The Use and Costs of Public Credit

REPORT 4

NEW JERSEY TAX POLICY COMMITTEE

The Report Consists of the Following Volumes

SUMMARY

Part I THE REVENUE GAP AND DISTRIBUTION OF THE TAX BURDEN

Part II THE PROPERTY TAX

Part III SERVICE LEVELS AND STATE AID

Part IV TRENDS IN CAPITAL NEEDS AND DEBIT BURDENS

Part V NON-PROPERTY TAXES IN A FAIR AND EQUITABLE TAX SYSTEM

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Part IV

of the Report of the

NEW JERSEY TAX POLICY COMMITTEE

The Use and Costs of Public Credit

Submitted to Governor William T. Cahill
pursuant to Executive Order No. 5 of 1970

The report consists of
five separate parts and
a summary volume

TRENTON, NEW JERSEY
February 23, 1972

NEW JERSEY TAX POLICY COMMITTEE

(appointed by the Governor pursuant to Executive Order No. 5 of 1970)

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NEW JERSEY TAX POLICY COMMITTEE

Report: Part IV

The Use and Costs of Public Credit
Synopsis of Part IV

The Debt Picture in General

This part of the Report deals with capital financing, and its impact on the tax requirements of local government. Obviously large sums are involved—

The Report projects capital needs of local governments at $430 million per year over the next ten years. Some of this will be financed with Federal aid; some with direct budget appropriations; and a large part with local bond issues.

Over the past 5 years the annual volume of local borrowing in New Jersey has been about $250 million. The Report projects that New Jersey taxpayers will be called upon to support new debt obligations of as much as $500 million annually for State and local purposes over the next few years.

Comparative Debt Burdens

Statistically, New Jersey State and local debt compares favorably with national averages—in fact, it represents a somewhat lesser comparative burden according to standard economic measures.

Borrowing Requirements

Based upon the volume of long-term debt outstanding, plus the need for permanent financing of debt authorized but unissued (including debt now in the form of temporary notes under bond authorization) it may be projected that New Jersey taxpayers will be called upon to support new debt obligations of $500 million annually over the next few years. In addition public authority debt to be incurred for needed environmental quality improvements, roads, and other revenue producing projects will make growing demands upon the people. Based upon past experience, however, a growing population and rising income levels may be able to absorb these burdens without undue sacrifice.

Future Debt Service

Should all the intrastate authorized and unissued debt ($2.2 billion at the end of fiscal 1970) be issued within the next four years at average net interest costs of 6.00 percent on an equal annual debt service pattern over a 25-year period, this would involve additional debt service costs of approximately $170 million per year by 1975 or 1976. Although there would be minor offsets due to retirement of some outstanding debt, this requirement for additional debt service—primarily from taxes—will constitute a significant budgetary consideration for both state and local governments in New Jersey.

Borrowing versus Pay-As-You-Go

The Report reviews in detail the alternatives of borrowing versus pay-as-you-go to finance capital needs. Local governments in New Jersey financed an average of 60% of their current capital outlays with new long-term debt during the period 1966-1969.

Local debt managers should evaluate the costs and benefits of pay-as-you-go versus borrowing in light of economic conditions, interest costs and the municipal bond market at the time capital funds are required, since the choices are much too complicated to set down any broad general prescriptions.

The present 5% down payment requirements should be retained; but

Local governments should be encouraged to increase the down payments to 10% whenever feasible, without making this a legal requirement.

Debt Limits

The Report contains a careful review of the scope, operation and effect of existing statutory limitations on county, municipal and school district debt.

The great majority of both school districts and municipalities has been able to live within the prescribed debt limits.

Local governments are not subject to any limitations as to the amount of their debt so long as the debt is self-supporting. In addition, public authorities operating without any municipal guarantee can issue only self-supporting debt which is not subject to any statutory limits.

The present provisions for "extensions of credit" are intended and operated as a constructive influence on municipal finance; but they present a needless source of market confusion or uncertainty in the very label and process; and these shortcomings can be corrected.

It is timely, with the proposed major revision of the

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property tax and massive increase in state aids to local governments, to accomplish revision in the measure of debt limitations.

The Committee recommends:

1. Require all county, municipal, school and local or regional public authority bond issues to be reviewed and approved by the Division of Local Finance, except as provided in 2 below;

2. Establish a ratio of total projected debt service of the issuer to the equalized valuation of its taxable property, as the debt guideline; and provide that any general obligation issue which falls within the guideline shall be deemed approved for purposes of paragraph 1 above.

3. Fix the guidelines at approximately two times the present net debt percentages in order to allow for the inclusion of projected interest payments in the measure of debt burden.

Temporary Borrowing

New Jersey local governments have been using temporary debt at a very significantly higher rate, in recent years, than local governments in the other 49 states. This has been primarily due to efforts to avoid permanent borrowing at the high interest costs of recent years. The benefits and the risks of this type of financing are analyzed in the Report.

The Committee recommends:

1. Major capital financing should be transferred to the permanent capital markets promptly, and should not be permitted to preempt a significant portion of short term funds available in the market;

2. A local government issuer should be required to appropriate a full year's interest on each bond anticipation note in the current or next succeeding budget;

3. A local government issuer should be required to appropriate and pay off within each year not less than that portion of each issue of bond anticipation notes equal to one divided by the period of probable usefulness prescribed by law for the purpose for which the bonds are authorized.

4. A local government issuer, including an authority, shall have no power to borrow any portion of required amortization or interest, except interest during construction required by a public authority.

5. The period of probable usefulness under the statute (N.J.S. 40A:2-22) should begin to run not later than one year after the capital improvement being financed becomes operational and is first used.

Revenue Financing

The trends, uses and costs of revenue bonds as compared with general obligation bonds issued by state and local governments are reviewed in detail in the Report. The Committee recommends essentially that the present statutory provisions regulating the use of revenue financing by municipalities are sound and that there is no need for the enactment of a revenue bond act. The Report contains recommendations for tightening up on the use of public authorities to finance capital outlays.

The Market for New Jersey Municipals

The costs of municipal borrowing are influenced substantially by the marketability of the bonds. Two major bond rating services, Moody's and Standard & Poor's, provide investors with quality ratings of municipal bond offerings, and these are extremely significant in determining the interest costs to the local government issuer.

The Committee concludes:

The tax savings to many local governments that could result from improved credit ratings would justify major new State facilities and programs designed for this purpose.

The Committee's program of state full funding of local school costs and of massive reduction in local property taxes should, of themselves, greatly strengthen the credit rating of New Jersey local governments.

A Central Municipal Credit Agency

The major recommendation of the Report is for the creation of a New Jersey municipal credit agency. The agency would consist of a independent public corporation, with provision for a distinguished board of directors and a businesslike management. It would include three branches to provide service to local governments in this State:

1. A central debt management advisory service;
2. A municipal bond guarantee fund; and
3. A municipal bond bank.

The Report concludes that:

Each of the approaches to strengthening the market for the obligations of New Jersey's local governments has advantages and disadvantages. The conditions of the market are so complex, moveover, and change so much with time, that a program which would permit the selection of whatever approach would be most useful for the type of municipality and the point in time at which it goes to market, would provide the optimum benefit in reduced borrowing costs for all local governments. To this end, a combination of the three approaches, that is, a centralized debt management advisory service, a guarantee fund, and a bond bank will be most effective.

Chapter I

Trends in Capital Needs and Debt Burdens

The people of New Jersey support the services of government through two broad channels of tax funds —tax collections which are used for daily operating expenses; and tax collections which are used to pay interest and principal (together known as debt service) on money borrowed by governments, primarily to finance capital needs. As a general rule, states and local units do not borrow for operating expenses (except temporarily pending the receipt of current tax collections) but it is usual to borrow for capital purposes.

From the viewpoint of a tax study, anything that can be done to reduce the costs of borrowed funds and the costs of borrowing itself can be significant factors in the total fiscal system. It is thus important to evaluate the long and short term trends in capital borrowing by State and local government, the need for new capital borrowing over the foreseeable future, and the ways of meeting that need at least cost.

Projection of Capital Needs of Counties and Municipalities

The credit needs of State and local government over the next ten years will reflect several broad influences:

1. A growing social consciousness of need to improve public institutions of all kinds—educational, charitable, penal, health and welfare, transportation;

2. A new determination to allocate an increased share of the resources of taxpayers and consumers to improvement of the quality of the environment; and

3. An accumulation of deferred demand for these and other purposes during recent periods of high interest rates.

The capital needs of the State were surveyed not long ago[1] and "top priority" was assigned to the following recognized capital requirements:

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

	Millions
Education (Elementary and 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	800.0
Total	$1,948.9

A major part of these recommendations has already been covered by authorized State bond issues and this report does not deal further with the capital needs of the State.

The impact of the capital needs of local government remains to be established (exclusive of school needs which are reviewed in Part III of this Report). It is impractical to review the capital planning of each county and municipality and an effort was made, therefore, to forecast capital needs using standard methods of economic projection. The Committee's consultant, in a 155-page report which is available for further elaboration, came to these conclusions:

1. *Aggregate Social Capital Needs.* During the next ten years the basic social capital needs of New Jersey's 21 counties and 567 municipalities will rise by over two-thirds (69 percent) from a current level of $431 million to nearly three quarters of a billion dollars annually by 1981.

New Jersey's suburban counties will exhibit the highest growth rate in spending for basic capital improvements, 95 percent over the next ten years. These counties will represent nearly one third of the State's total capital needs by the end of this decade.

Major urban counties, which now account for about one half of the State's future needs, will show a rate of growth in capital spending of less than 60 percent during the next ten years.

2. *Future Environmental Capital Needs.* In addition to the basic social capital expenditures discussed above, during the next decade New Jersey's counties and municipalities will spend a cumulative total of over $3.5 billion for protection of the environment. Nearly 60 percent of this represents the cost of regional sewerage collection and treatment facilities, now required under federal and state laws. The remaining 40 percent will be spent for development of bi-county regional systems for solid waste disposal, now required under the State's master plans and programs.

[1] Governor's Commission to Evaluate the Capital Needs of New Jersey, *A Capital Program,* (April 1968).

Of the total $3.5 billion needed for the environmental area, local government will be responsible for about 60 percent ($2.1 billion) and the State's share will be 40 percent ($1.4 billion). Most of the local shares can be financed from operating revenues of the system and from special assessments as well as from state and federal aids.

3. *School Needs.* These projections of State social and environmental capital needs do not include the capital needs of the school districts. It is believed that these have peaked during the decade 1970-1980, but the needs of core cities to replace obsolete school plants will surely continue to demand attention.

The Committee concludes

The projected capital needs of local government will continue to demand the use of substantial current revenues (user charges as well as taxes), growing recourse to the municipal bond markets, and increasing reliance on State and Federal aids for capital project financing.

Comparative Trends in State and Local Debt

New Jersey's capability to finance these needs may be measured in terms of a comparative view of the debt condition of State and local governments generally. The trends are evident from a comparison of Bureau

TABLE 4-1

TRENDS IN POPULATION, PERSONAL INCOME, STATE AND LOCAL GOVERNMENT DEBT, AND STATE AND LOCAL GOVERNMENT DEBT SERVICE PAYMENTS IN NEW JERSEY FOR 1957 - 1968-69

Item	1957	1962	1966-67	1968-69	Percent Increase 1957 to 1968-69
Estimated Population at close of period[1] (000)	5,770	6,331	6,737	6,948	20.4
Personal Income ($000,000)	14,089	18,032	24,750	29,185	107.1
Per Capita Personal Income					
As reported by Survey of Current Business	2,504	2,887	3,599[2]	4,138[2]	65.3
As computed	2,442	2,898	3,674[2]	4,200[2]	72.0
State and Local Government Revenue from own sources ($000,000)[3,4]	1,374	2,086	3,078	3,483	153.5
Per capita state and local government revenue from own sources	238.13	329.49	456.88	501.30	110.5
Outstanding debt of state and local governments ($000,000)[3,4]	2,279	2,878	3,862	4,452	95.9
Long-term debt	2,169	2,734	3,476	3,860	78.0
Short-term debt	111	144	386	592	433.3
Per capita debt	394.97	454.54	573.25	640.80	62.2
Debt service payments by state and local governments ($000,000)	162	213	293	322	98.9
Debt retirements in year ($000,000)	90	125	179	198	120.0
Interest payments on debt ($000,000)	62	88	114	129	108.1
Per capita debt service payments	28.08	33.64	43.19	46.27	64.8

Sources: U. S. Bureau of the Census, *Census of Government,* 1957, Vol. III, No. 5, p. 124-25.
U. S. Bureau of the Census, *Census of Government,* 1962, Vol. IV, No. 4, p. 106.
U. S. Bureau of the Census, *Census of Government,* 1967, Vol. IV, No. 5.
U. S. Bureau of the Census, *Governmental Finances,* 1968-69, p. 32, 37, 41.
Statistical Abstract of the U.S., 1959, p. 311-12; *1964;* p. 329; *1967,* 327.
Survey of Current Business, April, 1971, p. 21.

[1] Population is estimated at December 31, of each year by using semi-log rate progression based on actual population in 1950, 1960, and 1970 Census. Population for 1966-67 is for 12/31/66 and 1968 is for 12/31/68.

[2] Data is for average of two calendar years indicated in heading.

[3] U. S. Bureau of the Census figures for 1957 and 1962 are for calendar year ending December 31, and the other years are for the fiscal year.

[4] Data are fiscal years ending in period July 1 to following June 30. Thus data for 1966-67 would be for fiscal year ending June 30, 1967; however, municipal governments and county governments would be reported for fiscal year ending December 31, 1966.

TABLE 4-2

RELATIONSHIPS OF OUTSTANDING DEBT AND DEBT SERVICE TO PER CAPITA INCOME AND PER CAPITA REVENUE FROM OWN SOURCES FOR STATE AND LOCAL GOVERNMENT IN NEW JERSEY SELECTED YEARS 1957 TO 1968-69

		1957	1962	1966-67	1968-69
6.	Per Capita Outstanding Debt of State and Local Governments as a percent of:				
6.1	Per capita personal income	16.17	15.62	15.60	15.26
6.2	Per capita state and local government revenues from own sources	165.86	137.97	125.47	127.83
7.	Per capita debt service payments of state and local Governments as percent of:				
7.1	Per capita personal income	1.15	1.18	1.18	1.10
7.2	Per capita state and local government revenue from own sources	11.79	10.21	9.52	9.23
7.3	Per capita outstanding debt of state and local governments	7.11	7.40	7.59	7.22

Source: Computed from Table 4-1.

of the Census data for the period 1957—1968-69 (Table 4-1).

During this period total outstanding debt of State and local governments in New Jersey[2] rose less rapidly than did either personal income or State and local government revenue from their own sources. Thus the outstanding debt (i.e., issued debt that had not been retired at the end of the fiscal years involved) increased from $2.28 billion to $4.45 billion—or 95.9 percent. (A huge amount of authorized but unissued debt tempers any enthusiasm that might be gained from this moderate rate of increase in debt through 1968-69.)

Total debt service payments increased at about the same rate as the amount of outstanding debt. But, this is misleading as an indicator in the case of New Jersey because more than 13 percent of the outstanding debt in 1968-69 was in the form of temporary debt upon which the interest rates are much less than the interest rates on long-term debt.[3] Moreover, had this debt been issued at the time incurred, the requirements for principal payments would have occurred as debt service costs. Therefore, the total debt service for State and local government issues is probably understated by as much as $30 million, or about 10 percent due to the holding of the $592 million of debt in short-term form. Meanwhile, the current decline in interest rates has, fortunately, permitted conversion to permanent financing at lower interest costs.

Table 4-2 compares the per capita data for debt with that for personal income and revenues of New Jersey State and local governments from their own sources.

[2] The Bureau of the Census data for 1957, 1962 and 1966-67 is taken from the *Census of Governments* in those years. With minor exceptions, this census secures data from every State and local government in the United States. For intervening years, e.g., 1968-69 (the most recently reported year), information is secured from all State governments and from a sample of local governments. Therefore, the information for local governments for these intervening years is partly on the basis of estimates by the Governments Division. The outstanding debt of New Jersey State and local governments as reported by the Bureau of the Census includes not only the State and intrastate debt, but also debt of the Delaware River Port Authority.

[3] Thus, in the case of the reoffering yields for a number of bond issues marketed in January 1969, the yield rate on one-year bonds averaged 3.96 percent whereas all the yield rates for the first 20 maturities averaged 5.04 percent—a difference of 1.08 percentage points. Therefore, had the $592 million of short-term debt reported to be outstanding in 1968-69 been in the form of long-term debt, the total interest costs shown in Table 4-1 would have been approximately $136 million instead of the $129 million reported. This would have brought the percentage increase to more than 119—roughly comparable to the increase in outstanding debt. If the debt were being retired on a 25-year equal annual maturity schedule, the principal requirement would have been $23.7 million. Total debt service would be up by $30 million.

TABLE 4-3

COMPARISON OF PER CAPITA PERSONAL INCOME, REVENUE FROM OWN SOURCES, OUTSTANDING DEBT, AND DEBT SERVICE OF STATE AND LOCAL GOVERNMENTS IN NEW JERSEY WITH ALL STATES, SELECTED YEARS, 1957 TO 1968-69

	Amounts				Index 1957 = 100			
	1957	1962	1966-67	1968-69	1957	1962	1966-67	1968-69
Population (000):								
All States	170,207	183,350	192,747	197,075	100	108	113	116
New Jersey	5,770	6,331	6,737	6,948	100	110	117	120
N.J. as Percent of All States:								
Per Capita Income:								
All States	2,027	2,366	3,078	3,550	100	117	158	175
New Jersey	2,442	2,868	3,674	4,200	100	117	150	172
Percentage Differential of N. J. to All States	+20.5	+22.5	+18.3					
Per Capita State and Local Government Revenues from Own Sources:								
All States	219	323	421	455	100	147	192	208
New Jersey	238	330	457	501	100	138	192	210
Percentage Differential of N. J. to All States	+ 8.8	+ 2.0	+ 8.6	+10.1				
Per Capita State and Local Government Debt Outstanding:								
All States	312	443	590	615	100	142	189	197
New Jersey	395	455	573	640	100	115	145	162
Percentage Differential of N. J. to All States	+26.8	+ 2.6	− 2.8	+ 4.2				
Per Capita Debt Service of State and Local Governments:								
All States	24.04	36.15	48.28	47.03	100	150	200	196
New Jersey	28.08	33.64	43.49	46.37	100	120	155	165
Percentage Differential of All States	+16.8	− 6.94	− 9.9	− 1.6				
Per Capita Outstanding Debt as a Percent of:								
Per Capita Income:								
All States	15.4	18.7	18.7	20.0	100	121	121	130
New Jersey	16.2	15.6	15.6	15.3	100	96	96	94
Per Capita debt service payments of state and local governments as a percent of per capita state and local govt. revenues from own sources:								
All States	10.9	11.9	11.5	10.3	100	109	106	95
New Jersey	11.79	10.21	9.52	9.25	100	87	75	78

Sources: U. S. Bureau of the Census, *1957 Census of Governments*, III, No. 5, p. 17
U. S. Bureau of the Census, *1962 Census of Governments*, IV, No. 4, pp. 27, 30, 36
U. S. Bureau of the Census, *1967 Census of Governments*, Vol. 4, No. 5, pp. 25, 28
U. S. Bureau of the Census, *Statistical Abstract of the United States*, 1959, p. 311
N. J. data from Table 4-1.

Internal Relationships

1. Per capita outstanding debt of State and local governments in New Jersey has increased at rates slightly lower than the increase in per capita income.

2. Per capita outstanding debt of State and local governments in New Jersey has increased at an appreciably slower rate than the revenues of these governments from their own sources.

3. Per capita debt service payments of State and local governments have generally kept pace with per capita personal income. The decrease shown in 1968-69 was due to the fact that a considerable portion of the outstanding debt in 1968-69 was in the form of temporary debt—not from a genuine change in the relationships.

4. Per capita debt service payments of State and local governments in New Jersey increased significantly from 1957 to 1966-67. A decrease is shown in 1968-69—once again due to the large amounts of temporary debt in anticipation of the issuance of long-term debt.

5. Per capita debt service as a percent of the per capita outstanding debt of State and local governments has decreased during the period. Once again the understatement of debt service costs due to the short-term debt is largely responsible.

Comparison with Averages for All State and Local Governments

Table 4-3 presents data for the period 1957 to 1968-69 in terms of comparisons between the New Jersey State and local government trend with the trends in the totals for all State and local governments in the United States. The index numbers in the final four columns of the table are those which are most effective in showing the relative growth in the factors.

1. In terms of *total population,* the rate of increase in New Jersey has been slightly above the national average.

2. *Per capita income* has grown at a rate almost identical with that of the nation.

3. *Per capita State and local government revenues from own sources* developed more slowly in the 1957-62 period and more rapidly during the next four and one-half years. During the most recent two years in the period under study, the rate of rise in New Jersey was only perceptably above the national average rate.

4. *Per capita debt service payments,* for reasons previously noted, rose at a lesser rate than for the United States as a whole.

5. *Statistically, New Jersey State and local debt compares favorably* with national averages—in fact, it represents a somewhat lesser comparative burden according to standard economic measures.

Future Debt Service Requirements

Should all the intrastate authorized and unissued debt ($2.2 billion at the end of fiscal 1970) be issued within the next four years at average net interest costs of 6.00 percent on an equal annual debt service pattern over a 25-year period, this would involve additional debt service costs of approximately $170 million per year by 1975 or 1976. Although there would be minor off-sets due to retirement of some outstanding debt, *this requirement for additional debt service—primarily from taxes—will constitute a significant budgetary consideration for both State and local governments in New Jersey.*

Chapter II

Composition of the New Jersey State and Local Debt

The present composition of State and municipal debt can be described in various ways, but a systematic classification according to security pledged is most helpful. For this purpose, debt has been classified as general obligation debt and revenue debt, both with two sub-categories, as follows:

Classification of Security Pledged in Support of Debt

A. *General Obligation Debt:* The term *general* obligation debt is limited to the direct debt of a government with general taxing powers which has pledged its full-faith-and-credit in support of the debt.

A-1. *General Obligation Self-Sustaining Debt:*

State and State Agency Debt

Within New Jersey, the most dramatic increase has been the case of the direct debt of the State of New Jersey, which rose from $0.3 billion to $1.5 billion in the period. This is an increase of 368 percent, with the average compound annual rate of increase at 35 percent.

TABLE 4-4

TREND IN TOTAL DEBT IN NEW JERSEY FOR INTERSTATE, STATE AND LOCAL PURPOSES
(in millions of dollars)

	1965	1966	1967	1968	1969	1970	Increase 1965-1970 Amount	Percent
Total (Issued Plus Authorized but not Issued) By Level of Government	4,520	4,869	5,392	6,378	8,019	8,713	4,193	93.0
Interstate Agencies	1,182	1,144	1,216	1,718	1,732	1,892	710	60.1
Port of New York Authority	953	929	999	1,481	1,468	1,560	607	63.7
Delaware River Port Authority	115	102	106	125	140	210	95	82.6
Delaware River and Bay Authority	103	103	103	103	103	103	0	0
Delaware River Joint Toll Bridge Commission	11	10	8	9	21	19	8	72.7
State and Intrastate Agencies	3,338	3,725	4,176	4,660	6,287	6,821	3,483	104.6
State and State Agencies	1,078	1,207	1,405	1,553	2,881	3,068	1,990	185.5
State	322	307	293	277	1,253	1,508	1,186	368.3
State Agency	756	900	1,112	1,276	1,608	1,560	804	107.6
N.J. Turnpike Authority	330	480	451	619	829	770	440	133.3
N.J. Highway Authority	355	347	337	327	316	303	(52)	(14.6)
N.J. Expressway Authority	53	53	53	53	53	53	0	0
Rutgers, The State University	18	20	21	27	42	44	26	200.0
N.J. Housing Finance Agency	—	—	250	250	250	250	250	—
N.J. Educational Facilities Agency	—	—	—	—	18	24	24	—
*N.J. Mortgage Finance Authority		—	—	—	—	—	—	—
Higher Education Assistance Authority	—	—	—	—	100	100	100	—
South Jersey Port Corporation	—	—	—	—	—	16	16	—
Local Government	2,260	2,518	2,771	3,107	3,423	3,753	1,493	66.1
Counties	229	291	337	391	428	448	219	95.6
Municipal and School	1,774	1,943	2,117	2,286	2,612	2,880	1,106	62.3
School	1,092	1,196	1,291	1,393	1,500	1,568	476	43.6
School Debt Guaranteed by State	—	—	—	90	90	180	180	—
Municipal	682	747	826	893	1,022	1,132	450	66.0
Authorities	257	284	317	340	386	425	168	65.4

* This agency has planned to issue $100 million. Its first issue at $40 million (November, 1971) is not carried in total.

NB. Detail may not add to totals due to rounding.

This term is applied to general obligation debt bearing the full-faith-and-credit pledge of a government but under circumstances, where the facilities to which the debt is related produce sufficient revenue to meet *both* full operating and maintenance charges and the full debt service requirements relating to the debt.

A-2. *Tax-Supported General Obligation Debt:* The total amount of general obligation debt that is not in Class A-1.

B. *Revenue Debt:* Debt in respect to which the only security to which the investor has a legal right is the net revenues of the facilities financed from such debt or of the governmental agency issuing such debt.

B-1. *Tax-Supported Revenue Debt:* Debt that has been issued in the form of revenue debt but with respect to which a government with general taxing authority has an undertaking to make payments sufficient to meet the debt service charges—either in full or by way of supplementation of the net revenues of the issuer.

B-2. *Net Revenue Debt:* Debt which is supported solely by the net revenues of the issuer.

Growth in Gross Debt

Table 4-4 includes all debt known to be outstanding as well as the debt that has been authorized but not yet issued.[4]

At the end of 1965[5] gross debt amounted to $4.5 billion for the State, intrastate and interstate agencies combined. By the end of 1970, the amount of gross debt for these units of government had increased to $8.7 billion—an increase of 93.0 percent. On a compound rate, this meant that the gross debt had increased at the annual rate of 14 percent.

State and Intrastate Debt

The aggregates of gross debt, excluding the interstate agencies rose from $3.3 billion in 1965 to $6.8 billion in 1970. This aggregate increase in State and intrastate debt of $3.5 billion represented a total increase of 104.6 percent, or an average compound annual rate of increase of 15 percent.

[4] The debt of local housing authorities for low-rent public housing issued in the name of local governments under contract with the U.S. Department of Housing and Urban Development is not included.

[5] Data relates to close of fiscal year ending during the calendar year. Thus data for the State of New Jersey is for the fiscal year ending June 30th. The gross debt does not include the local public housing authority debt.

Local Government Debt

The aggregate amount of gross debt of local governments and local authorities rose from $2.3 billion to $3.7 billion. The five year growth was distributed quite evenly among the various types of local units:

(Amounts in billions of dollars)

	1965	1970	Amount of Increase 1965-1970	Percentage Increase 1965-1970	Approx. Average Annual Compound Percentage Increase
All Local Governments	$2.26	$3.75	$1.49	66.1%	11%
County Governments	0.23	.45	.22	95.6	14
Municipal and Schools	1.77	2.88	1.11	62.3	10
Schools only	1.09	1.75	.66	60.1	10
Municipal only	0.68	1.13	.45	66.0	11
Local Authorities	0.26	.43	.17	65.4	11

The trend in gross debt per capita during the five-year period was as follows:

(Amounts in billions of dollars)

	1965	1970	Increase 1965-1970	Percentage Increase 1965-1970	Approx. Average Annual Compound Percentage Increase
Total	$681	$1,216	$535	78.6%	12%
Interstate Agencies	178	264	86	48.3	8
State and Intrastate	503	952	449	89.3	13
State Government	163	428	265	162.6	21
State of New Jersey	49	210	96	195.9	24
State Agencies	114	218	104	91.2	14
Local Government	341	524	183	53.7	9
Counties	35	63	28	80.0	12
Municipal and Schools	267	402	135	50.6	8.5
Schools only	164	244	80	48.8	8
Municipal only	103	158	55	53.4	9
Local Authorities	39	59	20	51.3	8.5

TABLE 4-5

TREND IN TOTAL DEBT IN NEW JERSEY BY SECURITY PLEDGED

(in millions of dollars)

	1965	1966	1967	1968	1969	1970	Increase 1965-1970 Amount	Percent
Issued and Authorized by not Issued	4,520	4,869	5,392	6,378	8,019	8,713	4,193	93.0
General Obligation	2,694	2,901	3,096	3,384	4,622	5,169	2,475	91.9
State and State Agency	594	571	550	525	1,491	1,752	1,158	194.9
State	322	307	293	277	1,253	1,508	1,186	368.3
State Agency	272	260	257	248	238	244	(28)	(10.3)
Interstate Agency	97	96	92	92	91	89	(8)	(0.8)
Local Government	2,003	2,234	2,454	2,767	3,040	3,328	1,325	66.2
County	229	291	337	391	428	448	219	95.6
Municipal and School	1,774	1,943	2,117	2,376	2,612	2,880	1,106	62.3
School	1,092	1,196	1,291	1,393	1,500	1,568	476	43.6
School Guaranteed by State	—	—	—	90	90	180	180	—
Municipal	682	747	826	893	1,022	1,132	450	66.0
Self-Sustaining	257	281	296	308	343	350	93	36.2
Tax-Supported	425	466	530	585	679	782	357	84.0
Revenue Debt	1,826	1,968	2,296	2,993	3,397	3,544	1,718	94.6
Interstate Agencies	1,085	1,048	1,124	1,626	1,641	1,803	718	66.2
State Agencies	484	636	855	1,027	1,370	1,316	832	174.0
Local Authorities	257	284	317	340	386	425(E)	168	65.4

NB. Detail may not add to totals due to rounding.

Trends on Basis of Security Pledged

Trends in debt outstanding according to the security pledged are shown in Table 4-5 using only the broad classifications of general obligation debt and revenue debt; the changes from 1965 to 1970 may be summarized as follows:

	(Amounts in billions of dollars) 1965	1970	Increase 1965-1970	Percentage Increase 1965-1970	Approx. Average Annual Compound Percentage Increase
Total	4.52*	8.72*	4.20	92.9	14
General obligation debt	2.59	5.08	2.49	96.1	15
State and State Agency	.59	1.75	1.16	196.6	24
State of New Jersey	.32	1.51	1.19	371.9	37
State Agencies	.27	.24	(.03)	(11.1)	2
Local Government	2.00	3.33	1.33	66.5	11
Counties	.23	.45	.22	95.7	15
Municipal and School	1.77	2.88	1.11	62.7	10
School Only	1.09	1.75	.66	60.6	10
Municipal only	.68	1.13	.45	66.2	11
Revenue Debt	1.83	3.55	1.72	94.0	15
Interstate Agencies	1.09	1.80	.71	65.1	11
State Agencies	.48	1.32	.84	175.0	22
Local Governments	.26	.43	.17	65.4	11

* Total line includes the general obligation debt issued by the Port of New York Authority for the State of New York. The amounts are not included in the general obligation debt total.

Authorized But Unissued Debt

The amount of authorized but unissued debt for State and intrastate units of government in New Jersey stood at $0.35 billion at the end of 1965. By the end of 1970, the amount of unissued debt had risen to $2.20 billion—an increase of 529 percent. It is noted that the compounded annual rate of growth of the unissued debt for the five-year period was about 40 percent, compared with only 10 percent for issued debt. (Table 4-6) *This represents a major backlog of foreseeable credit needs.* The changes from 1965 to 1970 may be summarized as follows:

(Amounts in billions of dollars)

	1965	1970	Increase 1965-1970	Percentage Increase 1965-1970	Approx. Average Annual Compound Percentage Increase
Total	4.52	8.72	4.20	93.0	14
Issued	4.09	6.51	2.42	59.2	10
Interstate Agencies	1.10	1.87	0.77	70.1	11
State and Intrastate	2.98	4.63	1.65	55.2	9
State and State Agency	1.03	1.75	0.72	70.0	11
Local Governments	1.95	2.87	0.92	47.4	8
Counties	0.19	0.34	0.15	77.9	12
Municipal & Schools	1.50	2.11	0.61	40.4	7
Local Authorities	0.26	0.43	0.17	66.0	11
Unissued	0.43	2.21	1.78	441.5	40
Interstate Agencies	0.08	0.02	(.06)	(78.8)	(12)
State and Intrastate	0.35	2.20	1.85	528.6	50
State and State Agency	0.05	1.32	1.27	2,835.5	96
Local Governments	0.31	0.88	0.57	184.7	23
Counties	0.04	0.11	0.07	182.1	23
Municipal & School	0.27	0.77	0.50	185.1	23
Local Authorities	—	—	—	—	—

The market implications of the unissued debt are very significant, because this large amount of debt that has not been issued as long-term debt is equal to about one-half of the amount of outstanding long-term debt in 1970 for the State and intrastate agencies.

When the State and local units seek to fund such a large amount of debt within the next few years (coupled with some elements of new authorizations that will also reach the market), the market may be obliged to absorb more than $500 million annually of State and intrastate debt of New Jersey and its local governments.

Moreover, the implications for the taxpayers and those paying service charges upon which debt rests will also be significant. The total amounts of additional money required to service the debt will be in the range $170 million per year when all of this debt is marketed as long-term debt. The actual amounts will, of course, depend upon the rates of amortization and the interest rates at which the long-term debt is issued.

The Committee concludes:

1. The forecast of a rise in annual capital outlays of counties and municipalities from a current (1971) level of $431 million (from borrowing and other sources) to $750 million annually in 1981, together with an annual average of $200 million for environmental quality over the decade, is closely parallel to the result of this study of the current debt picture (including authorized but unissued debt).

2. Based upon the volume of long-term debt outstanding, plus the need for permanent financing of debt authorized but unissued (including debt now in the form of temporary notes under bond authorization), it may be projected that New Jersey taxpayers will be called upon to support new debt obligations of $500 million annually over the next few years. In addition public authority debt to be incurred for needed environmental quality improvements, roads, and other revenue producing projects will make growing demands upon the people. Based upon past experience, however, a growing population and rising income levels may be able to absorb these burdens without undue sacrifice.

3. The nature and volume of the debt outstanding and to be incurred for counties, municipalities, school districts and public authorities, together with the established needs of the State, underscore the importance of sound borrowing practices, effective controls and competent debt management.

TABLE 4-6

TREND IN GOVERNMENTAL DEBT IN NEW JERSEY ISSUED AND AUTHORIZED BUT NOT ISSUED, BY STATUS OF ISSUE 1965-1970

(in millions)

	1965	1966	1967	1968	1969	1970	Increase 1965-1970 Amount	Increase 1965-1970 Percent
Total: Issued Plus Authorized but not Issued	4,520	4,869	5,292	6,478	8,019	8,713	4,193	93.0
Issued	4,086	4,319	4,582	5,454	5,987	6,496	2,410	59.2
Interstate Agencies	1,102	1,066	1,136	1,671	1,716	1,875	773	70.1
Port of New York Authority	873	851	919	1,434	1,452	1,543	670	76.7
Delaware River Port Authority	115	102	106	125	140	210	95	82.6
Delaware River and Bay Authority	103	103	103	103	103	103	—	—
Delaware River Joint Toll Bridge Comm.	11	10	8	9	21	19	8	72.7
State and Intrastate Agencies	2,984	3,253	3,446	3,783	4,271	4,621	1,637	55.2
State and State Agencies	1,033	1,162	1,155	1,305	1,625	1,746	713	70.0
State	277	262	293	277	337	459	182	65.7
State Agency	756	900	862	1,028	1,288	1,287	541	71.6
Local Government	1,951	2,091	2,291	2,478	2,656	2,875	924	47.4
County	190	240	280	284	320	338	148	77.9
Municipal and School	1,505	1,567	1,694	1,854	1,950	2,113	608	40.4
School	959	981	1,044	1,153	1,196	1,241	282	29.4
School-Guaranteed by State	—	—	—	—	5	12	12	—
Municipal	546	586	650	701	749	860	314	57.5
Self-Sustaining	174	232	251	252	272	283	109	62.6
Tax-Supported	372	354	399	449	477	577	205	55.1
Authorities	256	284	317	340	386	425(E)	169	66.0
Authorized but not Issued	433	552	711	924	2,023	2,215	1,782	411.5
Intrastate Agencies	80	80	80	48	17	17	(63)	(78.8)
State and Intrastate Agencies	353	472	731	876	2,006	2,198	1,845	522.7
State and State Agencies	45	45	250	248	1,236	1,321	1,276	2,835.5
State	45	45	—	—	916	1,048	1,003	2,228.9
State Agency	—	—	250	248	320	273	273	—
Local Government	308	427	481	628	770	877	569	184.7
County	39	51	57	107	108	110	71	182.1
Municipal and School	269	376	424	521	662	767	498	185.1
School	134	216	246	240	304	327	193	144.0
School-Guaranteed by State	—	—	—	90	85	168	168	—
Municipal	135	160	178	191	273	272	137	101.5
Self-Sustaining	83	48	46	55	71	66	(17)	(20.5)
Tax-Supported	52	112	132	136	202	206	154	296.2

NB. Detail may not add to totals due to rounding.

Chapter III

Borrowing vs. Pay-As-You-Go

The question whether it is better to finance capital improvements by borrowing (with attendant annual debt service) or by annual appropriations for capital outlay (so far as feasible), continues to recur. Present law in New Jersey encourages some pay-as-you-go, as follows:

1. By requiring a 5% down payment (with few exceptions) for all capital improvements to be bonded; and

2. By providing for the creation of municipal capital improvement funds in which a municipality may accumulate, by annual appropriation, funds to be used in the future for capital expenditures.

In terms of financing total capital outlays, there is a notable difference between the practices of state governments and local governments. As shown in Table 4-7 the local governments' long-term debt issued equalled 68.2 percent of capital outlay costs but at the state level, only 38.3 percent. In New Jersey, the comparison is similar, as shown in Table 4-8. State capital outlays were fairly close to 37% of total expenditures but the debt ratio varied widely from year to year. Local governments show a debt to capital outlay ratio of close to 60% throughout the period.

Table 4-8 indicates that the volume of capital outlays at the State level of government in New Jersey increased at a phenomenal rate between 1965-66 and 1968-69—well over 100 percent. On the other hand, local government capital outlays in New Jersey increased by somewhat less than 30 percent.

TABLE 4-7

CAPITAL OUTLAYS, CONSTRUCTION EXPENDITURES, AND NEW LONG-TERM DEBT OF STATE AND LOCAL GOVERNMENTS IN THE UNITED STATES, 1968-69

(in millions of dollars)

Item	Total Capital Outlay			Construction Expenditure Only			Construction Expenditures as a Percent of Total Capital Outlays		
	State	Local	Total	State	Local	Total	State	Local	Total
Education	2,611	4,719	7,329	2,059	3,754	5,813	78.9	79.6	79.3
Highways	8,329	1,943	10,273	7,181	1,646	8,827	86.2	84.7	85.9
Health & Hospitals	379	382	761	310	311	622	81.8	81.4	81.7
Sewerage	—	1,207	1,207	—	1,161	1,161	—	96.2	96.2
Local Parks & Recreation	—	581	581	—	399	399	—	68.7	68.7
Natural Resources	605	200	804	458	170	628	75.7	85.0	78.1
Housing & Urban Renewal	1	1,237	1,238	1	660	661	—	53.4	53.4
Air Transportation	67	420	486	65	337	402	97.0	80.2	82.7
Water Transport & Terminals	133	159	292	119	124	243	89.5	78.0	83.2
Local Utilities	—	2,551	2,551	—	2,107	2,107	—	82.6	82.6
All Other	576	2,141	2,717	417	1,625	2,042	72.4	75.9	75.2
TOTAL	12,701	15,539	28,240	10,610	12,294	22,904	83.5	79.1	81.1
Long-Term Debt Issued	4,859	10,594	15,453	4,859	10,594	15,453			
Long-Term Debt Issued as a Percent of Capital Outlays	38.3	68.2	54.7	45.8	86.2	67.5			

Source: U.S. Department of Commerce, Bureau of the Census, *Governmental Finances 1968-69*, pp. 25, 28.

NB.: *Capital outlay* is defined as "Direct expenditure for contract or force account construction, for purchase of equipment (including replacements), and for purchase of land and existing structures."

Construction is defined as comprising "production of fixed works and structures and of additions, replacements, and major alterations, including design, site improvement, and provision of facilities that are integral parts of a structure."

TABLE 4-8

CAPITAL OUTLAYS AND NEW LONG-TERM DEBT ISSUED BY STATE OF NEW JERSEY AND ITS LOCAL GOVERNMENTS 1965-1969

(in millions of dollars)

	Total Expenditure	Total, Excluding Capital Outlays	Capital Outlays	Capital Outlays as percent of Total Expenditures	New Long-Term Debt Issued	New Long-Term Debt as percent of Capital Outlay
State Government						
1965-66	625.1	427.2	197.9	31.7	1.9	0.9
1966-67	757.2	481.8	275.4	36.4	224.1	81.4
1967-68	908.1	557.5	350.6	38.6	2.0	0.6
1968-69	1114.4	667.9	436.5	39.2	278.0	63.7
	3404.8	2144.4	1260.4	37.0	506.0	40.1
Local Government						
1965-66	1970.6	1660.9	309.7	15.7	160.1	51.7
1966-67	2162.0	1852.2	309.8	14.3	188.2	60.7
1967-68	2294.6	1961.8	332.8	14.5	204.4	61.4
1968-69	2667.5	2272.4	395.1	14.8	258.9	65.5
	9094.7	7747.3	1347.4	14.8	811.6	60.2
Total						
1965-66	2595.8	2088.2	507.6	19.6	162.0	31.9
1966-67	2919.1	2334.1	585.0	20.0	412.3	70.5
1967-68	3202.7	2519.3	683.4	21.3	206.4	30.2
1968-69	3781.8	2950.3	831.5	22.0	536.8	64.6
	12499.4	9891.9	2607.5	20.9	1317.5	50.5

Source: U. S. Department of Commerce, Bureau of the Census, *Governmental Finances, 1965-66,* pp. 36, 41; *1966-67,* pp. 36, 41; *1967-68,* pp. 36, 41; *1968-69,* pp. 36, 41.

The relationships of long term debt issued to capital outlays and of capital outlays to total expenditures provides some interesting insights:

a. At the State government level, new long-term debt issued during the four-year period accounted for only 40 percent of total capital outlays. During the same period capital outlay rose from 31.7 percent of total expenditures in 1965-66 to 39.2 percent in 1968-69.

b. In the case of local governments, new long-term debt averaged 60.2% of capital outlays and is reported to have more than kept pace with the growth in capital outlays—from 51.7 percent of capital outlays in 1965-66 to 65.5 percent in 1968-69.

The Committee concludes:

In New Jersey and in other State and local governments in the United States there has been a considerable reliance upon current revenues, or reserves developed from current revenue, in the financing of capital outlays. There is also an apparent trend away from such reliance due to current tax pressures.

Adverse Effect Upon Current Services

Overall considerations coupled with taxpayer resistance tend to place upper limits upon the proportions of private income of residents (and others subject to the levy of taxes and/or service charges) that can be diverted to the local or State public treasury at any given time. Consideration must therefore be given to the impact which the setting aside of current income for pay-as-you-go is likely to have upon the total amounts of funds available for financing current services. Obviously, if a heavy requirement for pay-as-you-go is likely to result in a reduction in the actual or potential amount of current service, careful evaluation of the relative benefits to be derived is required.

Cost of Planning, Issuance, and Servicing of Debt

Where debt is used as the means of financing, considerable costs may be associated with the planning and issuance of the debt, including but not limited to the following: preparation of the debt plan, development of materials for use in marketing the bonds, financial

consultant fees, legal fees, advertising and printing costs, bond rating fees, paying or fiscal agency fees, cost of maintenance of records and reporting upon debt, and the cost of securing the services of investment bankers in the sale and distribution of the credit instruments.

Interest

By far the greatest cost falls under the general heading known as interest. The costs which are denominated as "interest" vary from place to place. Generally, the term includes the following:

a. The cost of the use of money, i.e., the pure cost excluding the element of risk undertaken as to whether the money is likely to be repaid. Thus, the bonds of local public housing agencies that are backed by the full faith and credit of the United States are assumed to have little risk involved so long as one postulates a Federal government with the capacity and willingness to meet its financial obligations. This concept would also exclude the element of risk arising from inflation.

b. The element of risk involved in decrease in purchasing power of money at the times of payment of interest and the time of repayment of principal.

c. The element of risk in the case of a general obligation bond that the issuer will not be able to meet his obligations as they fall due or, that in the case of a revenue bond, the governmental enterprise will not provide sufficient net revenues to enable it to meet debt service requirements.

d. The cost of issuing the debt and the costs incident to sale through investment bankers of the debt instruments.

Beyond the costs of interest, there are the costs associated with the administration of outstanding debt. Although these are ordinarily a very small item when related to the amount of debt being administered, they do constitute an element of costs associated with the use of borrowed money vs. pay-as-you-go in the financing of capital projects.

In economic terms, items (a), (b), and (c) listed above are deemed to be nothing more than the future worth of a dollar in hand. The other costs constitute payment for services being rendered and are paid at the time of issue through reduction of a portion of the future interest to present value in the adjustment of the price at which the bonds are sold, or through the use of the discount-at-original-sale technique, i.e., acceptance of less than par value for the debt instruments being issued.

Additional Revenue Requirements

Except where new debt is in effect a replacement for debt being retired, each new issue of debt is likely to constitute not merely the anticipation of future revenue but more likely, the anticipation of *additional* new revenue.

Easy Spending

The argument is frequently made—and not entirely without foundation—that borrowed money is likely to be spent under fewer restrictions than current revenue. This argument is reinforced by observation of the relative care with which law and administrative actions have been developed to safeguard the budget planning and execution processes in respect to operating expense and the recent commencement of the development of a commensurate set of protections in respect to capital outlays, especially when financed from bond proceeds. This is not to assert that the proceeds of loans are wasted; however, as in the purchase of "extra" features of an automobile, it is easier to approve the addition of the costs of the extras as a part of the financing charge than to dig down in the pocket at the moment for that desirable but not so essential feature.

Voter Approval

Although many loan proposals are defeated each year, most public officials would prefer to raise a given amount of money through borrowing than confronting voters with requirements for a stiff increase in current taxes or charges to meet the pay-as-you-go cost of additional facilities. The "fly-now-pay-later" syndrome is not restricted to the airlines.

Burdens and Benefits

One of the most frequently cited reasons in support of borrowing is that it distributes the capital costs more efficiently in proportion to use of the facility. Pay-as-you-go financing tends to concentrate the burden upon a current generation of taxpayers, whereas debt service spread out over the useful life of the facility tends to allocate the capital costs more in accordance with the use of the facility. This approach, of course, does not deal with the question of cost-effectiveness, and suggests the direct use of service charges as an alternative.

Economic Evaluation of the Options

The general factors to evaluate in determining a choice of policy are:

1. Timing and periodicity of capital outlay program;
2. Rates of change in population;
3. Changes in per capita income;
4. Budgetary requirements for current operations;
5. Effect upon current services;
6. Costs of planning, issuing and servicing debt;
7. Interest costs;
8. Restraints on spending;
9. Economic factors affecting costs.

Economic evaluation of the alternative financing methods is most closely related to interest considerations and construction costs indexes.[6] The net effect may be considered by the following illustrations:

1. Relative costs of pay-as-you-go vs. full bond funding;
   A. At the 5 percent down-payment level; and
   B. At the 25 percent down-payment level.
2. Impact of the operation of the Federal income tax upon relative costs of full pay-as-you-go vs. full funding;
3. Effect of various inflation rates upon the ultimate costs of down payments vs. full funding; and
4. Impact upon credit position.

At the 5% down payment level there is relatively little effect on borrowing costs. At the 25% down payment illustration, the difference is clear, and depends in large part upon the added cost of inflation when the project is deferred long enough to accumulate the down payment.

Table 4-9 shows the effect of a five-year delay in which to accumulate the 25 percent down payment in the period 1960-65 and Table 4-10 shows the effect of a similar delay in the period 1965-70. In Table 4-9 Municipality "G" builds a facility which on the basis of the construction cost index is assumed to have cost $10,000,000 in December 1965. In December 1960, this facility would have been priced at $8,260,000. As a result of a delay of five years, the capital costs for "H" have increased by 21.07 percent. As a result, the 25 percent down payment which would have been $2,065,000 in 1960 must now be $2,500,000.

It is observed that although the total interest payable by "H" will be $238,000 (or 7.37 percent, less than that payable by "G", the total amount to be paid by "H" for project contract costs plus interest will amount to $12,992,000 as compared with the cost to "G" of $11,490,000—or a net increase in total costs of 13.07 percent.

An examination of Table 4-10 for the same two municipalities will show that due to the significant increase in rise of construction costs from 1965 to 1970 (from $10,000,000 to $14,099,000—40.99 percent) and also due to the increase in interest rates in the same period (from 3.50 percent to 5.375 percent —an increase of 53.57 percent) the total interest payable by "H" becomes $6,811,000 as compared with $3,989,000 for "G". In terms of the total costs (project contract costs plus interest) the project would have had a price tag of $20,910,000 for "H" as compared with $13,989,000 for "G"—an increase of $6,921,000, or 49.47 percent.

[6] Federal tax savings may also be material from the viewpoint of particular taxpayers.

TABLE 4-9

EFFECT OF A 25 PERCENT DOWN-PAYMENT ON TWO IDENTICAL CONSTRUCTION PROJECTS UNDERTAKEN BY MUNICIPALITIES "G" AND "H" WHEN MUNICIPALITY "G" AWARDED CONTRACT IN 1960 AND MUNICIPALITY "H" DELAYED CONTRACT AWARD UNTIL 1965 IN ORDER TO ACCUMULATE 25 PERCENT DOWN-PAYMENT

(Based upon Construction Project Costing $10,000,000 in December, 1965)

(Amounts in thousands of dollars)

	Municipality "G"	Municipality "H"	Increase (or Decrease) "H"—"G"	Percentage Increase (or Decrease)
Construction Costs				
December 1960	8,260			
December 1965		10,000	1,740	21.07
Down Payment		2,500	2,500	—
Amount to be Funded	8,260	7,500	(760)	17.40
Interest Rates (percent)				
December 1960	3.4375			
December 1965		3.50	.0625	1.82
Semi-Annual Debt Service Costs	287	262	(25.0)	(8.70)
Total Debt Service Costs	11,490	10,492	(998)	(8.70)
Interest Costs	3,230	2,992	(238)	(7.37)
Total Costs (Construction Costs, and Interest Costs)	11,490	12,992	1,502	13.07

TABLE 4-10

EFFECT OF A 25 PERCENT DOWN-PAYMENT ON TWO IDENTICAL CONSTRUCTION PROJECTS UNDERTAKEN BY MUNICIPALITIES "G" AND "H" WHEN MUNICIPALITY "G" AWARDED CONTRACT IN 1965 AND MUNICIPALITY "H" DELAYED AWARD OF CONTRACT UNTIL 1970 IN ORDER TO ACCUMULATE 25 PERCENT DOWN-PAYMENT

(Based upon Construction Project Costing $10,000 in December, 1965)

(Amounts in thousands of dollars)

	Municipality "G"	Municipality "H"	Increase (or Decrease) "H" - "G"	Percentage Increase (or Decrease)
Construction Costs				
December 1965	10,000			
December 1970		14,099	4,099	40.99
Less Down Payment		3,525	3,525	—
Amount to be Funded	10,000	10,574	574	5.74
Interest Rates (percent)				
December 1965	3.50			
December 1970		5.375	1.875	53.57
Semi-Annual Debt Service Costs	350	435	85	24.29
Total Debt Service Costs	13,989	17.385	3,396	24.27
Interest Costs	3,989	6,811	2,822	70.74
Total Cost (Construction plus Interest)	13,989	20,910	6,921	49.47

The Effect of Inflation

No discussion of pay-as-you-go vs. borrowing would be complete without taking into account the value of the dollars in terms of their purchasing power at the time paid. In order to test the effects of inflation over a long period of years, Table 4-11 has been developed under the following assumptions:

1. That Municipalities "L" and "M" were each confronted with a requirement for engaging in an identical amount of construction work with contracts to be let in December each year. Not only would the amounts be identical between the municipalities but also from year to year.
2. That the amount of work to be done each year would have cost $1,000,000 if contracted in December, 1948, in New Jersey.
3. That the increases in the costs of each year's contract would have been at the rate representing the average of the New York and Philadelphia Construction Price Index of the *Engineering News Record*.
4. That Municipality "L" has pursued a full pay-as-you-go policy and that Municipality "M" has pursued a policy of issuance of single coupon bonds with a maximum life of 20 years.
5. That the bonds bear the coupon rates shown in Column 3.
6. That the debt is issued on December 15 of each year in a manner that will cause it to be amortized in 40 equal annual installments, with the first two installments being provided in year following the date of issue.
7. That the Consumer Price Index for New York and Northern New Jersey be used as the adjustment factor in the value of dollars being paid for debt service. (To simplify the problem, the CPI for December of each year has been used, rather than using a June and December factor.) The value of the dollars has been adjusted to a basis that December, 1970, is equal to 100.0.
8. That the rate of inflation during the period 1970-1990 will proceed on a steady basis of 2.50 percent per annum. (The compound average rate of inflation from December, 1948, to December, 1970, was just slightly under a 2.50 percent rate. Of course it did not proceed at an even pace as is assumed for the 1970-1990 period.)

Under these assumptions, the results of the illustration may be summarized in a number of ways. First, looking at the results in terms of the "raw" or current dollars in which the transactions are actually recorded:

Cost pay-as-you-go	$42,319,000
Cost when fully funded	60,208,700
Difference	17,889,700*
Percentage difference	42.3

*As a matter of information, this represents an average return of approximately 3.75 percent over the whole life of all 23 issues taken as a composite.

TABLE 4-11

IMPACT OF INFLATION UPON RELATIVE COSTS UNDER FULL PAY-AS-YOU-GO VS. FULL FUNDING FOR A SERIES OF 23 IDENTICAL PROJECTS UNDERTAKEN IN DECEMBER OF EACH YEAR, 1948-1970

(Amounts in Thousands of Dollars)

	Project Cost	Bond Buyer 20-Bond Index in December (percent)	Interest Rate Used in Computation (percent)	Annual Debt Service	Value of $1 Under Consumer Price Index 12/1970 = 100	Project Cost In 12/1970 CPI Dollars	Debt Service in 12/1970 CPI Dollars	Yield Rates Used In Discounting Future Debt Service Costs	Value of Debt Service 1971-1990 At Yield Rates in Col. 8
1948	1,000	2.31	2.3125	—	1.712	1,712	—	—	—
1949	1,046	2.11	2.125	63	1.751	1,832	110	—	—
1950	1,187	1.75	1.75	127	1.563	1,855	198	—	—
1951	1,198	2.09	2.0625	198	1.577	1,889	312	—	—
1952	1,291	2.37	2.375	271	1.567	2,023	424	—	—
1953	1,368	2.60	2.625	353	1.553	2,125	548	—	—
1954	1,425	2.33	2.3125	441	1.565	2,230	690	—	—
1955	1,500	2.52	2.50	530	1.567	2,351	832	—	—
1956	1,576	3.24	3.25	626	1.520	2,396	952	—	—
1957	1,650	3.16	3.1875	734	1.479	2,440	1,086	—	—
1958	1,716	3.30	3.3125	846	1.447	2,483	1,224	—	—
1959	1,785	3.60	3.625	964	1.414	2,506	1,364	—	—
1960	1,851	3.43	3.4375	1,091	1.389	2,571	1,514	—	—
1961	1,900	3.51	3.50	1,219	1.383	2,628	1,686	—	—
1962	1,991	3.11	3.125	1,352	1.362	2,712	1,842	—	—
1963	2,043	3.31	3.3125	1,487	1.325	2,710	1,970	—	—
1964	2,133	3.18	3.1875	1,627	1.311	2,665	2,132	—	—
1965	2,241	3.50	3.50	1,772	1.284	2,877	2,276	—	—
1966	2,307	4.02	4.00	1,929	1.239	2,858	2,390	—	—
1967	2,446	4.45	4.375	2,098	1.206	2,950	2,530	—	—
1968	2,712	4.76	4.75	2,283	1.145	3,105	2,614	—	—
1969	2,794	6.72	6.75	2,431	1.071	2,992	2,604	—	—
1970	3,159	5.41	5.375	2,624	1.000	3,159	2,624	—	—
1971	—	—	—	2,813	.976	—	2,746	3.00	2,730
1972	—	—	—	2,739	.951	—	2,604	3.10	2,576
1973	—	—	—	2,658	.929	—	2,470	3.20	2,416
1974	—	—	—	2,569	.906	—	2,328	3.30	2,254
1975	—	—	—	2,480	.884	—	2,192	3.40	2,095
1976	—	—	—	2,384	.862	—	2,056	3.50	1,936
1977	—	—	—	2,277	.841	—	1,914	3.60	1,773
1978	—	—	—	2,164	.821	—	1,776	3.70	1,614
1979	—	—	—	2,046	.801	—	1,640	3.80	1,458
1980	—	—	—	1,920	.781	—	1,500	3.90	1,305
1981	—	—	—	1,792	.762	—	1,364	4.00	1,159
1982	—	—	—	1,658	.744	—	1,234	4.10	1,025
1983	—	—	—	1,524	.725	—	1,104	4.25	882
1984	—	—	—	1,383	.708	—	980	4.40	752
1985	—	—	—	1,238	.690	—	854	4.60	626
1986	—	—	—	1,081	.674	—	728	4.70	514
1987	—	—	—	913	.657	—	600	4.80	408
1988	—	—	—	728	.641	—	466	4.90	305
1989	—	—	—	516	.626	—	322	5.00	202
1990	—	—	—	260	.610	—	157	5.10	96
1948-1970				25,066		57,069	31,922		31,922
1971-1990				35,143		—	29,035		26,125
	42,319			60,209		57,069	60,957		58,047

This uncritical presentation of costs suggests that Municipality "M" is incurring substantial costs for interest—equal to 42.3 percent of the contract price for the projects of $42,319,000.

Taking Into Account Consumer Price Index

If one takes into account the Consumer Price Index for New York-Northern New Jersey, he finds that the 1948 dollars had a value to the typical citizen in terms of purchasing power equal to $1.712 for each dollar's purchasing power in December, 1970.

Therefore, if the payments made by citizens for pay-as-you-go and for debt service are adjusted to the value of December 1970 CPI dollars (with an allowance as previously stated for an average 2.5 percent inflation during the 1970-1990 period), the costs may be summarized as follows:

Municipality "L"	
Cost of pay-as-you-go in terms of dollars equal in purchasing power (CPI) to those of December, 1970	$57,069,000
Municipality "M"	
Cost of debt service in terms of dollars equal in purchasing power (CPI) to those of December, 1970	60,957,000
Difference	3,888,000
Percentage difference	6.81

Presented in this manner, the difference between the option of pay-as-you-go for Municipality "L" and Municipality "M" comes in at a rather low amount.

If one considers the $3,888,000 as the gross value of the interest payable in terms of December 1970 purchasing power dollars, he finds that in order to arrive at net interest, he must first deduct an allowance for the gross profit of investment bankers in distributing the bonds. Assuming a fee of 1 percent of the principal amount issued, the fee would have been $423,000. This would leave $3,465,000 of the $3,888,000 as return to the investor. In terms of percent per annum, this would constitute a net return to the investor of approximately 0.78 percent.

Taking Into Account Present Worth at December 15, 1970

Another approach to comparison is offered by reducing to present worth the value of the debt service payable after December 15, 1970. If this is done on the scale set forth in Column 8 of Table 4-11 (yield rates at which the $41,065,000 Nassau County, N. Y., 4.90 percent bonds were reoffered in *The Bond Buyer* on December 14, 1970), then the combination of money paid prior to and including December 15, 1970, plus the present value of the money payable in the future would be as follows:

Municipality "L"		
Cost of pay-as-you-go in terms of dollars equal in purchasing power (CPI) to those of December, 1970		$57,069,000
Municipality "M"		
Amount paid as debt service in the period June 15, 1949, through December 15, 1970, as debt service adjusted to dollars with purchasing power (CPI) equal to those of December, 1970	$31,922,000	
Present worth of future debt service at December 15, 1970, at yield rates indicated in Table I-14, Column 8	26,125,000	58,047,000
Difference		$ 978,000
Percentage difference		1.7

Impact Upon Credit Position

Certain obvious facts stand out in relation to the impact of pay-as-you-go on the credit position of the government, insofar as general obligation bonds are concerned:

1. Substantial reliance upon pay-as-you-go acts to reduce the amount of debt outstanding both because facilities are being financed from current revenues and also because the pressure developed by additional tax levies or service charges necessary to support pay-as-you-go acts to discourage simultaneous development of large levies for debt service.
2. The credit position of the issuer is expected to be better than it would be vis-a-vis full reliance upon funding. (Credit position here is used in the sense of market acceptance of the debt, which may not correlate fully with credit rating.)
3. A heavy reliance upon pay-as-you-go financing will reserve borrowing power for possible use at a future time.
4. On the other hand, where bonds are to be financed through revenue issues, a prior history of successful funding and prudent management may act to improve the credit position of the issuer vis-a-vis an issuer who is coming to market for the first time with a given type of bonds.

Summary of Advantages and Disadvantages

The advantages of pay-as-you-go can be substantial, but they are very closely related to economic conditions of the time when capital outlays are required. In a period of rapidly rising prices, high tax rates and a heavy back-log of accumulated capital needs, greater weight must be given to the advantages of borrowing. That is, financing with borrowed funds will tend to minimize the effects of inflation, reduce the effect of the capital outlay on the current tax levy, and spread the cost over the useful life of the outlay so as to require those who enjoy its use to share its financial burden.

The Committee recommends:

1. Local debt managers should evaluate the costs and benefits of pay-as-you-go versus borrowing in light of economic conditions, interest costs and the municipal bond market at the time capital funds are required, since the choices are much too complicated to set down any broad general prescriptions.

2. The present 5% down payment requirement should be retained; but

3. Local governments should be encouraged to increase the down payment to 10% whenever feasible, without making this a legal requirement.

Chapter IV

Debt Limits

Debt Limitation Generally. Some form of limitation on the amount or authorization of State and local debt is widely used among the States. A referendum requirement is common to authorize State debt. Various restrictions apply to local governments. See ACIR, *State Constitutional and Statutory Restrictions on Local Government Debt* (September 1961). In the ACIR survey there were 34 States having constitutional restrictions on local government debt and 14 States without constitutional restrictions (leaving this subject to legislation). New Jersey is one of the 14. The debt limits in New Jersey are somewhat complicated to state but turn on a prescribed debt-to-property ratio as follows:

Municipal	3.5% (net debt* percentage)
School	varying percentages depending upon grades covered e.g. K-12 - 4.0% Regional High School 3.0%
County	2.0%

In effect, school debt may cut into municipal borrowing power to the extent that school debt exceeds the statutory limit. There are the following procedures for exceeding the statutory school debt limit:

For Type I school districts: The school district debt limit may be exceeded through adoption of an ordinance by (a) 2/3 of the members of the local governing body or (b) a majority of the members of the local governing body and approval of the voters. (Newark may authorize debt in excess of 4 percent but not to exceed 8 percent.)

In the case of Type I school districts (with the exception of Newark), the combined school district debt limit and the municipal debt limit may be exceeded by the adoption of ordinance by the governing body of the municipality, with the approval of the Commissioner of Education, and the approval of the voters.

Type II district (including regional school districts): The debt limits may be exceeded by adoption of resolution by the Board of Education and the approval of the legally qualified voters at a regular school election or at a special election.

In the case of Type II school districts. (including regional school districts) the combined school district and municipal debt limits may be exceeded with the approval of the Commissioner of Education, the Local Finance Board, and the voters.

The county and municipal debt limits may be exceeded in 8 different types of situations:

1. to meet expenditures required as a result of fire, flood or other disaster as determined by the Local Finance Board;
2. for emergency construction of dikes, bulkheads or jetties needed for preservation of life or property as determined by the Local Finance Board;
3. for purposes ordered by the Department of Environmental Protection and within limits determined by Local Finance Board;
4. to fund, renew or retire notes issued pursuant to law;
5. in an amount during any year which does not exceed 2/3 of the amount of municipal and school debt returned and paid-off during the current year;
6. in an amount equal to the available debt margin when the bond law was enacted less the sum of previous authorizations under this section, under item (5) above and under "extensions of credit" pursuant to item (7) below;
7. debt issued under an "extension of credit" authorized by the Local Finance Board where it is satisfied and has determined that the debt meets certain statutory standards, and that the issuance of such obligations will not materially impair the credit of such local unit or substantially reduce its ability to pay punctually the principal of and interest on its debts and to supply other essential public improvements and services; (N.J.S. 40A:2-7d);
8. debt issued for self-liquidating purposes.

It is significant that 5 of the 8 exceptions involve administrative discretion by the Local Finance Board. In the case of item (7) above, the so-called "extension of credit" there is no effective debt limit at all. The Board imposes an administrative debt limit with each

* Net debt is gross debt issued by the municipality or its school district less:

a. School debt within the basic limits set forth previously in this Report.

b. School debt created by a regional school district

c. Self-liquidating as defined in Chapter 40A of the New Jersey statutes

d. Debt of a public body other than the local government in cases where payment of the principal and interest are guaranteed by the local government but only to the extent allowed by law

e. Bond anticipation notes

f. Sinking fund assets or other prescribed assets receivable from State or Federal government.

determination. The nature of this determination has been described by the Director of Local Finance, as follows:

> "Extensions of credit are generally granted and here, let me quote the law 'if the Local Finance Board shall be satisfied and shall have determined that each of the purposes or improvements . . . are in the public interest and are for the health, welfare, convenience or betterment of the inhabitants of such local units, and that the amounts to be expended for each of the purposes or improvements to be financed . . . are not unreasonable or exorbitant and that the issuance of such obligations will not materially impair the credit of such local unit or substantially reduce its ability to pay punctually the principle of and interest on its debt and to supply other essential public improvements and services. . . .' What does this mean? What it means is that the debt limitation represents not an absolute limitation, but rather a reasonable point at which an impartial body—the Local Finance Board—is required to review the general fiscal health of the municipality.
>
> "More specifically, the Local Finance Board is not merely reveiwing the fiscal factors but it is also required to make a determination as to whether the improvements which will cause the municipality to exceed the debt limit are really necessary. Such approvals are not granted in rubber stamp fashion, but on the other hand, there are some 460 municipal extensions that have been granted since 1957, and there should be no stigma attached to them. What it means is that they have been given a very careful evaluation and they have passed the test of fiscal ability and need. An extension to exceed the debt limit should not be a detriment, but rather an enhancement of a bond issue. . . .
>
> ". . . Again, an appearance before the Local Finance Board is not a negative function, but is a means of establishing a positive evaluation where doubt otherwise might exist."

Effect of Debt Limits

It is difficult to evaluate the debt limits because of the broad effect of the various exceptions, and particularly of the "extension of credit" provisions. An analysis of the operative effect of the present system of limits, however, discloses some surprising results.[7]

Table 4-12 shows that of the 567 municipalities in New Jersey, 92 (16.2% of the total) of them had no debt as of December 31, 1970. Of the remaining municipalities 334 (58.9%) had debt equal to less than 50 percent of their debt limits, and 78 (13.8%) had debt in the range of 50-99% of their debt limits.

On the other hand, 60 municipalities (11.0%) had debt which exceeded the debt limit. The amounts of the excess debt ranged from small percentages to more than 325% of the established debt limit.

School Debt

Consideration of school debt requires the division of the school districts into two categories: the regular school districts and the regional and other school districts.

In the aggregate, there are 580 school districts in the 21 counties of the State. These districts are divided as follows:

50	Type I
439	Single Municipality
8	Consolidated
18	Regional All Purpose
45	Regional High School
20	Vocation
580	Total School Districts

A tabulation of the ratios of school debt to borrowing capacity for the districts having debt in excess of the debt limit is shown in Table 4-13. The table shows 126 of the 551 districts[1] (22.7%) have debt in excess of the regular debt limits for school districts. This percentage runs to about twice the rate that has been shown in Table 4-12 for municipalities.

Almost half of these 126 districts have debt which only slightly or moderately exceeds the debt limit—within the range of 1 to 24%. In respect to the remainder, there are another 54 districts with debt exceeding the debt limit in the range of 25 to 99%. For the remaining 14 districts, the debt is 100% or more beyond the established debt limit for the district. In the case of the regular districts, this excess is chargeable to the debt limit of the municipality. In a considerable number of districts the school debt coupled with the debt of the municipality exceeds the combined debt limit of the district and the municipality.

In Table 4-14 data is brought together for 60 municipalities having a net debt of more than 100% of the debt limit as of December 31, 1970. Also presented in the table is the debt associated with 26 school districts having debt in excess of their debt limits where such debt is chargeable to the debt limit of the municipality.

Summary of Findings

The situation as of June 30, 1970, with respect to school district debt may be summarized as follows for

[7] Terminology is important for this discussion: i.e. "net debt" is the amount of debt chargeable to the borrowing power of the municipality or school district under the statutory limitations; "debt margin" is the difference between the net debt incurred and the maximum debt which may be incurred under the applicable limitation.

[1] Excluding Union County for which data was not available.

the 551 districts for which information was available:

	Type I and Type II Districts	Regional and Other School Districts	Total
Total number	495	56	551
Number with debt less than debt limit	385	41	425
Number with debt in excess of debt limit	110	16	126

	Type I and Type II Districts	Regional and Other School Districts	Total
Number with excess debt where debt is fully absorbed by municipal borrowing power	67	N.A.	N.A.
Number with excess debt in which combination of excess school debt and excess municipal debt exceeds municipal debt limit	43	N.A.	N.A.

In respect to the municipalities, the data as of December 31, 1970, may be summarized as follows:

Number of municipalities with no net debt		92
Number of municipalities with a net debt where the total net debt falls (school, municipal or combined school and municipal) within the debt limit of municipality		415
Number of municipalities with net debt in excess of debt limit:		60
Due solely to excess school debt	35	
Due to combination of excess school and municipal debt	25	
TOTAL		567

The Committee concludes:

1. The great majority of both school districts and municipalities has been able to live within the prescribed debt limits.

2. Although a total of 110 Type I and Type II school districts have debt in excess of their limits, in 67 of these districts the municipal borrowing power was sufficient to absorb the school district excess.

3. Of the 60 municipalities with debt in excess of their debt limits, the excess debt of associated Type I and Type II school districts was responsible for a portion of the excess. If school district excess debt excluded the debt chargeable to the municipal governments, the number of municipalities with excess debt would have been only 25 municipalities as of December 31, 1970.

4. The present law favors those municipalities where school functions are performed by regional school districts as compared to other municipalities. The debt of regional school districts is not chargeable against the unused borrowing capacity of the municipalities in respect to which the regional school district performs a portion of (or all) school functions.

In other words, as soon as the educational function is regionalized, the municipality is automatically relieved of any responsibility for accommodating the excess debt. Data are not available to show how many of the municipalities, served wholly or partially by regional school systems with excess debt, would themselves have excess debt should the regional district's debt be prorated against the municipality.

5. Local governments are not subject to any limitations as to the amount of their debt so long as the debt is self-supporting. In addition, public authorities operating without any municipal guarantee can issue only self-supporting debt which is not subject to any statutory limits.

Debt Limits in Other States

Local government debt limits in other states are generally related to assessed valuation of property. This results in substantial distortions, especially where assessment ratios are far below market value and in respect to which there is no mechanism similar to that employed in New Jersey to adjust the valuation for debt limit purposes. Unfortunately there is no recent comprehensive study of these debt limits and therefore it is not feasible to generalize concerning them in terms that would be meaningful as a comparison with the New Jersey situation.

There is substantial recent research evidence, however, that existing types of statutory or constitutional debt limits have been effective in limiting the use of debt financing, but they also may have some disadvantages.[8]

For example, when pressure for increased use of municipal credit rises, the limits remain unchanged, and they may be by-passed by issuance of revenue bonds and use of public authorities and special districts. These measures shift the risk of default from taxpayers to bondholders and therefore result in added interest costs.

[8] Pogue, T. F., *The Effect of Debt Limits: Some New Evidence,* XXIII National Tax Journal 36-49 (1970); Mitchell, W. E., *The Effectiveness of Debt Limits on State and Local Government Borrowing* (N.Y.U. Institute of Finance, 1967).

TABLE 4-12

DISTRIBUTION OF NET DEBT OF NEW JERSEY MUNICIPALITIES AND COUNTY GOVERNMENTS AS A PERCENT OF DEBT LIMITS AS OF DECEMBER 31, 1970, BY COUNTIES

Net Debt as a Percent of Debt Limit	Total		County Governments	Municipalities		INDIVIDUAL COUNTIES																				
	No.	Percent		No.	Percent	Atlantic	Bergen	Burlington	Camden	Cape May	Cumberland	Essex	Gloucester	Hudson	Hunterdon	Mercer	Middlesex	Monmouth	Morris	Ocean	Passaic	Salem	Somerset	Sussex	Union	Warren
0.0	92	15.6	—	92	16.2	5	6	6	6	3	6	1	6	—	10	2	1	3	2	4	1	9	1	7	1	12
0.1- 9.9	105	12.9	3	111	19.7	7	12	11	7	1	1	3	7	1	10	3	3	6	5	10	2	5	2	7	4	4
10.0- 19.9	61	10.5	5	57	10.1	1	12	5	7	—	—	6	2	1	—	1	2	4	2	6	2	—	1	2	3	—
20.0- 29.9	79	13.4	8	71	12.5	2	11	6	7	2	1	3	2	3	1	2	3	9	5	3	1	—	4	1	5	—
30.0- 39.9	50	8.5	3	47	8.3	1	10	2	3	—	2	1	—	1	—	2	2	4	4	3	3	—	3	1	2	3
40-0- 49.9	50	8.5	2	48	8.5	3	4	3	2	3	—	2	1	2	—	—	4	7	3	3	3	—	2	3	3	—
Sub-total	354	60.2	20	334	58.9	14	49	27	26	6	4	15	12	8	11	8	14	30	19	25	11	5	12	14	17	7
50.0- 59.9	20	3.4	1	19	3.4	1	1	1	3	—	—	1	—	1	—	1	1	3	1	1	1	—	1	—	2	—
60.0- 69.9	22	3.7	—	22	3.8	—	—	2	—	—	—	2	2	—	1	1	1	2	5	1	—	—	1	2	1	1
70.0- 79.9	15	2.6	—	15	2.6	—	—	1	1	1	2	—	—	—	—	—	2	2	2	—	—	—	3	1	—	—
80.0- 89.9	13	2.2	—	13	2.3	2	—	—	—	1	—	—	1	—	1	—	1	3	3	—	1	—	—	—	—	—
90.0- 99.9	9	1.5	—	9	1.6	—	2	—	—	1	—	1	—	2	—	1	1	—	1	—	—	—	—	—	—	—
Sub-total	79	13.4	1	78	13.8	3	3	4	4	3	2	4	3	3	2	3	6	10	12	2	2	—	5	3	3	1
100.0-124.9	15	2.6	—	15	2.6	1	1	1	—	2	—	1	—	1	1	—	1	3	1	1	1	—	—	—	—	—
125.0-149.9	9	1.5	—	9	1.6	—	—	—	1	1	—	1	1	—	—	—	1	—	2	—	—	—	2	—	—	—
150.0-174.9	14	2.4	—	14	2.5	—	2	1	—	—	1	—	1	—	—	—	2	1	2	1	1	—	—	—	—	2
175.0-199.9	6	1.0	—	6	1.1	—	1	1	—	1	—	—	—	—	—	—	—	3	—	—	—	—	—	—	—	—
Sub-total	44	7.6	—	44	7.7	1	4	3	1	4	1	2	2	1	1	—	4	7	5	2	2	—	2	—	—	2
200.0-224.9	3	0.5	—	3	0.5	—	1	—	—	—	—	—	1	—	—	—	—	—	—	—	—	—	—	—	—	1
225.0-249.9	2	0.3	—	2	0.4	—	1	—	—	—	—	—	—	—	1	—	—	—	—	—	—	—	—	—	—	—
250.0-274.9	3	0.5	—	3	0.5	—	2	—	—	—	—	—	—	—	—	—	—	—	1	—	—	—	—	—	—	—
275.0-299.9	2	0.3	—	2	0.4	—	2	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Sub-total	10	1.7	—	10	1.8	—	6	—	—	—	—	—	1	—	1	—	—	—	1	—	—	—	—	—	—	1
300.0-324.9	3	0.5	—	3	0.5	—	1	—	—	—	—	—	—	—	—	—	—	1	—	—	—	1	—	—	—	—
325.0-349.9	3	0.5	—	3	0.5	—	1	—	—	—	—	—	—	—	1	—	—	1	—	—	—	—	—	—	—	—
Not Reported	3	0.5	—	3	0.5	—	—	—	—	—	1	—	—	—	—	—	—	1	—	—	—	—	1	—	—	—
TOTAL	588	100.0	21	567	100.0	23	70	40	37	16	14	22	24	12	26	13	25	53	39	33	16	15	21	24	21	23

TABLE 4-13

DISTRIBUTION OF NEW JERSEY SCHOOL DISTRICTS HAVING DEBT IN EXCESS OF THEIR DEBT LIMITS AS OF JUNE 30, 1970*

Debt as a Percent of Debt Limit	Total	Percent of Total	Regular School Districts	Regional School Districts	Regional High School Districts
100.0-124.9	58	10.4	51	1	6
125.0-149.9	22	4.0	18	1	3
150.0-174.9	21	3.8	19	—	2
175.0-199.9	11	2.0	11	—	—
Sub-total	112	20.2	99	2	11
200.0-224.9	7	1.2	6	—	1
225.0-249.9	2	0.4	2	—	—
250.0-274.9	—	—	—	—	—
275.0-299.9	1	0.2	1	—	—
Sub-total	10	1.8	9	—	—
300.0-324.9	1	0.2	1	—	—
325.0-349.9	2	0.4	1	—	1
350.0-374.9	—	—	—	—	—
375.0-399.9	—	—	—	—	—
Sub-total	3	0.5	2	—	—
400.0-424.9	—	—	—	—	—
425.0-449.9	1	0.2	—	1	—
TOTAL	126	22.7	110	3	13
Total Districts in 20 Counties	551	100.0	495	— 56 —	

* Table does not include any districts in Union County.

The Debt to Property Ratio

Debt limits have also been criticized for an outdated reliance upon taxable valuations as the measure of local debt paying capability. The Advisory Commission on Intergovernmental Relations has recommended that there be a shift in the basis of debt limits away from property valuations by local governments.[9] On the other hand, the most recent *Model Bond Law* of the National Municipal League recommends a continuation with the use of assessed valuations.[10] The 1968 Pennsylvania Constitution established tax receipts as the base for the debt limit of the Commonwealth and mandated the establishment of a new debt limit for local governments which is also to be based upon revenues over a period of years.

The recommendations of the Commission and the action in Pennsylvania are largely based upon the assumption that with the substantial change in the base for locally generated revenues there is a decreasing degree of reliance upon the property tax which makes the property tax a less suitable measure of capacity to support debt. Similarly, the massive reduction in the property tax burden proposed by the Committee in this report (Part II) requires a reexamination of alternative measures. To this end, it is useful to reconsider what it is debt limits are intended to limit.

What is Debt Limit to Limit?

Of course, the more or less standard answer is that the debt limit is intended to establish the degree to which one may pledge anticipated future revenues through their capitalization at any given time.

But, the amount of a bond issue *does not* constitute a correct reflection of *the amount* of future revenue being capitalized. It represents the *present worth* of the amount being capitalized.

To illustrate, the following table has been developed. The function of this table is to illustrate several items in respect to two $2,500,000 bond issues sold in entirely different markets.

[9] Advisory Commission on Intergovernmental Relations, *State Constitutional and Statutory Restrictions on Local Government Debt*, (1961) pp. 75.

[10] National Municipal League, *Model Municipal General Obligation Bond Law*, (1970) p. 7.

TABLE 4-14

SCHOOL DEBT AS A FACTOR IN EXCESS DEBT OF 60 MUNICIPALITIES WITH NET DEBT IN EXCESS OF DEBT LIMIT AS OF DECEMBER 31, 1970

County Municipality	Municipal Debt Limit	Municipal Net Debt	Municipal Net Debt as a Percent of Debt Limit (2) ÷ (1)	School Net Debt Charged to Municipal Debt Limit		Municipal Net Debt Excluding School Net Debt		Reduction in Percentage Points (2) — (7)
				Amount	Percent of Municipal Debt Limit	Amount	Percent of Municipal Debt Limit	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Atlantic								
Sommers Point	1,508	1,585	105.1	449	23.3	1,136	75.3	—
Bergen								
Closter B.	2,994	8,059	269.1	—	—	8,059	269.1	—
Harrington Park B.	1,580	4,715	298.4	—	—	4,715	298.4	—
Hillsdale B.	3,437	4,294	124.9	—	—	4,294	124.9	—
Hohokus B.	2,111	3,688	174.7	—	—	3,688	174.9	—
Midland Park B.	2,243	3,600	160.5	—	—	3,600	160.5	—
Montvale B.	2,813	7,635	271.5	—	—	7,635	271.5	—
Northvale B.	1,798	4,081	226.9	—	—	4,081	226.9	—
Norwood B.	1,467	4,420	301.9	—	—	4,420	301.9	—
Park Ridge B.	2,488	6,839	275.0	—	—	6,839	275.0	—
Waldwick B.	2,945	5,396	183.2	39	0.7	5,357	181.9	1.3
Washington T.	3,048	10,280	337.2	R	—	10,280	337.2	—
Woodcliffe B.	2,134	4,344	203.5	—	—	4,344	203.5	—
Burlington								
Burlington T.	2,440	4,410	180.8	1,749	39.7	2,661	109.1	71.7
Edgewater Park T.	1,246	1,442	115.7	1,043	73.3	399	32.0	73.5
Maple Shade T.	2,283	3,472	152.1	2,869	82.6	603	26.4	125.7
Camden								
Camden C.	10,866	15,064	138.7	11,440	75.9	3,604	33.1	105.6
Cape May								
Cape May C.	1,134	1,622	143.0	—	—	1,622	143.0	—
Sea Isle C.	1,137	1,230	108.1	—	—	1,230	108.1	—
W. Wildwood B.	146	150	103.1	—	—	150	103.1	—
Woodbine B.	153	290	189.0	—	—	290	189.3	—
Cumberland								
Downe T.	252	380	150.7	—	—	380	150.7	—
Essex								
Caldwell B.	2,196	2,238	101.9	R	—	2,238	101.9	—
N. Caldwell B.	1,925	2,442	123.9	—	—	2,442	123.9	—
Gloucester								
Deptford T.	3,182	6,773	212.9	445	6.7	6,328	198.9	13.0
Harrison B.	567	732	129.1	—	—	732	129.1	—
W. Deptford T.	3,701	6,082	164.3	937	15.4	5,145	144.5	19.8
Hudson								
Jersey City	33,063	39,154	118.4	—	—	39,154	118.4	—
Hunterdon								
Bethlehem	473	673	136.6	—	—	673	136.6	—
Clinton Town	515	1,674	325.2	—	—	1,674	325.2	—
Milford B.	480	1,118	232.8	—	—	1,118	232.8	—
Mercer								
Middlesex								
N. Brunswick T.	6,745	10,784	159.9	5,786	53.7	4,998	74.1	85.8
Piscataway T.	9,233	15,686	169.9	147	—	15,542	168.3	0.3
S. Plainfield B.	5,820	7,672	131.8	—	—	7,672	131.8	—
Woodbridge	25,810	31,787	119.3	—	—	31,787	119.3	—
Monmouth								
Asbury Park C.	2,022	5,495	181.8	—	—	5,495	181.8	—
Holmdell T.	3,820	7,265	190.2	7,020	96.6	263	6.9	183.3
Keansburg B.	1,339	1,374	102.6	390	—	984	73.5	29.1
Loch Arbour V.	120	123	102.4	R	R	123	102.4	—
Marlboro T.	2,416	2,694	115.4	1,887	70.0	807	33.4	82.0
Neptune T.	5,455	9,816	111.5	—	—	9,816	111.5	—
New Shrewsburg B.	1,731	5,613	324.2	R	R	5,613	324.2	—
Rumson B.	3,356	5,763	171.7	—	—	5,763	171.7	—
Sea Bright B.	590	1,999	338.8	—	—	1,999	338.8	—
Morris								
Butler B.	1,633	2,168	132.8	940	43.4	1,228	75.2	67.6
Chatham T.	3,202	4,835	150.9	259	5.4	4,576	142.9	8.0
Mendham T.	1,582	2,230	140.1	1,080	48.4	1,150	72.7	67.4
Morris T.	4,777	5,935	124.1	—	—	5,935	124.1	—
Mt. Olive T.	2,483	3,890	156.6	1,884	48.4	2,006	80.8	75.8
Roxburg T.	4,396	11,067	251.7	6,108	55.2	4,959	112.8	158.9
Sussex								
Ocean								
Lakehurst B.	218	354	122.3	223	63.0	131	60.1	62.2
Lakewood T.	4,656	5,110	109.8	2,584	50.6	2,072	44.5	65.3
Passaic								
Halledon B.	1,601	2,483	155.1	—	—	2,483	155.1	—
Wanaque B.	1,894	2,212	116.8	1,929	87.2	283	14.9	101.9
Salem								
Salem C.	890	2,872	322.4	2,416	84.1	456	51.2	271.2
Somerset								
Green Brook T.	1,476	1,947	131.9	1,404	72.1	543	36.8	95.1
S. Bound Brook B.	3,218	4,245	131.9	—	—	4,245	131.9	—
Union								
Warren								
Alpha B.	381	961	252.4	53	5.5	908	238.3	14.1
Haskettown T.	1,707	2,801	164.1	159	5.7	2,312	135.4	28.7
Phillipsburg	2,390	3,812	159.5	2,257	59.2	1,555	65.1	94.4

R = Regional School District.

Issue B is assumed to be sold in a market similar to that now prevailing. The reoffering yields are patterned largely upon one recent New Jersey local government bond issue.

Issue A is a theoretical issue in which the reoffering yield rates are approximately the rates used in relation to Issue B. Let us assume that hopefully such a market will return in due course, along with a minimal degree of inflation.

The relative amounts of future revenue being capitalized by the two issues to secure cash in hand of $2,500,000 (excluding allowance for dealer's profit and other expense) may be stated as follows (in $000):

	Amounts Payable As:			Allocation of Present Worth of $2,500,000 to:		
	Principal	Interest	Total Debt Service	Principal	Interest	Total
Issue B						
Amount	2,500	2,044	4,544	1,358	1,142	2,500
Percent	55.0	45.0	100.0	45.7	54.3	100.0
Issue A						
Amount	2,500	1,024	3,524	1,718	782	2,500
Percent	70.9	29.1	100.0	68.7	31.3	100.0

It is thus clear that Issue B involves the pledging of $4,544,000 in future revenues in order to secure $2,500,000 in hand. On the other hand, Issue A involves the pledging of only $3,524,000 to secure the same amount in hand. In other words, the pledge involved in Issue B represents a pledge of future revenues that is $1,020,000 greater than in respect to Issue A—an increase of approximately 29 percent more in dollars.

Therefore, if the intent of the debt limit is to place a ceiling upon the extent to which future revenues should be allowed to be anticipated through borrowing, the debt limit might be more appropriately expressed as the aggregate amounts of future debt service that can be due at any given time.

To put the matter in still another perspective, the amount of money that could be borrowed by the pledging of $3,524,000 of future revenue would be $2,500,000 under the market represented in respect to Issue A; however, if the market were equivalent to that shown by Issue B, the amount of cash in hand that could be secured by the pledging of $3,524,000 in revenue would be only $1,939,000.

In many respects these two illustrations represent the difference that is present in revenue financing and in general obligation bond financing. In the case of revenue financing, the question is basically one which commences with the estimate of the amounts available for capitalization of expected future net revenue. In the case of general obligation financing, the process starts from the *amount* to be borrowed and relatively little attention is given to the extent to which future revenues are being capitalized.

Conclusions and Recommendations

The Committee concludes—

1. Existing debt limits on local governments have had a neutral effect for the great majority of counties, municipalities and school districts, since the limits in relation to the needs of these units are high enough to avoid any meaningful impact on the credit of the borrower.

2. The present distinction in the treatment of debt limits of regional school districts as compared with Type I and Type II districts (relating the transfer of excess debt over the district limit to the municipality) is undesirable so long as the present system of limitations is retained.

3. New Jersey already has a large measure of administrative rather than statutory debt limits, and they make the specific percentage of net debt set forth in the Local Bond Law and Educational Law of less real significance in local finance.

4. Proposals to abolish all formal statutory limits, and to substitute a pure administrative limit can find support in experience and economic analysis, but such a step is likely to be misunderstood, and its benefits would be outweighed by the concern it might cause taxpayers and bond investors alike.

5. The present provisions for "extensions of credit" are intended and operated as a constructive influence on municipal finance; but they present a needless source of market confusion or uncertainty in the very label and process; and these shortcomings can be corrected.

6. Is is timely, with the proposed major revision of the property tax and massive increase in State aids to local governments, to accomplish revision in the measure of debt limitations.

The Committee recommends:

1. Require all county, municipal, school and local or regional public authority bond issues to be reviewed and approved by the Division of Local Finance, except as provided in 2 below;

2. Establish a ratio of total projected debt service of the issuer to the equalized valuation of its taxable property, as the debt guideline; and provide that any general obligation issue which falls within the guideline shall be deemed approved for purposes of paragraph 1 above.

3. Fix the guidelines at approximately two times the present net debt percentages in order to allow for the inclusion of projected interest payments in the measure of debt burden.

Chapter V

Limitations on Temporary Borrowing

Three types of short-term financing are permitted for municipalities and counties under New Jersey law:

A. Revenue anticipation notes—with tax anticipation or utility anticipation notes;

B. Emergency notes; and

C. Bond anticipation notes.

Neither revenue anticipation notes nor emergency notes have presented any substantial issues of policy. Bond anticipation notes, however, have become a source of continuing concern.

Trends in Short-Term Debt

The only trend data concerning the use of short-term debt by the State and local governments in New Jersey are the annual estimates prepared by the Governments Division of the Bureau of the Census, U.S. Department of Commerce. Table 4-15 sets forth the estimates of fiscal year-end amounts outstanding for the years 1962 to 1968-69 for New Jersey and the remainder of the states.[11] From Table 4-15 it is apparent that the amount of local government short term debt in New Jersey has increased from $128.4 million in 1962 to $482.0 million in 1968-69—or by 275.4 percent. In the same period, as shown in Table 4-15, local governments short term debt in other states increased by only 107.6 percent. It appears that the short term debt was equal to about one fourth of the outstanding long term debt of local governments in New Jersey.

Table 4-16 shows the trend in short term debt for local governments in New Jersey for the period 1962 to 1968-69. This table shows an increase in local government short-term debt (including public housing authorities) from $128.4 million in 1962 to $482.0 in 1968-69—an increase of 275.4 percent.

Table 4-17 presents information from the U.S. Bureau of the Census for 1962 and 1966-67 as shown in the Census of Governments in those years. It is noted that in 1966-67, the short term debt (generally of December 31, 1966) was as follows:

	1966-67	*1968-69**
Counties	$21	$38
Municipalities	124	181
Townships	39	33
School districts	80	119
Special districts	83	112**
TOTAL	$347	$483

In the long term debt field in 1966-67, local housing authorities accounted for something over 40 percent of the special district debt; however, no data were available on housing authority short term debt.

From Table 4-18 it is apparent that per capita State and local short-term debt in New Jersey has risen by 309.2 percent while such per capita debt in all State and local governments (including New Jersey) has increased by only 146.7 percent per capita.

In brief, the per capita State and local government short-term debt in New Jersey has risen at a rate that is more than twice the national average.

When measured as a percent of revenue, it is found in Table 4-19 that the short term debt at the State level in New Jersey has been and is significantly below the rates in the other 49 states—despite the sharp increase in State government short term debt in 1968-69.

At the local level, the short term debt in New Jersey was equal to 8.64 percent of the total of general and utility revenues in 1962. This was slightly above the average of 8.09 percent for the other 49 states combined. More significant is the fact that local government short term debt in New Jersey as a percent of current revenue increased from 8.64 to 20.28 from

[11] This would be the fiscal year ending December 31, 1968 for those governments on a calendar year fiscal period and for the year ending June 30, 1969, for the governments on July 1-June 30 fiscal period. The data as published includes the debt of the Delaware Port Authority as a local government of New Jersey. Therefore, the short-term debt of that Authority is included in Table 4-15. The table does, however, include the short term debt of intrastate authorities and of the South Jersey Port Commission. It also includes the short term debt of public housing authorities. Table 4-16 has been developed to exclude the short-term debt of the Delaware River Port Authority. The Delaware River and Bay Authority is allocated to Delaware, the Delaware Joint Toll Bridge Commission is allocated to Pennsylvania, and the Port of New York Authority is allocated to New York.

* Letter from Francis W. Twiss, Chief, Finance Bonds, Governments division, Bureau of the Census, dated February 26, 1971.

** Excludes short-term debt of Delaware River Port Authority.

1962 to 1968-69—an increase of 134.72 percent. This may be contrasted with a rise of only 13.35 percent in the 49 states. Therefore, whereas short term debt in the 49 states in 1968-69 was less than 10 percent of total local government revenue, it is found that in New Jersey this was above 20 percent of current revenue from all sources.

The Committee finds:

That New Jersey local governments have been using temporary debt at a very significantly higher rate, in recent years, than local government in the other 49 states.

TABLE 4-15

TRENDS IN SHORT-TERM DEBT OUTSTANDING FOR NEW JERSEY AND OTHER STATES 1962—1968-69

(in millions of dollars)

	NEW JERSEY					OTHER 49 STATES and DISTRICT OF COLUMBIA				
	Amount			Percent Increase over 1962		Amount			Percent Increase over 1962	
YEAR	State	Local	Total	Local	Total State & Local	State	Local	Total	Local	Total State & Local
1962	0.2	128.4	128.7	—	—	410.7	3320.2	3631.0	—	—
1963	0.2	151.9	152.1	18.2	18.2	423.9	3724.2	4148.1	12.2	14.2
1963-64	0.2	169.8	170.0	32.1	32.1	640.4	3885.0	4525.4	17.0	24.6
1964-65	0.2	240.2	240.5	86.9	86.9	799.7	4268.7	5068.3	28.6	39.6
1965-66	1.2	295.4	296.6	129.9	130.5	1059.1	4695.3	5754.3	41.4	58.5
1966-67	1.3	347.8	349.0	170.7	171.2	1285.5	5358.2	6643.0	61.4	82.9
1967-68	7.1	394.7	401.8	207.2	212.2	2037.6	5987.7	8025.3	80.3	121.0
1968-69	50.1	542.0	592.1	321.8	360.1	2596.8	6893.5	9490.3	107.6	161.4

Source: Bureau of the Census, U. S. Department of Commerce, *Governmental Finance, 1962*, pp. 37-39, pp. 40-42; *1963*, pp. 40-42; *1963-64*, pp. 40-42; *1964-65*, pp. 40-42; *1965-66*, pp. 40-42; *1966-67*, pp. 40-42; *1967-68*, pp. 40-42; *1968-69*, pp. 40-42.

NOTE: Data for 1962 refers to fiscal year-end situation for fiscal years ending in the calendar years 1962 and 1963; data for the other years relate to fiscal year-end situation for fiscal years ending in the period July 1 to June 30 of the years indicated.

TABLE 4-16

TRENDS IN SHORT-TERM DEBT IN NEW JERSEY*

		Amount		Percent Increase of Local Short-Term Debt Over 1962		
Year	State	Local	Total	State	Local	Total
1962	0.2	128.4*	128.6	—		
1963	0.2	151.9	152.1	—	18.3	18.3
1963-64	0.2	169.8	170.0	—	32.2	32.2
1964-65	0.2	202.7	202.9	—	57.9	57.8
1965-66	1.2	257.9	259.1	500.0	100.9	101.5
1966-67	1.3	310.3	311.6	550.0	141.7	142.3
1967-68	7.1	357.2	364.3	3,450.0	178.2	183.3
1968-69	50.1	482.0	532.1	—	275.4	313.8

* Excludes short-term debt of Delaware River Port Authority.

Source: Table III-B, less debt of Delaware River Port Authority.

TABLE 4-17

OUTSTANDING LONG-TERM AND SHORT-TERM DEBT OF NEW JERSEY GOVERNMENTS BY TYPE IN 1962 AND 1966-67*

(in millions)

		LOCAL GOVERNMENTS								
						Special Districts				
	STATE GOVERNMENT	Counties	Municipalities	Townships	School Districts	Housing Authorities	Other**	Total	TOTAL LOCAL	TOTAL LOCAL AND STATE
1962										
Short-Term Debt	0.2	5.9	49.8	8.0	9.3	NA	NA	70.9	143.9	144.2
Long-Term Debt										
Full Faith and Credit	489.6	143.9	453.3	77.9	562.5	NA	NA	1.1	1238.7	1728.3
Non-guaranteed	433.4	—	14.6	8.5	—	NA	NA	462.5	485.6	919.0
SUB-TOTAL	923.0	143.9	467.9	86.4	562.5	NA	NA	463.6	1724.3	2647.3
TOTAL	923.2	149.8	517.7	94.4	576.8	NA	NA	534.6	1868.3	2791.5
Short-term debt as a percent of total debt	—	3.9	9.6	8.5	1.6			13.2	7.7	5.0
1966-67										
Short-Term Debt	1.3	21.4	124.2	38.6	80.3	NA	NA	82.6	347.1	348.4
Long-Term Debt										
Full Faith and Credit	558.3	181.7	457.7	130.3	738.1	NA	NA	5.2	1513.0	2071.3
Non-Guaranteed	633.9	—	43.6	12.8	—	261.8	378.0	639.8	696.2	1330.1
SUB-TOTAL	1192.1	181.7	501.3	143.1	738.1	NA	NA	645.1	2209.2	3401.3
TOTAL	1193.4	203.1	625.5	181.8	818.4	NA	NA	727.7	2556.5	3749.9
Short-term debt as a percent of total debt	—	10.5	19.9	21.3	9.8			11.4	13.6	10.0

* Data for 1962 for state government is for fiscal year ending June 30, 1961; for counties, municipalities and townships for calendar 1962; for special districts as of close of fiscal year ending in calendar 1962. For 1967, data for state government is for fiscal year ending June 30, 1967; for all other governments for fiscal year ending July 1, 1966, and June 30, 1967.

** Excludes debt of Delaware River Port Authority.

Source: *Census of Governments 1962*, VII, No. 30, pp. 26-27; *Census of Governments 1967*, VII, No. 30, pp. 30-31, 68, adjusted for debt of Delaware River Port Authority as reported in annual financial statements of that authority.

TABLE 4-18

TRENDS IN PER CAPITA SHORT-TERM DEBT OUTSTANDING 1962 TO 1968-69

	NEW JERSEY*		ALL STATES**		
YEAR	Amount	Percent Increase over 1962	Amount	Percent Increase over 1962	New Jersey Rate of Increase Per Capita as a Percent of the Rate of Increase Per Capita for All States
1962	20.24	—	20.24	—	100.0
1963	23.20	14.6	22.80	12.6	115.9
1963-64	25.45	25.7	24.54	21.24	121.0
1964-65	35.49	75.3	27.39	35.3	213.3
1965-66	43.00	112.5	30.89	52.6	213.9
1966-67	49.84	146.2	35.34	74.6	196.0
1967-68	56.77	180.5	42.16	108.3	166.5
1968-69	82.83	309.2	49.93	146.7	310.8

Source: Bureau of the Census, U.S. Department of Commerce, *Governmental Finance, 1962*, p. 45; *1963*, p. 48; *1963-64*, p. 48; *1964-65*, p. 48; *1965-66*, p. 48; *1966-67*, p. 48; *1967-68*, p. 48; *1968-69*, p. 48.

* Includes all local governments (including Delaware River Port Authority)

** Including District of Columbia

TABLE 4-19

SHORT-TERM DEBT OUTSTANDING AT YEAR-END AS A PERCENT OF TOTAL OF GENERAL REVENUE RECEIPTS AND OF REVENUES OF LOCALLY OPERATED UTILITIES

YEAR	NEW JERSEY			OTHER 49 STATES**		
	State	Local*	Total	State	Local	Total
1962	***	8.64	6.50	1.35	8.09	6.01
1962-63	***	9.64	7.14	1.25	8.44	6.36
1963-64	***	10.31	7.59	1.74	8.26	6.39
1964-65	***	13.24	9.84	2.00	8.43	6.63
1965-66	0.12	14.95	10.98	2.32	8.34	6.74
1966-67	0.10	16.18	11.46	2.53	8.63	7.06
1967-68	0.46	17.11	11.79	3.54	9.00	7.75
1968-69	2.72	20.28	15.09	3.98	9.17	8.17
PERCENT INCREASE 1962 to 1968-69	—	134.72	132.15	194.81	13.35	35.9

* All local governments (including Delaware River Port Authority)

** Includes District of Columbia

*** Less than 1/20th of 1 percent

Source: Developed from data contained in Bureau of the Census, U.S. Department of Commerce, *Governmental Finance, 1962*, pp. 28-30, 39-41; *1963*, pp. 31-32, 40-42, 44; *1963-64, pp.* 31-33, 40-42, 44; *1964-65*, pp. 31-33, 40-42, 44; *1965-66*, pp. 31-33, 40-42, 44; *1966-67*, pp. 31-33, 40-42, 44; *1967-68*, pp. 31-33, 40-42, 44; *1968-69*, pp. 31-33, 40-42, 44.

Bond Anticipation Notes

Section 40A:2-8 permits the issuance of bond anticipation notes. Minor amounts of capital notes (the lesser of $40,000, or one-half of 1 percent of the equalized valuation basis) are authorized.

Apparently, the only limit as to the amount of bond anticipation notes that may be outstanding is provided by the amount of authorized but unissued bonds. The only modification is a requirement that not later than the first day of the fifth month following the close of the third fiscal year after the issue of such original notes that there shall be a payment of not less than the first legal installment that would have been payable had bonds been issued. This is an effort to provide for at least one installment payment of the debt; however, representatives of the Division of Local Finance have stated relatively minor payments are made under this provision.

Prior to 1968 the maximum life for the bond anticipation notes was three years; this was extended in 1968 to five years.

Amounts of Bond Anticipation Notes

Representatives of the Division of Local Finance provided the committee with working papers derived from an analysis of bond anticipation notes outstanding as of December 31, 1968, for the municipalities with names beginning M through Z. A tabulation of these data was made and the results appear in Table 4-20. From this table, it may be seen that the total outstanding loans in anticipation of issuance of bonds for the 293 municipal governments amounted to $114.9 million. If the remaining municipalities had a similar record, this would have brought the total to about $225 million.

The function of bond anticipation notes is to give the local government the option of issuing long term debt in advance of capital requirements or of accruing the obligations in anticipation of the issuance of such long term debt through the use of bond anticipation notes.

Under existing practices a public structure can be designed, constructed and available for use within two years or less. Under present legislation, it can be occupied for a full three years (or more) before long term financing is arranged. This could prove to be an unsound practice, in that:

1. It permits an extension of the total time over which facilities may be financed beyond those stipulated by statute.
2. It permits present office holders to authorize and complete projects while simultaneously avoiding the kind of public political accounting for the debt service they have incurred—merely by deferment of the effective date of long term financing.
3. It can be costly, if used to outguess the trend of the bond market, although it could result in savings in a falling interest market.

The Committee recommends:

1. Major capital financing should be transferred to the permanent capital markets promptly, and should not be permitted to preempt a significant portion of short term funds available in the market;

2. A local government issuer should be required to appropriate a full year's interest on each bond anticipation note in the current or next succeeding budget.

3. A local government issuer should be required to appropriate and pay off within each year not less than that fraction of each bond anticipation note equal to one divided by the period of probable usefulness prescribed by law for the purpose for which the bonds are authorized.

4. A local government issuer, including an authority, shall have no power to borrow any portion of required amortization or interest, except interest during construction required by a public authority.

5. The period of probable usefulness under the statute (N.J.S. 40A:2-22) should begin to run not later than one year after the capital improvement being financed becomes operational and is first used.

TABLE 4-20

BOND ANTICIPATION NOTES OUTSTANDING
293 NEW JERSEY MUNICIPALITIES*
DECEMBER 31, 1968

Amount of Bond Anticipation Notes Outstanding (000)	Number of Municipalities			Aggregate Amount of Debt for Group (000)	Aggregate Amount Per Municipality in Group (000)
0			138	0	0
1-100	59				
100-199	26				
200-299	10				
300-399	4				
400-499	14				
Sub-total 1-499		113		$ 17,743	$ 157
500-599	6				
600-699	6				
700-799	3				
800-899	1				
900-999	3				
Sub-total 500-999		19		11,857	624
1,000-1,499	6			7,245	1,208
1,500-1,999	5			8,206	1,641
2,000-2,999	3			7,359	2,453
3,000-3,999	3			10,527	3,509
4,000-4,999	3			14,014	4,671
5,000-9,999	1			6,310	6,310
10,000-14,999	1			11,263	11,263
15,000-19,999				—	—
20,000-24,999	1			20,362	20,362
		23			
Sub-total 1-24,999			155	114,886	741
TOTAL			293	$114,886	$ 392

Source: N.J. Division of Local Finance.

* Data is for municipal governments with names beginning with letters M through W.

Chapter VI

Revenue Bonds Versus General Obligations

In New Jersey, all direct debt of local governments must be issued as general obligation, i.e., full-faith-and-credit debt with unlimited pledge of ad valorem taxation to support the debt. Only when a local authority device is used may debt payable solely from project revenues be issued. This raises two broad issues:

1. Should municipalities be authorized to issue pure revenue bonds?
2. Are public authorities over used because of their revenue bond feature or otherwise?

Table 4-21 sets forth a comparative picture of New Jersey outstanding local government debt as of December 31, 1965, and 1969. It shows that in 1965 total outstanding self-liquidating debt (direct and by use of municipal and county authorities) amounted to $430.7 million (line 13) and by 1969 it amounted to $658.1 million—a growth of 52.8 percent. In contrast, the amount of tax supported outstanding debt increased during the same four years by 34.7 percent (line 12). During this four year period, the amount of authority debt rose at the rate of 50.6 percent and the self supporting debt carrying the general obligation pledge increased by 56.0 percent.

The significance of these rates of growth in so short a period of time suggests strongly that public officials, and presumably the citizens, are increasingly relying upon self supporting debt, even though it accounted for only 23.8 percent of total outstanding debt of local governments at the end of 1969.

It is recognized that a period of four years is a short period for establishing a dependable trend; however, Table 4-22 provides information for a ten year period

TABLE 4-21

OUTSTANDING DEBT OF NEW JERSEY LOCAL GOVERNMENTS DECEMBER 31, 1965 AND 1969

(in millions of dollars)

LINE		1965				1969				PERCENT INCREASE 1965-1969		
		General Obligation	Revenue	Total	Percent of Total	General Obligation	Revenue	Total	Percent of Total	General Obligation	Revenue	Total
	Counties											
1	Direct Tax-supported	228.6*		228.6	11.5	428.2	—	428.2	15.5	87.3	—	87.3
2	Authority		77.8	77.8	3.9	—	134.8	134.8	4.9		73.3	73.3
3	TOTAL	228.6*	77.8	306.4	15.4	428.2	134.8	563.0	20.4	87.3	73.3	83.7
	Municipalities & School Districts Direct Tax-Supported											
4	Schools	958.5		958.5	48.2	1196.2		1196.2	43.3	24.8	—	24.8
5	Municipal	372.5		372.5	18.7	477.0		477.0	17.3	28.1	—	28.1
6	SUB-TOTAL	1331.0		1331.0	66.9	1673.2		1673.2	60.6	25.7		25.7
7	Self-liquidating	174.3		174.3	8.8	272.0		272.0	9.9	56.1		56.1
8	SUB-TOTAL	1505.3		1505.3	75.6	1945.2		1945.2	70.5	29.2		29.2
9	Authority		178.6	178.6	9.0		251.3	251.3	9.1		40.7	40.7
10	TOTAL	1505.3	178.6	1683.9	84.6	1945.2	251.3	2196.5	79.6	29.2	40.7	30.4
11	GRAND TOTAL	1733.9	256.4	1990.3	100.0	2373.4	386.1	2759.5	100.0	36.9	50.6	38.6
	Exhibit:											
12	Total tax-supported (1+6)	1559.6		1559.6	78.4	2101.4		2101.4	76.2	34.7		34.7
13	Total self-liquidating (2+7+9)	174.3	256.4	430.7	21.6	272.0	386.1	658.1	23.8	56.0	50.6	52.8
14	TOTAL	1733.9	256.4	1990.3	100.0	2373.4	386.1	2759.5	100.0	36.9	50.6	38.6

* Data for county direct debt is gross amount as data for outstanding debt was not reported.

and this also suggests increased reliance upon what the Bureau of the Census classifies as "special district" debt. The Bureau of the Census found that while general obligation debt accounted for 75 percent of the long term outstanding debt of local governments in New Jersey in 1957, by 1966-67, this had decreased to 68.5 percent.

National Trends

Three different organizations in the United States regularly collect statistics concerning the amount of debt that is issued by state and local governments:

A. The Bureau of the Census of the U.S. Department of Commerce;

B. The Investment Bankers Association of America; and

C. *The Bond Buyer,* a trade magazine.

The classifications used by the three sources are somewhat different. Each of them recognizes a general obligation classification; however, in the matter of the security pledged, The Investment Bankers Association (IBA) provides a more detailed classification than do the other two sources. The categories used by the three groups are shown in Tables 4-22, 4-23 and 4-24.

Trends in Outstanding Debt

Table 4-22 shows the trend in the outstanding long term debt for state governments and local governments by classes. It also sets forth the percentage of the debt which carries a full-faith-and-credit pledge. Unfortunately, reporting by some New Jersey local governments has apparently been incorrect inasmuch as a considerable portion of municipal and township debt is shown as being other than a general obligation debt —which is not in accordance with New Jersey law.

TABLE 4-22

OUTSTANDING LONG-TERM DEBT OF STATE AND LOCAL GOVERNMENTS IN THE UNITED STATES 1957, 1962, AND 1966-67

(in millions of dollars)

		AMOUNT			PERCENTAGE FULL FAITH AND CREDIT		
		1957	1962	1966-67	1957	1962	1966-67
Municipalities	United States	18,183	25,099	32,057	68.2	66.8	59.9
	New Jersey	456	468	501	85.5	96.8	91.4
Townships	United States	942	1,303	1,647	84.3	93.6	91.3
	New Jersey	60	86	143	83.3	90.6	90.1
Counties	United States	3,368	5,208	7,515	85.7	91.6	86.0
	New Jersey	144	144	182	90.3	100.0	100.0
School Districts	United States	8,851	13,656	18,249	100.0	100.0	100.0
	New Jersey	307	563	738	100.0	100.0	100.0
Special Districts	United States	5,977	10,189	15,993	19.4	14.6	17.9
	New Jersey	203	463	645	0.2	0.2	0.8
Total Local Government	United States	37,323	55,455	75,462	69.9	68.3	63.9
	New Jersey	1,172	1,868	2,209	75.0	66.3	68.5
State Governments	United States	13,522	21,612	31,185	48.0	47.7	43.5
	New Jersey	896	923	1,192	42.6	53.0	46.8
Grand Total State and Local Governments	United States	50,844	77,067	106,649	64.1	61.2	58.0
	New Jersey	2,067	2,647	3,401	61.1	65.3	60.9

Note: Debt of Delaware River Port Authority is excluded from New Jersey data for special districts and from total for local governments and grand total.

Sources: U.S. Department of Commerce, Bureau of the Census, *Census of Governments, 1957,* III, No. 5, pp. 67, 125; *Census of Governments, 1962,* IV, No. 4, p. 36; *Census of Governments, 1967,* IV, p. 35.

TABLE 4-23

STATE AND LOCAL GOVERNMENT BOND SALES AS REPORTED BY *THE BOND BUYER* 1960-1970

(in millions of dollars)

	GENERAL OBLIGATION			REVENUE			TOTAL					
				New Money				New Money				
YEAR	New Money	Re-funding	Total	General	Public Housing	Re-funding	Total	Public Housing	General	Re-funding	Total	Percent of New Money General Revenue Financing as Percent of all New Money Bonds
1960	5,000	35	5,035	1,794	383	18	2,195	383	6,794	53	7,230	26.4
1961	5,736	26	5,762	2,381	189	28	2,598	189	8,117	54	8,360	29.3
1962	5,833	89	5,922	2,112	382	172	2,666	382	7,945	261	8,588	26.6
1963	5,846	223	6,069	2,730	254	1,053	4,037	254	8,576	1,277	10,107	31.8
1964	6,726	161	6,887	2,525	636	497	3,658	636	9,251	657	10,544	27.3
1965	7,194	251	7,445	2,637	464	538	3,639	464	9,831	789	11,084	26.8
1966	6,969	43	7,012	3,459	440	177	4,076	440	10,428	221	11,089	33.2
1967	9,132	60	9,192	4,505	478	113	5,096	478	13,637	173	14,288	33.1
1968	9,542	75	9,617	6,175	525	63	6,763	525	15,717	138	16,375	39.3
1969	8,015	32	8,047	2,996	398	19	3,413	398	11,011	51	11,460	27.3
1970	11,767	30	11,797	5,790	131	27	5,948	131	17,557	56	17,744	33.0
Percent Increase of 1970 over 1960	135.3			222.7					158.4			

NB: Includes Puerto Rico and Virgin Islands.

Source: *The Weekly Bond Buyer*, V. 179, No. 1 (February 2, 1970), p. 14; V. 182, No. 3 (February 22, 1971), p. 18.

The data shows that in New Jersey the special district debt has been almost exclusively of the non-guaranteed variety, i.e., debt other than general obligation debt.

Trends in Amount of Debt Issued

Table 4-23 presents the trends during the 1960-1970 decade as measured by *The Bond Buyer* in its tabulations of the issuance of new bonds in the general obligation and revenue categories. From this table, it is seen that "new money" (i.e., total bond issues less refunding issues) general obligation debt sold in the year rose from $5.0 billion in 1960 to $11.8 billion in 1970—at a more or less regular rate, except for the decreases during 1966 and 1969 tight money periods.

The amount of general "new money" revenue debt (i.e., revenue debt other than that relating to federally financed public housing) increased much more dramatically, up by more than 222 percent in the decade —from $1.8 billion to $5.8 billion. During the years 1965-1968, much of the "new money" revenue debt was in the form of industrial aid bonds. This helps to account for the unusually high peak in 1968.

During the decade, the "new money" general revenue debt as a percentage of total general "new money" debt was in the range of 26.4 percent (1960) to 39.3 percent (1968) of total general "new money" debt as tabulated by *The Bond Buyer*.

Table 4-24 presents data on the new money issues during the period 1960-1969, as tabulated by the Investment Bankers Association of America.[12] It also shows the amount of new money debt issued by states and by various types of local governments.

From Table 4-24, it appears that the role of the statutory authorities in the issuance of new money debt has increased very significantly during the decade—at a substantially higher rate than the issuance of new debt by local governments but at a lesser rate of increase than by the state governments. In the final two columns of this table, new issue debt by state and local government in New Jersey is shown. It is noted that this has increased from 2.86 percent of the U.S. total in 1960 to 5.97 percent of the total in 1969.

Table 4-25 presents information concerning the type of pledge of security lying behind the total of new bond issues tabulated by *IBA*. This tabulation includes refunding bonds issued; however, the "industrial aid" bonds (so popular in many states in the 1965-1968 period) have been netted out in order to provide a more meaningful trend in the degree of reliance upon revenue debt for regular governmental purposes.

An examination of the final column in this table shows that although there were significant variations

[12] The fact that these data differ from those presented by *The Bond Buyer* is explainable in part by the differences in sources of information and in part by the fact that *The Bond Buyer* cumulates its data on the basis of the date of sale whereas the *IBA* cumulates its data on the basis of the date of delivery of the bonds.

during the decade in the degree of reliance upon revenue debt, the percentage for 1969 was not significantly different from that characterizing the early years of the decade.

Because school debt has loomed very large in New Jersey State and local government debt, Table 4-26 has been developed. From this table, it can be seen that on the basis of the IBA tabulations, one-half of

TABLE 4-24

AMOUNT OF NEW BOND ISSUES SOLD BY STATE AND LOCAL GOVERNMENTS IN UNITED STATES* 1960-1969

(in millions)

		LOCAL GOVERNMENTS											
Year	State Govern-ments	Counties	Munici-palities	Townships	School Districts	Special Districts	Total Local Govern-ment Excluding Authorities	Statutory Authorities	Total	Industrial Aid	Purposes Other Than Industrial	Total New Jersey	New Jersey as Percent of U.S. Excluding Industrial Aid Bond
1960	1,004	499	2,114	30	1,454	662	4,759	1,301	7,064	NA	7,065	202	2.86
1961	1,827	582	2,405	25	1,407	445	4,864	1,623	8,315	NA	8,315	235	2.83
1962	1,293	593	2,478	37	1,556	523	5,187	1,907	8,387	84	8,303	329	3.96
1963	1,307	542	2,766	40	1,427	745	5,520	2,076	8,903	133	8,770	293	3.34
1964	1,443	548	2,889	31	1,598	647	5,713	2,826	9,981	192	9,789	201	2.05
1965	2,272	680	2,305	23	1,709	830	5,547	2,463	10,284	212	10,072	225	2.63
1966	2,330	731	2,316	44	1,575	768	5,434	3,322	11,087	500	10,587	343	3.24
1967	2,676	1,199	3,661	55	1,991	865	7,771	3,748	14,195	1,391	12,804	348	2.72
1968	2,658	1,742	3,672	94	2,278	1,298	9,089	4,491	16,177	1,596	14,581	472	3.23
1969	3,253	1,091	2,264	32	1,474	556	5,417	2,974	11,643	48	11,595	692	5.97
% Increase 1960-1969	224.0	118.6	7.1	—	1.4	—	13.8	128.6	64.8	—	64.1	242.6	108.7

* Includes data on sales by District of Columbia, Puerto Rico, and Virgin Islands; excludes refunding issues.

Source: Investment Bankers Association of America, *Municipal Statistical Bulletin,* Fourth Quarter Issues, 1960-1969.

TABLE 4-25

SECURITY PLEDGED FOR DEBT ISSUED BY STATE AND LOCAL GOVERNMENTS IN THE UNITED STATES 1960-1969

(Data in millions of dollars)

	GENERAL OBLIGATION			REVENUE								
YEAR	Unlimited Tax	Limited Tax	Total	Utility	Quasi-Utility	Special Tax	Rental Revenue	Total Revenue	Sub-total, Excluding Industrial Aid and Federally Financed Housing Bonds	Federally Financed Housing Authority Bonds	Total	Revenue Bonds as Percent of Sub-total
1960	4,362	274	4,636	964	832	79	195	2,070	6,706	403	7,109	30.9
1961	5,393	322	5,715	855	1,163	57	310	2,385	8,100	315	8,415	29.4
1962	5,240	335	5,558*	839	1,308	100	330*	2,577*	8,135	437	8,572	31.7
1963	5,483	372	5,825*	1,883	1,512	43	638*	4,076*	9,901	254	10,155	41.2
1964	6,035	368	6,354*	1,440	1,634	94	269*	3,437*	9,791	163	9,954	35.1
1965	6,730	429	7,145*	1,144	1,542	205	430*	3,321*	10,466	464	10,930	31.7
1966	6,280	507	6,768*	828	2,088	205	221*	3,342*	10,110	440	10,550	33.1
1967	8,368	537	8,756*	918	1,882	189	705*	3,694*	12,450	478	12,928	29.7
1968	8,650	604	9,122*	1,527	1,269	172	2,076*	5,044*	14,166	528	14,166	35.6
1969	7,303	425	7,716*	930	1,356	87	1,146*	3,519*	11,235	402	11,637	31.3
% Increase 1960-1969	67.4	55.1	66.4	(5.5)	63.0	10.1	487.7	70.0	67.5	—	63.7	—

* Excludes industrial aid bonds.

Source: Investment Bankers Association of America, *Municipal Statistical Bulletin,* Fourth Quarter, 1960-1970.
NB: This table includes both new money and refunding bonds issued.

the total amount of new bonded debt issued in New Jersey in 1960 and 1961 was accounted for by issues to finance elementary and secondary schools. This decreased significantly during the decade, and dropped very dramatically in 1969. However, it is to be remembered that this tabulation is concerned with new bonded debt issued. It does not reflect the substantial amounts of increase in short term debt that was accumulated toward the end of the decade in anticipation of long term debt. If reliable trend data were available on this point, it is possible that the percentages would be fairly close to the 1960-1969 picture.

However, it should be noted that the second part of Table 4-26 shows that, on the basis of the amount of the bond issues sold in the United States, the percentage devoted to public school purposes has decreased from 36 percent to 20 percent of total issued in the period under consideration.

Given the declines in all measures of the numbers and rates of birth, there is reason to believe that at least for the next decade, additional school construction will require a substantially smaller part of the total capital projects to be financed than during the 1950-1970 period, and all school bonds are general obligations.

The Value of the General Obligation Pledge

What is the real significance of the general obligation pledge in respect to local debt? Generally, it is construed as pledging the full faith and credit of the issuing government and at the local level is ordinarily associated with the right to collect an unlimited ad valorem tax to the extent required to meet the debt service charges.

For many years, it has been thought by some students of public finance that the general obligation pledge constituted the best security that could be offered by the local government issuer and, therefore, would command the best position in the market insofar as interest costs were concerned. In most situations, this doubtless is still true. However, several conditions tend

TABLE 4-26

SALE OF LONG-TERM DEBT
NEW JERSEY AND ALL STATES FOR
1960-1969
(in millions)

YEAR	Elementary and Secondary Education		Other		Total		Percent for Elementary and Secondary Schools	
	No. of Sales	Amount	No. of Sales	Amount	No. of Sales	Amount	No. of Sales	Amount
				NEW JERSEY				
1960	93	$ 104	131	$ 98	224	$ 202	41.5	51.5
1961	108	118	162	117	270	235	40.0	50.2
1962	99	100	148	229	247	329	40.0	30.4
1963	97	107	143	186	240	293	40.4	36.5
1964	79	83	165	118	244	201	32.4	41.2
1965	81	84	178	181	259	265	31.3	31.7
1966	NA	48	NA	295	186	343	NA	14.0
1967	NA	108	NA	240	271	348	NA	31.0
1968	NA	130	NA	342	223	472	NA	27.5
1969	NA	65	NA	627	118	692	NA	9.3
				ALL STATE AND LOCAL GOVERNMENTS				
1960	2,564	$2,183	3,826	$ 3,896	6,390	$ 6,079	40.1	35.9
1961	2,524	2,543	4,147	5,786	6,671	8,332	37.8	30.5
1962	2,524	2,446	4,099	6,056	6,623	8,502	38.1	28.8
1963	2,229	2,382	4,567	7,806	6,796	10,188	32.8	23.4
1964	2,129	2,631	4,390	7,988	6,499	10,619	48.1	24.8
1965	2,036	2,703	4,154	8,266	6,190	10,969	32.9	24.6
1966	1,945	2,358	2,782	8,591	4,727	10,949	41.1	21.5
1967	1,962	2,371	3,311	11,824	5,273	14,195	37.2	16.7
1968	1,934	3,351	3,441	12,826	5,375	16,177	36.8	20.7
1969	1,378	2,359	2,389	9,284	3,767	11,643	35.8	20.3

Source: Investment Bankers Association of America, *Municipal Statistical Bulletin*, Fourth Quarter, 1960-1969.

to show that the general obligation pledge may not consistently offer the best basis for pledge of credit in support of debt:

A. During the Great Depression of the 1930's, it was observable that in some communities revenue debt, especially water revenue debt, proved to be more viable than did general obligation debt supported by the tax levy. It became apparent that in times of major economic stress, the threat (or actuality) of turning off the water resulted in current payment of water bills while real property taxes remained delinquent. This enabled many water bonds to maintain a better position in the market than the general obligation bonds of some governments.

B. The concept of bondholders looking solely to the general property tax is tending to give way to a broader view as many local governments expand their tax and revenue base.[13]

C. Taking note of the matter of improved market acceptability of well supported revenue bonds (that first became apparent in the 1930's) the rating agencies sometimes accord a higher rating to one or more of the revenue bond issues of a local government (supported by the general obligation pledge) than they do the general obligation pledge of the same government. Even more frequent is the situation in which the ratings accorded well secured revenue bonds are equal to those accorded to general obligation bonds.

This is not to deprecate the importance of the full-faith-and-credit pledge. In the case of non-revenue producing activities (e.g., public education, protection of life and property, and public health and welfare) it is obvious that the general obligation pledge is the best way to secure long term debt. On the other hand, in the case of governmental enterprise operations (whether state or local) the importance of the general obligation pledge is (or may be) significantly reduced.

The relative importance of the general obligation pledge vis-a-vis the revenue pledge depends upon a number of considerations, including:

A. The basic economic characteristics of the community;

B. The revenue structure of the government;

C. The degree to which the general obligation pledge has already been extended in relation to the general capacity of the community to support debt; and

D. The inherent strength or weakness of the net revenue potential for the governmental enterprise activities.

[13] In this respect, one is reminded of the fact that just after the turn of the present century, state government borrowing was largely tied to state general property taxes. Gradually as the states moved from that field, the market became willing to accept a general obligation bond of a state government that had no relationship to state general property taxation.

The Impact Upon the Credit Analyst

Of course, each credit analyst—whether employed by a rating agency, an institutional investor, or otherwise—has his own standards for judging the risk involved in relation to each government studied. To exclude revenue bonds from the gross debt obviously would appeal to those who are concerned with the gross rather than net debt ratio.

Some take a view that inasmuch as all local debt to be amortized from locally generated revenues must eventually rest upon the economy of the community, they make little or no adjustments for differentiation in the amounts of debt that are self-supporting. Others take the view that a reduction in the amount of general obligation debt through use of revenue debt acts significantly to improve the quality of the debt supported by the full-faith-and-credit pledge.

Let us consider two communities with very similar economic characteristics, each with an equalized valuation of $100 million and a gross debt of $12.5 million, composed of $5.0 million of self-sustaining debt and $7.5 million of tax supported debt. If all of the debt of Municipality "A" is general obligation debt, its general obligation debt ratio is 12.5 percent while that of Municipality "B" is only 7.5 percent, if the self-supporting debt is in the form of revenue debt. Clearly, it would appear that the general obligation debt of "B" is entitled to a superior position to that of "A" and should be able to obtain a better market for its bonds.

On the other hand, the position of the revenue debt of "B" will depend in large measure upon the anticipation of the production of net revenue adequate not only to meet debt service requirements, but also to provide ample excess coverage to provide for a margin of safety.

Marketing Considerations

Despite the foregoing considerations, there are also marketing factors to be considered. If only small amounts of self-sustaining debt are involved, it may prove advantageous to combine tax supported and self-supported debt and issue all of the debt as general obligations in order to make bond issues sufficient in size to attract a suitable degree of competition at bond sales.

On the other hand, if large amounts of debt are involved, it may prove advantageous to offer both general obligation bonds and revenue bonds in order to attract investors interested in both types of debt. Large mu-

nicipalities, especially older large population centers, may find a livelier interest in their revenue bonds than their general obligation bonds because of the hesitancy of some investors to purchase debt that rests upon the already overburdened taxing capacity of these governments. This is especially true where the indenture adequately protects the bondholder through the use of the terms that have become traditional in revenue debt contracts. Generally, the main market factor, however, appears in the form of higher interest costs for most revenue bond issues. This is common experience.

Caution

The use of revenue debt can result in higher costs for interest, legal fees, financial consultant fees, etc. Therefore, the foregoing should not be construed as advocacy of unfettered use of revenue debt—whether directly by municipalities and counties or through the authority device. Only when it appears that a *net* advantage is to be gained by use of a combination of general obligation bonds and revenue debt is it defensible to depart from the use of general obligation debt.

Dual Pledge

Before concluding this discussion, it is appropriate to mention the possibility of an alternative under which revenue debt is secured by a dual pledge of net revenues and the full faith and credit of the issuer.

From time to time one encounters debt of local governments which is issued as debt secured by the dual pledge. The best known illustration of this is some of the bonds issued two or three decades ago by the Los Angeles Department of Water and Power. In that case the bonds issued were full revenue bonds but were also supported by general obligation pledge. The effect of the dual pledge in such circumstances is to improve the quality of the debt instrument in the market where there is a good history and good prospects of ample net earnings to meet debt service and coverage requirements. It elevated this type of bond to a position superior to the general obligation bonds of that City. During recent years, the Los Angeles Department of Water and Power has generally issued all of its debt as straight revenue debt without the general obligation pledge.

Under recent Pennsylvania legislation some types of municipalities have the right to issue debt with the dual pledge. Under the existing New Jersey statutes it would be a simple matter to permit the same.

Although the dual pledge produces a superior position for such debt, this course of action gives little, if any, relief to the general obligation pledge itself with the consequent possible adverse effects on the cost of general obligation borrowing.

Public Authorities

The growing use and proliferation of public authorities of all kinds has been indicated in the tables showing marked increases in the amount of debt of such public bodies. It is not apparent that in all or even a majority of the cases the motivation for the use of a public authority is to avoid the general obligation requirement of financing by a county or municipality. Under New Jersey law, it is possible to create a variety of public authorities, illustrated by the following list:

1. Parking Authorities (N.J.S.A. 40:11A)
2. Sewerage Authorities (N.J.S.A. 40:14A)
3. Municipal Utilities Authorities (N.J.S.A. 40:14B)
4. County Sewerage Authorities (N.J.S.A. 40:36A)
5. County Improvement Authorities (N.J.S.A. 40:37A)
6. Port Authorities (other than interstate authorities) (N.J.S.A. 40:68A)
7. Local Housing Authorities (N.J.S.A. 55:14A)
8. Recreation Facility Authorities (N.J.S.A. 40:37B1)
9. Solid Waste Management Authorities (N.J.S.A. 40-66:35)

There are advantages and disadvantages to the use of authorities. In New Jersey, until the enactment of Laws of 1969, Chapter 288, public authorities were not subject to any State supervision. The 1969 Law extended the jurisdiction of the Division of Local Finance over the accounting, auditing and financial administration policies of county and municipal authorities. The authorities' laws generally provide for a semi-independent governing body, full revenue borrowing power limited only by what the market will take, no restrictions as to the manner in which bonds of the authority shall be marketed, and no recourse to taxation to pay any of the bonds.

The 1970 Report of the Division of Local Finance list 126 different public authorities, and the list does not purport to be complete. Most commonly, there are parking authorities, sewerage authorities and municipal utilities authorities. The borrowing costs of these authorities is not reported, but it may be assumed, in the light of experience elsewhere, that their interest costs are substantially greater than the general obligations of the municipalities in which they operate.

The Committee recommends:

1. The present statutory provisions requiring counties and municipalities to pledge their full faith and credit to bonds issued for revenue producing projects should be continued, but the statute should be amended to permit the issuing municipality to make a binding pledge, in addition, of the revenues of the project as further security for the bonds; for the purpose of possibly reducing borrowing costs.

2. The use of authorities for specific intermunicipal purposes should be continued but their financing should receive the approval of the Division of Local Finance.

3. Authority obligations, when issued, should be offered at public sale under regulations similar to statutes applicable to municipal bonds.

4. The use of intra-municipal Authorities should be prohibited unless the municipality receives the approval of the Division of Local Finance for the creation of the specific Authority being established and upon a showing that the financing of the proposed Authority can and will:

(a) Be by revenue bonds only—without municipal guarantee;

(b) Use bonds offered at public sale upon competitive bids; and

(c) Be of a kind and amount which will not impair the credit of the creating municipality.

Chapter VII

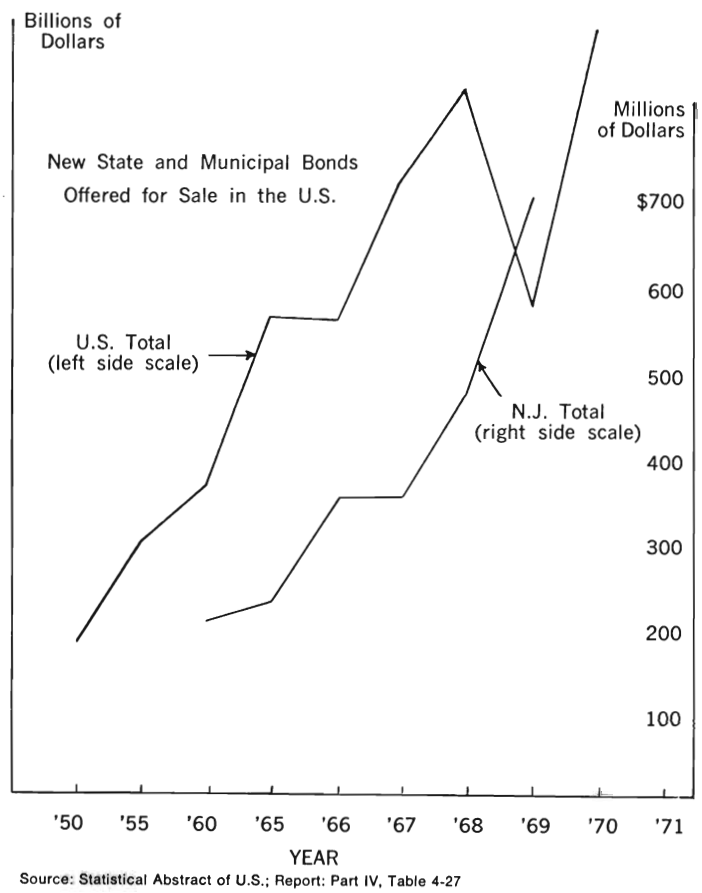
The Market for Municipals

The municipal bond market—and this includes the market for state, county, municipal, school and public authority obligations—is a market of financial specialists. It operates under practices established by custom and usage and distributes securities within a relatively narrow group of purchasers. Table 4-27 shows that nationally the bulk of the bonds is bought by commercial banks, with individuals aggregating the second largest group of holders, but a large part of their purchases is also made through the trust departments of commercial banks.

The rating services are a key element in the marketability of an issue and in the price it will command. The system is conveniently explained in a recent Special Bulletin of the Municipal Finance Officers Association of the United States and Canada. The bulletin, authored by Joseph F. Clark, points out that the private rating services consider certain basic criteria such as population, taxable valuations and debt ratios; the present and forseeable economy of the community; the characteristics of its population and government; and an analysis of its indebtedness. The Bulletin states:

> "To sustain the payment of debt service on issues of municipal securities held by investors, both actual and potential, is, of course, of the highest importance both to the investor and the issuer.

Source: Federal Reserve Bulletin



Source: Statistical Abstract of U.S.; Report: Part IV, Table 4-27

The professional private rating agencies are sensitive to this and are both alert and scrupulous in assigning credit ratings. Of necessity, these ratings have to be related to the tax revenue sources accessible to the municipal jurisdictions affected, even if such local financial resources are by no means the whole picture."

The bond ratings, and their designation, of the two principal rating agencies are described in the Bulletin as follows:

1971 Standard & Poor's Municipal Bond Ratings

Standard & Poor's Municipal Bond Ratings cover obligations of all states or subdivisions. 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: (1) either in the local economic base, (2) in debt burden, (3) in the balance between revenues and expenditures, or (4) 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

TABLE 4-27

OWNERSHIP OF STATE AND MUNICIPAL SECURITIES
U.S. TREASURY DEPARTMENT ESTIMATES AS OF JUNE 30, 1959 THROUGH 1969
(in millions of dollars)

	1969	1968	1967	1966	1965	1964	1963	1962	1961	1960	1959
Total Amount Outstanding	$132,500	$121,400	$113,300	$104,800	$99,200	$91,300	$85,900	$80,131	$71,730	$66,425	$61,985
Held By—											
Individuals (includes partnerships and personal trust accounts)	41,800	39,200	39,800	38,200	36,000	33,700	31,700	30,700	28,300	27,200	24,600
Commercial Banks	58,500	52,800	45,600	40,300	36,600	31,500	27,900	23,200	18,800	16,800	17,000
Insurance Companies	17,300	16,500	15,500	14,400	15,200	15,000	14,500	13,700	12,600	11,100	9,500
State and Local Funds*	4,600	4,500	4,200	4,600	5,000	5,600	6,400	7,200	7,400	7,100	6,800
Corporation†	6,200	5,000	4,800	4,100	3,300	2,700	2,600	2,400	1,900	1,700	1,700
Miscellaneous Investors††	2,500	2,000	2,100	2,000	1,900	1,800	1,800	1,800	1,600	1,500	1,300
Mutual Savings Banks	200	200	300	300	400	400	500	600	700	700	700
U.S. Government Investment Accounts	1,400	1,200	1,000	900	800	600	600	500	400	300	300

* Comprises trust, sinking and investment funds of State and local governments, Territories and possessions.

† Exclusive of banks and insurance companies.

†† Includes savings and loan associations, non-profit associations, corporate pension trust funds, dealers and brokers, and investments of foreign balances and international accounts in this country.

Figures are rounded and do not necessarily add up to the totals.

Information furnished by the Treasury Department.

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.

1971 Moody's Bond Ratings

Aaa—Bonds which are rated Aaa are judged to be of the best quality. They carry the smallest degree of investment risk and are generally referred to as "gilt edge." Interest payments are protected by a large or by an exceptionally stable margin and principal is secure. While the various protective elements are likely to change, such changes as can be visualized are most likely *not* to impair the fundamentally strong position of such issues.

Aa—Bonds which are rated Aa are judged to be of high grade quality by all standards. Together with the Aaa group they comprise what are generally known as high grade bonds. They are rated lower than the best bonds because margins of protection may not be as large as in the Aaa securities or fluctuation of protective elements may be of greater amplitude or there may be other elements present which make the long term risks appear somewhat larger than in Aaa securities.

A—Bonds which are rated A possess many favorable investment attributes and are to be considered as higher medium grade obligations. Factors giving security to principal and interest are considered adequate but elements may be present which suggest a susceptibility to impairment sometime in the future.

Baa—Bonds which are rated Baa are considered as lower medium grade obligations, i.e., they are neither highly protected nor poorly secured. Interest payments and principal security appear adequate for the present but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. Such bonds lack outstanding investment characteristics and in fact have speculative characteristics as well.

Ba—Bonds which are rated Ba are judged to have speculative elements; their future cannot be considered as well assured. Ofen the protection of interest and principal payments may be very moderate and thereby not well safeguarded during both good and bad times over the future. Uncertainty of position characterizes bonds in this class.

B—Bonds which are rated B generally lack characteristics of the desirable investment. Assurance of interest and principal payments or of maintenance of other terms of the contract over any long period of time may be small.

Caa—Bonds which are rated Caa are of poor standing. Such issues may be in default or there may be present elements of danger with respect to principal or interest.

Ca—Bonds which are rated Ca represent obligations which are speculative in a high degree. Such issues are often in default or have other marked shortcomings.

C—Bonds which are rated C are the lowest rated class of bonds and issues so rated can be regarded as having extremely poor prospects of ever attaining any real investment standing.

NOTE: Bonds within "A" or "Baa" categories are further refined by the use of the number "1" after the letter to delineate the higher quality within the respective rating.

How New Jersey Bonds are Rated

General Obligations of the State are rated Aaa. There is no school or municipal bond in New Jersey rated higher than Aa. There are forty-one New Jersey bonds rated Ba, and none in New York, Connecticut, Massachusetts, New Hampshire, Maryland, Ohio, Delaware, Illinois or Michigan, to name only a few. There is no rating below an A in Connecticut or Delaware, and only about 5% Baa in Massachusetts.

According to the National Center for Educational Statistics, over the past six fiscal years, there were $500 million rated bonds sold for school programs in New Jersey: 64% were rated under an A.

Aa	$ 39 million	8%
A	$142 million	28%
Baa	$258 million	52%
Ba	$ 61 million	12%
	$500 million	100%

While New Jersey's school bond sales for 1969-1970 fiscal year represented 5.3% of sales reported from all fifty states, 38% of those bonds rated Ba were from New Jersey.

These ratings are in spite of the fact that there have been no defaults since the early 30's. In addition, New Jersey school bonds are specially secured by four statutory remedies which assure prompt payment of principal and interest, that is, a prior claim on municipal tax collections, a first lien on the district's school building and capital reserve fund in the hands of the State Treasurer, a special state fund (now $30 million) which, in effect, guarantees payment of school bond debt service, and a statutory lien upon all the real property in the school district.[14] In a February 18, 1971 Wall Street Journal article about Chapter 177 Additional State School Aid Bonds, however, a Standard & Poor's analyst is quoted as saying: "We still haven't decided how much weight to assign the State's backing."

[14] These are described in greater detail, at page 46, infra.

The Necessity of a Moody's or Standard & Poor's Rating

As long as bank examiners are required to use national ratings, ratings cannot be avoided. The majority of New Jersey's local bonds are sold to New Jersey commercial banks, primarily for portfolio and trust purposes. Half of New Jersey bank assets— or over $5 billion—are now included in New Jersey bank holding companies. As the New Jersey market becomes more concentrated, it can be expected that demand for tax-exempt bonds will be for larger blocks of nationally marketable bonds, for reliable liquidity purposes.

It is unlikely that any significant change in rating policy can be expected from the two rating companies.

Possible Savings

In March 1971, the City of Newark refused to sell an issue of $18.7 million Chapter 177 Additional State School Aid Bonds at the interest cost that would have resulted from the Baa-1/BBB ratings awarded. After the Legislature amended the method of paying the Aid, a Aa rating was awarded. The Daily Bond Buyer of May 22, 1971 carried the article that estimated a 6¾% interest rate on the Baa-1/BBB rating versus the 5⅛% rate actually received, an estimated saving on that issue alone of $3.6 million. According to State Treasurer Joseph McCrane, the rating change for all future Chapter 177 bond sales will save $35 million over the life of the program.

Director Ehret also noted that the Division of Local Finance, through a concerted effort to convince the investment community of the merits of New Jersey bonds, was able to raise the ratings of some 30 local governments and aided in the retention of better ratings for 7 others. The resulting savings have been estimated at $4 million.

In a recent study published by the Investment Bankers Association, the positive effects of ratings on borrowing costs are substantiated. The study, *The Effects of Changes in Credit Ratings on Municipal Borrowing Costs* (1970) by Gerald R. Jantscher, comes to these conclusions (among others):

> "In general, communities' costs of borrowing were strongly affected by the changes made in their ratings. Aa-rated communities that were downgraded to A and Baa-rated communities that were improved to A both wound up with costs about midway between those of the highest-quality and lowest-quality A-rated communities. If these revisions had been made in 1958 or 1959, costs would have increased or decreased by nearly thirty basis points. Toward the middle of the 1960s the effects of the same changes must have become smaller."
>
> "It was also of interest to us to learn how speedily a community's cost of borrowing changed in response to a change in rating. Was the adjustment completed without delay, or did costs continue to change for months afterward? In order to answer this question we conducted tests to detect any continuing increases or decreases in communities' costs of borrowing during the months that followed their rating change. (The tests are described in detail in Appendix 1). The results suggest that costs continued to increase for a time after the downgrading of a community's credit rating, but that there was scarcely any tendency for costs to continue falling after a community's upgrading. Indeed, the results were not inconsistent with the hypothesis that the decrease in borrowing costs that occurred after the announcement of a community's upgrading was immediate and final. The evidence supporting these conclusions is particularly strong among communities that were moved between the Baa and A rating classes and between the A and Aa classes."

The Committee concludes:

The tax savings to many local governments that could result from improved credit ratings would justify major new State facilities and programs designed for this purpose.

Are New Jersey Local Government Bonds Generally Sold at Higher Interest Costs Than Those of Municipalities of New York State?

Before examining possible approaches to the reduction of interest costs, it is helpful to examine the contention sometimes advanced that New Jersey municipal bonds do not sell as well as those of municipalities of New York State. This is not borne out by an analysis of the data published by the National Center for Educational Statistics, of the United States Department of Health, Education and Welfare. Thus in the fiscal year 1968-1969, a comparison of the interest costs on school bonds issued results as follows:

State and Issues	Total Average Interest Costs	Maturities		
		Under 15 Years	15 - 24 Years	25 Years and Up
	%	%	%	%
New Jersey 45 issues— $104 million	4.67	4.13	4.67	4.72
New York 51 issues— $208 million	4.68	3.91	4.93	4.96

For the following year, 1969-1970, the bond sales reported by the same source were too few to be reliable. Thus in the case of bonds issued by municipalities, a total of $39 million was reported for New Jersey, of which $34 million was sold by Newark and Jersey City. Except for these issues, the comparative results as between New York and New Jersey were similar.

As shown in Table 4-28, a detailed analysis of the re-

offering yields of New Jersey municipal bonds as compared with New York municipals during the period March 15th through July 2, 1971, showed insignificant differences in the average reoffering yield between the municipals of both states, and for the sales during the months of March and April, the reoffering yields of the 53 New Jersey issues were actually under those of New York.

It is clear that whatever differences may exist, if any, as between New York and New Jersey municipals in cost to the borrower, the factors that make for any difference are subtle, complex and not readily generalized. The average maturity and the rating of the issue are the principal factors, but market acceptance and the timing of the issue obviously plays a part in determining the interest costs.

The Committee concludes:

The average municipal bond issue, including school bonds of New Jersey local governments, probably sells just as well as the average issue of New York local governments; but the big cities of New Jersey, such as Newark and Jersey City, and the little known and small municipalities from the viewpoint of resources, are not described by the averages. Moreover, State action to strengthen the credit standing of local governments generally can reduce the borrowing cost of those who have immediate need for such assistance but also of those municipalities that are now borrowing at average cost.

Present Borrowing Powers of State and Local Governments in New Jersey

New Jersey already has a sophisticated set of statutory and administrative controls on public borrowing, which primarily regulate counties, municipalities and school districts. The State government itself is subject to no limits on the amount of debt it may incur, so long as the debt is authorized at a referendum. It may incur debt for any purpose, and on any terms acceptable to

TABLE 4-28

New Jersey Tax Policy Committee

COMPARISON OF REOFFERING YIELDS IN 53 NEW JERSEY AND 66 NEW YORK LOCAL GOVERNMENT BOND ISSUES

SALES

March 15 - July 2, 1971

Line	Week Ending 1971	Number of Sales N.J.	Number of Sales N.Y.	10th Year Maturities N.J.	10th Year Maturities N.Y.	20th Year Maturities* N.J.	20th Year Maturities* N.Y.	New Jersey over or (under) New York 10th Yr.	New Jersey over or (under) New York 20th Yr.
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1	July 2	3	4	5.410	5.250	6.580	6.263	.160	.317
2	June 25	3	3	5.483	5.400	6.170	6.283	.083	(.103)
3	June 18	3	3	5.260	5.000	5.983	6.383	.260	(.783)
4	June 11	4	3	5.400	5.350	6.200	6.167	.150	.033
5	June 4	3	1	5.230	5.100	6.117	5.950	.130	.167
6	May 28	4	1	5.388	5.400	6.250	6.200	.002	.050
7	May 22	2	5	5.100	4.940	6.450	6.150	.160	.300
8	May 14	0	5	—	5.300	—	6.230	NC	NC
9	May 7	2	3	5.725	4.913	6.575	6.063	.280	even
10	April 30	4	6	4.988	4.708	6.050	6.050	.280	.025
11	April 23	—	3	—	4.450	—	5.900	NC	NC
12	April 16	1	5	4.500	4.538	5.850	5.543	(.038)	.307
13	April 9	8	7	4.325	4.493	5.590	5.620	(.168)	(.030)
14	April 2	3	8	4.150	4.333	5.250	5.531	(.183)	(.281)
15	March 26	9	6	4.106	4.200	5.295	5.333	(.094)	(.038)
16	March 19	4	3	4.175	4.317	5.580	5.430	(.142)	.150
17		53	66	69.240	77.692	83.940	95.116	.880	.114
18				+ 14	+ 16	+ 14	+ 16	+14	+14
19				4.946	4.856	5.996	5.945	.062	.008

* Where actual reoffering yields were available, these were used and averaged; where actual reoffering yields were not available due to bond issue being for less than 20 years, an estimate was made in each case for the 20th year in the light of the reoffering yield curve. All local government issues reported in *The Bond Buyer* for the period indicated were used, except for one reported sale of the City of New York.

Differential Col. 7 + Col. 4 line 19 = .062 + 4.856 = .01277

Differential Col. 8 + Col. 6 line 19 = .008 + 5.945 = .00135

the financial market, so long as the debt is for a public purpose. Local governments, however, are subject to detailed statutory and administrative regulations.

Counties and municipalities are subject to the Local Bond Law, Local Budget Law and Local Fiscal Affairs Law (all of which appear in Title 40A of New Jersey Statutes). With respect to borrowing, these statutes delegate broad powers to the counties and municipalities, and establish the director of the Division of Local Finance and the Local Finance Board in the Department of Community Affairs.

The Local Budget Law and its antecedents represents one of the first State efforts to introduce a measure of administrative supervision over local finance. The present law was adopted in 1936 and establishes what is known as a cash-basis budget requirement for all county and municipal governments. This law also regulates tax anticipation borrowing, and temporary borrowing to finance emergency appropriations.

The Local Bond Law provides the basic authority of counties and municipalities to borrow money and issue obligations. The same statute specifically limits the amount of indebtedness which may be incurred by any county or municipality, and requires a "down payment" from current appropriations or monies on hand before bonds may be issued for capital purposes. Short term financing, by the issuance of bond anticipation notes, is permitted and regulated by the act.

The same act fixes the maximum maturity of any bond issue according to its "period of probable usefulness". The law also requires that serial bonds be used, regulates the form of obligations and their sale, and provides in various ways for protecting the marketability of New Jersey municipal bonds.

School bonds are authorized and regulated under an entirely different statutory system, that is Title 18A of the New Jersey Statutes, which is generally the Education Law of the State. Chapter 24 of that Title provides for the authorization of school bond issues, and imposes limitations on the principal amount of bonds which may be issued, and governs form, execution, and sale of bonds. The chapter covers bonds issued by what are known as Type I districts, which are normally the city school districts where the Board of Education is appointed by the Mayor and Type II districts, which are normally the school districts in other municipalities, where the Board of Education is elected by the voters. Except for this complication, the School Law is much less detailed than the Local Bond Law in its regulation of borrowing by school districts.

The security behind county, municipal and school district bonds is primarily the taxing power of the issuing body. The school bonds, however, have four additional elements of security, as follows:

1. The municipality has a mandatory duty to pay over to the custodian of school monies of Type II districts the taxes required for school purposes, regardless of whether or not the municipality has actually collected such taxes (R.S. 54:4-75), and is required to borrow money if necessary to pay such taxes. (R.S. 54:4-76);

2. Under the School Building Aid Law, the State Treasurer is required to establish a school building aid capital reserve fund for each school district. The State Treasurer is required to use this fund to pay debt service on school bonds whenever a school district or municipality is unable to meet the payments of principal or interest on any such bonds when due. (N.J.S. 18A:58-25);

3. A special State fund, the Fund for the Support of Free Public Schools, which now has assets of about $30 million, is dedicated to the prevention of any possible defaults on the payment of principal or interest of school bonds. (N.J.S.A. 18A:56-16); and

4. A little-known provision of the School Law makes the obligations of a Type II school district a lien upon all of the real estate situated in the district, including the personal estates of the inhabitants of the district and the property of the district. (N. J. S. 18A:24-56).

This system of legislative and administrative controls over local borrowing has developed over the years, but until recently it has had some notable gaps. In particular, these include the lack of any supervision by the Division of Local Finance over the indebtedness of public authorities, ineffective capital budgeting at the local level, and lack of facilities to assist local governments with their debt management problems. All three of these areas have now been strengthened in varying degrees. About a year ago, the Local Finance Board issued a Capital Improvement Program Manual to be used by local governments, the authority of the Division of Local Finance was extended to cover public authorities, and a program of technical assistance of various kinds, including debt management, was inaugurated in the Department of Community Affairs in recent years.

It is notable that there have been no defaults on any New Jersey municipal securities, county, municipal, school or public authority, since the great Depression of the 1930's when some defaults were experienced in a number of states. Since that time, moreover, the State has adopted and administered an excellent set of laws and practices designed to achieve the highest standards of local finance.

The Committee's program of state funding of schools and massive reduction in property taxes should also strengthen the credit and borrowing powers of local governments.

Chapter VIII

A Central Municipal Credit Agency

The Committee's studies have developed three ways of reducing the interest costs of local government borrowing:

(a) The issuance and sale of all municipal bonds through a centralized State agency, such as in North Carolina;

(b) A loan guarantee fund, such as was proposed in the Congress by Senator Proxmire and Representative Patman a few years ago patterned after the F.D.I.C. (S. 398 and HR 2112, 91st Congress, 1st Session), and more recently has been offered by a private surety company known as AMBAC; and

(c) A State municipal bond bank, such as is now in operation in Vermont and has been introduced in the New Jersey Legislature as Senate No. 858 of 1970.

Administrative Supervision

The role of the State in supervising municipal finance is already well-established in New Jersey. A debt management advisory service can readily be developed as part of the municipal credit agency, in cooperation with the existing authority and facilities of the Department of Community Affairs. An adequate appropriation and highly skilled personnel will be required. The cost may well be recovered out of the fees and earnings of the agency. Once properly funded and staffed, the debt management advisory service could be of important assistance to local governments in the preparation and technical specifications of their bond issues, with a view toward minimizing interest costs of issuance.

The principal benefit of the North Carolina type of state activity is that it places a qualified state agency in a position to serve as financial advisor to the municipalities seeking credit. Small and large municipalities and school districts alike have access to the expertise of the agency which is specialized, and thus acquires a knowledge and experience that any single municipal or school district borrower is unlikely to have available. New Jersey has a successful record of State administrative assistance in local government debt management, through an advisory service offered by the Department of Community Affairs. The Committee believes that an expansion of such service, as compared with the centralization of the entire borrowing process, would be much more in accord with the traditions and capabilities of state and local government in New Jersey.

The Committee recommends:

That the debt management advisory services provided by the Department of Community Affairs be converted into a major function by appropriate increases in appropriation and personnel, to provide the kind of financial advisory service that will be capable of meeting the needs of local government.

Loan Guarantee Fund. A loan guarantee fund as proposed in the Proximire Bill was modeled after the FDIC program of bank deposit insurance. Other precedents include the mortgage guarantee feature of the State industrial finance authorities in New England and the recently announced AMBAC (American Municipal Bond Assurance Corporation) enterprise. For a premium charge of 1½% of the combined principal and interest payments to be incurred under the bond issue, the latter assures the purchaser of the bonds that annual debt service payments will be promptly made when due.

An illustration of the effect of the guarantee was very recently developed when the Township of Washington, in Bergen County, sold $3,450,000. of sewer bonds on December 29, 1971. The AMBAC policy resulted in a Standard & Poor's rating of AA and the bonds sold at an interest rate of 4.85% plus a $2,000. premium, whereas the bonds would have been rated BAA by Moody's without the AMBAC policy and one of the bids at 5.20% was made on that basis. It thus appears that the Township saved 35 basis points, resulting in a dollar saving of approximately $138,285. over the life of the loan. The Township paid a premium for the insurance policy of $40,231., thus resulting in a net saving in interest cost of approximately $98,054., without giving effect to the compound value of the premium payment or the present value of the annual savings of future interest. This was one of the first sales of municipal bonds in the United States to carry the insurance feature, and it illustrates the potential savings and interest costs and local tax burden which such a plan implies.

The actual risk of loss to any investor in bonds sold by local governments in New Jersey is almost nonexistent, judging from the record of no defaults since the great depression of the 1930's. At that time, no more than 2% of the outstanding bonds were defaulted

as to principal or interest, but those that were, received considerable notoriety. Moreover the lessons of that historical period were the basis of major improvements in the State's system of controls over municipal finances. As previously noted, the local bond law and the local budget laws were adopted during the 1930's, and they provide an excellent system of controls over long term and short term borrowing by counties and municipalities. In addition, Laws of 1947, Chapter 151 (The Fiscal Supervision Act) provides for the imposition of special restraints upon municipalities in, or in danger of falling into, unsound financial conditions—a piece of legislation which in itself provides a form of insurance against actual defaults. As noted above, bonds issued by school districts in New Jersey as well as bonds issued by municipalities for school purposes carry four different, but specific, types of assurance of prompt payment of principal and interest.

The Committee concludes:

New Jersey already has many of the elements of a municipal bond guarantee system, but its local governments do not seem to be receiving the benefits in lower interest costs that such a system would seem to warrant. What is needed is a fresh organization of the bond guarantee resources in such a way as to emphasize to the investment community the nature of the security provided.

A Municipal Bond Bank

The Problems of Small Issues—The proposal for an agency created by the Legislature to facilitate the marketing of bonds of some (or all) New Jersey municipalities arises from the belief that many of the municipalities do not have adequate access to the credit market on terms deemed adequate by the officers of such municipalities.[15]

Among the important elements of fact relating to the issue are the size and number of municipal bond issues being sold. Table 4-29 contains a tabulation of the number and size of 636 New Jersey municipal government bond issues reported by *The Bond Buyer* as having been sold between July 1, 1967, and June 30, 1971. Table 4-30 presents a tabulation for the same number of bond issues showing the number and dollar amounts of sales above and below $975,000.[16]

From Table 4-29, it may be seen that during the four periods studied, one-third of all sales were for less than $500,000. Another 19.3 percent were for amounts in the $500,000-$999,000 range.

In the aggregate, more than half the sales (52.4 percent) were in amounts of less than $1,000,000.

For the remainder of the sales, 39.0 percent were in the $1,000,000-$4,999,999 range; 5.0 percent were in the $5,000,000-$9,999,999 range; and 3.6 percent were in amounts of $10,000,000 or more.

Table 4-30 shows the distribution of 652[17] bond sales by local governments in New Jersey occurring in the period July 1, 1967, to June 30, 1971, on the basis of number and amount involved, using the amount of $975,000 as the dividing line between a "smaller" and "larger" issue. (This table should be read in concert with Table 4-29.) These 652 sales accounted for a total dollar volume of $1,300,600,000.

The data in Table 4-30 can be summarized in a number of ways. In terms of the total number of sales and the amounts of sales, the data show:

	PERCENT OF TOTAL				
	Municipalities	School Districts	Counties	Local Authorities	Total
As to number					
Under $975,000	33.0	19.2	0.2	0.2	52.5
Over $975,000	18.3	22.5	3.9	2.8	47.5
As to total dollar amount					
Under $975,000	5.9	4.7	.05	.05	10.8
Over $975,000	35.1	28.0	13.08	13.07	89.2

It is therefore apparent that, whereas more than half the total sales were under $975,000, they accounted for only 10.8 percent of the total dollar volume involved. In fact, the total dollar volume of the sales under $975,000 accounted for only $140.2 million, or an average of $35 million per year.

On the other hand, sales involving more than $975,000 per sale accounted for $1.16 billion, or almost $300 million per year.

With respect to the dollar value per sale, it is noted that:

For sales under $975,000, the average was $410,000 per sale

For sales over $975,000, the average was $3,743,000 per sale

If it be assumed that the sales involving more than $975,000—ordinarily advertised as sales of $1 million or more—attract a considerable degree of competition, then concern may be largely focused upon the large

[15] The term "municipality" as used in this memorandum is intended to comprehend all types of units of local government within the state—cities, towns, townships, boroughs, school districts, counties, and local authorities.

[16] The $975,000 amount is used in order that the sales advertised as $1,000,000. but bid at slightly below that amount under New Jersey practice will be included in the $1,000,000. and over sales.

[17] The difference between the number of 636 in Table 4-29 and 652 in Table 4-30 is largely accounted for by the fact that the results reported in the *Weekly Bond Buyer* of July 12, 1971, were not available when Table 4-29 was prepared. Some minor tabulation discrepancies may also be involved.

number of smaller sales. However, it is appropriate to note that the number of sales involving less than $975,000 has decreased from 68.2 percent of the total number of sales in the last half of 1967 to 44.2 percent in the first half of 1971. Although the pattern of decrease in the number as a percent of the total has been at a somewhat irregular rate, the trend is clear.

On the other hand, the very substantial increase in total sales during the first half of 1971 caused the absolute number of the smaller sales to be almost half again the number in the last half of 1968, the last period of a somewhat "normal" market.

Access of Smaller Bond Issues to Market.

Although no comprehensive study of the question has been undertaken, it appears from a review of New Jersey local government bond sales that the general pattern in recent months has been as follows:

1. In the case of issues where the amount is less than $1 million, local banks or individual investment banking firms are purchasing the bonds, ordinarily without reoffering them publicly.
2. In the case of bond issues involving more than $1 million, there is active competitive bidding.

A summary review of recent New Jersey local government sales indicates that (a) the term for the smaller issues (under $1 million) is typically in the 10-15 year range for the final maturity, and (b) the term for the issues of more than $975,000 is typically in the 20-25 year range. The reported average net interest cost on the shorter issues was generally below that of the longer issues; however, this does not tell the full story because of the high degree of rise in the reoffering yields in the market from the first maturity through the

TABLE 4-29

DISTRIBUTION OF 636 BOND SALES BY NEW JERSEY LOCAL GOVERNMENTS BY SIZE OF ISSUE, JULY 1, 1967—JUNE 30, 1971

Size of Issue ($000)	Municipalities	School Districts	County Governments	Local Authorities	Total Number	Total Percent
Under 100	35	6	—	—	41	6.4
100-199	41	15	—	—	56	8.8
200-299	25	9	—	—	34	5.3
300-399	29	22	—	—	51	8.0
400-499	17	11	—	—	28	4.4
Sub-total	147	63	—	—	210	33.0
500-599	21	15	—	1	37	5.8
600-699	18	9	—	—	27	4.2
700-799	17	10	1	—	28	4.4
800-899	4	11	—	—	15	2.4
900-999	7	9	—	—	16	2.5
Sub-total	67	54	1	1	123	19.3
Under 1,000	214	117	1	1	333	52.4
1,000-1,999	53	66	—	1	120	18.9
2,000-2,999	20	42	6	—	68	10.7
3,000-3,999	12	28	3	2	45	7.8
4,000-4,999	5	4	3	3	15	2.4
Sub-total	90	140	12	6	248	39.0
5,000-5,999	6	6	3	2	17	2.7
6,000-6,999	3	3	1	2	9	1.4
7,000-7,999	1	—	—	—	1	0.2
8,000-8,999	1	—	1	—	2	0.3
9,000-9,999	1	—	—	2	3	0.5
Sub-total	12	9	5	6	32	5.0
Over $10,000	12	—	7	4	23	3.6
TOTAL	328	266	25	17	636	100.0

TABLE 4-30

DISTRIBUTION OF 652 NEW JERSEY LOCAL GOVERNMENT SALES REPORTED BY THE BOND BUYER, JULY 1, 1967—JUNE 30, 1971, BY SIZE AS TO NUMBER AND AMOUNTS

(dollar amounts in columns in millions)

	1967	1968		1969		1970		1971		Percent of Grand Total	
	7/1-12/31	1/1-6/30	7/1-12/31	1/1-6/30	7/1-12/31	1/1-6/30	7/1-12/31	1/1-6/30	Total	Number	Amount
Municipalities											
Number—Under $975,000	45	24	35	8	21	19	28	35	215	33.0	
Over $975,000	19	14	9	3	12	8	13	41	119	18.3	
	64	38	44	11	33	27	41	76	334	51.2	
Amount—Under $975,000	$ 15.3	$ 7.6	$ 11.7	$ 3.1	$ 4.9	$ 6.3	$ 11.7	$ 16.6	$ 77.3		5.9
Over $975,000	64.8	46.2	35.0	9.6	50.7	51.4	39.3	159.3	456.3		35.1
	$ 80.1	$ 53.8	$ 46.7	$ 12.7	$ 55.6	$ 57.7	$ 51.0	$175.9	$ 533.6		41.0
School Districts											
Number—Under $975,000	13	11	18	14	6	3	12	48	125	19.2	
Over $975,000	5	9	19	5	10	10	25	54	147	22.5	
	18	20	37	19	16	13	37	102	272	41.7	
Amount—Under $975,000	$ 7.0	$ 5.1	$ 6.6	$ 5.8	$ 2.4	$ 1.1	$ 7.3	$ 26.1	$ 61.6		4.7
Over $975,000	12.7	16.4	70.4	13.0	26.2	27.6	68.2	129.8	364.1		28.0
	$ 19.7	$ 21.5	$ 77.0	$ 18.8	$ 28.6	$ 28.7	$ 75.5	$155.9	$ 425.7		32.7
Counties											
Number—Under $975,000	—	—	—	—	1	—	—	—	1	0.2	
Over $975,000	1	2	4	2	2	—	8	7	26	3.9	
	1	2	4	2	3	—	8	7	27	4.1	
Amount—Under $975,000	$ —	$ —	$ —	$ —	$ 0.7	$ —	$ —	$ —	$ 0.7		0.05
Over $975,000	2.0	5.2	24.5	28.5	11.5	—	51.1	47.2	170.0		13.08
	$ 2.0	$ 5.2	$ 24.5	$ 28.5	$ 12.2	$ —	$ 51.1	$ 47.2	$ 170.7		13.13
Local Authorities											
Number—Under $975,000	—	—	—	—	—	—	1	—	1	0.2	
Over $975,000	2	—	1	5	2	3	2	3	18	2.8	
	2	—	1	5	2	3	3	3	19	3.0	
Amount—Under $975,000	$ —	$ —	$ —	$ —	$ —	$ —	$ 0.6	$ —	$ 0.6		0.05
Over $975,000	9.3	—	3.1	27.3	7.6	61.5	15.1	46.2	170.0		13.07
	$ 9.3	$ —	$ 3.1	$ 27.3	$ 7.6	$ 61.5	$ 16.0	$ 46.2	$ 170.6		13.12
Total											
Number—Under $975,000	58	35	53	22	28	22	41	83	342	52.5	
Over $975,000	27	25	43	15	26	21	48	105	310	47.5	
	85	60	96	37	54	43	89	188	652	100.0	
Amount—Under $975,000	$ 22.4	$ 12.7	$ 18.3	$ 9.0	$ 8.0	$ 7.4	$ 19.7	$ 42.7	$ 140.2		10.8
Over $975,000	88.8	67.8	132.9	78.4	95.9	140.4	173.7	382.5	1,160.4		89.2
	$111.2	$ 80.5	$151.2	$ 87.4	$103.9	$147.8	$193.4	$425.2	$1,300.6		100.0
Percentages											
Number—Under $975,000	68.2	50.3	55.2	59.5	51.9	51.2	46.1	44.2	52.5		
Over $975,000	31.8	41.7	44.8	40.5	48.2	48.8	53.9	55.8	47.5		
Amount—Under $975,000	20.1	15.8	12.1	10.3	7.7	5.0	10.2	10.0	10.8		
Over $975,000	79.8	84.2	87.9	89.7	92.3	95.0	89.8	90.0	89.2		

20th and sometimes through the 25th or even 30th year maturity.

Use of State Agencies.

The use of State agencies for issuance of bonds to finance local public improvements is not an altogether new phenomenon in the United States and Canada. It appears that the principal experience to date has been in the following States and Canadian provinces:

Pennsylvania—Pennsylvania State Public School Building Authority (1947)
Georgia—Georgia Education Authority (formerly called the Georgia State School Building Authority.) (1951)
Maine—Maine School Building Authority (1951)
Alberta—Alberta Municipal Finance Corporation (1956)
Virginia—Virginia Public School Building Authority (1962)
Newfoundland—Newfoundland Municipal Financing Corporation (1964)
Saskatchewan—Saskatchewan Finance Corporation (1969)
Vermont—Vermont Municipal Bond Bank (1969)
British Columbia—The Municipal Finance Authority of British Columbia (1970)

Three other related programs include the issuance by the State government of bonds for financing local programs in Michigan, Minnesota, and Florida.

A brief description of the more significant of these programs is set forth below.[18]

Pennsylvania. The earliest and by far the largest program in which the State (or a provincial) government has been involved in the furnishing of money to finance public improvements up to that time largely financed by local governments is the Pennsylvania State Public School Building Authority, (PSPSBA) established in 1947. The local school districts execute contracts with the PSPSBA under which the Authority constructs local school buildings and rents them to the local school districts for a rental generally equal to 120 percent of the anticipated debt service on the bonds issued by PSPSBA to finance the projects.

Until the late 1950's these rentals were the sole security for the debt of the Authority. In that year the Pennsylvania Legislature adopted legislation under which the Authority has the right, in case of default of a payment by a local school district, to certify the amount of the default to the State Treasurer, and the Treasurer has the obligation to deduct from the next payment of funds by the State to the local school district the amount of such defaulted payment and remit it directly to the Authority.

Georgia, Maine and Virginia. Like the Pennsylvania Authority, these two authorities are empowered to issue revenue bonds secured primarily by the lease rental agreements with local school districts. They are entitled to certain additional State funds if needed to avoid deficits. Unlike an urban bank arrangement, the ownership of the facilities being financed by the Pennsylvania, Georgia, Maine and Virginia authorities does not pass to the local district until the debt has been fully paid.

Vermont. The Vermont Municipal Bond Bank is the only existing State government agency with broad powers to purchase the bonds of local governments. The only formal guarantees behind the bonds of that Bank are the receipts from the local governments in payment for debt service on their bonds owned by the Bank. The first (and to date, the only) issue by that Bank is the $46,000,000 issue dated December 1, 1970, and sold on December 21, 1970.

These bonds were well received by the market, and the purchasers reoffered the 20th maturity (callable on or after December 1, 1980, at 100¼ percent plus ¼ of 1 percent premium for each year or fraction thereof between the date called and the date of original maturity for the bonds) at a yield of 5.50 percent at par. This rate was almost identical to the then prevailing market as measured by *The Bond Buyer's Index* which was at 5.47 percent on December 18, 1970, and at 5.50 percent on December 24, 1970.[19]

Michigan. The State of Michigan issues general obligation bonds of the State and uses the proceeds to make grants, loans, and advances to various local governments for such purposes as water resources, hospitals, and recreation.

Florida. There has been a long standing practice in Florida of permitting the Florida State Board of Education to issue bonds for local school purposes that are guaranteed by the local districts pledging their respective portions of the motor vehicle license revenue that is allocated by the constitution to such districts as a part of the State educational aid plan. Since last November,

[18] This description has drawn heavily upon the excellent presentation of E. Carlton Heeseler of the firm of Shearson, Hammill & Co., Inc., which is reprinted in *The Bond Buyer*, Special Conference Issue No. 2, June 21, 1971, pp. 27-28; 45-48. The address was to the Annual Conference of the Municipal Finance Officers Association of the United States and Canada, New York, May 30-June 4, 1971.

[19] On the other hand, it is appropriate to note that the purchasers hedged their bets somewhat by establishing a differential in the price paid for the bonds and the price at which they were reoffered of $23.37 per $1,000, whereas other highgrade bonds were being sold in the region with price differentials that were considerably less, e.g., the $75,000,000 issue of the State of New Jersey. Of course, a portion of the differential was due to the normal practice of providing somewhat greater differential in the case of new market instruments.

the Florida constitution has provided that the State may issue general obligation bonds to acquire water and air pollution control facilities or to lend such funds to local governments for these purposes.

British Columbia. The province of British Columbia adopted legislation in 1970 establishing a Municipal Finance Authority of British Columbia. This agency has the right to issue debentures, or other evidences of debt, to facilitate the financing of water, sewer, and pollution control and abatement facilities.

A guarantee provided by this agency is of very substantial dimension since the trustees of the Authority are authorized and required to levy a tax upon all taxable property in the province sufficient to provide an adequate debt service reserve.

Other States. Beyond New Jersey, legislation is being actively considered by the legislature in Alaska. Studies are also being conducted in Connecticut, California, Ohio, and Florida evaluating the possibilities of the creation of some type of State agency for the issuance of bonds as an aid to local governments.

Arguments Pro and Con.

The arguments for the establishment of a State municipal bond finance agency in New Jersey may be summarized by reference to the Vermont type as the most likely alternative:

1. Improvement of access of the smaller municipalities to credit markets on more favorable terms.

2. Overcoming the limitations on the capability of smaller municipalities in planning and marketing their debt. To a degree not widely understood, the technical aspects of the design of bond issues and the specifications under which they are marketed may have a very significant influence upon the total debt service payable, especially in the case of callable bonds.

3. Reductions in unit costs associated with issuance of bonds. Aside from the matter of the basic interest, i.e., the net rate of return provided the investor, there are (in addition to financial advisory services discussed above) six kinds of services which are generally priced in part in relation to the size of the bond issue, with the cost per $1,000 involved decreasing as the size of the issue increases:

   A. Legal costs—both local and bond counsel
   B. Underwriting costs
   C. Fiscal or paying agent fees
   D. Bond printing costs
   E. Advertising costs
   F. Rating agency costs

Whether these costs would be decreased under a central bond agency concept would depend in large measure upon the mechanics involved. It would be important to so design the central state agency to prevent duplication of these services at both local and state levels.

4. Provision to facilitate secondary market operations. For most investors who make up the municipal bond market, the ability to find a ready secondary market for bonds is a very important element in the investment process, and affects the interest cost.

The secondary market depends upon many factors, including the availability of current, accurate information concerning the credit of the local government. Through the Division of Local Finance, those interested in New Jersey have a better access to such information than in the typical state; however, this information does not extend to current data on the social and economic characteristics of the community.

Another factor in maintaining an adequate secondary market is a sufficient supply of a given type of bonds to insure there will be a considerable number of secondary market sales of any given issue—at least sufficient to create fairly broad knowledge of (and hopefully interest in) such bonds.

5. Diversity of economic base.

Given the fact that New Jersey has a large number of relatively small municipalities, many of them have an economic base that is largely dependent upon a single industry and in some instances on a single manufacturing or other economic unit.

Obviously, bonds of such a municipality appear to (but do not necessarily) carry more risk than the larger scale operations encompassed by a State bond finance agency.

Moreover, as the process of urban decay tends to take over in older centers of population, there is a significant increase in the price at which those communities may borrow money. Yet, the State has a genuine interest in preserving such communities in some form.

However, there are a number of arguments against State involvement in the local borrowing process, as follows:

1. Impairment of State credit.

Easily the most important of the arguments against the establishment of a State agency to finance local government debt is the potential impairment of the credit of the State itself.

Of course, the proposal in Senate Bill 858 undertakes to and specifically states that the credit of the State will not be placed behind the bonds of the proposed agency. On the other hand, the proposed legislation contemplates (as does the Vermont legislation) the making up of any deficit caused by local default in payment of debt to the State agency (or in respect to bonds of the local municipality held by the State agency).

So long as this is a central element of the plan for a State agency, those who evaluate the credit of the State must either assume that the Legislature has taken on an obligation in good faith and will discharge the obligation should conditions at a future date require State appropriations; or that the Legis-

lature does not expect to honor the obligation implicit in the proposed legislation. If there is an obligation, moral or otherwise, it will support the local credit and be weighted in the State's credit rating; if not, the plan would have little purpose.

Nature of the State's Commitment. The extent to which a guarantee fund or a bond bank can be successful in achieving an Aa rating for the bonds affected depends upon what is known as the "make-up provision" of the enabling legislation. There are various examples of such a provision under existing State laws, and a typical one may be found in the New Jersey Housing Finance Agency Law, as follows:

> "In order to assure the maintenance of the required minimum capital reserve in the Housing Finance Fund, there shall be annually appropriated and paid to the agency for deposit in said fund, such sum, if any, as shall be certified by the chairman of the agency to the Governor as necessary to restore said fund to an amount equal to the required minimum capital reserve. The chairman shall annually, on or before December 1, make and deliver to the Governor his certificate stating the sum, if any, required to restore said fund to the amount aforesaid, and the sum or sums so certified shall be appropriated and paid to the agency during the then current State fiscal year" (N.J.S.A. 55:14J-21).

It is apparent that the financial community views this type of provision as a moral obligation of the State, since the bonds of the agency, which are otherwise secured only by a pledge of mortgage payments from project sponsors, are rated Aa, only one level below the bonds of the State itself. It is recognized that no one can compel the legislature to appropriate the sums indicated, but it is also strongly apparent that no legislature would feel free to disregard the obligation because of its obvious effect upon the credit of the State. Moreover, it is now established that such a moral obligation does not constitute a debt within the meaning of the State constitutional limitations on the incurring of State debt.

It is not feasible to determine at what point of indebtedness, including moral obligations, the State of New Jersey would lose its Aaa rating. One consultant suggests that this is a matter of comparing the debt burden of other Aaa and Aa rated States, more than it is a matter of absolutes. The risk of a change in rating may mean a difference in cost to the State of 25 basis points (¼ of 1%) in interest rate on its bonds. On the other hand, in order to bolster local credit the State has already committed itself to the debt service on $180 million in school bonds under L. 1971 ch. 10, and this piecemeal approach could be more of a burden on State finance than the systematic plans under discussion.

The Committee recommends:

Each of the approaches to strengthening the market for the obligations of New Jersey's local governments has advantages and disadvantages. The conditions of the market are so complex, moreover, and change so much with time, that a program which would permit the selection of whatever approach would be most useful for the type of municipality and the point in time at which it goes to market, would provide the optimum benefit in reduced borrowing costs for all local governments. To this end, a combination of the three approaches, that is, a centralized debt management advisory service, a guarantee fund, and a bond bank will be most effective.

A Proposed New Jersey Municipal Credit Agency

The Committee recommends:

A three-part program which should reduce the borrowing costs of local governments, including school districts, which are attributable to the smallness of the issue, the low credit rating of the issuer, or the lack of adequate capability for debt management by the issuer. The program can be implemented as follows:

1. **Corporate structure.** The legislature would create an independent public corporation with provision for a distinguished board of directors and a business-like management.

2. **Name.** New Jersey Municipal Credit Corporation.

3. **Divisions.** The corporation would be organized with a qualified executive and three divisions: a bond bank, the guarantee fund, and the debt management service.

4. **Bond Bank Division.** The bond bank division would be structured, empowered, administered and financed as provided in Senate No. 858 (1970). It would be authorized to hold the bonds of counties, municipalities, school districts, intermunicipal and county authorities, but not more than 10% of its portfolio may consist of the obligations of any one issuer and not more than 25% of any one issue of the bond bank may be for one local issue. It should be supported by a *make-up* provision, as in the N.J. Housing Finance Agency Law.

5. **Guarantee Fund.** The guarantee fund would be established by the State, with its initial capital consisting of a transfer of the balance in the fund for support of Free Public Schools (N.J.S. 18A:56-16) and the school building aid capital reserve funds (N.J.S. 18A:58-25), earmarked to continue to support capital borrowing for school purposes as now authorized. In addition, a State appropriation of a capital reserve to underwrite the guarantee for municipal bonds would be effective, according to the Committee's information,

to guarantee bonds equal to 12.5 times the amount appropriated were there no "make-up" provision. With a "make-up" provision, the ratio could be substantially greater. The reserve fund would grow with earnings, assuming no defaults.

The Committee strongly recommends a constitutional amendment to permit the State School Fund to become a general guarantee fund for municipal as well as school issues of the future.

6. **Optional Guarantee.**

A. The Fund would upon request—and with suitable supervision of the local borrowing and subject to prescribed standards and limits of amounts—guarantee the prompt payment of principal and interest on any local issue. The issuer would pay a premium to the Fund. Since there is no record of any municipal default since the Great Depression, when 2% of the issues were in default, a premium charge of 1½% of debt service over the life of the issue would appear to be adequate.

B. If the Bond Bank wished to dispose of any of its holdings of municipal bonds in the secondary market, it could make them more marketable by adding the guarantee of the Fund.

C. It would be anticipated that municipalities with high credit ratings would not use either the guarantee fund or the bond bank, but these facilities, as well as the debt management service, would be open to all local governments.

7. **Earnings of the Fund.** The Fund would realize two types of earnings: (1) a return on investment of its assets, and (2) premium income. The earnings on its initial capital might be reserved to limit recourse to the make-up provision. The premium income could be held in a second reserve to strengthen the guarantee. After sufficient years of operation, whenever premium earnings are sufficient, together with capital, to provide a two times coverage of the maximum annual debt service payable in any future year on bonds guaranteed, the surplus could be distributed in whole or in part to the State to repay the initial capital.

8. **Guarantee of the Fund.** The Fund would guarantee to the holder of any bonds issued under the provisions of this act, and duly endorsed with the guarantee, that principal and interest will be promptly paid as it falls due. If a paying agent is not in funds 5 days before the due date, he may notify the Fund which shall immediately deposit the required amount with the paying agent.

9. **Default Options of the Fund.** These would be the same as the bond bank.

10. **Municipalities in Unsound Fiscal Condition.** This law would apply for greater security of the issue.

11. **Limit on Outstanding Commitment.** The Fund shall at no time accept for guarantee any issue which together with all outstanding guaranteed issues would exceed a stated multiple of its capital reserve. This would enable the Legislature, through its control over appropriations to the reserve, to control the total moral obligation.

Advantages and Disadvantages

1. The Bond Bank will be available to serve those public issues with inadequate access to the municipal bond market.

2. The Guarantee Fund will provide improved credit rating, particularly for any larger municipalities with Baa ratings which have used the maximum permitted by the Bond Bank or to any municipality or school district which may prefer this to the Bond Bank.

3. The risk of an adverse effect on the State's credit rating, involved in a bond bank alone, will be lessened if not fully avoided.

4. When coupled with the planned strengthening of State administrative supervision of local borrowing practices, the program should result in major savings in interest costs to local units.

5. The price of these advantages is obviously greater interdependence of local units in financing and greater State participation in the local borrowing process.

6. The State would systematize its present diverse and scattered responsibility in relation to local bond issues.