be sure it will be taken in as part of the hearing.

MR. CARPENTER: I think personally today, as I said before, I would like to listen to the proceedings and listen to the witnesses and be put down on future hearings that we would like to be represented at these hearings.

MR. MAGOVERN: Thank you, Mr. Carpenter.

I have Mr. Dalin, Mr. Johnson and Mr. Cooper, on behalf of Hornblower and Weeks-Hemphill, Noyes. I don't know which one is going to testify. You are all welcome.

Mr. Dalin?

I R V I N G D A L I N: My name is Irving Dalin and I am a municipal bond analyst with the investment banking firm of Hornblower and Weeks - Hemphill, Noyes.

In recent years my municipal research activities have been largely concentrated on revenue bonds and I do not claim to be an expert on New Jersey governmental finance.

I am especially pleased, therefore, to be accompanied by two of my colleagues, Tristram Johnson, the Municipal Manager of our firm's Trenton Office, and Foster Cooper, Vice President of the Municipal Department in our New York Office. In addition to their extensive experience in the investment industry, these two men are well acquainted with New Jersey local government. Mr. Johnson, a resident of Princeton, once served as Acting Mayor of that municipality and was Finance Chairman for five years. Mr. Cooper is presently Council President and Finance Chairman of the Borough of Montvale.

It will come as no surprise to you to be told that public capital facilities are inadequate, that public capital expansion requirements seem to be unlimited, and that this sad state of affairs does not exist only in New Jersey. Probable result - New Jersey governmental units, State and local, will be making heavy demands on the bond market during the 1970's and in so doing they will encounter strong competition from other borrowers, public and private.

I do not expect that such demands will be diminished by increasing resort to pay-as-you-go financing of public capital expenditures. If anything, the trend is likely to be in the opposite direction.

Bear in mind also that New Jersey ranks very low relative to other states in state and local governmental expenditures. For example, according to the 1967 U.S. Census of Governments, New Jersey ranked 49th among the 50 states and the District of Columbia in state and local public expenditures per \$1000 of personal income on education, public welfare and health and hospitals. It may be that a dollar of public expenditure buys much more in New Jersey than in other states or that New Jerseyites are more self-reliant than citizens of other states. As a New Yorker, I shall withhold comment on these matters.

If my assumptions of increasing capital expenditures and increasing borrowing by New Jersey state and local governments are correct, then such matters as access to capital markets, ability to issue bonds at reasonable interest rates, and credit standing or ratings should be of great interest to the people of New Jersey and their representatives. And there is a great deal to be done. Consider, for example, that of the five hundred or so New Jersey municipalities, school districts and other local governmental units rated by Moody's, 65 are rated BA, which is regarded as an inadequate rating for bank investment. In New York State not one rated unit carries a lower rating than BAA, the lowest bank investment grade rating, and in Mississippi, hardly the wealthiest and best governed state of the Union, not one rating less than BAA.

Of course, Moody's does not have the last word in determining the credit worthiness and interest rates of New Jersey municipal bonds. And I believe that the other rating agencies, Standard and Poor's and Dun and Bradstreet, have a more positive opinion of New Jersey municipal credit

generally. Still Moody's is important and it is my impression that New Jersey local government credit is held in rather low esteem by many investment institutions.

There may be some objective bases for this evaluation; chiefly, I believe, the following: the comparatively low level in New Jersey of State aid to local units for education and other purposes; the large number of New Jersey municipal defaults in the 1930's; and finally perhaps frequent exposures of mismanagement and corruption. But it seems to me that the investment community is insufficiently aware of various strengths of New Jersey municipal finance, for example, the municipal cash basis budget requirement, municipal capital budgeting requirement, State supervision of local government finance, unlimited property tax rates for debt service on general obligation bonds, the priority position of school levies in the allocation of property taxes, the availability of certain State school aid funds to prevent or correct defaults on local school bonds, and the development of a service contract between sewer and water authorities and their constituent municipalities as a powerful instrument for the security of authority bonds.

The foregoing list of positive features of New Jersey municipal bonds could undoubtedly be extended. Furthermore, too frequently there is an inadequate effort to inform potential bond buyers of the economic strength of the borrowing municipality, district or authority and of the need for and benefits that will accrue from the projects being financed.

I am aware of the fine work being done by the Division of Local Finance to inform the investment industry of the positive aspects of New Jersey municipal bonds and of the high quality of its personnel. But it seems to me that more needs to be done and can be done to help local borrowers present their strong features to underwriters and investors.

If I may be permitted a plug at this point, I think

that many local governmental units would do well to retain experienced underwriting firms to assist them in the preparation of bond prospectuses that will help to sell their bonds, in the determination of the most advantageous times to offer their bonds for sale, or alternatively to issue bond anticipation notes, and in capital planning.

Although there is only time to mention capital planning in passing, it is very important not only to municipal management but also to the credit standing of the municipality. Let me quote from a talk delivered recently by William McCarthy, who is in charge of Moody's municipal bond ratings, and this is the quotation: "Another prejudice which bond-rating analysts may possess is concern for capital planning. A studied approach to future capital needs will tend to assure credit stability and confirm the ability to pay debt."

I have not touched on the possible effect of fundamental and sweeping changes in the structure of New Jersey local finance, such as vastly expanded State aid to local units, which would have to be accompanied by significant increases in State revenues, or the creation of a municipal bond bank. Obviously, I could not hope to do justice to these important and complex matters as well as the others listed in the hearing guidelines in the little time remaining to me.

Let me close by emphasizing that something can be done now by many New Jersey municipalities to improve their access to bond markets short of the enactment of such fundamental revisions, that is, by better publication of the strengths of New Jersey local finance.

Now I believe that Mr. Johnson would like a chance to make some comments and then the three of us will be ready to field your questions. Thank you.

MR. MAGOVERN: Thank you very much, Mr. Dalin.
Mr. Johnson?

T R I S T A M B. J O H N S O N: My comments will be more informal and directed, I think, at the marketing end

of municipal bonds, at the structure of statutory regulation and statutory restriction, if you will, on the present offering of bonds by municipalities to the marketplace.

New Jersey's present municipal bond market is based on the reaction to the real estate excesses and the municipal defaults of the '20's and '30's. I believe it is past time when there should be instituted a relevant and deep review of all statutes passed in those years, specifically as they relate to current dimensions of problems.

First, the debt limit: There is presently established a limitation on the right to incur debt by any municipal entity in the State of New Jersey. The statistics creating this limit are again based on need and factors established in the early '30's. There may have been some extension of these, but basically the concept remains during the period of 30 to 40 years of vastly expanding need. You cannot say that the need for school district capital was as great in the '30's. A regional sewer authority probably had never been conceived of.

I suggest that while our laws have allowed application to the Bureau of Local Government for the right to exceed debt limit, I believe this right has only been denied once in the recent past, so that in effect there is no debt limit in New Jersey in practice. But in the impact on the marketability of the bonds, there is in Wall Street. Because if the notice of sale must establish the fact that a municipality had to apply for the right to exceed its debt limit, this can't be considered other than a black mark against the municipality under the present New Jersey statutes.

You might well spend some thought on: Is it the more effective municipality that is remaining within its debt limit or is it the more effective municipality that is struggling with its problems that forces it to exceed its debt limit?

Certainly the question of urban renewal was not a

capital need in the '30's. The City of Newark can exclude certain urban renewal debt from its debt limit. It cannot exclude certain other urban renewal debt. The City of Newark could perhaps have available to it an additional \$20 million worth of borrowing power if the State were to consider that under current dimensions of problems all urban renewal type of debt should be considered beyond the debt limit, you might say.

I am suggesting that in the area of the establishment of a debt limit you may have a relationship with the 60 some municipalities carrying a BA rating.

There was also established in bygone eras a limitation as to interest rates. The last two or three years have created across the nation the problem of a need arising, requiring capital, which cannot be raised because of a previously imposed ceiling on the rates. The ceiling did not prevent the arising of the need. It has only caused the need to go back to the electorate or back to the legislature to remove the ceiling - either a moratorium as there is in this State and in New York or permanent removal or merely a postponement to a second level of limit.

I suggest again that under current dimensions of financial needs, is such a thing as a rate limitation a valid statutory limitation?

Municipalities in the State of New Jersey have a standard format within which they can offer their bonds for sale. It calls for only one coupon. Many states now have the right to issue any number of coupons. From a marketing point of view, this means that one coupon requires some bonds to be sold at a premium, some bonds to be sold at a discount. Under bank tax laws as they now pertain, banks very often prefer to buy only par bonds. The State of New Jersey is requiring its municipalities at this time to issue bonds that are less popular than bonds being issued by competing, equally-rated municipalities in other states.

Finally - as you see, I am picking just items here - I finally pick up one further one which seems to me again to draw attention to a general area of review. The legislature has created a program providing for State aid to school construction. Unless my information is incorrect, there has been one marketing, a single marketing, of a State aid bond issue. The first notice of sale drew no distinction between that portion of the bonds that would receive full State aid for amortization and that portion of the bonds that would solely be relied upon by the tax resources of the municipality. The notice of sale was still issued. The sale was only cancelled two days before notice when somebody realized there were two separate bonds being sold here. The bond issue again was noticed for sale. There were two separate bid forms. To my knowledge, both bonds were still granted a BA rating.

This means the State of New Jersey, gentlemen, received a BA rating. I suggest again that there is an area for review. The total area of regulations and statutes presently governing the offering of debt to the marketplace can bear study in the 1970's.

MR. MAGOVERN: Thank you, Mr. Johnson.

In essence, that is one phase of this Task Force's responsibility, to take a look at this sort of thing. I wasn't quite sure if I had to draw a conclusion from what you say - you wouldn't eliminate or would you eliminate all statutory debt limits?

MR. JOHNSON: I would emphasize-- and I am talking from the marketing side of the bond business but also, I hope, in an attempt to extend our knowledge to the issuer, so that when he presents himself to the marketplace, he has packaged his program so that it will give him the best rate. It would be more important in my opinion to emphasize to Wall Street, if you will, the validity of your Bureau of Local Government than it would to have any debt limit. At

the present time, no authority has any restriction on its right of issuing bonds. It has no need to go to the public nor to a State body. However, at the same time, a school board of the same municipality must go and apply for a right to exceed a debt limit.

To have a review board and to have the review board effective would be more useful than a black mark of having to exceed a debt limit.

MR. MAGOVERN: I take it, if I had to boil it down, you would in effect say you look to a more flexible - would that be a proper descriptive word to use with respect to your proposal ---

MR. JOHNSON: Yes, if you want to call it that. We in the street can obviously realize the City of Newark has some extensive problems. The City of East Brunswick, we ought to consider has nowhere near the kind of dimension of problems the City of Newark has. To see the City of Newark applying for an extension of debt limit has a flexible response from us in the street. Why have it?

MR. MAGOVERN: When you spoke with respect to debt limits, you stressed the relationship of need rather than some of the other characteristics that affect that. But would you suggest that need is the primary criterion?

MR. JOHNSON: I must turn the question back to you and say that there are instances in the State now where one division of the State, the Division of Health, may prevent any further development of a particular community until it incurs the debt to create a regional sewer authority. Now there is a need. No debt limit can be allowed to stand in the way of meeting that need. You can have one municipality with five authorities - a parking authority, a sewer authority, an urban renewal authority - all of these will require cash to service their bond issues. They aren't included under the debt limit. Of what validity is the debt limit?

MR. MAGOVERN: The committee fortunately is not

required to respond to your question. [Laughter.]

I would be interested in this school district that you speak of that got a BA rating.

MR. JOHNSON: Jefferson Township.

MR. MAGOVERN: What was it?

MR. JOHNSON: Jefferson Township. I have the notice of sale in my briefcase here.

MR. MAGOVERN: That was a rating obtained, but it had made no objection or do you know what it did? Did it just go ahead and sell the bonds on that basis?

MR. JOHNSON: It is my understanding the Jefferson Township Board of Education carried a BA rating prior to the sale and was awarded a BA rating on this issue at the time of sale and that there were two issues of bonds, one supported by the Township and one supported by State aid, and that both of them received a BA rating. Now the one supported by State aid was never reoffered publicly, so that we in the State had no chance to compare the yields at which the two issues were offered.

MR. MAGOVERN: That may be the answer to the apparent complexity there when you say they both arrived with the same rating, one with the State guarantee and one without.

Does any member of the Committee have a question?

MR. JESSER: We realize that we have to sell our bonds in the general marketplace with other issues. Also we realize that there is going to be a tremendous volume of municipal bonds coming on the market in the next five years. Have you ever seen any figures of projections of how much in the way of municipal financing is going to take place in the next five years?

MR. DALIN: Well, I have seen those figures. I don't recall what the total was, except that it was enormous. You are speaking of the nation as a whole, aren't you?

MR. JESSER: Yes.

MR. DALIN: Foster, do you know about what the current volume is?

MR. COOPER: The projection for five years? I haven't the slightest idea.

MR. MOAK: Mr. Chairman, the Congressional Committee on this subject put out its report in 1966 and projected we would reach a level of between \$22 and \$25 billion by 1975, which was in contrast to a level at that time of around \$10 billion.

MR. DALIN: That is per year.

MR. MOAK: Per year. The report was issued in 1966.

MR. JESSER: I think the point here is, Mr. Chairman, if we are going to compete in this larger market, certainly it behooves the State of New Jersey to have as favorable a reception for their securities as possible. So any restrictions that we have, any practices that we have, anything that restricts the marketability of our issues is going to be to our detriment because the demand, I think, everybody agrees is going to be so heavy that if we don't go into this marketplace in a very favorable light and do everything we can to present our bonds in a most favorable way, it is going to be to the detriment of the State and the municipalities. That was the point I wanted to make.

MR. JOHNSON: May I just suggest one other comment there. The business of selling bonds now places a premium on imagination and on initiative in creating a cash flow to service those bonds. The time when we could conveniently divide bonds between revenue and general obligation tax-supported bonds is well past. The so-called double-barrelled obligation is now commonplace where a bond is sold initially to be serviced by the revenues from that facility and then a final backup by the municipality in the event of a default - a regional sewer authority, a parking authority, name it as you will.

Again I think in our mere use of semantics, we create a disadvantage to the double-barrelled bond seller who is

forced to put a revenue bond or sell an authority bond when it is really backed up by the general obligation of the general tax revenues of a municipality. We tend to increase the cost rather than saying this is even a stronger bond. I don't know that the legislature can help this in establishing new semantics in the business, but it is specifically on your subject.

MR. DALIN: It does have to do, if I may interject here, with the way that New Jersey's bonds are presented to the investment industry. The New Jersey Regional Sewer Authority bond is a very ingenious instrument and an extremely well-secured instrument. Yet I think it is safe to say that large segments of the investment industry treat it as a revenue bond and consequently as something less well secured than a general obligation bond.

SENATOR CRABIEL: I want to get back, Mr. Johnson, to your Jefferson Township bond. All municipalities have State aid. What was different about the Jefferson Township bond than any other municipal bond put out by boards of education?

MR. JOHNSON: You are the member of the Legislature, sir. As I understand, there was a program created that provided a cash flow specifically to assist lower-rated and, therefore, less wealthy school districts in meeting the construction needs that they were faced with and that their current financial condition made it difficult for them to meet. This program brought itself to the marketplace stage in presenting to Wall Street two separate issues then.

Let me get this notice of sale right here. "Board of Education of the Township of Jefferson, County of Morris. First notice of sale, May 19; second notice of sale, August 25." First notice of sale draws reference to \$672,000 Series A. That is a State aid bond, serviced entirely by contributions from the State. Series B, \$3.3 million, school bonds of Jefferson Township serviced solely by the general revenues of Jefferson Township Board of Education. In the initial

notice of sale, there was one single notice of sale for both issues.

SENATOR CRABIEL: May I interrupt a moment. Can any municipality put out a brochure of that same type?

MR. JOHNSON: Again it is my understanding that the statute provided aid only for those municipalities that needed it and, therefore, the need had to be certified by the Board of Education and then the Bureau of Local Government.

SENATOR CRABIEL: That isn't backed by State aid any more than any other municipality. This is what I am trying to get through my craw.

MR. JOHNSON: State school building aid bonds under New Jersey State 18A:58-33.4 (d) - it is a pure citation.

SENATOR CRABIEL: But every municipality could do the same thing.

MR. JOHNSON: It is my understanding the statute requires a certification of need before a school district can avail themselves of that aid.

SENATOR CRABIEL: I will yield on that until I get some research on it. It is not my understanding.

MR. JOHNSON: I could be wrong.

SENATOR CRABIEL: My next question has reference to the bond bank, and your associate, Mr. Dalin, just passed it aside - in other words, whether you have any view as to whether by putting the credit of the State behind these bonds of some of these municipalities it would help in any way in solving our problem.

MR. DALIN: Well, I think it would obviously solve the problems of certain small, unrated or low-rated municipalities because they would be able to enjoy the advantage of the rating of the State agency which will issue the bonds. How this works out - what its net effect on New Jersey finance would be - I cannot say. That would depend, for example, on how the bond bank is set up, on the rating that

its bonds receive and on its effect on New Jersey credit, on the rate of interest carried by New Jersey State bonds. My understanding is that the bond bank bonds would be what are called moral obligations rather than direct general obligations of the State. Is that correct?

SENATOR CRABIEL: I believe so.

MR. DALIN: If so, they would carry a higher interest rate than the direct general obligations of the State. Also, I suppose, there would have to be a certain amount of staffing for the bank. So there would be a cost there. But the advantage is obvious. What the net effect would be, I can't say. But it is certainly something to consider very seriously and to explore.

SENATOR CRABIEL: One other question: Mr. Johnson, you indicated you also were a municipal official or a former municipal official. In your opinion would it be wise to eliminate completely any reference to a debt limit in municipalities?

MR. JOHNSON: As a municipal finance officer, you mean, you are asking that question for me to answer.

SENATOR CRABIEL: Yes.

MR. JOHNSON: Let me respond this way: I think it would not be surprising to make the general comment that it would be unusual to find among elected officials of local governments extraordinary ability in engineering, extraordinary ability as an architect or as a municipal bond expert. What I am suggesting is, therefore, while I continue to recommend the elimination of any limit, I recommend the strengthening of the advisory function of the Bureau of Local Finance so that those who are sincere, energetic municipal officials but with not the expertise of a municipal bond profession would have available to them from the State level the advice the municipality should need to keep its capital financing in line.

SENATOR CRABIEL: Would you give the same answer as a

resident and a taxpayer of a community, realizing there are 587 municipalities in this State with municipal officials who don't have all the expertise, as you have indicated?

MR. JOHNSON: I would have to answer that again by saying "yes" because at the same time I am being buffeted with the ecological needs, the environmental needs, the sewer authority needs, and all the rest of these needs. Needs are there. Legislation won't eliminate them.

MR. MAGOVERN: Turning that question into the marketability, would you like to hazard an opinion as to the effect of a municipality that came in with a bond that did not have that advice or criteria of the experts and one that did? In other words, what I am asking is: Would it not have the effect of channeling everything through that unit or that organization from a marketability standpoint?

MR. JOHNSON: I understand your question, sir. There are municipal bond banks, if you want to use that as a generic term, in operation throughout the nation in some states for different purposes. The Commonwealth of Pennsylvania, if I use the right language, has a school building authority. I believe the State of Michigan, the State of North Carolina, the State of Virginia, have different kinds of bond banks. I think specifically from our point of view I mention a small item but it is an important item. It may be more logical for a municipal finance officer and a registered municipal accountant to program a maturity schedule so it fits an outstanding maturity schedule to maintain a rather level debt service requirement than it does to package a bond issue so it is more palatable, more salable, more merchandizable on the street. A hundred bond maturity per year is a very salable bond maturity; 60, 75, 80 bonds are not - a small item but an important item in establishing an interest rate and a cost of that issue, not one you very often see fed into the consideration and the preparation of an issue.

MR. MILLER: Either Mr. Dalin or Mr. Johnson - I am

intrigued with Mr. Dalin's observation that bonds of equal quality or apparently equal quality when you go behind some of the obscurities in New Jersey do not have as favorable an interest rate in the market as bonds of municipalities of other states. It is hard to believe that a sophisticated market like this one is not aware of the quality and goes blindly by a rating which apparently isn't justified. Could either of you comment on that?

MR. DALIN: Well, I wouldn't say that the market goes blindly by the rating, but certainly Moody's rating is a very important consideration. Even if you personally disagree with Moody's rating, you would hesitate to buy a bond with a low rating because the person to whom you might want to sell that bond in five years might take the rating more seriously than you do. So it certainly cannot be ignored.

MR. MILLER: I am still unaware from your remarks as to whether the rating is or is not justified. Obviously if it is justified, it shouldn't be ignored. And if it isn't justified, there should be a remedy. Where do you take hold of this?

MR. DALIN: I don't want to get into a, let's say, sort of long-distance quarrel with Moody's about the justifiability of their ratings, particularly since I have not reviewed all of their 65 BA-rated bonds and presumably they have. It just strikes me on the evidence that I have presented to you, the fact that New Jersey in spite of being generally a wealthy state with pretty good State laws regarding municipal finance should have so many low-rated bonds compared with New York and other states -- it just strikes me that there is something wrong there, something that is not completely objective and I would guess that a representative of Moody's, if one were here, would have something to say on that matter.

I do believe, as I indicated in my presentation, that aside from the sweeping changes on the State level, the formation of a bond bank, etc., I have seen a number of New Jersey municipal bond brochures and very frequently they

simply don't do anything to sell the bonds. This is not only a matter of Moody's rating because the same municipality might have presented more data to Moody's than it does to the investor. But in many cases perhaps it has not made an adequate presentation of the case to Moody's.

MR. MILLER: On the average, this is true in other states also. They are not any better at writing them. You have seen some pretty bad ones.

MR. DALIN: That's right.

MR. MILLER: How can you explain it?

MR. DALIN: I would have to fall back on the points which I made which may be objective reasons for the low ratings of New Jersey bonds, particularly in the school areas, the fact that State aid to schools is fairly low in New Jersey. It is comparatively high in New York and this State school aid in New York has to be applied to debt service on New York school bonds if the district in question should fail to raise sufficient money from property taxes. That is a comparative strong point for New York school districts.

MR. MILLER: But you have a better strong point - in New Jersey the school debt service takes priority over the municipal and county, you said.

MR. DALIN: That is true. I don't know --- You mean the tax collection --

MR. MILLER: Tax collection, yes.

MR. DALIN: [Continuing] -- takes priority.

MR. MILLER: The schools call on the tax collector to turn over their share of collections.

MR. DALIN: In New York, on the other hand, counties frequently are responsible for collecting taxes for school districts and municipalities and funnelling those taxes first to the municipalities.

What you seem to be asking me is: Why is a New Jersey municipality generally rated lower than those of New York and

other states? I can't say more than I have already.

MR. MILLER: Well, could you say how much it costs the taxpayers of the State to enjoy that favored position?

MR. DALIN: I don't know. Would you say, Tristram, that New Jersey municipal bonds generally carry a significantly higher rate than those of other states? Well, one thing to bear in mind in comparing municipal interest rates is that New York State, for example, has an income tax, so that everything else being equal, there would still be an interest rate advantage to a New York municipal bond because the residents of New York State would have more incentive to invest in a New York State bond.

MR. JOHNSON: There is the gap in the statement just made that any state with an income tax exempts the interest from its own obligations or obligations of its own municipalities from that tax. If New Jersey is considering a State income tax, this might be one of the positive selling points.

MR. MILLER: You mean there will be more people driven to buying New Jersey bonds?

MR. JOHNSON: Driven into it, yes.

MR. MILLER: Isn't the market sufficiently large at present of New Jersey bond buyers to absorb the issues offered over the years?

MR. JOHNSON: Anything can be sold at a price. This doesn't mean it was sold at the price it was initially offered at.

[Discussion off the record.]

MR. MAGOVERN: Does any member of the Committee have any further questions?

MR. MOAK: You raised a question about the desirability of permitting a broader number of coupon rates. Am I correct in understanding that there is an advantage to being able to re-offer bonds at par --

MR. JOHNSON: Yes, sir.

MR. MOAK: [Continuing] -- over either discount or premium?

MR. JOHNSON: I would say generically, yes, sir. I would also say this is a subject that you could raise with others who will be testifying who are more conversant with the preparation of bond bids and you can get probably more specific and even mathematical proof of that position. But I think it is a valid statement to make generically.

MR. MOAK: If that be true, then in order to provide for the compensation of the successful syndicate, would it be desirable to permit the bonds to be sold at a discount substantially equal to the gross profits of the syndicate?

MR. JOHNSON: My best answer is to say that present bid requirements in New Jersey include more restrictions than are necessary in the marketplace in 1970, certainly in competition with obligations offered by other jurisdictions of other states.

I add one other item here - and I suggest it be another one to be considered: Why is there a need of a good faith check? The industry, what is left of it now, is a fairly sound and responsible industry. But the requirement to leave committed for the delay period between bid, sale and settlement of a good faith check is a loss of that capital to the municipal bond market's value, the municipal bond market's use. And any active underwriting house may be in the process of bidding on, and succeeding in their bid, on three, four and five issues a week, but it may be a month before the settlement date. So they have an accumulation of good faith checks serving neither the issuer or the buyer a purpose.

MR. MOAK: Would part of your objection to that process be met if the issuer were obliged to deposit the check in an escrow account which would bear interest during the intervening period?

MR. JOHNSON: I would think he would do that anyway. I don't think that again answers the question. I think if you are trying to create as viable and healthy a relationship

between your issuer and your seller, the issuer and the buyer of the bond -- Wall Street is known these days for being in need of capital. The experience of Goodbody spread across the papers for merely the need of \$15 million is evidence of the need of capital in Wall Street. For the municipal bond industry to continue to require the tying up of capital is the question.

MR. MOAK: Moving to another point, if I may, if you free up the number of coupons, how do you guard against the disadvantages to the issuer which arise from deep discount coupons on the final maturity or final two maturities or whatever it happens to be? Are you familiar with that area?

MR. JOHNSON: I am familiar with the practice, but again I am not personally familiar in my business experience with the mathematics that justify bid preparation. I suggest you raise the question to other people that come before you.

MR. MOAK: Is there a substantial difference in the profit per \$1,000 on a \$500 thousand issue, a \$1 million issue and a \$5 million issue from the standpoint of the purchasing syndicate of the same issuer and in what magnitude?

MR. COOPER: You say a substantial difference. It may be that what you term substantial and what I term substantial may be entirely different. But I would visualize a \$500 thousand issue in today's market, the underwriting spread being somewhere in the neighborhood - let's talk about a B double A bond - of a point and a half to a point and three-quarters.

MR. MOAK: \$15 to \$17.50 per thousand.

MR. COOPER: Right. And that would be on a smaller loan. On a \$5 million loan, I can visualize it being a point and a quarter.

MR. MOAK: \$12.50?

MR. COOPER: \$12.50.

MR. MOAK: Is there any reaction in the investment industry to the North Carolina type of conduct of sales for municipalities at a single point by a single officer, although

they be bonds of the issuing government in the same form as in New Jersey, but there is a requirement for central sale of the bonds? Is there any opinion within the industry concerning that that makes that more or less favorable?

MR. DALIN: I am not familiar myself with that.

MR. COOPER: I have no comment.

MR. MOAK: Mention was made of the fact that it would be desirable to have advisors, fiscal advisors, in the preparation of bond issues for issuers. Would such advisors be prohibited from participating in the purchase of the bonds or in the distribution subsequent to purchase?

MR. DALIN: Well, it is my understanding that a financial advisor may not underwrite the bonds. I might be mistaken on that point. That is my understanding.

MR. MOAK: From your point of view, what is desirable?

MR. DALIN: If you say from my point of view as an investment banker, I would have to answer that it would be desirable from our point of view that financial advisors be permitted to underwrite and deal in the bonds as well.

MR. MOAK: But perhaps not so from the point of view of the issuer?

MR. DALIN: I am not sure there are questions of conflict of interest. That, of course, is the reason for the law as it now stands. Whether or not that fear and concern are appropriate, I really don't think that I should answer that.

MR. JOHNSON: I would like to make two quick comments on that. I personally feel preventing an advisor from participating in the distribution or underwriting of an issue prevents that part of Wall Street that is the most informed, the firm that is most informed about the issuer. This seems to be a detriment to the issuer. However, I think it can also be said from the competitive aspect in the street, if the financial advisor is also allowed to participate in the underwriting, it may take a while for the street to accept the fact he has a right to be there, rather

than that he is an insider and knows so much - why should we bother to bid? So there is a matter of education, I think, to be accomplished both ways. But I think if it is moved in this direction, it will be to the benefit of the issuer.

MR. MOAK: Thank you.

MR. MILLER: Following the same question, considering all the legal safeguards and restrictions that you mention, is it really possible for a financial advisor to design a package that only he would be favored by?

MR. JOHNSON: Under the careful guidance of bond counsel, I think it would be impossible. For him to tailor an issue that only he could bid on - the industry is not so constructed.

MR. MILLER: Well, it is not only he, but a very small group.

MR. JOHNSON: I think I could generically say, no.

MR. MILLER: What is the secret that he would have that the rest of the industry wouldn't have merely because he has been a financial advisor?

MR. JOHNSON: The only secret he would have would be that he knew this was coming for a longer period of time so he could generate interest among potential purchasers that bidders come lately might not have the time span to spend on it.

MR. MOAK: What position is he in on the day of the sale to advise the issuer whether or not to accept the lowest bid?

MR. JOHNSON: I find it hard to believe that there can be statutes that allow a bid to be accepted that is higher than the lowest.

MR. MOAK: In other words, to reject all bids.

MR. JOHNSON: Oh, to reject all bids. If he is serving his function as a financial advisor, the sale will not have reached the point of a sale at which bids will not be received adequately. If I may, without pointing fingers,

suggest that the situation that the State of New Jersey found itself in when they had a bond sale several weeks ago in which no bids were received need not occur either in an advisory situation, in a competitive situation or in any situation.

MR. MOAK: But it may well occur that due to some event overnight --

MR. JOHNSON: Oh, well.

MR. MOAK: [Continuing] -- that circumstances have changed making it unadvisable to accept bids, although you received bids - the price is wrong. And if he is also a bidder, does this influence his judgment in this circumstance?

MR. JOHNSON: I have enough confidence in my industry to say it would not influence his judgment. If you have a bond sale scheduled for tomorrow and tonight the prime rate is dropped or the rediscount rate is changed substantially, you have an immediately different market level tomorrow. All bids are adjusted as of tomorrow. Bids are submitted by telephone, not over a span of time. I generally feel the industry can adjust itself to any overnight change.

MR. DALIN: I might add there, if I may, in this case the financial advisor - underwriter would after all be putting his reputation on the line. Presumably he would not represent a firm that just goes into New Jersey occasionally and then has nothing to do with the state the rest of the time. Chances are that these investment banking firms will be firms that deal regularly in New Jersey municipal bonds and consequently their reputations will be extremely important to them.

MR. JESSER: Mr. Chairman, the main point that I gather here is that by removing some of these limitations and restrictions - for example, the debt ceilings - by having a bond bank - by having maybe better advisors and presenting the bond issue in a more favorable light, finding some of these other factors you have brought up here - that the average municipality in New Jersey could come out with bonds at a higher price and a lower rate and, therefore, over a

period of years, we could save very considerable sums of money. Is that right?

MR. DALIN: I believe so.

MR. JOHNSON: I would go a step further and say that I think there is no process of business in which the bidding process, the actual bidding process, is more highly competitive than exists in the bond-bidding business. The whole underwriting field is so conversant with each other's opinions of the market moment to moment that any particular issue will draw bids very close in their relationship to each other. So it is less in that area in which you can expect improvement than it is in the area of the issuing of the bonds themselves, I think.

MR. MAGOVERN: Thank you very much, gentlemen, Mr. Dalin, Mr. Johnson and Mr. Cooper, for appearing.

Mr. Pfeiffer of Standard and Poor.

J O H N K. P F E I F F E R: I returned from a two-week tour of the entire country on Saturday. This morning there was a note, "You are due at 1100 Raymond Boulevard, at ten o'clock." I am not prepared. However, I do have a copy of a talk I gave in relation to municipal ratings, contract ratings, which I would like to submit to the Committee.

MR. MAGOVERN: The Committee will be very happy to receive it.

[Copy of Mr. Pfeiffer's talk can be found beginning on page 98 of this transcript.]

MR. PFEIFFER: I would be more than happy to cooperate at future meetings.

MR. MAGOVERN: Would you be willing, Mr. Pfeiffer, to attempt to respond to some questions that the Committee might have with respect to ratings?

MR. PFEIFFER: Yes.

MR. MAGOVERN: There were questions that were prompted, I guess, in part by references to Moody's and earlier to Standard and Poor's. Dr. Miller has a question.

MR. MILLER: You were present and heard the various references which speak for themselves.

MR. PFEIFFER: Yes.

MR. MILLER: Perhaps the easiest way to get into it, if you don't have some other you prefer, would be to start where Mr. Mohor left off. He made an observation about the new practice of the rating services and perhaps you would care to comment in response.

MR. PFEIFFER: All right, fine. Just for a little brief briefing, we decided to charge a fee for our municipal ratings back in March of 1968, the reasoning being that we are not a philanthropic organization. We were losing some \$200,000 a year. We had the choice of either charging for ratings or going out of business as far as municipal ratings were concerned. As you can appreciate, our biggest expense, of course, was salaries. Municipal analysts are few and far between. Actually when I have some young people come in and try to induce them to go into municipal finance, their reaction is that there is no romance in it and they prefer the stock market, which to them is a one-way street. They subsequently find out differently.

Nevertheless, there has been - I don't like to use the word pirating, but I guess that is as good as any other word - in the street for municipal analysts. It takes two or three years to indoctrinate one, to get him on his feet, so to speak, and the first thing you know some house downtown will take him at a fairly substantial salary. So the end result was that we had no choice but to either charge or go out of the municipal business.

Our fees are based not on the population, not on the amount of the issue, but merely on the time consumed. In other words, you could have an issue, as an example, for the Port of New York Authority. They will come out with a \$90 million issue. We are familiar with it. It takes us two or three hours to resolve our rating ideas. On the other hand, we could have a small gas revenue issue down in

Tennessee that might entail even sending a man down to see the area and the fee is reflected, as I said, in the time consumed.

MR. MILLER: This everyone understands is a problem. But I think the key thing is what came up a moment ago in Mr. Dalin's testimony and others we have heard - his wasn't the only one - about the difference in rating of New Jersey bonds of apparently equal quality as compared with other bonds, let's say, in this general area or part of the country. Can you explain why this is and what we could do to correct it?

MR. PFEIFFER: Well, I can't naturally explain Moody's reasoning and frankly, and I wish it were off the record, I don't go along in their BA situation that they have with the 65. I think we have 1 or 2 in the State of New Jersey at the present time. I think we look at it more realistically. I think Moody is still looking back in the '30's when we were in a different ballgame. I can't see much difference between the ratings in general in the State of New Jersey and in other states.

MR. MILLER: That being so - and I don't expect you to give any off-the-cuff opinion on it - isn't a state or aren't the municipalities in a rather peculiar position? You have three rating services. They each might rate and if one of them rates you down, the other two don't do you any good. Is there any way of correcting for that?

MR. PFEIFFER: I can't see any at the moment. We are competitive - Moody's and Standard and Poor's. Now Dun and Bradstreet doesn't rate issues per se as we do. If there is a difference of opinion in one rating, that could happen. That's only natural. When they are two notches apart, then one of us is decidedly wrong. Fortunately we don't see that happen very often. When it does occur -- and Jefferson Township is one in particular that we noted. We weren't asked to rate the issue. We observed immediately that

there were two distinct issues and surprised when Moody put the BA on it. But to get back to your question, if we watch and we are more than one grade away, one of us is wrong. What can be done about it? I can't say. We do everything we can. We look into it. We say, "Did we make a mistake?" We are human and we do make mistakes from time to time.

MR. MILLER: Do you rerate issues which come out of states where they have a state rating agency?

MR. PFEIFFER: Oh, yes.

MR. MILLER: Do you differ very much with the state rating agencies?

MR. PFEIFFER: No.

MR. MILLER: You pretty much agree with them?

MR. PFEIFFER: That's right.

MR. MILLER: To your knowledge does the market pay particularly much attention to a state rating?

MR. PFEIFFER: Definitely, no question about it.

MR. MILLER: Would that be, do you think, any kind of solution to our problem?

MR. PFEIFFER: I think it would. I think it would have quite a strong effect on it.

MR. MILLER: Thank you very much.

MR. MOAK: Just one question: You have a pricing service and you price bonds.--

MR. PFEIFFER: That's correct.

MR. MOAK: [Continuing] -- for ---

MR. PFEIFFER: -- municipal corporates.

MR. MOAK: Primarily, I take it, for evaluation purposes.

MR. PFEIFFER: That's correct.

MR. MOAK: Does that extend only to the issues rated by Standard and Poor's or does it extend beyond it?

MR. PFEIFFER: It extends beyond it - any issue where we can get an indication of what the bond is selling for.

MR. MOAK: Thank you.

MR. DILWORTH: If there were a state rating agency, would you feel that its ratings would have immediate acceptance in the market or do you think this is a matter ---

MR. PFEIFFER: A state rating agency?

MR. DILWORTH: Yes.

MR. PFEIFFER: No, it would not have. As a good example, North Carolina is doing a terrific job. Now it might have an effect, and I am sure it does, within the state - with the banks within the state. But, no, they haven't gained acceptance.

MR. MILLER: One other question along the same line: New Jersey is or was one of very few states that had a strong state-administrative supervision over municipal budget and borrowing and this over the years since the '30's, at least. Does this, in fact, operate to strengthen our municipal credit rating?

MR. PFEIFFER: My feeling is that it does, yes.

MR. MILLER: If it does, and I would assume it would, why is it that doesn't overcome some of the other features which apparently - well, you haven't said they have hurt us - but if we did have other features, would it as a rating matter help to overcome this?

MR. PFEIFFER: Oh, yes.

MR. MAGOVERN: Thank you very much, Mr. Pfeiffer.

It is quite obvious that there must have been some mixup in the notice of this hearing and the regulations and details that went out. We are proceeding without the filing of statement.

If it should appear when this hearing is over this morning that some witness would like to reopen or we should feel the need for a further hearing or an adjourned hearing, we may do that. At this juncture, however, I think we should proceed right along this way and I hope it is satisfactory.

Mr. Breen of John J. Ryan, and I believe you have an associate with you. Would you give your names to the secretary, please.

[David Breen and Jack Rosenthal identify themselves.]

D A V I D B R E E N: Gentlemen, I don't know how pertinent this actually is going to be. As I said, I was not notified until Thursday afternoon. I haven't prepared anything but I thought that I would perhaps deliver a talk that I gave before the New York Municipal Analysts Group some two or three weeks ago, and I think it might be helpful.

Those of you who are familiar with New Jersey revenue financing --

MR. MAGOVERN: Do you have copies there?

MR. BREEN: Yes, I do.

MR. MAGOVERN: Enough for the Committee?

MR. BREEN: Yes, I believe there will be enough.

MR. MAGOVERN: Do you want to file this and just tell us about it or did you want to read it in full?

MR. BREEN: Well, it seems it may take a little time. I probably can just talk about it generally and file it, and then you probably will have some questions that I hope I can answer for you.

MR. MAGOVERN: Not to digress, but Mr. Pfeiffer, I believe is also going to file his talk with us. So it would be helpful to the Committee if you would summarize.

MR. BREEN: I realize that and I will try to do it to the best of my ability.

Primarily this talk that I gave was based on a legal opinion handed down by John Trimble of Caldwell, Trimble and Mitchell, now Mudge, Rose Bond Counsel in New York. And in this statement, Mr. Trimble points out that New Jersey Revenue Authority Bonds are, in fact, more secure under the law than are those municipal bonds which are supported by general taxation, because of various recourses that bondholders have on the revenue bonds as opposed to the general obligation bonds, and the various ways in which you can act in foreclosure proceedings, and so on and so forth, which are much quicker under this Act than those are generally under the strict general

obligation bonds. And I felt that this was very important, myself, having been a former municipal official myself, chairman of a utility authority down in South Brunswick. I have felt very strongly about these things for a number of years now. And I just feel that it's almost incomprehensible today to believe that any municipality can long exist without water and/or sewer services, especially sewer service. And, in fact, we know that building bans are being employed now in various areas of the State because of the sewer needs.

I do feel very strongly that the sewer revenue bond need not necessarily be a double-barrelled obligation, as is done quite frequently now. I think I should make a distinction here, though, - a regional sewer authority as opposed to a municipal sewer authority - because obviously a regional sewer authority couldn't possibly work unless it had contracts with those municipalities that it served. So, therefore, the service contracts are needed. But I don't believe that it should necessarily follow that, as far as a local municipal authority, the service contract should be needed as there seems to be more than enough recourse for the bondholder to foreclose or go into receivership, or what-have-you, if it becomes necessary.

I feel very strongly that the sewer revenue bonds should be independently rated, as opposed to a municipality. I think they should be placed in a class by themselves.

I guess that's really just about as much of a summary as I can give. I take it at your own leisure you can go into it and get something a little more out of it.

MR. MAGOVERN: I wasn't sure, Mr. Breen, whether I heard you mention authorities and authority revenue bonds. Are you classifying authorities into the same group as authority revenue bonds?

MR. BREEN: No. I don't think you can do that. I think I'm talking primarily and solely about sewer authorities. I am not going to classify a sewer authority in the same class as an electric authority or gas authority or something like that, which I don't believe we have any of in the State anyway. But I don't think you can put them all together. The law isn't written that way. I mean, the law is written for sewer revenue bonds and this is what I'm primarily interested in. And, seeing that we're going to have a great deal of sewer revenue financing, or what-have-you, in the State in the future, this I think is some place where a great deal of education is needed.

MR. MAGOVERN: Limiting it to the sewer authorities, or sewer revenue bonds you classify there, it wouldn't disturb you one way or the other whether it was a separate authority or not? You classify security on the same basis?

MR. BREEN: Well, as I said, I believe that a sewer revenue bond under an authority, as set up by Chapter 138, Laws of New Jersey, 1946, is more secure than is a general obligation bond, and less likely to default, simply, as I said, because you can't live without sewer service. And I think an individual is going to pay that sewer bill before maybe he will pay his local school tax.

MR. MAGOVERN: Do any members of the Committee have any questions of Mr. Breen?

MR. MOAK: Does the extension of the general obligation pledge to the authority bonds have the effect eventually of diluting the value of the general obligation pledge?

MR. BREEN: No, I don't believe so. It has been a common practice to have, what we call in the business, service contracts, whereby a local municipality will back up it's authority anywhere from the required reserves all

for instance, Bergen County Sewer Authority, - they have service contracts. I believe each municipality levies taxes to pay a proportionate share. Now, if you have a BA rated community, say all seven communities were BA rated, I doubt very much that their tax collections would go up any greater just because they have a regional sewer authority. Therefore, I would say probably not. It would be a BA. But I'm talking now where you've got a local municipality it's strictly a revenue type of thing. They are empowered to go in there and levy the rates that are necessary to maintain that system for debt service and for the maintenance and operation of the system as well as extensions. So there is a difference.

MR. JESSER: Where you have your group of communities involved in a sewer authority, it's inconceivable to me that the authority could ever enforce any penalty against a municipality, such as turning off or closing the connection.

MR. BREEN: I don't see why you should say that then.

MR. JESSER: Well, because the Board of Health wouldn't permit it.

MR. BREEN: Well, I think, under the law that the authority was set up under, they could in fact. But I'm not an attorney. I believe that they could in fact turn off that service.

MR. JESSER: Well, I raised this question and it has come back that the Board of Health would not permit them to do it, you know, for one hour.

MR. BREEN: Well, would the Board of Health then permit, or would some State agency then permit the authority to go into default?

MR. JESSER: Then they would have to work something out. It's understandable, though, because there is no other course.

MR. BREEN: Well, I think, here again, we have trustees appointed by the various authorities to oversee

the way up to the actual backing of the bonds themselves. There are various types of service contracts. I just don't believe, myself, that there should be a necessity for a service contract but, as long as bonds are sold this way, if investors feel that they are more secure, which I question, then I would have no objection, of course, to going along with it. I just don't feel that there is a need for it, that's all, except, as I said, on a regional basis. Of course, it's obvious you have to have contracts there.

MR. JESSER: If a sewer authority involves seven communities and the seven communities, just for example, all have BA ratings, would it be possible for the authority, because of the diversification, the fact that you say they're not going to turn off - they are not going to permit them to turn off the valves and back up the sewers -- would it be possible for the authority to have a rating of A or BAA?

MR. BREEN: I think that's a question for the rating services.

MR. JESSER: This is your point, though, isn't it?

MR. BREEN: No. I said there's a difference. On a regional basis it's different than on a local basis. On a local basis, I think it's an altogether different animal and I think that they should be rated perhaps higher than a local municipality. If we have a BAA rating, say for South Brunswick, I think perhaps the South Brunswick Utility Authority could have an A rating, because of the recourse that bondholders have.

MR. JESSER: Well, that's my point, only instead of having one municipality - up in Bergen County we have five or six or seven or even more.

MR. BREEN: Right.

MR. JESSER: And the idea is that you get your diversification, in other words that the authority has a better credit standing and rating than any one of the average municipalities.

MR. BREEN: Generally speaking on a regional basis -

MR. MILLER: We've had various suggestions, and they've been in the Legislature too, for the enactment of a municipal revenue bond law which would expand the concept. I thought perhaps in your experience you might have run into the need for it or the lack of need for it.

MR. BREEN: No. I can't say that I have because - I mean, in effect, you could almost - well, it's not a revenue type of thing but you can go through an assessment program, you can have a user charge for utility service, where the charge for the service is something like, you know, an authority would do only what could be done under a municipal operation.

MR. MILLER: That being so, why should a single municipality, if there are any left that are going to have sewerage systems, create an authority just to serve its own municipality?

MR. BREEN: Well, there may be some areas where they can't afford a big regional authority.

MR. MILLER: All right, now, but why should they go to an authority? Why shouldn't they do it as a municipal utility operated by the municipal government?

MR. BREEN: Well, they would run into problems of debt limit. I believe that's one of the reasons why the authorities are created.

MR. MILLER: They're deductions from the debt limit, if they're self-liquidating.

MR. BREEN: Well, if they're self-liquidating.

MR. MILLER: Well, they would have to be if they're an authority, so they probably would be -

MR. BREEN: Well, if they are an authority.

MR. MILLER: And they probably could still make themselves liquidating as a municipality.

MR. BREEN: Well, they could do it through user charges.

MR. MILLER: Yes.

these things, to prevent their happening. This is for the protection of bondholders. Actually, it's for the protection of everybody. That's the job of a good trustee, qualified trustee to go in there and see that these things do not happen, that the bills are met when presented.

MR. MILLER: Mr. Breen, do you have any experience between, let's say, two different types of parking authority bonds, those where the municipality did not, at the outset, pledge its full faith and credit, and those where they did, and any difference in the interest rates?

MR. BREEN: From my personal experience, no.

MR. MILLER: Are there now any parking authority bonds issued which do not have the municipal guarantee?

MR. BREEN: Well, I would think there are. I know of one that is thinking of what way to go, actually, that I'm talking to. And as we get further into it, I think we will have to look into it very thoroughly to see which is going to be their best way. But, again, I am not all that knowledgeable when it comes down to parking authorities. My main interest has always been in sewer.

MR. MILLER: Oh, I'm sorry. Well, taking sewer then, do you have any opinion about the advisability for New Jersey to enact a revenue bond law so that municipalities could operate - particularly a single municipality could operate a sewer system under that kind of financing as distinguished from the need to create an authority to do it, although I realize it really isn't that necessary.

MR. BREEN: No. And it would just seem to me to be kind of superfluous, really. But you can do it now.

MR. MILLER: Is there anything, though, about the remedies, which you point out very effectively in your paper, which are available to the holder of a revenue bond under an authority which aren't parallel for revenue bonds issued by a municipality?

MR. BREEN: I really don't know.

Scranton, Pennsylvania, had a problem where the city was not going to pay that which it had promised to pay under an agreement, a service type agreement, but the trustee or trustee group of banks stepped in to see that the monies were advanced to prevent a default. I mean, this is obviously their job. It's maybe not their job to lend the money but it's their job to certainly see that those rates are increased to a point where they will be self-supporting again.

MR. MILLER: Thank you.

MR. MAGOVERN: Mr. Rosenthal, you had something to say?

MR. ROSENTHAL: Well, I started to ask some things before, in that you were asking some questions of some people up here that necessarily weren't coming up with the answers or weren't giving you some answers and I thought maybe I could help you at the time on some specifics.

I'm connected strictly in sales with our firm and marketing of bonds in the State of New Jersey, in municipalities, and our past experience, as I said before, - I think we do as much underwriting in this State as any firm and we usually manage the syndicates we're involved in. And we take a look at these municipalities with an eye to what we need and how to sell them. And I disagree that Jersey municipalities sell cheaper than the general run in the country, as a whole. Sure, we have adjacent states, like New York and Pennsylvania, that do have state income tax, where they're more beneficial, let's say, to certain residents to buy their locals rather than come across the river and buy Jersey bonds for New York residents. And being there are more people in New York, they'll stick with that. Our joint authorities, back and forth between New York and New Jersey, - we have tremendous success and they sell much higher, I think, than authorities throughout the country. The New Jersey Turnpike gets away with murder,

MR. BREEN: But I don't see any advantage.

MR. MILLER: Well, wouldn't the same user charge permit municipal operation outside the debt limit?

MR. BREEN: Yes, if it's self-supported.

MR. MILLER: Well, why don't more of them do it?

MR. BREEN: I don't know.

MR. MILLER: Are they being advised to create authorities when they don't need them?

MR. BREEN: Well, no. I think they're running into problems. You have local officials who are elected, on a part-time basis, who consequently can't be cognizant of all of the things going on. I have to agree with what Mr. Dalin said before. I think it would be very advisable for these municipalities to retain competent, financial consulting services. And I think, if that were to happen, a lot of their problems could be solved. I won't say it's going to happen overnight or something like that because we've been going on for years now and the problems are becoming more and more complex. And I frankly feel for a lot of these local officials who have to go to business during the day and many times they are out three or four nights a week trying to conduct municipal business.

MR. MILLER: That's sure true. One other thing. You talked about sewer authorities. I take it your remarks also go to utility authorities which cover both sewer and water?

MR. BREEN: Right.

MR. MILLER: The same thing.

MR. BREEN: Yes. Well, as you pointed out, they have to be self-supporting, under law. And the job of a good, competent trustee is to see that they are self-supporting. If they're not, then some remedy will have to be worked out, and I think they always have been. It was brought to my attention here, a city, I believe

normally, on a bond issue compared to what other authorities in the country will be going for. The Port Authority, the same way. When we get into New Jersey here, sure, we'll have BA loans sell cheaper. That's a fault in our investment community in the fact that we put Moody's Investor Service up here (indicating) someplace where most of us don't believe they belong but, unfortunately, the bankers in this State, particularly who do the buying, give Moody's a holier-than-thou position, where Standard & Poor, and I agree, are very realistic, in recent years, and Dun & Bradstreet, which very few people look at because they don't put a number on it - they'll say, "better medium grade" or something but that takes some thinking about what they mean. We know A, B, C, so it's very easy to say, "Oh, that's A, I'll buy it. BAA, I won't buy it. BA, the book says that's below bank credit quality so we won't buy that." The banks won't buy it other than a local situation.

So we have a problem in marketing these BA bonds because Moody's has put a BA on them. The fact that Standard & Poor's has put a triple B on them, it's still - for the bank examiners, the bankers are scared to buy, they don't want to be subjected to any criticism. So we have to find a way to make Moody see the light, maybe, or today, now that they require a buying of a rating, it's ridiculous that a municipality goes to them if they think they'll give them a BA because they're better off non-rated. The banks will buy non-rated bonds but they won't buy a BA. So, if they don't go and buy the rating, if they think they're going to get a BA, they'll just take that non-rating that they give them for not rating. And many of our top municipalities of the State are not rated. In the past it has been a non-rating because they haven't had enough debt to be rated. Now it's a non-rating because they weren't willing to get up the cash to buy a rating. And sometimes it's detrimental to pay the money to get a rating if it's going to be an adverse rating.

There was another area that you talked about, things that can be done in this State to help market bonds, and I am a strong believer that the financial advisor should be allowed to bid. You asked that question before. There is no criticism of a financial advisor buying the New Jersey Turnpike bonds, being the financial advisor to the Turnpike, - which we were one of them; or city managers, and tell them when to come to market, give them the rate, sit down and negotiate, sign the deal as an advisor and then go ahead and market the bond issue at the right time, at the right price, go in then. What's the difference? What's the difference if you're dealing with the Jersey Turnpike or you're dealing with some township up in Bergen County or someplace else?

MR. MOAK: Is there not this difference, sir, that it is presumed that the New Jersey Turnpike has keen appreciation of the municipal bond market?

MR. ROSENTHAL: Right.

MR. MOAK: Whereas the butcher, the baker, the candlestickmaker, who serve as a part-time official on an authority or municipal board - it cannot be presumed that they have the same keen appreciation.

MR. ROSENTHAL: It's true. That's one of the problems we have. We will go into a municipality and they'll think nothing of inviting investment bankers from the east - it many times involves the east but strictly most of them are located in New York and New Jersey, they're heading the syndicates, - think nothing of going all the way down to Cape May County, go down on a bond issue, and they know damn well what rates they're going to get and they have you drive all the way down there, a man spends his time and then they'll say we reject the issue, when they got a better rate than what they could have possibly dreamed of because the lawyer or the doctor sitting on that board is a financial advisor, and he doesn't know what's going on, I mean from a sophisticated standpoint. And there is no reason why every municipality in this State

should not hire a financial advisor.

MR. MOAK: But my point is --

MR. ROSENTHAL: They shouldn't be listening to some man sitting on this board who spends all his time operating in a hospital or with his accounting books or as a lawyer in court who really isn't following the market.

MR. MOAK: My question is this. If I am ignorant concerning this matter and I hire you as my advisor and you advise me to buy from you at a given price, how do I know that you aren't taking advantage of me.

MR. ROSENTHAL: This is competitive bidding. There must be competitive bidding in this State. We are not negotiating with your municipality. We're coming in there and you'll probably get - if you're an average municipality in this State, you'll probably get anywhere from six to ten bids which will involve anywhere from six to maybe thirty firms that are bidding on your bonds. And the bids are there for everybody to see. And you can see what the next bidder is bidding. You can see if your financial advisor isn't giving you a lot better bid than anybody else has given you, and in many cases he will. But the fact that the figures are there. He isn't going to steal that bond issue from you, not with the competitive bidding we have today. And I would have to say to you that New Jersey is probably one of the most competitive areas in the United States today in the bond bidding business, in the secondary market and in the primary market. There is not anywhere that I can think of in this Country where there is more competition or more firms interested in buying the bond issue. And the only reason that Jersey gets lower bids, in some instances, is because of the rating service, of Moody's reluctance to change its practices of thirty years ago so that a BA bond issue - like Asbury Park gets a BA rating and they have never hired a financial consultant or somebody to try to change that thing or present the facts, and some of these municipalities just

don't get the information in on time. But Moody's was burned back in the depression. I think at that time they had Atlantic City as a triple A bond, if I'm not mistaken, and they've never forgotten that, they've never forgotten that. But on all other issues, our A rated and our BAA's, I'll put those bids againt any state in the Union, other than a few specific states like Texas and a few others, Virginia where you have an exceptional situation, taxwise. And the number of bids that you get here in this State - and I think when we do go off in bidding it's because maybe we've had more issues come to market in the period, like we see in New England sometimes, where A rated bonds in this State will sell much higher than they will sell in Massachusetts when they've had quite a few come to market over a short period of time and the banks cannot absorb them.

So it gets back to the law of supply and demand, and the number of issues coming. We bought an issue just last week of Gloucester County which Moody had changed the rating on, most recently, to an A rating. That issue sold higher, probably, than any A rated bond that came out last week in all of the United States.

MR. JESSER: Do you know what percentage of an issue goes into the bank portfolio and what goes out, in general?

MR. ROSENTHAL: I know when we buy them.

MR. JESSER: What percentage would go in their bank portfolio?

MR. ROSENTHAL: What rated bond?

MR. JESSER: Well, an A.

MR. ROSENTHAL: An A rated bond, 90 percent of the issue will go into the banks in this State, or out of the State.

MR. JESSER: How many would go into the State, of the --

MR. ROSENTHAL: Of the banks in this --

MR. JESSER: New Jersey.

MR. ROSENTHAL: I would say the banks in this State do an excellent job of supporting the bond issues. And there are certain counties in this State, the banks of certain counties that have a tremendous reputation, much better than other counties in this State, of backing the issues, the smaller issues, within the State.

Now I'm not going to get into the counties that do a good job or that don't do a good job. But I would say that the bond issues, in my opinion, get excellent support from the banks in this State.

MR. MOAK: Was this true in 1969 even when, nationally, the banks absorbed almost no additional municipal --

MR. ROSENTHAL: No, it couldn't have been true. We were in a tight money market and naturally it couldn't have been true. But, relatively speaking. You're talking about the support of banks in other states, now?

MR. MOAK: No, I'm speaking nationally. The banks have about 50 percent of the total holdings of municipal obligations --

MR. ROSENTHAL: Correct.

MR. MOAK: -- which has been increasing, as a percentage, and has been increasing in dollar volume up to '68, but in '69 both the percentage of total holdings - that decreased --

MR. ROSENTHAL: Their ability to buy went down in that period.

MR. MOAK: And my question is, during that period were you still successful in that being your primary market in New Jersey?

MR. ROSENTHAL: On an A rated bond, yes, no question about it. Now their ability to buy was not as great and, of course, that was relative, but the support from the banks - if that's what you're talking about - Jersey banks support tremendously Jersey bond issues, as a rule. Now as soon

as a bond issue starts to fall in grade, under BAA, support goes down and rightly so, probably, from their standpoint. Not too many bank officers want to take the risk, particularly outside of their county, of buying a BA bond - for what? to be subjected to the bank examiners of this State saying that you have over 5 percent of your holdings in BA bonds and get rid of them, or don't buy any more. The pressure comes from there. That's why they don't buy them. They would love to buy them for the yield. The yield is great on BA bonds. And we know, everybody in the investment community knows, that the credit is great. Take a bond like Parsippany-Troy Hills, BA rated, - who wouldn't want to own that bond at the price it would have to sell because Moody's put the BA rating on it, backed by the full faith and credit of that municipality?

Ask the man from Standard and Poor what he thinks of Parsippany-Troy Hills - and I've never seen what he writes, you know. That's the problem. The marketing of bonds? There's no trouble marketing bonds in this State and we'll get as good a rate in this State as any other state.

MR. MAGOVERN: Well, would you want to comment on any view you might have with respect to a state rating authority?

MR. ROSENTHAL: Yes, I have a few views on that. My feeling is, you run into one problem, as the gentleman here mentioned, you start to dilute the quality of the state itself, if you have them state backed. I don't know exactly how you plan to have this. And if the State of New Jersey should ever lose its triple A rating because now it has these contingencies outstanding - we've seen this happen in other states. It happened in the State of New York where the rating has gone down because it is indirectly and morally backing a lot of authorities. There is a strong moral obligation - housing authorities and dormitory authorities and one thing or another, so

that the rating has been dropped because of all these contingencies. What is the cost to the State of New Jersey if they go into a bond bank and Moody's decides to drop them to a double A bond? Now you're talking big money because if you drop a rating on a state level, when you're going to come out with some size, and the State has still got these college bonds - has still got, I think, about \$750 million more to come, right?, on that \$900 million program - the State is going to have trouble marketing its own bonds. And the last two or three times the State came to market the investors and bankers that bought the issues took a good bath on them, and they're not too quick to buy State of New Jersey bonds anymore and market them.

Now if the State starts to come with many more issues besides this \$900 million program they have now, I'm wondering how long they're going to keep a triple A rating. And many people in the investment community are going to wonder about that.

Then the expense of running this program, I don't know if you are going to lose more in trying to build up the things that are the problem of the underwriting, and these lower rated bond issues - why don't they get better ratings? - seeing that they get financial advisors, seeing that they come to market at the proper time. Timing is so important to save them money. Issuing, the way to issue; all the things that a good sound financial advisor would do at almost no cost to them. The cost to these small municipalities is peanuts. There isn't a financial advisor in the business that would charge much money, compared to some of these fees that these attorneys get, and so forth, that I've seen for some of these large authorities. Most of the bond houses work very inexpensively, very inexpensively.

MR. MAGOVERN: Mr. Breen, do you have something?

MR. BREEN: Yes. I was going to say, I've often

questioned the need for a bond bank, to begin with, anyway. I understand the idea behind it but if we have local school districts and local municipalities in this State that have BA ratings, and I can think of a number of them that probably should be rated better, - wouldn't it be better to follow a formula, such as New York State has done by instituting an income tax in the State of New Jersey and thereby giving a more equitable share of the revenues to these school districts. I don't see why the credit of the State should be impaired when it could be done another way completely.

MR. MILLER: The object is, of course, to force more people into buying New Jersey bonds by enacting the New Jersey income tax. You're before the wrong Task Force for that.

MR. ROSENTHAL: I think it would be easier to pass the bond bank.

MR. BREEN: At the same time, this may be so but I think we've got to look at it realistically too. I mean, New Jersey has had an horrendous history of extremely high property taxes. I mean, I pay my taxes so I know.

MR. MAGOVERN: It will be part of the record that maybe we should forward a section of this record to the proper Task Force.

MR. BREEN: I would like to say one thing further in regard to a question that was raised before on bond anticipation notes. I think bond anticipation notes very definitely serve a purpose. I think a lot of people confuse them. I do agree, however that they should not go out indefinitely. I think a three year period of time is sufficient, myself, because there is nothing to say you're not going to play Russian roulette with these things. You go out at the end of five years and you find yourself in a bad bond market, what do you do? run down to Trenton and say, "Look, fellows, I need two more years," or something

like that? We've got to be realistic in that regard. I think at the end of the three year period they should be getting those bonds permanently financed, those notes. But I think during the period of construction if they are in a bad bond market I think they should very definitely go to bond anticipation notes in the hope that the market will change. Anything can happen over a twelve month period of time, or longer, - to have them come out and issue a permanent financing at that time.

MR. MAGOVERN: Could I get back for a moment to your views with respect to a state rating authority as contrasted to your views on the state banking system.

MR. ROSENTHAL: My views?

MR. MAGOVERN: Yes.

MR. ROSENTHAL: I don't think the state rating authority will affect one thing. The only area where it may help us is possibly in the area of, if the State Examiners will approve of the state rating, then it would be worthwhile, just for that alone. Otherwise, the general investment community - it won't have any effect at all. They are not concerned with what Dun & Bradstreet rates the bonds; they're not going to worry about what the State does. But if the banks will recognize it and respect it, it will be a wonderful thing.

MR. MAGOVERN: Any members of the Commission have anything to add?

MR. JESSER: I would just like to say this, if a bank buys a BA bond but it backs it up with a credit analysis, as it would on a loan, where it makes its own independent credit judgment, the bank examiner certainly has to take a look at that. He won't say that any bonds you have with a BA or less rating --

MR. ROSENTHAL: True. But put yourself in the position of the average banker, not the man that stands up here who has a little backbone and does what he thinks is the thing to do, but the average banker. The average

banker does not want to be criticized for his actions. It's not worth the action. He can buy the bonds. Why does he have to stick his neck out that possibly he was wrong or to go to that effort, other than he's getting deposits from the local community in his bank, in that area, you see. And there's a secondary reason for buying local BA loans. But in order to sell a \$5 million BA loan, you need more backing than just the local bank, you need them throughout the whole State. But the banker at the other end of the State he's not going to stick his neck out for some community up in Bergen County that has a BA rating, if there were one, and subject himself to that problem - Why? to buy \$50,000 worth of bonds? The heck with it, we just don't buy it. Or to the board of directors breathing down his neck at the next board meeting - Why did you buy those bonds? You're dealing with a human being. It's easier to play it safe.

MR. MAGOVERN: Does any other member of the Committee have any questions? (No questions.)

Thank you very much, Mr. Breen and Mr. Rosenthal.

We have one more registered witness and that is the New Jersey City Management Association, Mr. McHugh and Mr. Meholick.

We will take a five minute recess.

(Recess)

After recess

MR. MAGOVERN: Mr. McHugh and Mr. Meholick. Is Mr. McHugh here?

MR. MEHOLICK: Unfortunately, he could not attend so I will present the statement.

MR. MAGOVERN: All right. Mr. Meholick.

G E O R G E T. M E H O L I C K: I am representing the New Jersey City Management Association as one of its Past Presidents. (For statement, see p.116)

MR. MILLER: Aren't you also the Business Administrator of the fastest growing township in New Jersey?

MR. MEHOLICK: Yes, I'm also that.

MR. MILLER: About 100,000 population isn't it?

MR. MEHOLICK: If you say so, I will agree.

SENATOR CRABIEL: I want you to know this is Middlesex County day.

MR. MEHOLICK: I am representing the New Jersey City Managers, State of New Jersey City Managers.

I will try to briefly summarize my statement. I made it into three components, namely, introduction, some of the things that we ought to know and talk about, some of the problems that I see, and then recommendations.

In the introductory remarks I call attention to the problems of the '60's, in terms of municipal financing, and I say that they are still here and have become very critical. In fact, while the sixties were dubbed as the decade of protest and unheralded confrontation, the very foundation of local government was being shaken and the viability of our being able to meet this challenge was questioned.

I do want to call your attention to the fact that municipal debt has reached an all-time high; interest costs are at the highest levels in history; and urban needs are critical, the most critical now, with the greatest stress, as you know, being placed on the conservation of our natural resources, human ecology, etc.

I also, in the introductory remarks, make reference a Dr. Paul Ehrlick in his recent book titled The Population Bomb. He states that if we continue to grow at our present rate, we will double our population within the next thirty years and that we will have to in effect double the capital improvements that have been built since the days of our founding fathers.

So, as a broad overview, it appears to me and it appears to our organization of city managers that we must be cognizant of this fact that we have a tremendous problem and a backlog, so to speak.

We feel that technology and science got us where we are, hopefully they will take us out of this problem.

I state, starting with page two, some of the problems that city managers run across. We state that if the decade of the '60's saw the greatest growth in municipal debt - and you will see that on page three - I have an exhibit there where I show for approximately ten years, from '56 or '57 through '67, a growth of \$17,560,000,000 to something like \$37,500,000,000, or almost double.

We feel that in the decade of the '70's it is safe to predict that you haven't seen anything yet in terms of capital needs. I list some of the ones that we have talked about in our Association meeting. They comprise such things as housing, public works programs, transportation, and the like.

Now, getting down to the recommendations. Before I get into that, I would like to put into the record this paragraph that I have on page 4, about the center of the page:

"These are some of the constraints and problems that confront local administrators today and in the future. In addition, the competitive money market requires, indeed mandates, that the finance administrator of today be very knowledgeable about the municipal bond

market, its trends and marketing techniques so that municipal bond sales will be sold at costs which local governments can justify and afford to pay."

Now, going into the recommendations. I have something like 12 recommendations - I should say "we" have, the New Jersey City Management Association.

Exhibit "A", as I indicated earlier, outlines the latest figures on municipal debt which is, in a sense, doubled over the last ten years. New Jersey municipalities pretty well follow this trend. Therefore, we respectfully submit the following for your study and review:

1. Since approximately one-third of the municipal debt in Exhibit "A" is revenue bonds, we feel that self-liquidating bonds should be encouraged but the pledging of the full faith and credit of the municipality is essential if these bonds are to be successful in the bond markets of the future. A good example is the New Jersey statutes that you have now on the books concerning swimming pool facilities, acquisition and operation, - a self-liquidating utility, pledging the full faith and credit of the municipality.

2. We feel that municipal bonds should be exempt from all or any State or Federal taxes. A recent attempt has been made to remove such exemption.

3. While pay-as-you-go is a laudable principle and should be used when a community is wealthy enough to utilize this means, we find that the very great majority of local governments must continue to look for short and long-term borrowing or fall far behind in needed capital construction and equipment.

4. I strongly urge the creation of a central credit agency which will serve all New Jersey municipalities. This agency would assist all communities who are considering bond issues and, in particular, many New Jersey communities who have no knowledge of marketing.- I guess that has

already been brought up very emphatically here. - no knowledge of marketing procedures and time after time fail to receive any bids.

This central credit agency could very well become a part of the debt management program that the Department of Community Affairs already administers through the Division of Local Finance.

I might digress and say, it is our opinion, the opinion of the New Jersey City Management Association, and I am sure shared by the New Jersey Finance Officers Association, that this debt management program is indeed a wonderful thing and should be enlarged and retained.

5. The present high interest rates on municipal bonds must be reduced. It appears it may be several years before municipal bond investors will feel free to purchase long-term municipal bonds with confidence that the income will be tax exempt throughout the life of the municipal bond.

We are saying that something will have to be done to continually reassure this. One way to do it, possibly, is to establish a permanent and unequivocal tax exemption. We also suggest the possibility of say a federal urban bank - rather than use the word "bank" a depository or a system to back up municipal bonds by guaranteed interest payments until refinancing needs are met. We're talking here in cases where refunding needs have to be met or where there is a dire need to fill a community need and the financial facilities are not available.

6. And this was discussed earlier in the meeting. I believe your Consultant brought this out, that the Joint Economic Committee of the Congress of the United States, in a study published in December, 1966, estimated that the total needs of local government would rise from about \$33,560 million in 1965 to more than \$65,000 million in 1975. Thus the inter-relationship of short and long term financing, interest costs, available and interested markets and the ability of local government to raise needed

funds should be very carefully examined as never before in the light of the expenditures of this magnitude of money. Therefore, it seems to us that one ought to seriously consider the continuance and expansion of the Debt Management Program presently limited in scope, funding and areas of responsibility. I further suggest that the following matters be examined by the Debt Management Group and request that they report to you their findings, both pro and con.

Now we list here something like seven areas that we feel ought to be considered, in addition to the ones I have mentioned earlier. And you've heard some of these already:

Increase state and federal grants-in-aid to local governments, particularly where urban decay and financing for capital improvements for same are impossible and improbable by local revenue sources. This, again, is the possibility of the Federal Bank coming in or the State Urban Bank.

(b) Investment of state and local government pension and retirement funds, along with other funds not needed in short and long term municipal bonds. This is an attempt to get additional money out into the marketplace.

(c) Improving your marketing programs. This may mean a program of inducing individuals of modest means who have been buying taxable securities to choose tax exempt municipal securities as part of his investment choices.

(d) A possible revision of the statutory debt limits for municipal and school financing. In particular, the provision of averaging out the last three years of assessed valuation seems ultra-conservative. By that I'm referring to when you have your community reassessed or revalued, before you can get the full impact of that revaluation you must wait almost four years because each year you get a succeeding third added on. The benefits of

reevaluation are not realized until almost four years have gone by.

(e) That a State-wide reevaluation program be instituted. In my opinion, there are startling differences, to say the least, not only in method and approach but in the equalization program.

(f) And this is one I think ought to really be examined carefully because of the kinds of money we are talking about in the next ten years. Insist that the five-year capital programs be implemented and meaningful. Projections of not only capital program costs but a projection of financing costs which would include temporary financing costs of notes and other related costs should be included. PPBS, or Planned Program Budget Systems should be encouraged which would include alternative actions concerning the proposed capital expenditures and utilize cost-benefit techniques along with PERT techniques. For example, the decision not to build a library because of one alternative not being available, namely that since construction costs go up one-and-a-half percent per month what would be the impact of delaying a needed library construction for one year for some other alternative. In other words, the alternative may be that the market may seem too high. When you consider the possibility of paying higher construction costs the following year, over what your increased interest cost would be, you may well decide to take the former and pass the ordinance and build the library.

(g) Provide local governments with capable and trained consultants who can analyze capital needs and the ability of a given community to finance same. This was talked about earlier this morning. These consultants can be made available from the Central Credit Agency or from the Debt Management Program. In any case, however, this will mean additional state personnel to do this kind of work.

As a result, we feel that while we are talking about spending this kind of money we kind of end up saying somebody must be the watchdog of the treasury. And all of this must be done, of course, with the ability of not only the given communities but the State, through it's total municipalities, to pay the bill.

This, in substance, is the text of our offer.

MR. MAGOVERN: Mr. Meholick, in your item four you speak of an agency that would deal with debt management. You do not go so far as to suggest or recommend any start of a state bonding authority that would act on behalf of municipalities. Would this debt management eventually encompass any such thing as that?

MR. MEHOLICK: It could. However, I don't want to rule out the possibility of help coming from the private sector as well as the municipal sector. I think there is proprietary, as well as municipal, interest involved. And I feel that the creation of a central credit agency in terms of its programming ought to be studied by people who know the business. And I would suggest, as I believe I did earlier, that possibly this should be reviewed by your own debt management people or by somebody who is knowledgeable in the field.

MR. MAGOVERN: This does not, however, as recommended here, encompass a state bonding authority.

MR. MEHOLICK: No, sir. It could very well be. I do not envision that.

MR. MAGOVERN: I'm not sure that I understood your item five where you recommend that there be a backup of municipal bonds by some sort of a federal or state banking undertaking. Apparently it would not be only in the event of the tax status changing but would be in the event of default of any kind?

MR. MEHOLICK: Yes, sir. One of the prime factors, and you've heard it over and over and I will repeat it because it certainly is worth repeating, is, during the

'20's and '30's; when many, many cities in New Jersey defaulted - the municipal bond rating people are very conservative in changing rates. You can notice, and you have already noticed, I'm sure, in previous testimony, the many constraints placed upon this kind of rating. The consideration of some kind of an urban depository - I don't want to use the word "bank" - I talked to Dr. Miller earlier and I said, "What shall we call this thing?" - a backup, a backup source, very much as the banks operate, they have it right on their window - "We insure your deposits up to \$20,000. Don't worry, we're good. Uncle Sam is going to take care of you." I'm suggesting possibly a similar situation. Maybe we ought to guarantee certain kinds of basic costs. They may be interest to carry on the principal, or refunding issues of some kind.

MR. MAGOVERN: Using that example, this would be in effect a charge against the municipalities for the creation of a source of guarantee? Is that what you mean?

MR. MEHOLICK: Yes.

MR. MAGOVERN: Like a re-insuring corporation?

MR. MEHOLICK: Yes, because of the consequences, again, using an analytic technique of an entire system. What are the consequences if you don't do that? We already heard the consequences. I'm trying to make some constructive suggestions that may or may not, you know, work. I'm not sure that they will work. Our intent, I may add, is purely to make recommendations. We know some of them aren't so good. We don't like to think they are many in number, and few in excellence, but we would like to suggest that these are some of the things that we talk about and this is our first opportunity to express them frankly.

MR. MAGOVERN: Since this is aimed at reducing interest rates on municipal securities and would, in effect, be a charge against the municipality, do you visualize

over the period much of a saving to the municipality?

MR. MEHOLICK: It could very well be, depending upon the circumstances of the offer. It could be.

MR. MILLER: Along the same line, if the tax could mean instability created by threats to tax exemption is costing municipalities money, if you believe that those threats will never be more than that, are you suggesting that maybe the municipalities would be well advised, with statutory authority, to comment that in the event that tax exemption is lost that they will accept a new interest rate charge to make up the difference?

MR. MEHOLICK: That's a good idea.

MR. MILLER: Kind of their own guarantee that they will never have to make good on it, they hope?

MR. MEHOLICK: Right. That's an excellent idea. I think that ought to be thrown into the hopper. Certainly it does give the guarantee to the investor into the market and that's who we're concerned about. It was very revealing for me this morning to hear the market speak one way, and they are in the field constantly meeting and talking with people, dealing with municipal officials, - to state that they feel some of our ratings are indeed too conservative and don't meet the needs of the present time because of defaults. And there are so many things that have happened since the 30's to improve the cash basis, for example, of your municipal budget systems. And, Dr. Miller, you know, as well as I, - we've gone through many of these in our seminars - that those fears are pretty well gone or should have been gone.

MR. MILLER: Of course, I agree with you.

MR. MAGOVERN: Does any member of the Committee have any questions?

SENATOR CRABIEL: Mr. Meholick, addressing yourself to the urban bank you're talking about, wouldn't your proposal increase cost to municipalities? Wouldn't we be much better with the bond bank proposal where only

those municipalities that really need help go to the State and get support from the State rather than charging municipalities, whether they need it or not, a fee?

MR. MEHOLICK: That's an interesting thought and one that certainly ought to be looked at more or less by a benefit cost ratio, if you want to use that approach. There is some value, some intrinsic value, it would seem to me, and some moral support value, if you want to use that word, - I've heard that used here quite a bit, morally, - that if all municipalities, whether they needed this or not, in terms of some of the initial programs. It may well be that in the future they may design some programs that could be beneficial to all concerned. But I think the most crying need throughout the State is marketing procedures to many, many municipalities. I think that municipality after municipality will tell you of the need for marketing procedures. Most finance officers and staffs, administrators and city managers, are so busy - they just have to take time out, as we stated in our message, to do this now. But really this could very well be performed by this debt management team and enlarge this concept.

SENATOR CRABIEL: Doesn't the State also work against itself when you talk about investing pension and retirement funds in municipal bonds? Isn't the intent of the pension funds to get the most for the --

MR. MEHOLICK: That's right. So I say that's a provocative question. And I think I mentioned earlier, a lot of the things that we put in there aren't necessarily what we advocate very strongly. I feel that we ought to suggest that these are some of the alternatives that we hear that maybe you might not have heard and no one would tell you. These are things that we hear all along - Why don't you use the pension fund? You know, that's always tossed out. I think we ought to set it to rest one way or another.

SENATOR CRABIEL: And, thirdly, do I understand that you approve of some sort of credit borrowing controls but you think that the present controls are not realistic - limits, I'm talking about, debt limits.

MR. MEHOLICK: Yes. The debt limits, I feel, of something like 7 1/2%, I guess, for schools, plus the municipality. Now, for example, a given community can exceed its school debt limitation but not its municipality, but when you add the two together you're under 7 1/2. I feel, you know, you ought to put a total of all - library; fire districts, if you have them; school districts; and municipality - and say put a ceiling of - I don't know, toss it out here, there are a lot of bond people here - 10%, would that be too high? 10% of assessed valuation being the absolute maximum? Because, as you now have it, once you exceed your local limit you go down to the Director of Local Government and request respectfully for reasons that you have and can show capability and need, and more than likely he will grant you the right to exceed your debt limit. I think, from an over-all marketing point of view, the present ceiling is now, I believe, 7 1/2 with both. The question ought to be, do you want to go above that and, if so, state right out that it ought not to exceed say a combination of library, municipal needs, fire district needs and school needs, etc. I don't think 10% is unusual.

MR. MILLER: You said 10% of assessed, you mean 10% equalized, don't you?

MR. MEHOLICK: 10% equalized, yes, in light of the statistics that I seem to have been reading as to the costs of the programs and the scope of the programs in the next decade.

SENATOR CRABIEL: Now you also talked about putting the faith and credit of a municipality against such things as a swimming pool.

MR. MEHOLICK: Yes.

SENATOR CRABIEL: Isn't there some sort of limit

that the faith and credit ought to be put against things that are unanimously agreed as essential? I mean, where one municipality will argue for a swimming pool, another municipality might not think that's essential, and it would get you up into a debt limit and later on you're going to need sewers or something else.

MR. MEHOLICK: Absolutely. The matter of priorities and the matter of scale is a continuing policy decision problem in the governing bodies. Hopefully we try. This is why I stress very heavily the need of the five-year capital improvement programs and that when they are filed that the municipalities be required to live up to them. You know, a lot of them file them - I'm not saying they think of them as a joke, they take them as procedural. I think they should be not only procedural but they should be operational, or why bother?

MR. MAGOVERN: Any other member have a question?

MR. JESSER: Yes, one short question, please.

On page 7, paragraph (c) - improve marketing programs by having individuals of modest means who have been buying taxable securities choose tax exempt.

Do you have any idea how you would implement that program?

MR. MEHOLICK: Well, again, that was a provocative suggestion but a possibility because we are getting more and more people in the so-called middleclass, the affluent class, and many of them want to create trust funds for many reasons, somehow or other, not directly from a municipality but possibly through our marketing people, or possibly, if the debt management program becomes say the marketing system for our State, that we ought to try to sell this idea, that there is nothing wrong with a tax exempt municipal bond, if you are going to buy and set up these bonds for an educational trust fund, for your children, for marriage or whatever it is.

MR. JESSER: I think we must say there that if you want to really implement that the rate would have to be compatible. Somebody in the 20 or 30% income tax bracket you're not even going to get them to switch from corporate bonds into tax frees unless it made sense because of the increase in yield.

MR. MEHOLICK: Well, I don't know how much money this would mean but it has been talked about that possibly we have not done a good job on it. But we do know that the people who buy our bonds market into trust accounts with these same people. It's an idea. Again, it should be looked into and either laid to rest or tossed out.

MR. MAGOVERN: Any other questions?

Thank you very much, Mr. Meholick.

Mr. Rochlin of Tecott Jackson & Company

A R T H U R R O C H L I N: My name is Arthur Rochlin, Principal in the firm of Tecott Jackson & Company, dealers in municipal securities, located in Newark.

First of all, to my knowledge we did not receive any official notice of this sitting of the Committee. I would appreciate it if we would be notified of any such sitting in the future. And since we did not have any notice and did not hear of this sitting until, I believe it was Friday, I would respectfully request, on behalf of myself and some other gentlemen in our industry, that rather than closing the hearing at the end of this meeting that you consider adjourning. I believe that there would be some statements forthcoming from them, as well as from my firm, with a little bit more preparation.

I would like to direct myself to a number of things that were stated here by various of your witnesses, particularly concerning, first of all, the bond fund. I'm not really that familiar with it but my understanding is that it would be a state agency which would sell its own obligations and, in turn, purchase the obligations of

those municipalities from the state that needed this type of financial help.

I don't think that this is a fine solution to the problem. There are about 60-odd municipalities in the State which are rated BA by Moody's. A large percentage of that, I believe, is school district bonds. And I think that the problem of selling these bonds at a more realistic interest rate relative to their absolute quality, on the basis of analysis, might be solved by a more constructive approach to analysis.

Before, one gentleman was talking about the value of New York State School District Bonds because of the laws pertaining to them, which give the bondholder a great deal of protection. The laws pertaining to school districts in New Jersey are also extremely strong. However, I don't think they have been as well publicized.

It seems hard for me to understand why a school district, any school district, in the State of New Jersey would be rated lower than BAA, considering the various State laws applicable to their debt. In addition, the volume of bond issues of this lower quality, the total absolute dollar amount over any given year is not that great. And really, I believe, we're dealing with what is a local problem, a problem to be handled within the State.

When you create a State agency, such as Pennsylvania General State Authority or any of these others, you are taking the financing to what we call the general market. There are local markets for municipals and there are general markets for municipals. General markets are generally - what we call general market bonds are generally bought across the country by various banks and institutions, usually your larger banks and institutions. And I somehow doubt that there would be enough of a volume of these types of issues that we're discussing in order to generate the need for something that would be

of a size to be general market, because here we're talking about issues of \$50 million and \$100 million at a clip; we're not talking about five, ten or fifteen million dollars. Don't misunderstand me, that's a lot of money too, but I believe it can be raised locally.

Most of your school district bonds in New Jersey are sold within the State. Most of your BA bonds, school district or non-school district, are sold within the State. They are sold to individuals. They are sold to local banks. And these individuals and banks have been able, up until now, to absorb virtually all of the bonds that have come to issue.

On the negative side of the coin, as far as a state bond bank is concerned, in the two states that we call neighbors, New York and Pennsylvania, they have set up state agencies to do additional financing which they did not want to do directly.

There are not too many people in the industry that would disagree with me when I say that I feel this has definitely hurt the credit of the state as far as selling their own general obligation bonds.

When you have something like the New York State Housing Finance Agency, which is generally considered to be a moral obligation of the State, and we are talking basically about an agency which I believe would be considered along the same line, it does have an effect on the way bond underwriters look at the total outstanding debt of the State of New York, and it would have an effect, albeit since this would probably be relatively small, a small effect on the State of New Jersey.

The State of New Jersey, I think, has some very pressing needs. It's a fast-growing state. And many of these things will probably be able to be done best on the State level, which will entail State financing. I think the cost of having the rating of the State of New Jersey reduced would be more than the value to be derived from it

in reducing the interest rate to be paid by 60-odd different municipalities in the State, on a net basis. I have not looked at the figures. I'm just thinking of it in general terms and, of course, the necessary administrative costs of having the agency.

The other possibility that occurs to me, with having a fund which would absorb the new bonds of these smaller municipalities, is there might possibly be a loss of foresight on the part of some of these small municipalities as to what their "needs" are. And there might be some financing done because of the increased ease of financing which might not be in the best long-term interest of the municipality.

We have, over the past several years, been financing not only roads and schools but swimming pools, golf courses, and various other recreational facilities in municipalities. There is a demand for it. But when you look at some of the other problems that we have, where monies can be spent in this State and throughout the country, I personally sometimes wonder whether or not using the borrowing capability of state and local governments for these purposes is in the long-term best interests of the community.

Now, let me skip on to some discussion that we had about sewerage authorities and municipal utility authorities.

One of the big problems that we have, as far as having new sewerage authorities, of which there is a great need in this State for them, is that there is a time lag between the time that the bonds are issued and the authority is functioning. This generally runs two to three years. Now during that period of time the sewerage authority must pay interest, in addition to which, until the authority is running at such a level that it is a self-supporting entity, it may range anywhere from five to ten to fifteen years. As a result, when we in the

industry go to market these various bonds all that the buyer, the insurance company or the bank or the trust department, has to go on, if it is a straight revenue bond, are the engineering projections. Certainly there are laws pertaining to how much of a rate you must charge, etc. However, the ultimate investor basically has to go on engineering projections. And there is a significant difference, in our experience, between having a municipal utility authority or a sewerage authority with some kind of a service contract with a municipality which, in effect, guarantees the bond, and just having a straight sewerage revenue bond, a significant difference in the rate that the authority must pay.

Just as an aside, if my memory serves me correctly, the laws pertaining to municipalities, utility authorities and municipalities and between sewerage authorities and municipalities are somewhat different. I don't know whether this is an error of omission or whether it was intended to be written this way. But it does make it very, very difficult for a municipal utility authority, under the present law, to have an unlimited service agreement, in other words, a service agreement which will back the sewerage authority, where the municipality will back the sewerage authority to an unlimited degree. However, - pardon me, that would be a municipal utility authority. In sewerage authorities these agreements are perfectly fine.

One other comment about these various new authorities which are being set up to solve the sewerage problem, etc.

Many of these sewerage authorities, parking authorities, various other types of revenue or quasi revenue bonds that we have in the state are sold primarily to institutional purchasers throughout the country. The reason for this is that they are generally considered to be more risky and they are generally considered to have a higher rate of return, or they generally do have a higher

rate of return. And it takes a more sophisticated investor to look at them and understand them. Also, most of them are of fairly long duration to maturity. Your local bank and your individual investor generally tends to favor a shorter term obligation rather than 30 or 40 years to maturity.

As a result, these bonds are general market bonds in the sense that they are sold all across the United States, not just here in New Jersey or in the surrounding area. And the value, in terms of selling these bonds, of having some kind of a service agreement with the municipality where there is a backing, when you're talking to a man, in let's say the State of Illinois, should be quite obvious.

Thank you.

MR. MAGOVERN: Thank you very much.

Does any member of the Committee have any questions?

MR. MOAK: I wanted to ask a question on that matter that you're emphasizing. Let's take a municipality which on the one hand would have \$10 million of G.O. debt outstanding, up to its limit, we'll say. If that's its limit, it has that committed. Then it comes along with \$5 million of sewer authority bonds. Now, if you extend the G.O. pledge, in effect, to that, through contracts or otherwise, how much are you downgrading the value of the G.O. bond?

MR. ROCHLIN: Most of the service agreements that I have seen, and this is not all of them by any means, do not extend a G.O. backing per se; what they do is they state that they will make up any and all deficiency in revenues that the sewerage authority does have at any given time.

MR. MOAK: Even if it's not a G.O., even if it's a commitment, it's nevertheless a financial commitment that is bound to have some effect upon the credit of the man who makes the commitment. A man who has no commitment versus a man who has a contingent commitment is in a different

position.

MR. ROCHLIN: We have found, as dealers in bonds, that the effect has been relatively insignificant. The reason for this is that most municipal utility authorities and sewerage authorities are set up to be self-liquidating. In my experience, the effect of the back-up commitment, as it were, on the over-all credit of the municipality has been slight, at worst.

MR. MOAK: Even if they have signed a note which could, under any adverse circumstances, equal 50% of that G.O.P.?

MR. ROCHLIN: You are presuming, in your question, an entire default on the part of the system. I don't think that that is realistic because if there was not a need for the system presumably it would not have been formed. So they are going to have some revenues. And not only that, our laws in the State require that sufficient rates be charged in order to cover the various expenses. In addition to this, most of the sewerage authorities and municipal utility authorities that I have seen, in the trust indenture require rates to be charged at a rate in excess of one times coverage for additional protection, in this case of both the municipality, who is in effect underwriting the debt, indirectly, and the bondholder. And these are some of the reasons why I say in our experience there has been very, very slight, if any, effect upon the rate received by the municipality as a whole.

MR. MAGOVERN: Are there any further questions?

Thank you very much, Mr. Rochlin.

We have a gentleman from Fidelity Union Trust Company who wants to file a statement.

W A L T E R H. S T O L L: I do not have any formal statement to make, not having heard about this until late Friday afternoon, but there were several comments made this morning that I would like to comment upon myself.

First of all, as you will recall, the question came up about Jefferson Township. I am not a lawyer. I was asked in the Bank to interpret Assembly Bill No. 938 - this is the one that has to do with the dual bond issue of Jefferson Township. And in making up my statement for the Bank, I did clear this with a well known bonding firm in New York City which agreed that it was substantially correct.

I will read that to you so you will know what it includes: "An Act known as Assembly Bill 938 was adopted amending New Jersey Statutes, P. L. 1968, Chapter 177. This Act provides that a sum not in excess of \$90 million can be used to assist school districts not able to provide necessary facilities under 18A:33-1. This will be allocated on the basis of not exceeding \$25.00 per student enrolled on September 30, 1968, provided same is approved by the State Board of Education, the Commissioner of Education, the State Treasurer and the Local Finance Board. If a resolution of the State Board of Education was adopted prior to April 1, 1970, determining the allocation of State School Building Aid, it will be construed to be a reference to resident enrollment on September 30, 1968. If the local school board applying for aid had adopted a resolution and/or ordinance becoming effective prior to January 1, 1968, it will not obtain the benefit of this Act. The amount of allocation under this Act shall be used only for the payment of debt service, principal and interest. If permanent bonds were issued under this Act prior to January 13, 1970, they would not qualify."

"In my opinion, any bonds issued under this Act should get a better rating, but that depends on the services."

That, I hope, will clarify the dual situation insofar as Jefferson Township is concerned.

Now, some other questions were brought up about

short-term financing --

MR. MILLER: May I ask, before you go on, did you read the notice of sale in this particular issue and come to the conclusion that it didn't indicate the support that it had?

MR. STOLL: At the time - we bid on the Jefferson bonds, by the way. In our own particular syndicate meeting, in the absence of another rating, we had no other choice but to bid the same rate as we did for the other bonds, although intrinsically we felt they were worth more.

MR. MILLER: And only because of Moody's rating --

MR. STOLL: That's right. If Moody had changed the rating, then it would have made a big difference.

MR. MILLER: Suppose they rated them much too high?

MR. STOLL: Moody kept it the same, they didn't change the rating. We have since, incidentally, sent copies of this to Moody and we are hoping they will take some action on it, but at the moment we have heard nothing favorable as yet.

MR. MILLER: Is Moody's responsible for mistakes?

MR. STOLL: Pardon?

MR. MILLER: In your view, is Moody's responsible if they give you a rating and you follow it and then it turns out to be a bad bond, do you hold Moody's responsible?

MR. STOLL: No. We cannot hold - after all, Moody puts a rating on the bond and we can't hold them responsible. We can put our own interpretation --

MR. MILLER: Would you hold the municipality responsible for Moody's error?

MR. STOLL: No, we don't hold a municipality responsible. We can put our own interpretation on this but when we underwrite bonds we have to be careful that we serve the wants of the investing public.

MR. MILLER: I guess, because the label that's on it, you can't --

MR. STOLL: Well, we can think it's an A and Moody can put a BAA on it. We can tell the customer that but nine times out of ten a customer says, "Well, I still want an A bond." If Moody puts an A on it, he wants the Moody rating.

MR. MILLER: It's a label.

MR. STOLL: So, no matter what we think, it doesn't always count.

Now on the question of short-term bond anticipation notes, I feel that there shouldn't be any ceiling rate as to limit on interest rate. I do feel this, however, that when the bond anticipation note is issued for one year and it's renewed then at least one year's downpayment should be put in the following year's budget for each they extend it beyond that. For example, if a municipality plans to issue a million dollars worth of bonds over 20 years, theoretically they would be paying off \$50,000 a year. Now, if they were to issue bond anticipation notes for the first year, the second year I think they should pay off \$50,000 in the general budget and borrow \$950,000; and the third year, put another \$50,000 in and borrow \$900,000 until the time runs out.

Now the other question came about the New Jersey Finance Agency. I went through the bill and there were several - I think that's known as Senate No. 858. On page 9, line 53, paragraph (e) - it says: "Bonds or notes of the agency may be sold at public or private sale at such price or prices as the agency shall determine." I think that's a little dangerous. I think it leaves itself open for corruption or graft or bribery, perhaps, by having a private sale.

On page 15, line 1, paragraph 15: "The agency shall have power to purchase bonds or notes of the agency out of any funds or money of the agency available therefor." It doesn't tell how. I'm thinking now back

20 or 30 years ago when we had the scandals in Trenton.

Page 17 - I think this is important - line 24, paragraph (c) "To the extent that the State Treasurer shall be the custodian at any time of any funds or moneys due or payable to a governmental unit at any time subsequent to written notice to the State Treasurer from the agency to the effect that such governmental unit has not paid or is in default as to the payment of principal of or interest on any municipal bonds of such governmental unit then held or owned by the agency, the State Treasurer may withhold the payment of such funds or money from such governmental unit until the amount of such principal or interest then due and unpaid has been paid to the agency."

My question is, why should the New Jersey Finance Agency have a priority over a general obligation bond that might be in default, that the State Treasurer would withhold funds to pay just the state agency and not the other holders of obligations?

On page 20, line 1, paragraph 28. In essence, that whole paragraph bypasses every statute on the books for limiting rates of interest or cost to maturity or other factors. In other words, they can do no wrong.

Page 23, line 9, paragraph 36: "All municipal bonds at any time purchased, held or owned by the agency shall upon delivery to the agency be accompanied by all documentation customary in the municipal bond market, including approving bond opinion." I think that should be spelled out, either local or recognized New York municipal bond attorneys. There is a big difference. A lot of investors will not buy a bond issue where you have a local opinion. I've even had cases in the past where we've had issues turned down when Arthur Vanderbilt, who was formerly President of the American Bar Association, had his own law firm in New Jersey and had bond issues turned down because it was not a recognized New York municipal bond firm.

My last point - a question came up about the possible deterioration of credit of the State of New Jersey. I refer to Moody's Bond Survey of March 11, 1968, in commenting on the State of Pennsylvania:

"The Authority was originally conceived to finance predominantly rural districts lacking recognized credit stature. However, like many bureauracies, the Agency has expanded its activities and now competes with underwriters in negotiating loans to any school authority borrowers." It goes on for another two pages and they finally end up by saying: "In view of the continuing diminution of state credit occasioned by a spiraling indebtedness with no prospect of a near term reversal in the trend, the general obligations of the Commonwealth are now rated A." They were dropped.

The State of New York had a similar situation in 1964 where Moody's said: "In reviewing the over-all picture and giving due credence to the preferred position of the State's direct debt, it is our opinion that general obligation debt now properly falls in the high grade rather than prime quality category. Effective today, our rating on the State's general obligation has been reduced to double A."

I can see the same problem happening in New Jersey. We still have quite a few of the \$900 million, believe it or not. I don't like to see bond issues. It costs money to borrow. By the time that \$900 million is paid off, it will have cost the State pretty close to a billion and a half when you add almost \$600 million for interest charges.

Thank you very much.

MR. MAGOVERN: Are there any questions by the Committee?

MR. MILLER: Mr. Stoll, may I ask you just one question. In this change of rating, do you have any way of knowing what the actual cost to the Commonwealth of Pennsylvania was, or to the State of New York, as a result

of the change?

MR. STOLL: I will have to go back to those specific years, which I did not check, but I will say this, that in today's market - and, incidentally, a lot of these problems that came up in connection with the bank bill was when we had a tight money policy. You know, a lot of that has changed. Conditions have changed, money is easing. I would say that if the State of New Jersey - well, we had difficulty selling \$75 million here back in early October at a 6⁰⁷% level. I think they sold at 5.99.

MR. MILLER: That's a better rated bond --

MR. STOLL: That's a triple A rating. I think if they had a double A at the time, they wouldn't even have been able to negotiate, under our present ceiling.

MR. MILLER: I don't know whether there have been any recent issues of Pennsylvania or New York State bonds, but would they sell at any different price --

MR. STOLL: They had some recently, although, frankly, I've been out of touch with the market for three weeks, I just got back from Mexico.

MR. MILLER: Lucky you.

MR. STOLL: I didn't see a newspaper, radio or television, or anything.

MR. MILLER: Well, would you happen to know whether there is any difference in the price at which they sell new issues now, as compared with New Jersey?

MR. STOLL: Well, I would say, if the State of New Jersey sold bonds today - there, again, you have to go by the maturity schedule. If it's a long-term bond issue --

MR. MILLER: Under the same maturities.

MR. STOLL: Say the average?

MR. MILLER: Yes.

MR. STOLL: I think they could pretty nearly do 5.75 or 5.80 in today's market.

MR. MILLER: And what could the Commonwealth of Pennsylvania or the State of New York do?

MR. STOLL: 6.25. That's Pennsylvania.

MR. MILLER: This is attributable to the difference in the rating?

MR. STOLL: The State of New York would be nearer New Jersey prices, because New York does have a certain preference with all the money in the New York State banks.

MR. MILLER: Pennsylvania, however, you would account for that by the difference in the rating?

MR. STOLL: Well, sometimes ratings make a difference and sometimes they don't. Most often, - for example, the State of West Virginia has a single A rating, and sometimes they sell at double A prices because there's a scarcity. But, believe me, there will be no scarcity of New Jersey bonds. I'll say this, I think the State of New Jersey's investment banking fraternity has done a wonderful job. When you realize in the period from September 15th to October 30th they had to handle close to \$100 million to \$150 million worth of state, county, municipality, and school district bond issues. That's a lot of underwriting.

One other thought. On the question that came up here about the various interest rates as against a single rate. I don't think there is anything in the present statutes that prohibits a municipality from issuing bonds under various interest rates. I know Hoboken has done it a couple of times. But, by and large, you've got to bear this in mind, when you're asking for different rates, sometimes you might get a 12% coupon on that the first two or three years, and maybe a tenth of 1% on the last year. And the poor politician who is in office when he gets the 12% interest charge to pay for the first year gets awful mad. So, unless there are certain limitations on coupon rates that can be issued, I'd say stick with the present system which has worked very well.

MR. MILLER: Speaking of that, do you see any

great advantage or disadvantage of present statutory provisions with respect to selling at a discount, issuing at a discount?

MR. STOLL: Advantage in what?

MR. MILLER: Selling at a discount.

MR. STOLL: There is no advantage in selling at a discount because the discount is subject to capital gains taxes.

MR. MOAK: Is there an advantage in terms of the issuer? You have the option of the issuer selling at par, the syndicate having to put high coupons on the first few maturities in order to pick up its profit, forgetting about the deep discounts --

MR. STOLL: I'll put it to you this way.

MR. MOAK: Wait till I finish. You have the option of selling at par with say an 8% coupon on the first six maturities in order to develop your profit, therefore, they have to be reoffered at premium; versus selling at a discount equal to the profit which the syndicate hopes to develop. As between those two alternatives, do you see any advantage one way or the other?

MR. STOLL: Basically, I don't think there is much difference. If you were to take one serial bond issue, say running out in 20 years, and you put a single coupon on it - let's assume you come up with a 6.70 yield or a 5.70 coupon - and you take a multiple coupon, a various coupon arrangement, you might come up to 5.69. Is that .01 worth the difference? It can be for sharpening the pencil, that's all.

MR. MOAK: Thank you.

MR. MAGOVERN: Thank you very much, Mr. Stoll.

MR. STOLL: Thank you.

MR. MAGOVERN: We have one clarification, for purposes of the record. Please identify yourself, for the record.

J O S E P H F. H U G H E S: Joseph F. Hughes,

Finance Director of the Township of Edison.

Speaking about the bond attorney's fees, I may have given the impression that I thought that each time bond anticipation notes are issued the original bond attorney's fees doubled, tripled or quadrupled. I didn't mean that. I meant that we are exposed to additional charges each time we issue bond anticipation notes prior to issuing the permanent bond itself. It's not necessarily doubling, tripling and quadrupling.

MR. MAGOVERN: Thank you very much.

Gentlemen, there are two things I regret - one, I regret having kept you so long but we felt we were coming close to the end of this hearing and decided that we would run through until it was over, rather than coming back; and, more importantly, the Committee regrets that there was some mixup in the mailing of notices and the giving of adequate advance notice of this hearing.

We will keep the record open for the purpose of receiving any statements which anyone wishes to file. If it appears, after reviewing the record, or if we get requests for an additional adjourned hearing, we will reschedule a hearing. Although that would be a matter of attempting to determine how extensive such a hearing would be or what it would accomplish.

Thank you all very much. We appreciate your help.

* * * * *

Gentlemen:

Those of you who are familiar with New Jersey Revenue Financing are aware that such financing is accomplished by means of Authorities created for that purpose. As my subject has to do with sewer and/or water revenue financing, I shall confine my comments to that particular type of Authority. Under the Sewerage Authorities Law, Chapter 138, Laws of New Jersey 1946, amended, it is evident that sewer authorities in New Jersey have greater financial protection in respect to revenue security than do their parent municipality.

Tax bonds of counties or municipalities in New Jersey, for which unlimited ad valorem taxes are pledged, have steadily risen in recent years in their standing in municipal market and are today rated among the best municipal credits in the United States. However, there are certain additional legal rights and remedies authorized by the Act under which Authority bonds are issued which, in many respects, make such bonds an even better security than such ad valorem tax bonds. The reason for the unusual legal security and remedies of such Authority bonds are as follows:

1. THE BONDHOLDER'S SECURITY IS GREATER THAN THE SECURITY FOR MOST AD VALOREM TAX BONDS:

The Act provides sources and means for assuring the payment of debt service on sewer revenue bonds which give the holder of sewer revenue bonds a maximum of legal security, as follows: The Act provides in Section 8 that service charges must be collected for the use of the sewer system which must comply with any contract with bondholders, and "will at all times be adequate to pay all expenses of operation and maintenance of the sewerage system, including reserves, insurance, extensions, and replacements, and to pay punctually the

principal of and interest on any bonds and to maintain such reserves or sinking funds therefor as may be required by the terms of any contract of the sewerage authority or as may be deemed necessary or desirable by the sewerage authority.

These service charges constitute the basic source of payment of debt service on sewer revenue bonds, and the mandatory duty of the Authority to fix and collect sufficient charges for all debt service and reserves, in addition to expenses of operation and maintenance and other required payments, assures the holder of sewer revenue bonds of adequate revenues for the payment of such bonds, as any bondholder can compel the Authority, by legal proceedings, to raise such service charges, whenever necessary to the required extent, to comply with all debt service, reserve and other payments required by the bond resolution, trust indenture or other proceedings which authorized the issuance of the sewer revenue bonds (hereinafter referred to as "bond proceedings").

The quality of the security of service charges should be apparent to any investor in public securities, and was amply demonstrated during the economic difficulties of the 1930's. In that period, tax bonds of many municipalities in New Jersey and other states defaulted in payment of debt service on tax bonds for varying times, due to the low percentage of tax collections and the inevitable necessity of using available tax receipts for the continuance of essential governmental operations and services without which such municipalities could not have continued to exist.

Service charges during the same period, however, for municipally owned essential public utilities such as water, electric and sewer systems, were collected in many defaulting municipalities at a much higher percentage than real estate taxes. This higher percentage of collections was due to the very nature of the services of essential utilities without which people cannot exist in modern municipalities, and the effective remedies for quick collection service charges. The true test of the value of a security, as far as prompt payment of debt service charges is concerned, is its collectability in periods of depression as well as in periods of prosperity. In many instances in the 1930's municipalities defaulted in payment of tax bonds but not in

payment of bonds payable from the revenues of essential municipal utilities.

(b) LIEN FOR SERVICE CHARGES ON LANDS SERVED BY THE SEWER SYSTEM.

In addition to the security of service charges,

the holder of sewer revenue bonds has the additional security of all the lands served by the Authority in its area of operation, which in New Jersey is usually the same as the area of the municipality or municipalities creating the Authority.

Under the Act the sewer service charges are a lien upon the lands served if not paid as and when due, which lien is superior and paramount to the interest in such land of any owner, lessee, tenant, mortgagee, or other person except the lien of municipal taxes and is on a parity with and deemed equal to the lien on such lands of the municipality where such lands are situated for taxes thereon due in the same year and not paid when due, in the manner provided in Section 21 of the Act.

Most tax bonds, in the final analysis, are secured only by the lien of the ad valorem taxes levied for the payment of such tax bonds on the lands of the municipality and the mandatory obligation of the municipality to levy and collect such ad valorem taxes without limit as to rate or amount. As sewer revenue bonds are, in most cases, payable from service charges on substantially the same lands on which ad valorem taxes for the payment of tax bonds must be levied, the holder of a sewer revenue bond has, for all practicable purposes, the same security of the value of the lands in the area served as the holder of a tax bond.

Since the holders of sewer revenue bonds have substantially the same security on the lands in the area served as the holders of tax bonds, and the additional security of mandatory and legally enforceable service charges adequate for payment of the sewer revenue bonds, the security of the holders of such sewer revenue bonds is greater than the security of the holders of most tax bonds.

(c) Sewer revenues are segregated trust funds

Under Section 16 of the Act and the bond proceedings, all funds of the sewer system are trust funds, and the holders of sewer revenue bonds have a lien on such funds until applied in the manner provided in the Act and bond proceedings. This, in effect, means that all revenues of the Authority are segregated trust funds which cannot be used for any general purposes of the municipality, but must be used by the Authority only in the manner provided in the Act and the bond proceedings which authorized the issuance of the sewer revenue bonds.

Bonds payable from ad valorem taxes, except for a few exceptions, do not have any specific lien on any funds of the municipality, nor is the municipality required to segregate its tax revenues for the payment of such bonds. Consequently, if the tax collections are insufficient to provide for all the purposes for which the taxes were levied, there is no legal assurance that the holder of an ad valorem tax bond will receive full payment of his principal or interest, as a municipality must fulfill its essential services and functions in order to continue its existence.

If the sewer revenues collected are insufficient for payment of all costs of operation and maintenance, debt service on sewer revenue bonds and other payments required by the bond proceedings, it is true that the bondholder might not receive payment of all his principal and interest punctually. In such event, however, the holders of competent jurisdiction, require the rates of sewer service charges to be raised sufficiently to provide for all operating and maintenance costs, debt service, reserves and other payments provided for in the bond proceedings, including any deficiencies for prior payments. Since the Authority will, in practically all cases, have a substantial monopoly on an essential public utility, the mandatory obligation of the Authority, both under the act and the bond proceedings, to raise its rates for sewer services to whatever extent may be necessary to comply with the Act and bond proceedings, is, in most cases, a more effective security than is generally available to the holders of tax bonds.

(d) Reserve Funds.

The Act authorizes the Authority to covenant and agree with the holders of sewer revenue bonds to provide for rates sufficient to include reserves for debt service as well as maturing payments of principal and interest, which covenants may be enforced by any holder of such sewer revenue bonds. It is customary in the bond proceedings authorizing the issuance of sewer revenue bonds to provide for an adequate reserve fund for debt service.

If the issue of sewer revenue bonds is soundly conceived in its inception, the reserve fund will enable the sewer system to overcome temporary economic difficulties, which is an important advantage to the bondholder and the Authority, and an additional security for the holder of a sewer revenue bond.

2. THE REMEDIES FOR COLLECTION OF SEWER SERVICE CHARGES ARE EFFECTIVE AND QUICKLY ENFORCEABLE.

The Act provides quick and effective remedies for the collection of sewer service charges and the enforcement of the rights of the holders of sewer revenue bonds which, in many cases, are not available to the holders of other municipal bonds. These collection and enforcement remedies are substantially discontinued of sewer services.

(a) The Lien of sewer service charges is more quickly enforceable than the lien of ad valorem taxes.

Section 21 of the Act provides that the lien of sewer service charges on the premises served may be foreclosed or otherwise enforced by the Authority by action or suit in equity as for the foreclosure of a mortgage on real property.

A mortgage on real property in New Jersey can be foreclosed in a much quicker period of time than such real property can be foreclosed for the lien of ad valorem taxes. The lien on real estate for ad valorem taxes cannot be foreclosed as a general rule until the year after such taxes become delinquent, whereas the lien on real estate for delinquent sewer service charges can be foreclosed under the Act as soon as such charges become delinquent.

(b) The right to appointment of a receiver of the sewer system.

Not only can the holder of a sewer revenue bond enforce any of the provisions of the Act or of the bond proceedings in any court of competent jurisdiction, but such holder, for any defaults in payment of principal or interest on his bond, or in compliance by the Authority with its covenants in the bond proceedings, is entitled, under Section 18 of the Act, as of right to the appointment of a receiver of the sewer system by a court of competent jurisdiction to operate the sewer system under the supervision of such court until all such defaults have been cured and made good and such right is cumulative as to subsequently recurring defaults.

This right is an important remedy for the holder of a sewer revenue bond. Not only can the Authority be compelled to charge sufficient sewer rates to pay the sewer revenue bonds and comply with the bond proceedings, but the possession and control of the sewer system itself can be taken away from the Authority and operated under the terms of the bond proceedings by the courts, thus further insuring compliance by the Authority at all times with the bond proceedings.

The value of this remedy is often not recognized by investors in municipal bonds. If the sewer system is an economic failure it is true that a receivership will not be of much benefit as obviously a receiver cannot collect exorbitant sewer service charges any more than the Authority itself. However, since sewer services do constitute an essential public service, and experience has demonstrated that most public sewer systems in areas with a reasonable density of population are economically successful enterprises, the power to enforce strict compliance with the Act and all the covenants of the bond proceedings gives the holder of sewer revenue bonds an extremely valuable remedy.

3. THE SEWER SYSTEM MUST BE OPERATED AS A SEPARATE UTILITY ENTERPRISE.

One of the greatest advantages of a sewer revenue bond, from the standpoint of legal security, is the requirement of the Act and the bond proceedings that the sewer system must be operated as a separate utility enterprise, and if the bond proceedings are properly prepared, such enterprise must be conducted upon an efficient business basis, and is not subject to the same influences which may affect the security of tax bonds.

The holders of tax bonds have little control over the general activities of the municipality which issued them. Such municipality may also levy taxes for any other purpose without limitation, may issue additional tax bonds in amounts permitted by law, may have wasteful budget practices and inefficient administration, and may embark upon new and unnecessary projects or purposes, all of which may affect and dilute the security of the holder of such taxbonds.

Since the sewer system under the Act is a separate utility enterprise conducted on a business basis, and the method of operation and application of revenues and the rights and remedies of the holders of sewer revenue bonds are fixed by the Act and bond proceedings and can be enforced by such bondholders, the source of their security cannot be impaired or diluted by the general acts or activities in the municipality served by the Authority to the same extent which is possible in the case of tax bonds.

4. COVENANT OF THE STATE OF NEW JERSEY

Not only does the Act provide for legally binding and enforceable covenants of the Authority, but also contains a covenant of the State of New Jersey itself reading as follows:

"Pledge of State to bondholders:

The State of New Jersey does hereby pledge to and covenant and agree with the holders of any bonds issued pursuant to a bond resolution of a sewerage authority that the State will not authorize or permit the construction or maintenance of any system of sewers or sewage disposal plants which will be competitive with the sewerage system of the sewerage authority, and will not limit or alter the rights hereby vested in the sewerage authority to acquire, construct, maintain, reconstruct and operate its sewerage system, and to fix, establish, charge and collect its service charges and to fulfill the terms of any agreement made with the holders of such bonds or other obligations and will not in any way impair the rights or remedies of such holders, and will not modify in any way the exemptions from taxation provided for in this act, until the bonds, together with interest thereon, with interest on any unpaid installments of interest and all costs and expenses in connection with any action

or proceedings by or on behalf of such holders are fully met and discharged." Much of the above was supplied in an opinion written by John Trimble of Caldwell, Marshal, Trimble and Mitchell, now Mudge, Rose Guthrie & Alexander, in 1957 and who has given me his permission to use excerpts from that opinion, and I here and now express my appreciation.

Since then many authorities have entered into various types of Service Contracts which, in varying degrees, act as an agreement between the Authority and its parent municipality, whereby the municipality agrees that for services rendered, it will guarantee anywhere from the required reserves of the Authority, under the Trust Indenture up to and including a guarantee of the bonds themselves, by means of taxation. This is generally accepted as the most secure obligation. However, I question whether it is even necessary.

This is the crux of my argument. If, as the Authority Act states, the authorities have even greater recourse than does the municipality, why should a service contract be necessary at all. Unless, of course, it is viewed merely as a reaffirmation by the municipality of intent which was made by it when it created the authority in the first place.

This same argument is, however, not necessarily true in the case of Regional Sewer Authorities. Here we have a different animal in that it is created solely as a treatment unit and can only construct trunk lines for collection purposes to the municipal boundary line. If the R. S. A. constructs internal collection lines, it does so only on a contributory basis via a contract as a participant in the cost not only of the internal lines and outfall lines but also of the trunk line and treatment plant as well. If an Authority is created on the basis of contribution, I would think it only differs with a municipal unit in size and scope but not in operation or resources. If, on the other hand, an R. S. A. is created on a customer basis, it has no recourse or legal position, I would think, except via a contract.

I believe that, in this day and age, it is inconceivable that a populace can long endure without public sewer service and the effective treatment thereof. This fact is well recognized by every public agency involved in pollution control and abatement. It is because of this recognition and because of the arguments presented here that I believe that Authorities in New Jersey and, perhaps in the nation, should be rated in a manner separate and distinct from the method employed in rating general tax obligations. I would appreciate your comments in writing, if possible, whether pro or con, in order to prepare a paper for submission to the rating service.

FACTS AND CONSIDERATIONS IN BOND RATINGS

Remarks prepared by John K. Pfeiffer for presentation before the County and Municipal Bond Rating Seminar sponsored by the North Carolina Local Government Commission and the Institute of Government at Chapel Hill on Friday, Dec. 19, 1969.

Standard & Poor's municipal bond ratings are "quality ratings" as opposed to "market ratings". A quality rating is not a recommendation to buy or sell; it is a comparative rating which attempts to measure the relative investment quality of one municipal obligation to another. It is not merely a measure of safety of interest or principal. If it were, then municipal bonds would be rated yes or no: default likely or unlikely. The function of ratings, therefore, is to attempt to provide the investor with a distinction between the quality of the credits available to him for investment.

One of the basic requirements for investments by banks, for example, is that of marketability and liquidity. Bonds with certain quality ratings are considered readily marketable, and principally for that reason, bonds with these ratings are not questioned by bank examiners as to marketability and book value. With the passage of time, ratings began to be used for the purpose of appraising relative investment quality by investors, underwriters and dealers as well as by personnel of government agencies such as the Controller of the Currency and the FDIC. I respectfully submit that these ratings have obviously established some enduring merit, or they would never have enjoyed the use to which they have been put and the respect which has been accorded them.

The issue of the adequacy of the municipal bond rating systems used by the major rating services has not been questioned for most of the twenty years during which the Standard and Poor's Corporation has been grading municipal credit. But over the past years of rising interest rates the issue was spotlighted, to the tune of two congressional hearings and the introduction of bills (by Representative Patman and Senator Proxmire) which, by producing a Federal Guarantee on State and Local Government Debt, would have effectively eliminated the need for a rating system. It seems appropriate, and timely, to review the factors behind the rising interest in this subject. There would seem to be two:

1. Interest costs of local governments will soar over the next decade because of vast public facility needs. Also in areas where needs are greatest (the core cities), credit ratings are in many cases low.
2. Ratings are determined subjectively and consistently at best, but in any case the exact methods or rationale used in evaluating a government's credit standing are not always articulated. Rating has been an art, not a science.

Three basic questions can be raised: (a) What is the evidence that ratings determine interest cost differentials, (b) What are the expectations for rapid increases in state-local interest costs and (c) What are some of the innovations that make up the new look in Standard & Poor's municipal ratings?

Underwriters will quite correctly tell you that the difference in interest cost between a bond rated AAA and BBB can be tremendous. I didn't - and they won't - say it is all due to rating, but they will say there is a fantastic spread. It can immediately be proven that it is not all due to rating. Last month various local public housing authority bond issues sold, all at the same time. All the issues were rated AAA because of the Federal backing. However, there was difference of almost 20 basis points of interest cost between the issues, despite the uniform AAA rating.

My point is that several factors influence interest cost; rating, volume, secondary market supply, buyer acceptance, the underwriters' liking for the bond and their anticipated results of distributing it, and so on.

Assuming that quality ratings do determine some amount of differential in interest costs, the rating methods take on a significance for the Federal government for two reasons. First, because of projections of unprecedented expansion of state and local capital plants, and because of the major role the Federal government will play and must play in financing the improvement of local facilities, interest costs per se will be a vital concern. Second, because of the Federal commitment to attempt equalization of public service levels, there is a special concern with the nature of the differential costs imposed by nationally recognized ratings. Underlying these two basic reasons for Federal concern is the premium which has necessarily been placed on efficiency in government operations and which naturally leads to a search for methods to reduce governmental costs without affecting the quality of services. Viewed in this perspective, such a question as "Why is New York City BBB instead of A or AA?" seems most appropriate.

Total and Per Capita State and Local government debt outstanding have increased at a rapid rate since 1946, even more rapid than the increase in population. Comparisons of numbers show the 1968 level of total new debt issued to be double the 1960 level. Moreover, prospects are for even more rapid increments as estimates of public facility capital outlays place the increase between now and 1975 at approximately 100 percent. Under the assumption that long-term borrowing will account for about 50 percent of annual capital outlays (requirements), total new debt issued is expected to rise from the 1968 level of \$16.3 billion to \$22.7 billion in 1975. Then total debt outstanding will have grown from \$100 billion at the end of 1965 and \$113 billion at the end of 1968 to almost \$200 billion at the end of 1975.

While the volume of debt outstanding describes the overall level and burden of debt, an examination of the trend and pattern of interest costs gives a general picture of the drain on the current budget. Two factors may contribute to the greater claim of interest cost on local budgets. The first is the rising level of debt described above. The second is the generally rising level of interest costs that state and local governments in this country have experienced since about 1950. The average interest rate on bonds in 1950 was 2.01 percent; in 1960, 3.53 percent; and currently around 6.85%.

Compounding the concern with rising capital facility needs is the possibility that the rating systems induce a "counter-equalizing" effect on local government costs, since lower ratings are (and in many cases should be) assigned to those local governments least able to afford the higher interest costs. For it must ultimately be agreed credit ratings reflect different probabilities of default, and default would seem most probable in communities with high and increasing public service needs, inadequate and declining tax bases, low levels of income, etc. Then high default probabilities and consequently high interest costs may well characterize American central cities. Securities of the poorest of the central cities have the lowest quality ratings and perform poorest in the market. At least part of the greater level of Federal assistance being channeled into these urban areas is offset by higher interest costs.

We at Standard & Poor's began recognizing the problems caused by growth several years ago. We bolstered our municipal rating department with additional personnel to cope with the increasing demands. But the sheer volume and complexity of new issues forced us to reappraise drastically our position. Back in 1949 we volunteered to rate municipals; no one asked us to. The task we volunteered for became huge and to handle it caused us losses which became unbearable.

These spiraling demands being thrust upon us by the greater municipal financing activity and the extremely tight municipal analytical labor market strongly suggested the desirability of change. In the light of the losses which we were suffering in the rendering of this service, we felt compelled to make a basic modification in policy.

On January 24th, 1968, we announced that we would no longer rate municipal bonds voluntarily but, rather, would assign ratings only upon request and payment of a fee to reimburse us for the time and expense required in analyzing the issue. This change was announced in a statement which was given intense national distribution. Since that time, there have been minor changes in our policy in accordance with suggestions from the Investment Bankers Association and the Municipal Finance Officers Association.

Our fee basis rating system has accomplished already many things. It obviously reversed the loss situation and in turn has allowed us to launch new areas of improved service. We now have resident municipal bond

analysts - men living in particular areas of the country who gather information and work on the credits in their areas. More will be added as qualified people are recruited and placed. We have greatly enlarged our staff in New York. Perhaps most important, we have virtually completed a research study of our systems and methods and are now implementing some of these conclusions. The study was conducted with the assistance of the Maxwell School for Urban Studies at the University of Syracuse along with other representatives from other parts of the academic and federal government areas. It is virtually completed, clearly demonstrating "The New Look in Quality Bond Rating."

As a first step in re-evaluating the rating process, Standard and Poor's rewrote its definition of municipal bond ratings. The reference to market performance which was contained in the description of ratings has been dropped and it should be made clear that market factors are not considered in arriving at a quality rating. Since there are many factors which enter directly and indirectly into the rating process, and since the reasons for any given rating should be publicly available, Standard & Poor's will make available (a) a summary description of the methods and measurements generally used in deriving ratings, (b) the important statistics used in deriving ratings, and (c) an explanation of the reasoning behind each rating assigned. The purpose of Standard and Poor's municipal bond rating is to group and rank communities according to the probability that they will not be able to meet principal repayment and interest obligations. Market considerations are irrelevant to this objective and therefore are not considered in the determination of Standard and Poor's quality ratings.

All municipal debt is broken into two general groups - "investment" grade (AAA to BBB), and "speculative" (BB and below). Since, virtually all of our ratings fall into the first four grades, I will limit myself today to the definitions of only these categories.

The four grades reflect estimates of differing probabilities of default under alternative assumptions about the future. As the approach here is consistently pessimistic, we are most concerned with how poorly the community might do under the worst circumstances and not with how well it might do under the best circumstances. Our analysis involves assessment of (a) the expected performance of the local economy in a period or national decline; (b) the expectations that the local economy will undergo some kind of local decline apart from national cyclical movements; and (c) the expected ability of the local government to meet principal and interest payments under either of these circumstances.

There are four grades of probability of default, while the post World War II history of defaults shows the probability of actual default for any to be effectively zero. At Standard and Poor's we have had only one default of a bond issue rated BBB or better, and even this default is minor and in the process of being cured.

The following are the definitions of Standard & Poor's rated classes of "investment" grade securities:

STANDARD & POOR'S MUNICIPAL BOND RATINGS

Standard & Poor's Municipal Bond Ratings cover obligations of all states or sub-divisions. In addition to general obligations, ratings are assigned to bonds payable in whole or in part from special revenues.

AAA-Prime -- These are obligations of the highest quality. They have the lowest probability of default. In a period of economic stress the issuers will suffer the smallest declines in income and will be least susceptible to autonomous decline. Debt burden is not inordinately high. Revenue structure appears adequate to meet future expenditure needs. Quality of management would not appear to endanger repayment of principal and interest.

AA-High Grade -- The investment characteristics of bonds in this group are only slightly less marked than those of the prime quality issues. Bonds rated AA have the second lowest probability of default.

A-Upper Medium Grade - Principal and interest on bonds in this category are regarded as safe. This rating describes the third lowest probability of default. It differs from the two higher ratings because there is some weakness, either in the local economic base, in debt burden, in the balance between revenues and expenditures, or in quality of management. Under certain adverse circumstances, any one such weakness might impair the ability of the issuer to meet debt obligations at some future date.

BBB-Medium Grade - This is the lowest investment grade security rating. Under certain adverse conditions, several of the above factors could contribute to a higher default probability. The difference between A and BBB ratings is that the latter shows more than one fundamental weakness, whereas the former shows only one deficiency among the factors considered.

BB-Lower Medium Grade - Bonds in this group have some investment characteristics, but they no longer predominate. For the most part this rating indicates a speculative, non-investment grade obligation.

B-Low Grade - Investment characteristics are virtually nonexistent and default could be imminent.

D-Defaults -- Interest and/or principal in arrears.

As in all descriptions of the rating process, the basic considerations are, and remain, economic base, debt burden, fiscal management and revenue-expenditure balance. But there are two differences between this and the traditional statement of the approach to municipal bond ratings. First, the specific attributes constituting each of these factors will be enumerated. Thus, a reference to "economic base" considerations means specifically industrial diversification, relative employment in durable goods and tourist-oriented industries, projected growth in local economic activity, the current and projected growth in population, and (for metropolitan central cities) population growth relative to that of the larger metropolitan area.

The second difference between our new approach and the traditional approach is that the comparative - high, lower, above-average, etc., - has specific meaning in this procedure. That is, via a computer based comparative analysis we are able to isolate those communities which have, e.g., and inordinately high or low debt burden.

Also, there has been developed a more standardized procedure for the Standard and Poor's analysts to follow in evaluating the credit of a local government. Procedures have been devised encompassing the same fact gathering techniques so that all analysts start at the same point, deviating from the general review only in predetermined methods to the conclusion of the factual analysis. After combining these data and reviewing the bond prospectus, the analyst formulates a rating. He then submits (a) the standardized comparative data sheet, and (b) a written summary of the basis for arriving at a given rating. Detailed explanation is needed primarily to clarify any subjective considerations.

The written report is reviewed by the senior staff and a meeting is held to accept or reject the conclusions of the analyst. If accepted, a copy of the report enumerating the specific factors which contribute to the credit weakness of community is made available to all interested parties.

The use of the standard analysis form markedly increases the consistency within the ratings department and reduces overall subjectivity of the process.

To accomplish the standard analysis we have developed and continuously update a data bank for municipal analysis, and a data retrieval system which makes extensive comparative analysis possible. The system includes relevant and detailed data from the Censuses of Population, Government, Housing, and Business, and is updated annually from the Compendium of City Finances and other more regularly published services. Perhaps more important, it is used to store all data collected from contracting local governments - since statistics such as overlapping debt, true valuation of property, and debt repayment schedules are not readily available elsewhere.

The data received directly from the local government is coded and kept current.

These improvements came about because of our awareness that if ratings are worthwhile, if they are necessary and beneficial to the smooth conduct of marketing municipal bonds, then the municipal industry deserved the best, the best in analysis, research, independence, and thought. To do this required effort and money. If something is worthwhile, if it is good and well done, if it has merit, it should cost something. This is why we felt it imperative to alter our policy and charge a fee for our services.

STANDARD & POOR'S MEMORANDUM RE MUNICIPAL BOND CONTRACT RATINGS AND
INFORMATION REQUIRED FOR BOND RATINGS PURPOSES APPEAR ON THE FOLLOW-
ING PAGES



STANDARD & POOR'S CORPORATION

345 HUDSON STREET, NEW YORK, N. Y. 10014

MEMORANDUM RE MUNICIPAL BOND CONTRACT RATINGS

Standard & Poor's Corporation no longer rates municipal bonds voluntarily, but only upon request and payment of a fee to reimburse us for the time and expense required to analyze the issue. The fee is payable upon completion of the analysis and will take into account the amount of work necessary to arrive at the rating and the anticipated work in keeping the rating under surveillance.

We will maintain continuous rating surveillance on the issue for an indefinite period or until the next bond sale, at which time the contract may be renewed by mutual agreement.

The request for contract rating analysis may come from the issuer, underwriter, consultant, institution, etc.

The party requesting the rating should submit all necessary information and agrees to supply later or current information on request. We rely on the person submitting such information for its accuracy, completeness and substantiation. Standard & Poor's reserves the right to withdraw from any contract if it feels that proper and sufficient information is not being received.

S & P reserves the right to advise its own clients and subscribers of such rating, or to publish the same at any time, in its publications or otherwise.

It must be understood that in providing such rating S & P necessarily relies on the information then before it and not on any later information. Further, it must be understood that S & P cannot guarantee the accuracy or completeness of the information upon which the rating is based, and that such rating is subject to change or withdrawal at any time without notice. Parties to contract ratings should also be aware that S & P reserves the right to enter into any future contract rating relative to the same issue or debt.

June 3, 1968



STANDARD & POOR'S CORPORATION
345 HUDSON STREET, NEW YORK, N. Y. 10014

JOHN K. PFEIFFER
Assistant Vice President

INFORMATION REQUIRED FOR BOND RATING PURPOSES

Gentlemen:

We have received your inquiry regarding the forthcoming sale of municipal bonds by your unit. We do not require the submission of information in any special form, but we would like to receive the following information for bond rating purposes:

1. Debt statement, including maturities, with bonds segregated as to security; overlapping debt, which is this unit's share (on the basis of proportionate valuations) of the debt of overlapping taxing units.
2. Assessed valuation for the last four years, segregated as to realty and personality, and as to industrial, commercial, utility and residential; basis of assessment.
3. Tax collection statement for four years including amount of current levy, amount collected on that levy in ensuing year, and amount collected to some recent date. Statement of this unit's tax rate and the overall tax rate for the past four years.
4. Recent population estimate.
5. Copies of the past two annual reports and the latest budget.
6. List of the ten leading taxpayers with their assessed valuations, including the number of employees for industrial taxpayers.
7. Brief description of the economy of the area, including the character of development, the level of building activity, and the value of homes (for residential areas).
8. School enrollment for the past ten years (where applicable).
9. Future borrowing plans by this unit and overlapping units.
10. Five-year proposed capital improvement program.

Very truly yours,

SUBMITTED BY DAVID BREEN

Gentlemen:

Those of you who are familiar with New Jersey Revenue Financing are aware that such financing is accomplished by means of Authorities created for that purpose. As my subject has to do with sewer and/or water revenue financing, I shall confine my comments to that particular type of Authority. Under the Sewerage Authorities Law, Chapter 138, Laws of New Jersey 1946, amended, it is evident that sewer authorities in New Jersey have greater financial protection in respect to revenue security than do their parent municipality.

Tax bonds of counties or municipalities in New Jersey, for which unlimited ad valorem taxes are pledged, have steadily risen in recent years in their standing in municipal market and are today rated among the best municipal credits in the United States. However, there are certain additional legal rights and remedies authorized by the Act under which Authority bonds are issued which, in many respects, make such bonds an even better security than such ad valorem tax bonds. The reason for the unusual legal security and remedies of such Authority bonds are as follows:

1. THE BONDHOLDER'S SECURITY IS GREATER THAN THE SECURITY FOR MOST AD VALOREM TAX BONDS.

The Act provides sources and means for assuring the payment of debt service on sewer revenue bonds which give the holder of sewer revenue bonds a maximum of legal security, as follows: The Act provides in Section 8 that service charges must be collected for the use of the sewer system which must comply with any contract with bondholders, and "will at all times be adequate to pay all expenses of operation and maintenance of the sewerage system, including reserves, insurance, extensions, and replacements, and to pay punctually the

principal of and interest on any bonds and to maintain such reserves or sinking funds therefor as may be required by the terms of any contract of the sewerage authority or as may be deemed necessary or desirable by the sewerage authority.

These service charges constitute the basic source of payment of debt service on sewer revenue bonds, and the mandatory duty of the Authority to fix and collect sufficient charges for all debt service and reserves, in addition to expenses of operation and maintenance and other required payments, assures the holder of sewer revenue bonds of adequate revenues for the payment of such bonds, as any bondholder can compel the Authority, by legal proceedings, to raise such service charges, whenever necessary to the required extent, to comply with all debt service, reserve and other payments required by the bond resolution, trust indenture or other proceedings which authorized the issuance of the sewer revenue bonds (hereinafter referred to as "bond proceedings").

The quality of the security of service charges should be apparent to any investor in public securities, and was amply demonstrated during the economic difficulties of the 1930's. In that period, tax bonds of many municipalities in New Jersey and other states defaulted in payment of debt service on tax bonds for varying times, due to the low percentage of tax collections and the inevitable necessity of using available tax receipts for the continuance of essential governmental operations and services without which such municipalities could not have continued to exist.

Service charges during the same period, however, for municipally owned essential public utilities such as water, electric and sewer systems, were collected in many defaulting municipalities at a much higher percentage than real estate taxes. This higher percentage of collections was due to the very nature of the services of essential utilities without which people cannot exist in modern municipalities, and the effective remedies for quick collection service charges. The true test of the value of a security, as far as prompt payment of debt service charges is concerned, is its collectability in periods of depression as well as in periods of prosperity. In many instances in the 1930's municipalities defaulted in payment of tax bonds but not in

payment of bonds payable from the revenues of essential municipal utilities.

(b) LIEN FOR SERVICE CHARGES ON LANDS SERVED BY THE SEWER SYSTEM.

In addition to the security of service charges, ~~the holder of sewer revenue bonds has the additional security of service charges,~~ the holder of sewer revenue bonds has the additional security of all the lands served by the Authority in its area of operation, which in New Jersey is usually the same as the area of the municipality or municipalities creating the Authority.

Under the Act the sewer service charges are a lien upon the lands served if not paid as and when due, which lien is superior and paramount to the interest in such land of any owner, lessee, tenant, mortgagee, or other person except the lien of municipal taxes and is on a parity with and deemed equal to the lien on such lands of the municipality where such lands are situated for taxes thereon due in the same year and not paid when due, in the manner provided in Section 21 of the Act.

Most tax bonds, in the final analysis, are secured only by the lien of the ad valorem taxes levied for the payment of such tax bonds on the lands of the municipality and the mandatory obligation of the municipality to levy and collect such ad valorem taxes without limit as to rate or amount. As sewer revenue bonds are, in most cases, payable from service charges on substantially the same lands on which ad valorem taxes for the payment of tax bonds must be levied, the holder of a sewer revenue bond has, for all practicable purposes, the same security of the value of the lands in the area served as the holder of a tax bond.

Since the holders of sewer revenue bonds have substantially the same security on the lands in the area served as the holders of tax bonds, and the additional security of mandatory and legally enforceable service charges adequate for payment of the sewer revenue bonds, the security of the holders of such sewer revenue bonds is greater than the security of the holders of most tax bonds.

(c) Sewer revenues are segregated trust funds.

Under Section 16 of the Act and the bond proceedings, all funds of the sewer system are trust funds, and the holders of sewer revenue bonds have a lien on such funds until applied in the manner provided in the Act and bond proceedings. This, in effect, means that all revenues of the Authority are segregated trust funds which cannot be used for any general purposes of the municipality, but must be used by the Authority only in the manner provided in the Act and the bond proceedings which authorized the issuance of the sewer revenue bonds.

Bonds payable from ad valorem taxes, except for a few exceptions, do not have any specific lien on any funds of the municipality, nor is the municipality required to segregate its tax revenues for the payment of such bonds. Consequently, if the tax collections are insufficient to provide for all the purposes for which the taxes were levied, there is no legal assurance that the holder of an ad valorem tax bond will receive full payment of his principal or interest, as a municipality must fulfill its essential services and functions in order to continue its existence.

If the sewer revenues collected are insufficient for payment of all costs of operation and maintenance, debt service on sewer revenue bonds and other payments required by the bond proceedings, it is true that the bondholder might not receive payment of all his principal and interest punctually. In such event, however, the holders of competent jurisdiction, require the rates of sewer service charges to be raised sufficiently to provide for all operating and maintenance costs, debt service, reserves and other payments provided for in the bond proceedings, including any deficiencies for prior payments. Since the Authority will, in practically all cases, have a substantial monopoly on an essential public utility, the mandatory obligation of the Authority, both under the act and the bond proceedings, to raise its rates for sewer services to whatever extent may be necessary to comply with the Act and bond proceedings, is, in most cases, a more effective security than is generally available to the holders of tax bonds.

(d) Reserve Funds.

The Act authorizes the Authority to covenant and agree with the holders of sewer revenue bonds to provide for rates sufficient to include reserves for debt service as well as maturing payments of principal and interest, which covenants may be enforced by any holder of such sewer revenue bonds. It is customary in the bond proceedings authorizing the issuance of sewer revenue bonds to provide for an adequate reserve fund for debt service.

If the issue of sewer revenue bonds is soundly conceived in its inception, the reserve fund will enable the sewer system to overcome temporary economic difficulties, which is an important advantage to the bondholder and the Authority, and an additional security for the holder of a sewer revenue bond.

2. THE REMEDIES FOR COLLECTION OF SEWER SERVICE CHARGES ARE EFFECTIVE AND QUICKLY ENFORCEABLE.

The Act provides quick and effective remedies for the collection of sewer service charges and the enforcement of the rights of the holders of sewer revenue bonds which, in many cases, are not available to the holders of other municipal bonds. These collection and enforcement remedies are substantially discontinued of sewer services.

(a) The Lien of sewer service charges is more quickly enforceable than the lien of ad valorem taxes.

Section 21 of the Act provides that the lien of sewer service charges on the premises served may be foreclosed or otherwise enforced by the Authority by action or suit in equity as for the foreclosure of a mortgage on real property.

A mortgage on real property in New Jersey can be foreclosed in a much quicker period of time than such real property can be foreclosed for the lien of ad valorem taxes.

The lien on real estate for ad valorem taxes cannot be foreclosed as a general rule until the year after such taxes become delinquent, whereas the lien on real estate for delinquent sewer service charges can be foreclosed under the Act as soon as such charges become delinquent.

(b) The right to appointment of a receiver of the sewer system.

Not only can the holder of a sewer revenue bond enforce any of the provisions of the Act or of the bond proceedings in any court of competent jurisdiction, but such holder, for any defaults in payment of principal or interest on his bond, or in compliance by the Authority with its covenants in the bond proceedings, is entitled, under Section 18 of the Act, as of right to the appointment of a receiver of the sewer system by a court of competent jurisdiction to operate the sewer system under the supervision of such court until all such defaults have been cured and made good and such right is cumulative as to subsequently recurring defaults.

This right is an important remedy for the holder of a sewer revenue bond. Not only can the Authority be compelled to charge sufficient sewer rates to pay the sewer revenue bonds and comply with the bond proceedings, but the possession and control of the sewer system itself can be taken away from the Authority and operated under the terms of the bond proceedings by the courts, thus further insuring compliance by the Authority at all times with the bond proceedings.

The value of this remedy is often not recognized by investors in municipal bonds. If the sewer system is an economic failure it is true that a receivership will not be of much benefit as obviously a receiver cannot collect exorbitant sewer service charges any more than the Authority itself. However, since sewer services do constitute an essential public service, and experience has demonstrated that most public sewer systems in areas with a reasonable density of population are economically successful enterprises, the power to enforce strict compliance with the Act and all the covenants of the bond proceedings gives the holder of sewer revenue bonds an extremely valuable remedy.

3. THE SEWER SYSTEM MUST BE OPERATED AS A SEPARATE UTILITY ENTERPRISE.

One of the greatest advantages of a sewer revenue bond, from the standpoint of legal security, is the requirement of the Act and the bond proceedings that the sewer system must be operated as a separate utility enterprise, and if the bond proceedings are properly prepared, such enterprise must be conducted upon an efficient business basis, and is not subject to the same influences which may affect the security of tax bonds.

The holders of tax bonds have little control over the general activities of the municipality which issued them. Such municipality may also levy taxes for any other purpose without limitation, may issue additional tax bonds in amounts permitted by law, may have wasteful budget practices and inefficient administration, and may embark upon new and unnecessary projects or purposes, all of which may affect and dilute the security of the holder of such taxbonds.

Since the sewer system under the Act is a separate utility enterprise conducted on a business basis, and the method of operation and application of revenues and the rights and remedies of the holders of sewer revenue bonds are fixed by the Act and bond proceedings and can be enforced by such bondholders, the source of their security cannot be impaired or diluted by the general acts or activities in the municipality served by the Authority to the same extent which is possible in the case of tax bonds.

4. COVENANT OF THE STATE OF NEW JERSEY

Not only does the Act provide for legally binding and enforceable covenants of the Authority, but also contains a covenant of the State of New Jersey itself reading as follows:

"Pledge of State to bondholders:

The State of New Jersey does hereby pledge to and covenant and agree with the holders of any bonds issued pursuant to a bond resolution of a sewerage authority that the State will not authorize or permit the construction or maintenance of any system of sewers or sewage disposal plants which will be competitive with the sewerage system of the sewerage authority, and will not limit or alter the rights hereby vested in the sewerage authority to acquire, construct, maintain, reconstruct and operate its sewerage system, and to fix, establish, charge and collect its service charges and to fulfill the terms of any agreement made with the holders of such bonds or other obligations and will not in any way impair the rights or remedies of such holders, and will not modify in any way the exemptions from taxation provided for in this act, until the bonds, together with interest thereon, with interest on any unpaid installments of interest and all costs and expenses in connection with any action

or proceedings by or on behalf of such holders are fully met and discharged."

Much of the above was supplied in an opinion written by John Trimble of Caldwell, Marshal, Trimble and Mitchell, now Mudge, Rose Guthrie & Alexander, in 1957 and who has given me his permission to use excerpts from that opinion, and I here and now express my appreciation.

Since then many authorities have entered into various types of Service Contracts which, in varying degrees, act as an agreement between the Authority and its parent municipality, whereby the municipality agrees that for services rendered, it will guarantee anywhere from the required reserves of the Authority, under the Trust Indenture up to and including a guarantee of the bonds themselves, by means of taxation. This is generally accepted as the most secure obligation. However, I question whether it is even necessary.

This is the crux of my argument. If , as the Authority Act states, the authorities have even greater recourse than does the municipality, why should a service contract be necessary at all. Unless, of course, it is viewed merely as a reaffirmation by the municipality of intent which was made by it when it created the authority in the first place.

This same argument is, however, not necessarily true in the case of Regional Sewer Authorities. Here we have a different animal in that it is created solely as a treatment unit and can only construct trunk lines for collection purposes to the municipal boundary line. If the R. S. A. constructs internal collection lines, it does so only on a contributory basis via a contract as a participant in the cost not only of the internal lines and outfall lines but also of the trunk line and treatment plant as well. If an Authority is created on the basis of contribution, I would think it only differs with a municipal unit in size and scope but not in operation or resources. If, on the other hand, an R. S. A. is created on a customer basis, it has no recourse or legal position, I would think, except via a contract.

I believe that, in this day and age, it is inconceivable that a populace can long endure without public sewer service and the effective treatment thereof. This fact is well recognized by every public agency involved in pollution control and abatement. It is because of this recognition and because of the arguments presented here that I believe that Authorities in New Jersey and, perhaps in the nation, should be rated in a manner separate and distinct from the method employed in rating general tax obligations. I would appreciate your comments in writing, if possible, whether pro or con, in order to prepare a paper for submission to the rating service.

PRESENTATION OF GEORGE T. MEHOLICK
BUSINESS ADMINISTRATOR
WOODBIDGE, NEW JERSEY

T O

NEW JERSEY TAX POLICY COMMITTEE
TASK FORCE F (Public Credit)

State Office Building
1100 Raymond Boulevard Rm 212
Newark, New Jersey
November 9, 1970

I N T R O D U C T I O N

The rapid development of science and technology over the past three decades have been accompanied by social, political and economic problems of ever growing complexity. In order to cope with these emerging problems, persons charged with the administration of local government are looking to the future with guarded optimism about the financing of these programs during the decade of the 70's. These problems which faced us in the 60's not only remain but have become very critical. In fact, while the 60's were dubbed as the decade of protest and unheralded confrontation, the very basic structure of local government was being shaken and the viability of home rule and local government tested. We are being challenged as never before and innovative solutions to problems must be found within our financial capability. The treasury of local governments are sorely in need of revenues to meet these problems and at the same time

- 1) The Municipal Debt has reached an all time high
- 2) Interest Costs are at the highest levels in history
- and 3) Urban needs are critical with great stress being placed on the conservation of our natural resources and human ecology in the forefront. Urban blight, poverty, air and water pollution, drug abuse, transportation and housing are problems that cannot be ignored.

As our population continues to multiply as pointed out by Dr. Paul Ehrlich in his recent book titled The Population Bomb, we must utilize population control or face a race to oblivion. If we continue to grow at our present rate, we will double our population in the next thirty years and in effect double the capital

-2-

improvements that have been built since the days of our founding fathers. Technology in effect played a major role in getting us where we are today and we must insist that technology and science be utilized in a major role to get us out so to speak. Cheaper and more standardized methods must be found to build streets, sewers, roads, airports, housing and solid waste disposal units. The status quo and multiple excuses for one reason or another can no longer be tolerated.

THE PROBLEMS

The ability of local governments to meet the minimal needs of capital outlays is being questioned, studied, reviewed, regretted and unrecouped. Year by year we have witnessed a steady erosion of the property tax base which is the major source of revenues to finance municipal capital outlays. The decade of the 60's saw the greatest growth in municipal debt that this country has seen to date as detailed in Exhibit "A" and it is safe to predict that the 70's will show "That you haven't seen anything yet". Let us examine some of the problems so as to help us in examining methods to finance same:

- * Housing is consistently lagging way behind documented needs.
- * Public Works Programs such as solid waste collection and disposal, sanitary waste treatment, air pollution, street construction and water conservation are five to ten years behind schedules.
- * Transportation problems are increasing at a greater rate than solutions or financing methods are found.

-3-

EXHIBIT "A"

CHRONOLOGY OF NATIONAL SUMMARY OF
TOTAL MUNICIPAL DEBT OUSTANDING AT
END OF FISCAL YEAR*

<u>YEAR</u>	<u>AMOUNT</u>
1967-68	\$37,505,000,000
1966-67	35,256,000,000
1965-66	33,714,000,000
1964-65	31,862,000,000
1963	28,743,000,000
1962	26,819,000,000
1961	24,804,000,000
1960	23,178,000,000
1959	22,057,000,000
1958	20,355,000,000
1957	19,076,000,000
1956	17,560,000,000

*SOURCE: THE INTERNATIONAL CITY MANAGE-
MENT ASSOCIATION, THE MUNICIPAL YEAR
BOOK - 1970.

-4-

- * School Construction and present curriculums are inadequate to meet present needs let alone the needs of the 70's.
- * Decay in our central cities is not being checked, it is in fact increasing.
- * Hospital and health needs for our senior citizens are being neglected and inadequate to meet the needs of today.
- * Construction costs are at an all time high and provide no evidence of at least leveling off.
- * The cost of local financing over the past ten years and in the last few in particular have sky rocketed. Exhibit "A" indicates that we have doubled our bonded indebtedness over a ten year period between 1957 to 1967.
- * Interest rates in the 6-8 per cent range are far to high and municipal investors are fewer in number when it comes time to bid.

These are some of the constraints and problems that confront local administrators today and in the future. In addition, the competitive money market requires, indeed mandates, that the finance administrator of today be very knowledgeable about the municipal bond market, its trends and marketing techniques so that municipal bond sales will be sold at costs which local governments can justify and afford to pay.

R E C O M M E N D A T I O N S

Exhibit "A" outlines the latest figures on municipal debt expenditures over a ten year period which is doubled from \$19,070 million in 1957 to \$37,505 million in 1967. New Jersey municipalities pretty well follow this national trend. To meet the needs of the most urbanized state in the United States, I re-

-5-

spectfully submit the following for your study and review:

- 1). Approximately one third of the municipal debt in Exhibit "A" are Revenue Bonds. I sincerely feel that self liquidating bonds should be encouraged but the pledging of the full faith and credit of the municipality is essential if these bonds are to be successful in the bond markets of the future. A good example is New Jersey Statutes concerning the financing of Swimming Pool Facilities.
- 2). Municipal Bonds should be exempt from all or any State or Federal Taxes. A recent attempt in the Congress was noted lately, to remove such tax exemption.
- 3). "Pay as you go" is a laudable principle and should be used when a community is wealthy enough to utilize this means; however, the very great majority of local governments must continue to look for short and long term borrowing or fall far behind in needed capital construction and equipment.
- 4). I strongly urge the creation of a Central Credit Agency which will serve all New Jersey municipalities. This agency would assist all communities who are considering bond issues and in particular, many New Jersey communities who have no knowledge of marketing procedures and time after time fail to receive any bids.

-6-

This Central Credit Agency could very well become a part of the Debt Management Program that the Department of Community Affairs administers through the Division of Local Finance.

- 5). The present high interest rates on Municipal Bonds must be reduced. It appears it may be several years before municipal bond investors will feel free to purchase long term municipal bonds with confidence that the income will be tax exempt throughout the life of the municipal bond. Unless and until an amendment to the constitution of the Federal Government is adopted, which establishes a permanent and unequivocal tax exemption of local government bonds, bond buyers will be obliged to assume that the Congress or the Courts may modify the present tax exemption at any subsequent time. Thus, the consideration of say a Federal Urban Bank or a State Urban Bank to backup Municipal Bonds by guaranteed interest payments until refinancing needs are met or outright purchases of certain local government debt by federal refunding grants, should be studied.
- 6). The Joint Economic Committee of the Congress of the United States in a study published in December, 1966 titled State and Local Public Facility Needs and Financing estimated that the total needs of local government would rise from about \$33,560 million in 1965

-7-

to more than \$65,000 million in 1975. Thus, the inter-relationship of short and long term financing, interest costs, available and interested markets and the ability of local government to raise needed funds should be very carefully examined as never before in light of the expenditures of this magnitude of money. Therefore, it seems to me that one ought to seriously consider the continuance and expansion of the Debt Management Program presently limited in scope, funding and areas of responsibility. I further suggest that the following matters be examined by the Debt Management Group and request that ^{they} report to you their findings both pro and con.

- a). Increase state and federal grants-in-aid to local governments - particularly where urban decay and financing for capital improvements for same are impossible and improbable by local revenue sources.
- b). Investment of state and local government pension and retirement funds along with other funds not needed in short and long term municipal bonds.
- c). Improve marketing programs. This may mean a program of inducing individuals of modest means who have been buying taxable securities to choose tax exempt municipal securities as part of his investment choices.
- d). A possible revision of the statutory debt limits for municipal and school financing. In particular, the provision of averaging out the last three years of assessed valuation seems ultra conservative. The benefits of revaluation is not realized until almost four years have gone by.

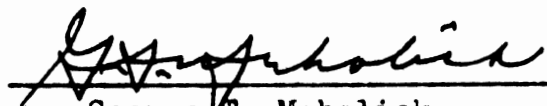
-8-

- e). That a state wide revaluation program be instituted as soon as possible. In my opinion, there are startling differences to say the least not only in method and approach, but in the equalization program.
- f). Insist that the five (5) year capital programs be implemented and meaningful. Projections of not only capital program costs but a projection of financing costs which would include temporary financing costs of notes and other related costs. PPES - Planned Program Budget Systems should be encouraged which would include alternative actions concerning the proposed capital expenditures and utilize cost-benefit techniques along with PERT techniques.
- g). Provide local governments with capable and trained consultants who can analyse capital needs and the ability of a given community to finance same. These consultants can be made available from the Central Credit Agency or from the Debt Management Program. In any case, this will mean additional state personnel as the present debt management program needs manpower.

In closing, I am sure that you agree with me that honest and dedicated public administrators are the keystone of public confidence in local government. Therefore, the image of all of us, both state and local officials must always be upper most in our minds as we consider the alternatives in spending public monies. We should strive for the coveted title of "Watch Dog of the Public Treasury"

Finally, I strongly urge that the results of your study be directed at the citizenry in a persuasive education program, giving them the facts in language that they can understand what proper and informed action needs to be taken in the future.

November 9, 1970


George T. Meholick
Business Administrator

TOWNSHIP of WILLINGBORO
NEW JERSEY

Municipal Building

TRiangle 7-2200

November 9, 1970

Mr. John J. Magovern, Jr.
Chairman, Task Force F
New Jersey Tax Policy Committee
134 West State Street
Trenton, New Jersey 08625

Dear Mr. Magovern:

I am in receipt of your invitation of October 23rd to participate in the first of a series of public hearings before your Task Force on Public Credit.

I am sorry that my schedule and that of many members of our Association did not permit us to participate at your November 9th hearing. I will be meeting with our Association members in November at the Atlantic City Conference and I will bring the work of your group to their attention and suggest that if they have any recommendations to offer they may do so by correspondence to the above address.

I would also like to take this opportunity to offer one comment on the present statutes controlling debt limitations in our state. As you are undoubtedly aware, a township's valuations are averaged over a three-year period for this purpose. While this procedure might have some validity for well established municipalities, it creates an undue hardship on rapidly growing suburban municipalities. The Willingboro Township Board of Education has had to make two appearances before the New Jersey Commissioner of Education and the New Jersey Division of Local Finance to request extension of credit hearings. These hearings have been necessitated because the present statutes require that our borrowing capacity be related to an average valuation of \$140,000,000. based on the following years:

1967	-	\$123,000,000.
1968	-	\$140,000,000.
1969	-	\$159,000,000.

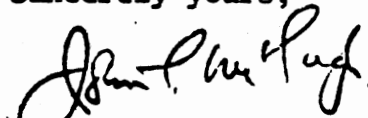
By contrast, our 1969 valuations were \$193,000,000. and our 1970 valuations were almost \$232,000,000.

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I do believe that a great deal of effort on the part of both local officials, their professional consultants and various state employees and officers could be saved if the basis for computing the debt limitation was amended to realistically include the valuations which have already been realized. To this end, municipalities and schools should be allowed to utilize valuations of that current year once they have been certified to their County Tax Bureau. I would of course have no objection to an off-setting percentage to allow for any reductions due to taxpayer appeals prior to the closing date for such appeals.

I trust I have set forth my concern in this matter adequately for your purpose. If I could provide any additional material or information, I would be more than pleased to hear from you.

Sincerely yours,



John T. McHugh,
Township Manager

JIMCH:bgs

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NEW JERSEY TAX POLICY COMMITTEE

TASK FORCE F (Public Credit)

**COMMENTS AND SUGGESTIONS CONCERNING PUBLIC FINANCE SUBJECTS OUTLINED
IN TASK FORCE MEMORANDUM FOR PUBLIC HEARING HELD NOVEMBER 9, 1970**

(The following memorandum is in two parts including (1) a summary of our findings and recommendations on each subject and (2) a detailed discussion of each subject).

PART I

SUMMARY OF FINDINGS AND RECOMMENDATIONS ON PUBLIC FINANCE SUBJECTS

1. Burden of Present Outstanding State and Local Debt

In order to properly evaluate the burden of present outstanding debt of New Jersey local governments it is necessary to concurrently consider the debt burden of the State government.

State Debt Burden: The total State debt (outstanding and authorized) totals \$1,582 million and represents 3.1% of the estimated full valuation of State ratables and 3.7% of the State's estimated 1969 personal income which is significantly higher than the corresponding 1.4% and 2.8% median figures for the 50 States. In addition, when we recognize (1) that there are conservatively estimated additional immediate State capital needs of over \$1,000,000,000, (2) that emissions by State agencies could total \$100,000,000 annually, and (3) the seemingly insatiable demands for further capital facilities such as nursing homes, mental health facilities, mass transportation, urban rehabilitation, etc. which can only be financed by the State or through State agencies, the need for the careful, selective and restrained application of the State's credit is imperative if the State's credit rating is to be maintained at its optimum level so that such capital projects can be financed by the State at the lowest possible interest rates.

Local Government Debt Burden: Based upon debt figures for New Jersey local governments as of December 31, 1969 the gross municipal, county and local authority debt totaled \$3,336 million,

representing 6.6% of the estimated \$50,884 million full value of State ratables.

It is most difficult to obtain any reliable statistics of local government debt of the 50 States to measure the debt burden of New Jersey local municipalities. However, we would judge that the debt load of New Jersey local governments is not significantly heavier than other States in relation to economic strength. In general, other States have more diversified revenue bases than New Jersey which relies heavily upon real estate levies. It is obvious that New Jersey must revamp its tax structure at both the State and local levels to more equitably share the costs of capital facilities and generate new and additional revenues to meet constantly higher costs of government.

2. Anticipated Credit Needs of State and Local Governments

The State expects to issue \$250 million bonds annually, local governments should require some \$200 million annually, existing State agencies will probably require \$100 million annually resulting in total annual bond emissions at the State and local government levels exceeding \$500 million annually for the foreseeable future. It is also probable that the New Jersey Turnpike Authority and the New Jersey Highway Authority will require sizeable bond issues during the next six year period. Also, the immediate State capital needs deficiency for which bonds have not yet been authorized total \$679 million without considering future State needs or the additional sums required to compensate for the continuing sharp increase in costs of construction.

3. Borrowing or "Pay-as-you-go"

Anyone familiar with the fiscal structure of both the State and local governments of New Jersey recognizes, like in most other States, that it will be impossible to finance capital projects on a "pay-as-you-go" basis in the present and foreseeable future. The costs of construction of public facilities and the costs of operating State and local government have escalated sharply in recent years.

In order to be able to finance the construction of capital projects at a cost which is economically practical it is absolutely essential that the required funds be raised through borrowing in the bond market. It is important that the period of amortization of the bond issue be no longer than the useful life of the capital project (New Jersey Statutes include practical limitations on periods of amortization).

4. The Use and Limits of Short-term Financing

During the recent years of historically high interest rates the use of short term financing by local governments in New Jersey has been

over done to the detriment of the borrowing costs of these local bodies. The crisis which developed in 1969 when many local municipalities had reached the expiration of their statutory limit on further short-term borrowing, coupled with the then prevailing 6% statutory interest rate limit which made long term permanent borrowing impossible for many local municipalities, would have been much less severe, if not avoidable, had these local municipalities borrowed in the long term market when they needed the funds rather than gamble on the unpredictable bond market.

We believe that the present statutory limits for short-term borrowing which permit short-term borrowing for two years without amortization and thereafter for three more years subject to minimum annual amortization payments are adequate and reasonable under present circumstances. A further precautionary step might be to require local municipalities prior to the fourth and fifth year of short-term borrowing to meet with the Division of Local Finance to discuss the advisability of undertaking such further extensions.

We would like to suggest that the State undertake an aggressive public relations program to make local governments in New Jersey aware of the advantages of including a refunding (callable) provision in their permanent bond issues during the present historically high interest rate period.

5. The Relationship of Anticipated Credit Needs to Present Statutory Debt Limits

We do not believe the present statutory limitations have any measurable effect upon the interest rates received by New Jersey municipalities on their bonds and, if anything, due to their conservative levels probably have a salutary effect. We strongly feel the fiscal discipline imposed by the present statutory limits far outweigh the only argument raised against such limits -- namely, that municipalities must subject themselves to the test of necessity before the Division of Local Finance -- if they desire to exceed the present limits. The Division of Local Finance is certainly best able to judge the reasonableness of the present statutory limits. Any increase in the present statutory limits should be taken only after careful study -- be limited in nature -- and not result in adversely affecting the present favorable ratings on the vast majority of New Jersey municipal bond issues.

6. Control and Expansion of Credit for Local Governments

- a. Possible Revisions of Statutory Debt Limits: - See comments in (5) above.
- b. Use of General Obligations vs. Revenue Bonds: The present general obligation laws permit allocating costs in all the ways available under revenue bond financing including those

based upon service (i.e., rate schedules), or upon the specific benefit derived (i.e., assessments), or upon the general benefits derived (i.e., property taxes) and can be sold at lower interest rates; therefore, the use of general obligation bonds by local governments in New Jersey will and should continue to be favored over revenue bonds.

The use of revenue bonds by regional authorities is the most practical means of financing of regional facilities such as sewerage, water and refuse disposal.

- c. Use of Local Authorities: Unless there are unique circumstances prevailing the use of local authorities should be avoided. The cost of financing is higher and the independence of local authorities from any responsibility to the elected municipal body are imposing disadvantages. However, the authority vehicle is the most practical approach to regional or multi-municipal financing.
- d. Access to Credit Market and Cost of Borrowing
 - i. Effect of Central Credit Facility: We feel the creation of a central credit agency is not needed and will only add a new State agency with its attendant worthwhile administrative and operating costs without providing any supplemental services to enhance the public credit situation in New Jersey. The availability of expert fiscal advice to all New Jersey municipalities from the Division of Local Finance and the private investment banking firms and banking institutions, together with the proven marketing structure which has provided all New Jersey municipalities, large and small, with capital funds at competitive interest rates regardless of credit market conditions dictate against the need for such an agency.
 - ii. Possible Improvements in the Statutes: The bonding statutes in New Jersey are among the best in the Nation. The only suggested changes in the present statutes which might be helpful would be to require local municipalities to consult with the Division of Local Finance prior to the fourth and fifth year extensions of short-term financing, the need for local authorities to be given the power to assess and to issue assessment bonds and consideration of enactment of a State industrial revenue bond statute.
 - iii. Use of a Municipal Bond Financing Agency and State Sewerage Agency: In the light of the actual experience over many years, and particularly during the high interest, tight money conditions prevailing during the last year or so, during which time New Jersey municipalities in their independent undertakings found adequate capital for financing their

improvements at competitive rates, together with the high present need and the continuing growing demands for public improvements which can only be financed at the State level, we do not feel it is necessary nor in the best interests of the State to create the proposed New Jersey Municipal Finance Agency because we believe (1) it will have an adverse effect upon the high credit rating of the State of New Jersey and its ability to finance at the lowest possible interest cost, (2) result in only limited savings to certain local municipalities, (3) result in creation of another State agency with its attendant ever increasing operating and administrative costs, (4) inject some \$200,000,000 more State bonds into the bond market in direct competition with the \$250,000,000 presently authorized State bonds and \$100,000,000 existing State agency bonds which must be sold annually (5) permanently damage the proven marketing structure for local New Jersey bonds and (6) undermine local government self-reliance.

Another New Jersey public credit agency being considered is a State sewerage authority. We believe that the objectives of such a State agency can be better achieved through amendment of the present statutes for creating county and multi-municipal sewerage authorities.

- e. Debt Management Facilities: The debt management facilities provided by the State Division of Local Finance have been excellent. The outstanding services being provided by this Division has been the prime factor in achieving of the acceptance of New Jersey municipal bonds by virtually every substantial professional institution in the United States which invests in tax free municipal obligations.

We have no suggestions to make concerning means of improving the high caliber of the services of the Division of Local Finance.

7. Value of Tax Exempt Aspects of State and Municipal Financing

It is imperative that interest on municipal bonds remain tax-exempt in order to retain for the State and local municipalities tax-free bonds -- the proven financing instrument which permits the raising of funds for capital projects at the lowest possible cost.

PART II

DETAILED DISCUSSION OF FINDINGS AND RECOMMENDATIONS ON PUBLIC
FINANCE SUBJECTS

1. Burden of Present Outstanding Local Debt

In order to properly evaluate the burden of present outstanding debt of New Jersey local governments it is necessary to concurrently consider the debt of the State government. The funds to pay State bonds derived from sources outside of New Jersey is nominal. Therefore, the true burden of debt which the residents and businesses in New Jersey must support is the total of local and State debt.

With this in mind let us analyze the present debt burden for both State government and local government in New Jersey.

State Debt Burden: The State debt picture, after giving effect to the last sale of \$75,000,000 bonds in July 1970, is as follows:

State Bonds Outstanding	\$ 608,870,000
State Bonds Authorized but Unissued	<u>973,500,000</u>
Total State Bonds	\$1,582,370,000*

*Does not include \$228,000,000 New Jersey Highway Authority bonds guaranteed by State.

Based upon the above State debt of \$1,582,370,000 the debt burden transforms from its present moderate level (based only on presently outstanding State bonds) to being significantly above the median debt burden for the 50 States, as indicated below:

<u>Direct Net Debt</u>	<u>% Est. Full Value</u>	<u>% 1969 Personal Income</u>
New Jersey	3.1%(1)	3.7%(2)
Median - 50 States(3)	1.4%	2.8%

- (1) Based on estimated Full Value of \$50,884,621,000.
- (2) Based upon estimated personal income per capita of \$4,278 in New Jersey in 1969.
- (3) Computed by national statistical service.

The State debt burden shown above must be further adjusted by giving effect to potential additional demands for State financing and to take into account the outstanding and prospective debt of various existing State agencies.

The Commission to evaluate the capital needs of the State in its 1968 report stated that "the price of these years of inactivity in capital appropriations is now very large. But it must be paid if we are to prevent further atrophy and create a viable and progressive State." The Commission reported that the immediate capital requirements for State projects alone amounts to \$1,948.9 million itemized as follows:

Recognized Capital Requirements:

(Financing required in addition to projected Federal aid and State appropriations)

	<u>Millions</u>
Education (Elementary & Secondary including Vocational)	\$ 227.5
Education (Higher)	492.4
Educational Broadcasting Network	17.4
Institutions	100.0
Water Pollution Control	190.6
Conservation	121.0
Transportation	<u>800.0</u>

Total Recognized State Capital Requirements . . \$1,948.9

Of this total immediate need, the State voters have approved the sale of State bonds totaling \$1,261 million (i.e., 1968- \$990 million for transportation and school and hospital buildings; 1969- \$271 million for water pollution control and water supplies). These State bond authorizations are reflected in the aforementioned figures. Therefore, there remains a minimum need for additional State debt of \$679 million to meet the immediate capital needs for State projects.

The above immediate State capital needs are based upon 1968 cost levels. It is important to note that the eroding effects of inflationary forces have already made the proceeds from the \$1,261 million authorized State bonds substantially inadequate to construct the capital projects envisioned at the time such bond referendums were held. State officials would be able to more precisely estimate the amount of such "inflationary deficiency." In one area with which we are familiar, that of water pollution control, we would estimate that an additional \$200 million would be needed to finance the State's 25% share of regional water pollution facilities due to a combination of "inflationary deficiency" and the addition of the Passaic Valley Sewer Commission's needs which were not included in the \$271 million Clean Water State bond issue approved in 1969.

The remaining area of State debt which must be considered is State agency debt. We will dismiss the debt of the New Jersey Turnpike Authority and the New Jersey State Highway Authority (while recognizing that some \$228,000,000 New Jersey Highway Authority bonds are guaranteed by the State) as being self-supporting from tolls of their respective

facilities. The other New Jersey agencies with proposed bond programs are as follows:

New Jersey Housing Agency
New Jersey Higher Educational Facilities Authority
New Jersey Higher Education Assistance Authority
New Jersey Mortgage Finance Agency

The current bonding programs of the State agencies require the issuance of more than \$100,000,000 bonds. The year-to-year demand for bond funds by these State agencies is difficult to estimate because their programs are greatly affected by conditions in the money markets (i.e., the availability of private funds). Under the present high interest rate conditions bond emissions by these State agencies could readily require \$100,000,000 annually.

Summary of State Debt Burden: The debt burden of the State (outstanding and authorized) is significantly higher than the median of the 50 States. In addition, when we recognize (1) that there are conservatively estimated additional immediate State capital needs of over \$1,000,000,000, (2) that bond emissions by State agencies could total \$100,000,000 annually, and (3) the seemingly insatiable demands for further capital facilities such as nursing homes, mental health facilities, mass transportation, urban rehabilitation, etc., which can only be financed by the State or through State agencies, the need for the careful, selective and restrained application of the State's credit is imperative if the State's credit rating is to be maintained at its optimum level so that such capital projects can be financed by the State at the lowest possible interest rates. (If the State's "AAA" rating is lowered to "AA" because of the escalating issuance of State bonds for other than State government purposes the interest rate on State bonds could increase by 1/4 of 1%, which, when applied to the balance of the approximate \$1,000,000,000 State bonds yet to be sold, the annual interest cost increase would be \$2,500,000).

Due to the large current and projected State capital needs, we strongly oppose the application of the State credit, directly or indirectly, to other than meeting the State's capital needs. It is vital that local governments continue to be responsible for financing capital needs at the local level. Therefore, we are opposed to the creation of the New Jersey Municipal Finance Agency as well as the State guaranteeing up to \$500,000,000 local municipal bonds to be issued for water pollution projects. In connection with the latter proposal it must be realized that the State will have to consider authorizing an additional \$200,000,000 or more in State bonds if it desires to achieve its objective of funding 25% of the cost of regional water pollution projects.

Debt Burden of Local Government: Let us now review the debt burden of New Jersey local governments:

Debt figures for New Jersey local governments for 1969, are reported as follows:

	<u>Gross Debt</u>
Debt - Municipal	\$ 2,521,855,625
Debt - County	<u>428,172,500</u>
Total	\$ 2,950,028,125
Estimated Full Valuation	\$50,804,621,000
Gross Debt to Estimated Full Valuation	5.80%
Authority Debt	\$ 386,051,017
Authority Debt to Estimated Full Valuation	0.76%
Gross Debt and Authority Debt.	\$ 3,336,079,142
Gross Debt and Authority Debt to Estimated Full Valuation	6.56%

We are not aware of comparative statistics of local government debt of the 50 States to measure the debt burden of New Jersey local municipalities. However, we would judge that the debt load of New Jersey local governments is not significantly heavier than other States in relation to economic strength. In general, other States have more diversified revenue bases than New Jersey which relies heavily upon real estate levies. It is obvious that New Jersey must revamp its tax structure at both the State and local levels to more equitably share the costs of capital facilities and generate new and additional revenues to meet constantly higher costs of government.

Anticipated Credit Needs of State and Local Governments: Since the State and local governments are vying for the available capital funds in the bond market, it is important to consider both areas when evaluating anticipated credit needs.

At the local government level there are about 1,400 separate jurisdictions in New Jersey which can issue bonds to meet capital needs, including about 600 school districts, 570 municipalities, 21 counties and 180 authorities and special districts. While we have not seen any figures concerning the future capital demands for New Jersey local governments, based upon our historical records we would estimate that such demands will continue at the \$200,000,000 annual level of recent years. The State has indicated that its objective would be to hopefully sell the present authorized but unissued State bonds at an annual rate of \$250,000,000. In addition, we must consider the probability of \$100,000,000 of State agency debt annually.

Therefore, the State and its agencies and local governments will be issuing bonds exceeding \$500,000,000 annually. It is also probable that the New Jersey Turnpike Authority and New Jersey Highway Authority will require sizeable bond issues in the foreseeable future to meet their ever growing demands. Also, as mentioned above, the immediate State capital deficiency based upon 1968 costs total \$679 million without considering future State needs or the additional sums needed to compensate for constantly higher costs of construction.

2. Borrowing or "pay-as-you-go"

Anyone familiar with the fiscal structure of both the State and local governments of New Jersey recognizes, like in most other States, that it will be impossible to finance capital projects on a "pay-as-you-go" basis in the present and foreseeable future. The costs of construction of public facilities and the costs of operating State and local government have escalated sharply in recent years. To illustrate this point, in the early 1950's New Jersey sewerage authorities financed sewer systems with annual residential sewer rates of \$40 to \$50. A large regional sewer system financed in 1970 has an annual residential sewer rate exceeding \$200 (and this is based upon amortizing the capital cost over a 40 year period).

In order to be able to finance the construction of capital projects at a cost which is economically practical it is absolutely essential that the required funds be raised through borrowing in the bond market. It is important that the period of amortization of the bond issue be no longer than the useful life of the capital project (New Jersey Statutes include practical limitations on periods of amortization).

4. The Use and Limits of Short-Term Financing

During the recent years of high interest rates the use of short-term financing by local governments in New Jersey has been unprecedented. It is understandable that local officials are most reluctant to borrow permanent funds when interest rates are at historically high levels. However, the local official should also be aware that unless such short-term borrowing is dictated by reasons other than the state of the credit market (i.e., because construction is not yet on a firm contractual cost basis, etc.), that he is subjecting his constituents to a potentially higher bonding cost by gambling on an unpredictable bond market.

The dangers of abusing the use of short-term borrowing was well illustrated during the last year or so when a number of New Jersey municipalities had reached the end of their statutory short-term borrowing period and they had to rely upon emergency action by the State Legislature to extend the period and declare a moratorium on interest rate limitations in order to avoid default. In most instances such emergency legislative action would have been unnecessary if local officials had faced up to

their responsibility and permanently financed their projects when they needed the money rather than prove to be unsuccessful gamblers in the complex and volatile bond markets.

We believe that the present statutory limits for short-term borrowing which permit short-term borrowing for two years without amortization and thereafter for three more years subject to minimum annual mortization payments is adequate and reasonable under present circumstances. A further precautionary step might be to require local municipalities prior to the fourth and fifth year of short-term borrowing to meet with the Division of Local Finance to discuss the advisability of undertaking such further extensions.

We would also like to suggest that the State undertake an aggressive public relations program to make local governments in New Jersey aware that they can incorporate refinancing provisions in their bond issues which will permit them to refinance at lower interest rates prior to the maturity of their bond issue should bond market conditions justify such refinancing. There is some cost involved in including a refinancing provision but in today's historically high interest period we believe municipalities will find the cost insignificant when measured against the prospects of refinancing at lower rates substantially prior to the maturity of most bond issues.

5. The Relationship of Anticipated Credit needs to Present Statutory Debt Limits

The present statutory debt limits in New Jersey can be considered conservative. The applicability of these statutory limits varies widely as among municipalities. For example, many smaller communities which financed their schools, water and sewer facilities and other basic municipal services during the low-cost period of the 1930's probably are not approaching the statutory limits. Whereas, many of the larger cities and fast growing communities which have had to finance during the recent high cost period are constantly challenged by the present limitations. Since the statutory limits may be exceeded with the approval of the Division of Local Finance, where the need is justified, the present statutory limits appear flexible enough to accommodate anticipated credit needs.

We do not believe the statutory limitations have any measurable effect upon the interest rates received by New Jersey municipalities on their bonds and, if anything, due to their conservative levels probably have a salutary effect. We strongly feel the fiscal discipline imposed by the present statutory limits far outweigh the only argument raised against such limits -- namely, that municipalities must subject themselves to the test of necessity before the Division of Local Finance -- if they desire to exceed the present limits. The Division of Local Finance is certainly best able to judge the reasonableness of the present statutory limits. Any increase in the present statutory limits should be taken only after careful study -- be limited in nature -- and not result in adversely affecting the present favorable ratings on the vast majority of New Jersey municipal bond issues.

6. Control and Expansion of Credit for Local Governments

a. Possible revisions of statutory debt limits -- See comments in (5) above.

b. Use of General Obligations vs. Revenue Bonds: The use of revenue bonds by municipalities (as distinguished from authorities) in New Jersey has been very limited. The reason for this is that New Jersey has one of the most flexible financing laws relating to general obligation financing in that it permits self-supporting municipal utilities to be financed with general obligation bonds and also permits assessment financing where this is the most equitable means of allocating capital cost. Since the present general obligation laws permit allocating costs in all the ways available under revenue bond financing including those based upon service (i.e., rate schedules), or upon the specific benefit derived (i.e., assessments), or upon the general benefits derived (i.e., property taxes), and the fact that general obligation bonds can be sold at lower interest rates the use of general obligation bonds by local governments in New Jersey will and should continue to be favored over revenue bonds.

The use of revenue bonds by regional authorities is the most practical means of financing regional facilities such as sewerage, water and refuse disposal.

c. Use of Local Authorities: The use of local authorities (as distinguished from regional authorities) is subject to question. Unless there are unique circumstances prevailing (i.e., need to transfer administrative responsibility for a complex utility system from an overly burdened municipal body, etc.), local authorities should be avoided. The cost of financing is higher and the independence of local authorities from any responsibility to the elected municipal body are imposing disadvantages.

d. Access to the Credit Market and Cost of Borrowing:

1. Effect of Central Credit Facility: Over the years New Jersey municipalities have been able to obtain the guidance required in effecting the sale of their bond issues from the Division of Local Finance and from the many investment banking firms and banking institutions specializing in New Jersey municipal finance. Bonding attorneys and local auditing firms have also been very helpful to local municipalities in establishing successful bonding programs. Therefore, there has been available and continues to be available to all New Jersey municipalities the professional expertise and assistance both from the State government and private investment banking firms and banking organizations that is necessary to establish a sound bond financing program and consummate the successful sale of their municipal bonds.

The marketing structure for New Jersey municipal bonds has proven to be among the most efficient in the Nation. This is due in great measure to the many investment banking firms and New Jersey banking institutions who dedicate themselves to bidding, trading and distributing municipal bonds of every municipality in New Jersey offering bonds or notes for sale. The prices received by New Jersey municipalities for their bonds have been at competitive levels dictated by the supply and demand factors of the credit market.

The idea of packaging many smaller issues into one large issue of bonds to be sold by the State appears to be sound in theory, but in practice it will not prove significantly beneficial. The reason for this is that those bidding on the larger package must, of necessity, base their bid upon the credit strength of the constituent municipalities comprising the package. Therefore, the price paid for the municipal bonds offered individually versus that which would be paid for a larger package of the same relative credit quality will not vary significantly. We believe all New Jersey municipalities, large and small, have received bids from private municipal bond specialists for their bond issues. Their bids have reflected competitive interest rates based upon prevailing bond market conditions. Therefore, we do not see the need for packaging of municipal bonds and question that any tangible advantage would result from this procedure.

Another purported justification for creating a central credit facility is that it might provide the means for establishing a State municipal bond rating system which would be more equitable than the established private rating agencies. Greater interest in this idea has been evoked by the recent decision by Moody's and Standard & Poor's to charge for municipal ratings. The philosophical justification for such fees is unimportant because they are now a matter-of-fact. No one will deny the tangible influence in the market place of ratings assigned by these agencies. They are presently used by virtually all investors as the standard measurement of credit. It will be very difficult to develop another rating agency at the State level to challenge the market influence of these recognized agencies. Perhaps a nationally sponsored rating agency might most nearly provide a substitute but no one has been able to structure such a body and develop the nationwide financial sponsorship required.

In summary, we feel the creation of a central credit agency is not needed and will only add a new State agency with its attendant substantial administrative and operating costs without providing any worthwhile services to enhance the public credit situation in New Jersey. The availability of expert fiscal advice to all New Jersey municipalities from the Division of Local Finance and the private investment banking firms and banking institutions, together with the proven marketing structure which has provided all New Jersey municipalities, large and small, with capital funds at competitive interest rates regardless of credit market conditions dictate against the need for such an agency.

ii. Possible Technical Improvements in the Statutes: The bonding statutes in New Jersey are among the best in the Nation. Except for possibly requiring local municipalities to consult with the Division of Local Finance prior to the fourth and fifth year extensions of short-term financing, the need for local Authorities to be given the power of assessment and consideration of enactment of a State industrial bond statute which are discussed below, we feel the statutes are satisfactory.

We believe that the passage of Assembly 1013 which supplements the Sewerage Authorities Law would be very beneficial. Under the Sewerage Authorities Law when an Authority is created it is given the exclusive right and power to finance, construct and operate all facilities for the collection of sewage within its municipal boundaries. In order to meet this very important duty and obligation in the most expeditious and efficient way it is absolutely essential that an Authority have all the financing "tools" available to it.

One of the most practical and equitable methods for financing sewer collecting lines is by special assessment. The fact that this method is not available to Sewerage Authorities has stymied the construction of vitally needed sewer facilities in New Jersey. The reason for this is that in various instances the elected municipal officials have not been willing to risk the possible negative election consequences inherent in financing sewer lines via the assessment route. In such instances the local Sewerage Authority, not having the right to assess, is unable to perform its legal obligation to provide these sewer facilities. This most unfortunate void in Sewerage Authority financing should be rectified by the passage of Assembly 1013. A more detailed discussion of Assembly 1013 is appended as Exhibit "C".

We suggest that New Jersey consider the enactment of industrial revenue bond legislation. This suggestion is

occasioned by our having been approached recently by two of our corporate clients concerning the advantages of their locating plants in New Jersey or in our neighboring States of New York, Delaware or Pennsylvania, all of which have such industrial revenue bond statutes. They eliminated New Jersey from consideration after they were informed New Jersey did not have an industrial revenue bond act. Some 40 States have industrial revenue bond statutes. Under industrial revenue bond financing the local municipality or authority would issue its tax-exempt bonds (limited to \$5,000,000 by Internal Revenue except for sewers, stadiums and other specific purposes) to construct the industrial plant and the bonds would be repaid solely from annual lease payments received from the industry. The pledge of the State's credit directly, or indirectly, (i. e., as in proposed municipal bond financing agency -- Senate No. 958), should be specifically prohibited.

iii. Use of Municipal Bond Financing Agency -- The Need for a State Sewerage Authority: In considering the advisability of creating a municipal bond financing agency we must briefly reemphasize the present status of the State's credit and the prospects of future general obligation debt emissions by the State together with prospective bond issues of the various State agencies. At present New Jersey general obligation bonds are rated "Aaa" by Moody's and Standard & Poor's. There are presently about \$1 billion of the \$1.2 billion general obligation bonds authorized by the voters yet to be sold. In addition, the following State agencies will have continuing bond issues to sell:

New Jersey Housing Finance Agency
New Jersey Higher Education Facilities Authority
New Jersey Higher Education Assistance Authority
New Jersey Mortgage Finance Agency

It is reported that the State would like to sell an average of \$250,000,000 of the presently unissued \$1 billion annually. The various present State agencies mentioned above could easily add an additional \$100,000,000 annually. Both the New Jersey Turnpike Authority and the New Jersey Highway Authority, during the immediately foreseeable period, are expected to require sizeable additional financing. We can expect that there will be additional State general obligations voted in the future to provide for the seemingly insatiable demand for State financed facilities. Additional State agencies will need to be created to finance vital projects which local governmental units are not willing nor able to undertake.

With this background of ever increasing demands upon the State to finance, either directly or through State agencies, those facilities which are the State's direct responsibility or which cannot be undertaken by local political entities, the advisability of creating the proposed New Jersey Municipal Bond Finance Agency may be best evaluated by answering the following question:

Is the limited potential temporary savings in interest cost on local municipal bonds vital enough to the economies of such local municipalities to expose the State to an additional potential \$200,000,000 or more of "contingent moral debt" and jeopardize the State's credit rating?

In focusing upon this question let us assume the New Jersey Municipal Bond Finance Agency initially receives a "AA" rating, one gradient lower than the present "AAA" rating assigned to the State of New Jersey Bonds, (such a rating relationship prevails in New York and Pennsylvania with agencies having a reserve fund which the State Legislature must maintain by appropriation). Based upon this assumption it is conceivable and under the terms of the proposed Act all of the municipalities, school districts and authorities having ratings lower than "AA" might gain a fractional savings in interest cost by selling their bond issues to the Agency rather than in the private market. Probably 90% of the municipalities, school districts and local authorities in the State of New Jersey have ratings lower than "AA". (Even if the Agency received an "A" rating the majority of municipalities in New Jersey might realize some limited benefit in utilizing the Agency financing route).

If this sequence of events should occur the amount of agency bonds and notes issued could easily reach \$200,000,000 annually, and outstanding debt of the agency would quickly escalate to substantial balances. As such bonds and notes represent a contingent liability, morally or otherwise, of the State of New Jersey the present "AAA" rating of the State would be jeopardized. If the State rating should be lowered due to the heavy contingent liability represented by bonds of the Agency the cost of borrowing will be significantly increased to the State for those capital needs, which the State has the direct responsibility to finance through the issuance of its general obligation bonds or where the State through one of its agencies must provide bond funds because there is no other means of financing a vital public improvement. The downgrading of the ratings of the Commonwealth of Pennsylvania and the State of New York give credence to this possibility. Attached as Exhibits "A" and "B" are excerpts from Moody's Bond Survey of comments made at the time of lowering the

ratings of New York State and Pennsylvania and are very pertinent.

It is difficult to agree with the theory that this Agency can limit its activities to purchasing only municipal bonds of those municipalities in dire financial need. We feel that in practice it would be very difficult to deny any New Jersey municipality this means of financing, no matter how small the benefit.

It was early in 1969 when the thrust to create the New Jersey Municipal Bond Bank (now to be called New Jersey Municipal Bond Finance Agency), was last considered by the State Legislature. New Jersey was not alone in its municipal financing dilemma at that time. All the other States were experiencing the same difficulty. The Legislature, following the lead of other States, wisely lifted the 6% interest rate limitation and the panic and concerns of imminent defaults on note borrowing by New Jersey municipalities immediately disappeared. Every New Jersey municipality was immediately able to finance its municipal improvements at the going rates established by the supply and demand factors of the market.

In summary, in the light of the actual experience over many years, and particularly during the high interest, tight money conditions prevailing during the last year or so, during which time New Jersey municipalities in their independent undertakings found adequate capital for financing their improvements at competitive rates, together with the high present need and continuing growing demands for public improvements which can only be financed at the State level, we do not feel it is necessary nor in the best interests of the State to create the proposed New Jersey Municipal Finance Agency because we believe (1) it will have an adverse effect upon the high credit rating of the State of New Jersey and its ability to finance at the lowest possible interest cost, (2) result in only limited savings to certain local municipalities, (3) result in creation of another State agency with its attendant ever increasing operating and administrative costs, (4) inject some \$200,000,000 more State bonds into the bond market in direct competition with the \$250,000,000 presently authorized State bonds and \$100,000,000 existing State agency bonds which must be sold annually, (5) permanently damage the proven marketing structure for local New Jersey bonds and (6) undermine local government self-reliance.

Another New Jersey credit agency that is presently being considered is a State sewerage authority. It is argued that such a State agency would permit the State to more expeditiously move ahead with regional

water pollution facilities where local initiative is lacking. We believe that this objective can be better achieved through amendment of the present statutes for creating county and multi-municipal sewerage authorities rather than by creating another State agency. Such amendment could permit the creation of regional authorities at the recommendation of the State Department of Environmental Protection. The governing bodies of the municipalities comprising the drainage area, or the county freeholders of the county or counties involved, could be given a specified period of time to appoint members to the State imposed local regional authority. If such local officials did not appoint members within such period the State Department of Environmental Protection could make the appointments. This approach would achieve the desired objective without the need for creating another State agency to finance, operate and control local regional facilities.

The major need in realizing the construction of regional water pollution control facilities is for the State Department of Environmental Protection to use every moral and legal power available to it (court ordered cessation of building in a particular community, etc.) to persuade municipalities and local authorities to sign agreements with regional authorities and thus provide the security base required for the regional authority's bonding. The reluctance of municipalities and local authorities, primarily because of political considerations, to enter into agreements which will of necessity require higher local sewer charges, even though it is the most economical way to comply with State statutes is the most serious impediment to the early realization of modern regional water pollution facilities.

e. Debt Management Facilities: We believe that the debt management facilities provided by the State Division of Local Finance are among the most competent and progressive of any State in the Nation.

The conservative credit standards which this Division applies to those municipalities seeking to borrow in excess of this statutory limits has had a most salutary result. The public relations programs and the recent efforts of the Division to gain improved ratings for those New Jersey municipalities with sub-standard ratings was most helpful.

The outstanding services being provided by this Division has been the prime factor in achieving of the acceptance of New Jersey municipal bonds by virtually every substantial professional institution in the United States which invests in tax free municipal obligations.

We have no suggestions to make concerning means of improving the high caliber of the debt management services offered by the Division of Local Finance.

7. Value of Tax-Exempt Aspects of State and Municipal Financing

The value of tax-exempt aspects of municipal bonds was amply demonstrated in 1969 by the increase in interest rates on municipal bonds resulting from the threat of proposed Federal legislation which would have imposed a tax upon the interest on municipal bonds. It was found that the mere threat of such a tax caused an increase of 1/2 of 1% in the interest rates on high quality State bonds. To be more specific, an increase of 1/2 of 1% in interest rates would add \$6,250,000 per year to the cost of financing the State's present capital program and about \$1,000,000 annually to local governments in New Jersey based upon the historic \$200,000,000 volume of local bonds.

Assuming New Jersey municipalities will continue to sell \$200,000,000 bonds each year, the additional interest cost would build up to \$15,000,000 per year before new bond sales and old bond maturities reach equilibrium. Revenues to cover this additional cost would have to be obtained by increasing real estate taxes. The overall effect of an increase of 1/2 of 1% in interest rate at the State and local levels in New Jersey would be an increase in motor fuels, sales and real estate taxes by at least \$21,000,000 per year.

A careful study by the Investment Bankers Association of the suggestion that the Federal Government subsidize State and local municipalities for the added cost which would result from their issuing taxable bonds rather than tax-exempt bonds, reached the following conclusions: "In sum, after taking into account all capital market shifts and economic side effects, the IBA concluded that, even if the Treasury were to subsidize the interest cost of States and municipalities by no more than 32 per cent, the net loss to the Treasury would be \$66 million, and to all governments \$114 million, on each year's financing and if the Treasury should subsidize at 40 per cent of the interest cost, the net loss would be \$115 million for the Treasury and \$163 million for all governments. These figures are for each year's financing and would accumulate year after year."

It is imperative that interest on municipal bonds remain tax-exempt in order to retain, for the States and municipalities, the proven financing instrument which permits the sale of bonds at the lowest possible interest cost.

Excerpt from Moody's Bond Survey - March 11, 1968
concerning lowering of rating on Commonwealth of
Pennsylvania Bonds from "AA" to "A".

Tax-Exempts

Month-Long Decline in Prices Continues

Last week's new issues sold at prices five to ten basis points cheaper than issues of corresponding quality of a week ago. Despite this circumstance, investor reception was highly selective, showing a preference for quality bonds at concession prices. Although housing bonds are a unique tax-exempt security, the new issue looked very rich.

Still lacking is any evidence that the market has found a workable level.

Commonwealth of Pennsylvania

State Public School Building Authority, General State Authority and the Commonwealth

The State Public School Building Authority plans to market \$40,000,000 school lease revenue bonds, series X, on March 12.

Purpose: The bonds will be issued to finance the cost of 14 separate school building projects, including two community college building projects and to pay the related legal, trustee, financing and administrative expenses.

Security: Series X bonds, together with \$406,333,000 parity bonds, series D through W, will be secured by the aggregate rentals payable to the authority by the lessee school districts. As lessee, a school district (or districts in jointure) agrees to pay an annual rental to the State Public School Building Authority sufficient to (1) cover the author-

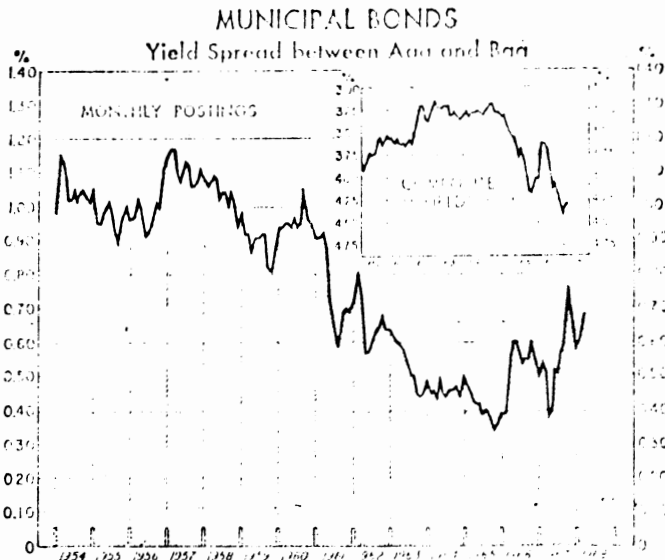
ity's administrative expenses not provided for by the state; (2) pay bond principal and interest; and (3) establish a debt service reserve (over a ten-year period) equal to average annual debt service. Each lease specifies an annual rental which, when combined with all rentals due under all parity bond issues, will average not less than 110% of average annual aggregate debt service requirements. School districts are empowered to levy unlimited ad valorem taxes for rental payments. In addition, the individual district is responsible for all costs of operating and maintaining the building. The state will reimburse the district for a portion of its lease rental; the exact amount of the grant will vary from year to year under the Pennsylvania formula for school aids.

Additional Bonds: Additional parity lien bonds may be issued if aggregate annual rentals under leases securing outstanding and additional bonds and executed prior to the date of the indenture afford a coverage of 1.10 times average annual debt service requirements.

However, in the case of financing the cost of acquiring or constructing additional projects, additional bonds may be issued only on the basis of agreements and leases to be deposited with the trustee if aggregate annual rentals average at least 1.20 times the average annual debt service requirements on such additional bonds in each fiscal year beginning with the year in which the latest date when a payment of rental first shall be payable to the trustee.

Community Colleges: Pursuant to the Pennsylvania Public School Code of 1949 (as amended by Act No. 50, July 18, 1967), the authority is now empowered to undertake projects consisting of the construction, maintenance and equipment of community colleges. Said facilities will be leased by the authority, as lessor, to the Board of trustees of a community college or to the Department of Public Instruction, as lessees. The department in turn will enter into subleases with the "local sponsor" (board of trustees of any city, borough, town, township or county) of a community college. Lease rentals (in an amount sufficient to pay debt service) payable by the department for community college building projects are payable from current revenues of the commonwealth. Further, certain payments and reimbursements are made for operating costs and capital expenses. The "local sponsor" is authorized to levy a tax for establishing, operating and maintaining a community college, the aggregate of which cannot exceed certain limits set up under the Community College Act.

Background: The authority was created by the legislature two decades ago. The authority device was selected as the most efficacious means of bypassing a restrictive constitutional provision limiting a school district's debt to 7% of its assessed value. Since then, various authority bonds have financed the bulk of Pennsylvania's postwar capital im-



provements, in conjunction with a program of legislative grants-in-aid. Authorities now are irrevocably entrenched in the mores of Pennsylvania's economic life. This authority has financed numerous school projects through a series of closed indentures (\$26,276,000 outstanding on Feb. 1, 1968, \$6.1 million of which is held by a state retirement fund). These bonds, together with \$406,388,000 other outstanding obligations (not including the present sale and \$56.9 million advance refunded bonds to be called in 1975), financed under the new open end indenture and refinanced on a parity with series X, comprise the entire indebtedness of the authority.

The complexity that has evolved under this new open end indenture as the result of the combined multitude of leases makes for a formidable analytical job. Further complications result from the credit variables while the indenture prescribes a 1.10 cover in all leases subsequently negotiated; it necessarily fails to spell out criteria relative to the credit worthiness of new lessees. Within the limits of legal liability, authority credit would be little better than the credit of the weakest lessees. As a composite, it would in theory vary from time to time as new leases are added.

The authority was originally conceived to finance predominantly rural districts lacking recognized credit stature. However, like many bureaucracies, the agency has expanded its activities and now competes with underwriters in negotiating loans to any school authority borrowers. As a result, the composite quality of the authority's holdings has been upgraded and management hopes that, given time, the

NEW TAX-EXEMPT ISSUES OFFERED

Sale Date	Dollar Amount (000)	Issue	Moody's Rating	Sec Page	Yields by Selected Maturities						Opinion
					5-yr.	10-yr.	15-yr.	20-yr.	25-yr.	Longest	
3/5	35,370	Illinois Building Authority Building	Rev. Aa	857	4.10	4.50	4.75C	4.90C	---	---	Concession priced.
3/5	30,000	Hawaii State of Various public improvements	A	854	3.90	4.15	4.35	4.50	---	---	In line.
3/5	24,000	Prince George's County, Maryland Various municipal facilities	A	854	3.95	4.20	4.40	4.55	5.40	---	Traditionally priced
3/6	143,810	Public Housing Agencies Low-rent (lot no. 1) Low-rent (lot no. 2)	Aaa Aaa	855 855	3.65 3.65	3.85 3.85	4.00C 4.00C	4.10C 4.10C	4.30C 4.35C	4.37C 4.50C	Rich Rich
3/6	21,000	Los Angeles Department of Water and Power (Los Angeles) California Electric	Rev. Aa	857	N.R.	4.25C	4.50C	4.65C	4.75C	4.85C	Attractive.

All issues are general obligations unless otherwise specified. Opinions here expressed relate to current market conditions and are a forecast and exclude reference to maturities tailored by use of abnormally high or low coupon rates to selected buyers. C-Callable. N.R.—Not reoffered. T—Term.

MOODY'S MUNICIPAL BOND YIELD AVERAGES

	Weekly				Monthly		1968	
	Mar. 7	Feb. 29	Feb. 21	Feb. 15	Feb.	Jan.	High	Low
Composite	4.19	4.39	4.32	4.27	4.28	4.31	4.19	4.18
Aaa	4.27	4.16	4.06	4.00	4.01	4.06	4.27	3.90
Aa	4.32	4.20	4.12	4.05	4.07	4.15	4.32	3.96
A	4.31	4.42	4.37	4.33	4.33	4.37	4.52	4.25
Baa	4.86	4.78	4.73	4.69	4.69	4.66	4.86	4.60
Ten-Year State								
Aaa	3.96	3.95	3.88	3.82	3.83	3.93	4.05	3.75
Aa	4.03	4.00	3.95	3.90	3.89	3.97	4.10	3.81

For bonds used in averages, see Bond Survey of Dec. 25, 1967, page 30.

quality of its composite liabilities will live up to its current market rating

Because the investment attributes of the authority's bonds necessarily defy conventional analysis, investors will have to rely on the state's involvement. In this regard, one has only to look to the membership of the authority's administrative board to deduce that authority architects have achieved about as strong a moral commitment as possible. Pennsylvania's Governor, for example, is president. Other members include the Speaker of the House of Representatives, the President Pro Tempore of the Senate, the State Treasurer and the minority leaders of both houses of the legislature—certainly a strong state endorsement.

Of course, all bonds issued under this new indenture incorporate the provisions of the now familiar Act 333, which provides that in the event of nonpayment of rent, the Department of Public Instruction shall withhold an amount equal to the defaulted rental payment out of any state appropriations due the offending school district and pay it over to the authority. No one doubts that this legislation can effectively combat small fires. However, assured effectiveness in controlling a major conflagration remains to be demonstrated, for the diversion of funds from defaulting school districts during times of prolonged economic stress could demoralize the state's educational system. Widespread enforcement of Act 333 might presage an early repeal. In that event, reserves will alleviate short-term embarrassment. Beyond that, investors would look to remedial legislative action, for the state seemingly has little choice but to preserve the credit sanctity of this agency. Additionally, in that the authority is continually making parity construction loans, its bonds are perpetually exposed to risks indigenous to construction projects.

Comment: The moral commitment of the state with regard to the above Public School Building Authority offering is somewhat less than that afforded the General State Authority obligations with the possible exception of Community College Bonds, which are the first two issues leased to the Department of Public Instruction. With the major exception of rental reimbursement and other appropriations, the school districts have no recourse to the state. On the other hand, General State Authority obligations are secured by a pledge of all rentals payable to the authority by the Commonwealth of Pennsylvania from its current revenues. Strong reliance must be placed on the obligation of the legislature to make adequate provision for rental payments in biennial budgets. In essence, the bondholders have no contractual recourse to the commonwealth, the source of debt service funds.

In the market, obligations of the General State Authority are accorded an investment dignity significantly below the direct obligations of the commonwealth; the state's role in financing through the lease-rental device rather than by

PROSPECTIVE TAX-EXEMPT BOND OFFERINGS
GENERAL AND LIMITED LIABILITY OBLIGATIONS

Sale Date Amount Time	Issuer: (County) (State)	Rating	Maturity: (Callable) Purpose	Fiscal Year: Assessed Value (Est.) Assessed to Market Value	Net Direct & Over-all Debt Equivalents	Opinion
3-11-68 7:30 PM EST	Romulus Comm. Schools (Wayne), Michigan	Baa	5-1-83 at 100; New school building and additional facilities; Qualified issue.	1968 Est. \$1,450,000 1967 \$78,855,221 1966 \$52,350,135	\$7,639,976 \$24,171,776 \$2,414,776 17% of N.E. 89% of M.V.	Located here is Detroit Metropolitan Airport covering approximately 11% of the district. Economy is industrially-oriented with Kelsey Hayes the largest taxpayer (\$17,557,122), employing more than 1,000. Much of rise in 1967 is due to revaluation and industrial expansion. N. General Motors; Power Corp., the largest taxpayer, accounts for over 35% of district's tax base. Infrequent levies for state obligations. Substantial overall debt levels after deduction of about 36% state aid. Approximately 25% of debt will be retired in ten years. Rapidly growing district located between Dearborn and Ford Worthly Hill Heights; the largest taxpayer accounts for 46% of A.V. Factory employed 2,000. Due to growth experienced from Ford Worthly District's Regional Airport and related industries which will divert traffic into the district.
3-11-68 3:00 PM EST	Moreau, Northumberland and Wilkes-Barre, S. D. No. 1 (Santee), N. Y.	A	Grad. ser. 4-1-69-96 (N.C.A.) School purposes including purchase of sites and construction of two elementary schools.	1968 Est. \$1,175,000 1967 \$7,720,000 1966 \$5,740,910 1965 \$1,475,135	\$2,300,000 \$2,300,000 \$2,300,000 17% of M.V. 71% of M.V.	
3-11-68 8:00 PM CST	Hurst-Eulless-Ridgford Ind. S. D. (Tarrant), Texas	Baa	Grad. ser. 7-15-70-96 (beg. 2-1-88 at part) School purposes.	1968 Est. \$1,000,000 1967 \$1,087,710 1966 \$1,000,000 (67%)	\$2,000,000 \$2,000,000 \$2,000,000 14% of A.V. 91% of M.V.	
3-11-68 12:30 PM CST	Waconia Ind. S. D. No. 110 (Carver and Hennepin), Minnesota	Baa	Grad. ser. 2-1-71-98 (beg. 7-1-83 at 100) School ad-Grants.	1968 Est. \$1,000,000 1967 \$1,000,000 1966 \$1,000,000	\$2,000,000 \$2,000,000 \$2,000,000 100% of A.V.	Assessed value of \$1,000,000. City of Waconia is located in Hennepin County, Minnesota. City's economy is primarily based on service industry. City's largest taxpayer is the Waconia Public Schools. The city's largest taxpayer is the Waconia Public Schools. The city's largest taxpayer is the Waconia Public Schools.
3-11-68 3:00 PM CST	Howard Ind. S. D. No. 102 (Miner), South Dakota	A	Grad. ser. 4-1-70-85 (beg. 4-1-82 at 101) School building.	1968 Est. \$1,000,000 1967 \$1,000,000 1966 \$1,000,000	\$2,000,000 \$2,000,000 \$2,000,000 8% of A.V. 4% of M.V.	Assessed value of \$1,000,000. City of Howard is located in Miner County, South Dakota. City's largest taxpayer is the Howard Public Schools. The city's largest taxpayer is the Howard Public Schools.

conventional municipal borrowing has proved extremely expensive in terms of interest costs.

Since 1949 Pennsylvania has utilized the GSA as the medium by which it has financed the construction of public buildings housing state institutions and colleges and their related sewage treatment works, arsenals, armories, airports, dams and related flood control projects.

Authorities have become a way of fiscal life in Pennsylvania. Because of dependence upon legislative recognition of the recurring moral obligation to appropriate, we regard limited liability obligations of this type as being somewhat inferior to direct full faith and credit general obligations, despite the dictates of practicality which preclude a default. Should the legislature be so short-sighted as to fail to honor its moral commitment via appropriation of the annual lease rentals, the resulting default would inevitably impair the credit of the issuer's direct general obligations.

We now rate the lease rental revenue bonds of the Pennsylvania General State Authority **Baa** but we continue our policy of not rating the obligations of the State Public School Building Authority for the aforementioned reasons.

On a statewide basis, combined net direct and underlying debt, including tax-supported and agency obligations, continues to rise resulting in high full valuation and per capita

ratios; no improvement in state over-all ratios is expected.

Net bonded indebtedness of the Commonwealth of Pennsylvania as of June 30, 1967:

Table with 2 columns: Description and Amount. Rows include General obligations (\$130,293,639), Authority bonds (1,774,354,070), Capitalizing rental reimbursements (1,800,000,000), Underlying debt (4,550,700,000), Total (\$8,255,347,639), Less self-supporting highway and bridge gas tax revenue bonds (327,956,000), Estimated net total (\$7,927,391,639).

Based on an estimated 1966 population of 11,358,000, the above represents a formidable \$690 per capita, 36.0% of assessed valuation and 18.0% of estimated market value.

Authorized and Unissued Obligations

Table with 2 columns: Description and Amount. Rows include Conservation reclamation (G.O.'s) (\$500,000,000), Transportation-Assistance Authority (\$3,000,000,000).

In view of the continuing diminution of state credit occasioned by a spiraling indebtedness, with no prospect of a near-term reversal in the trend, the general obligations of the commonwealth are now rated **A**.

New and Revised Ratings

TAX-EXEMPT SECURITIES

NEW RATINGS

Table listing tax-exempt securities with ratings. Includes Athens-Clarke County Industrial Development Auth., Ga. (Baa), Big Rapids, Mich. Bonds selling Mar. 18, 1968 (A), Carbon County, Wyo. Bonds selling Mar. 26, 1968 (A), Cook County Metro. Fair & Expo. Auth., Ill. Expo. bldg. rev., 11/1/67 (Aa), Granite City, Ill. General obligations (A), Howard Ind. S.D. No. 102, S.D. Bonds selling Mar. 11, 1968 (A), Kittery, Maine General obligations (A), Lane County S.D. No. 97J, Ore. Bonds selling Mar. 13, 1968 (Baa).

Table listing tax-exempt securities with ratings. Includes Pennsylvania General State Auth. General obligations (Baa), Springfield, Mo. Waterworks rev., 1968, selling Mar. 12, 1968 (A).

RATINGS REVISED

Table listing revised ratings for tax-exempt securities. Includes Greenville County, S. C. General obligations (A to Aa), Greenville County S. D. S. C. General obligations (A to Aa), Pennsylvania, Commonwealth of General obligations (Aa to A), Waconia Ind. S. D. No. 110, Minn. General obligations (A to Baa).

TAXABLE SECURITIES

NEW RATINGS

Table listing taxable securities with ratings. Includes American Broadcasting Companies, Inc. Conv. sub. deb., --s, 1993 (Baa).

Table listing taxable securities with ratings. Includes Container Corp. of America S.f. deb., --s, 1993 (A), Louisiana Power & Light Co. First mtge., --s, 1998 (A), Pacific Gas & Electric Co. First & ref., --s, QQ, 2000 (Aa), Pittsburgh & Lake Erie Railroad Co. Eq. tr., --s, trust of 1969, 1969-83 (Aa), Sundstrand Corp. Conv. sub. deb., --s, 1993 (Ba).

*Provisional ratings are assigned to bonds not yet offered. They are based on available information, including SEC registration statements, if any, and are subject to change as additional information becomes available. Con. () Lease rental obligation wherein rents begin when facilities are completed but insurance coverage minimizes construction risks. Parenthetical rating denotes probable credit status to be attained upon completion of construction.

CORPORATE AND GOVERNMENT BOND YIELDS

Table showing Corporate and Government Bond Yields. Columns include Moody's Ratings (7-1), 1967-68 High/Low, and 1966 High/Low. Rows include Av. Corp., Av. P.U., Av. R.R., and Av. Ind. with various sub-ratings (Aaa, Aa, A, Baa).

YIELDS ON U. S. TREASURY ISSUES

Table showing Yields on U.S. Treasury Issues. Columns include Weekly (Mar. 5, Feb. 27, Feb. 20, Feb. 13) and Monthly (Jan., Feb.). Rows include 91-Day bills, 182-Day bills, 3-Year index, 5-Year index, and 10-Year index.

U. S. TREASURY ISSUES—YIELD AVERAGES—DAILY

Table showing U.S. Treasury Issues Yield Averages Daily. Columns include 3-5 years, D'Long-Term, and 1967-68 High/Low.

Based on daily closing prices. Selected notes and bonds between 3 and 5 years to maturity. Bonds neither due nor callable in less than 10 years. Average accepted bid in weekly auction nearest the indicated date. Indicated yield for an issue of the given maturity, taken from a market yield curve. Not available. Due to insufficient components outstanding, Moody's Aaa railroad average was discontinued as of Dec. 18, 1967. This affects the average yield for over-all investment quality railroad bonds which will now be limited to three rating classifications, Aa to Baa, rather than the former four classifications. The result will not be comparable with former figures. To a lesser extent this also has some effect in the over-all average corporate yield. For latest list of bonds used in corporate average see Bond Survey of Dec. 25, 1967, page 28.

NOTE—Moody's Investors Service, Inc., has used due care and caution in the preparation of this publication. The factual information has been compiled from sources of repute, although not infallible. Errors, when discovered, are corrected. Opinions are based partly upon compiled factual information and partly upon other factors affecting our judgment of the matter treated. They are independent and unbiased. Printed in U.S.A.

Excerpt from Moody's Bond Survey - October 19, 1964 concerning
the lowering of the rating on New York State Bonds from "AAA" to "AA".

460 • Moody's Bond Survey

October 19, 1964

Comments on Coming Issues

New York State . . .

. . . is offering at competitive bidding on October 28, \$34,895,000 general obligation bonds. Proceeds of sale will be used to finance state loans to several limited-profit housing projects in New York City and in other areas of the state.

This offering follows the sale of \$39 million park and recreation land acquisition bonds on September 15, the state's first direct obligation borrowing in sixteen months. In BOND SURVEY of September 7, 1964, page 536, the \$30 million issue was discussed and observations were made concerning certain phases of state fiscal operations and the mounting cost and breadth of state commitments. Still earlier, in May of 1963, we discussed the philosophy of the state's "pay-as-you-go" program and the part that financing by agency borrowing has played in making this avowed "pay-as-you-go" program possible.

Since our last comments, the New York State Housing Finance Agency has announced plans to sell approximately \$70 million mental hospital construction bonds. This is the initial phase in a program designed to create around \$500 million of additional mental hospital facilities. The bonds are designed to be self-sustaining; to bring this about a Mental Hygiene Facilities Improvement Fund Income Account has been established to which has been credited all payments made on or after January 1, 1964, for the care, maintenance, and treatment of patients in every mental hygiene facility of the Fund; such payments amounted to close to \$35 million in the state's last completed fiscal year with the money paid in prior to January 1, 1964, going into the state's general fund.

The Housing Finance Agency has been given the power to issue up to \$1 billion in debt for limited-profit housing, \$700 million for university construction and \$500 million for mental hygiene facilities.

The sources of revenues pledged to each class of debt of the agency will be nominally adequate to provide for full coverage of debt charges, at least in good times, but in the case of tenants or mental patients it is possible that the agency would suffer a loss in revenues but more likely the state would be morally obligated to continue the service during a period of economic depression even if the recipient lost part or all of his ability to pay. Also it is generally true that interest costs on state agency debt are greater than they would be were the state to issue its own direct obligations. Furthermore, prior to the creation of the Housing Finance Agency, it was the state's custom to use the direct method of debt creation.

Following this sale of limited-profit housing bonds, the state will have an authorized but unissued backlog of \$1,178,660,000 general obligation debt, including \$208 million for higher education, \$188 million for mental hospitals, \$82 million for limited-profit housing and \$250 million for low-cost housing. In addition, the voters are being asked to approve at this year's general election \$165 million more for low-cost housing.

Approval to issue general obligation debt is obtained by the following procedure: The bonding proposal must be approved by two successive legislatures and this must be followed by voter sanction at the next general election. Creation of state agencies with bonding powers requires legislative and executive approval only.

Looking at the state's debt structure alone, over all state general obligation debt is not burdensome and, as a first

charge on the state's general fund, is well secured. In the case of agency debt, the state has only a moral and not a legal obligation to vote funds for debt service and then only if reserve funds in the various agency accounts are depleted, but it is unlikely that the state would fail to meet its moral obligations, if for no other reason than to preserve the sanctity of the state's credit. However, the transfer of cost on construction of the South Mall Project in Albany which in essence is a gigantic rehabilitation and development operation involving state, city and perhaps county buildings and other related facilities. Not all of the estimated \$200 million-to-\$400-million cost will be borne by the state, but as indicated in this space previously, the state is committed to enter into a long term lease for its share of the cost, this has the same impact as incurrence of debt.

But debt service is only one part and a small one in the complex operation of the New York State government. The state's current budget for fiscal 1964-65 is a record \$7.9 billion, up \$136 million over 1963-64, and only by resorting to every available expediency has it been brought into balance. Of this amount, all but a small part is the current expense of what are essentially long-term projects and commitments.

Education expenditures are estimated at \$1,347 million, or 46% of the budget. State aid for locally operated elementary and secondary schools in the state is budgeted at \$1,044 million, or about 42% of local costs and the state hopes to provide up to 49% eventually. Underlying school debt, not including \$650 million New York City debt issued for schools, amounts to roughly \$2 billion and under present law the state is committed to pay a substantial part of this debt service on this long-term debt. Higher education grants and other programs are estimated to cost \$168 million. Public and mental health expenditures are budgeted at \$560 million, or 14% of the state's budget and this also is essentially a long-range commitment. Social welfare accounts for \$327 million, 11% of the budget, while general government accounts for only \$148 million, or 5%.

In our opinion, state debt and its long-range programs are inexorably intertwined. As these new facilities are created and as more and more state residents use these facilities, operating costs will surely rise.

The state's current budget, utilizing every available source of revenue to the full, is only tenuously in balance. It seems almost certain that in the next fiscal year the state will be forced to find new sources of revenue or raise the rates on current revenue sources to balance the 1965-66 budget, even if general business conditions remain good, as the state no longer appears to possess the capacity to use non-recurring items or other temporary expedients to alleviate the problem.

In reviewing the over-all picture and giving due credence to the preferred position of the state's direct debt, it is our opinion that general obligation debt now properly falls in the high grade rather than prime quality category. Effective today, our rating on the state's general obligations has been reduced to Aa.

In addition to the general obligation debt, the state has guaranteed \$500 million New York State Thruway Bonds (the balance of the Thruway debt is secured solely by toll revenues), and up to \$100 million Port of New York Authority commuter car bonds (\$17,590,000 outstanding). The rating on these bonds has also been reduced from Aaa to Aa.

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October 19, 1970

The Honorable Raymond H. Bateman
21 East High Street
Somerville, New Jersey 08876

My dear Senator Bateman:

We are vitally interested in the passage of Assembly 1013 which supplements the Sewerage Authorities Law. Under the Sewerage Authorities Law when an Authority is created it is given the exclusive right and power to finance, construct and operate all facilities for the collection of sewage within its municipal boundaries. In order to meet this very important duty and obligation in the most expeditious and efficient way it is absolutely essential that an Authority have all the financing "tools" available to it.

One of the most practical and equitable methods for financing sewer collecting lines is by special assessment. The fact that this method is not available to Sewerage Authorities has stymied the construction of vitally needed sewer facilities in New Jersey. The reason for this is that in various instances the elected municipal officials have not been willing to risk the possible negative election consequences inherent in financing sewer lines via the assessment route. In such instances the local Sewerage Authority, not having the right to assess, is unable to perform its legal obligation to provide these sewer facilities. This most unfortunate void in Sewerage Authority financing should be rectified by the passage of Assembly 1013.

The basis for the opposition to Assembly 1013 on the part of the New Jersey State League of Municipalities as outlined in the letter to the Honorable Raymond H. Batemen, dated September 30, 1970, is subject to question. In order to rebut the contentions of the League in this regard we will enumerate them below:

Contention: Assembly 1013 might lead to all authorities and all agencies being given the power to levy assessments and the poor property owner would never know from day to day what municipal agency might place an assessment on his property.

The Honorable Raymond H. Bateman
Page 2
October 19, 1970

Comment: It seems to us that the matter of which authorities or agencies should have the power of assessment must be answered fundamentally by asking whether the assessment financing vehicle will be helpful to the authority or agency in fulfilling its exclusive legal obligation to expeditiously finance the essential municipal facilities involved (i.e., sewer, water, etc.). If the power to issue assessment bond will expedite the construction of vital municipal services such power should be made available to such authorities and agencies. There is more danger in depriving authorities of the assessment financing vehicle and thereby perhaps making it impossible for them to perform their municipal function than in expanding its availability to such authorities and agencies.

Since the language in Assembly 1013 provides in part that "Such special assessments shall be levied by the sewerage authority in the same manner and mode of procedure as provided in article 2 of chapter 56 of Title 40 of the New Jersey Statutes" . . . (the same statute governing municipal assessment powers), it is hard to accept the argument that "the poor property owners and taxpayers would never know from day to day what municipal agencies might place a levy and assessment on his property."

Contention: Granting to authorities the power of assessment is contrary to the philosophy of authorities and will create general chaos in determining whose special assessment had priority.

Comment: The basic philosophy of creating an authority to undertake the exclusive financing, construction and operation of municipal facilities is not predicated upon the elimination of property taxes as a possible means of paying for such facilities. Authorities are created in order to relieve the already overburdened municipal official of the added responsibility of administering a complex and specialized municipal utility operation as well as providing a flexible financing vehicle which is unhampered by the various municipal debt limitations which may be too restrictive. New Jersey Sewerage Authorities, except for the important power to issue assessment bonds, have available to them all the other types of bonding which permit them to finance sewer facilities in the most equitable manner including the use of sewer rates, or a combination of sewer rates together with property taxes via sewer service agreements with its constituent municipality. To accept the theory that Authorities philosophically cannot meet a portion of their costs from property tax funds where such avenue is the most equitable way to allocate that portion of the capital cost would be contrary to the public interest.

The Honorable Raymond H. Bateman
Page 3
October 19, 1970

The concern over whose assessment has priority seems unwarranted. Based upon the actual experience during the depression of the 1930's the financially troubled property owner did not pay any of his assessments. Therefore, the matter of priority was not pertinent.

Under Assembly 1013 the fact that the sewerage authority would bill and collect the sewer assessment, separate and distinct from the municipality or any other agency, would in itself make it absolutely clear that any sewer assessment paid to the sewerage authority would be its revenue and not that of the municipality or any other municipal agency.

In summary, it continues to be our very strong feeling, based upon years of experience in the specialized area of New Jersey Municipal Finance, and after seriously considering the objections raised by the New Jersey State League of Municipalities that the passage of Assembly 1013 is in the best interests of the residents of New Jersey for the following reasons:

1. Anything that expedites the cleansing of our waterways of pollution without adversely affecting the sound and proven municipal financing system in New Jersey, should be enacted. In our opinion Assembly 1013 meets this criteria.
2. It is most unfortunate that a municipal body -- sewerage authority -- duly created and with the exclusive power and responsibility to finance sewer collecting facilities is deprived of the use of a financing vehicle which is needed right now in order to finance sewer collecting facilities in the most equitable way for its constituents. Assembly 1013 would provide this important financing vehicle.
3. The fact that Assembly 1013 requires that the sewerage authority must follow the same manner and mode of procedure as the present municipal assessment law should alleviate any concerns over a sewerage authority not following the established procedure.
4. There has been great concern voiced over the reluctance of local municipal officials to take the initiative in the financing of costly, but absolutely essential anti-pollution sewerage facilities. Assembly 1013 evolves from the desire of sewerage authority officials to meet their legal responsibility in financing such needed sewerage facilities which they cannot otherwise equitably finance. The passage of Assembly 1013 will permit these responsible and dedicated sewerage

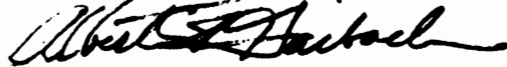
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The Honorable Raymond H. Bateman
Page 4
October 19, 1970

authority officials to meet their responsibilities in the most equitable way and, thereby, benefit their constituents and the State of New Jersey through the immediate financing of sewer facilities which will abate both pollution and the menace to public health.

Very truly yours,

Kidder, Peabody & Co.
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Albert F. Haiback
Vice President

AFH:MC

cc: Members of New Jersey Senate

