

Committee Meeting

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of

SENATE STATE GOVERNMENT COMMITTEE

"Testimony on the issuance of bonds by the
State, State authorities and commissions,
and State colleges"

LOCATION: Room 319
State House
Trenton, New Jersey

DATE: October 19, 1993
10:00 a.m.

MEMBERS OF COMMITTEE PRESENT:

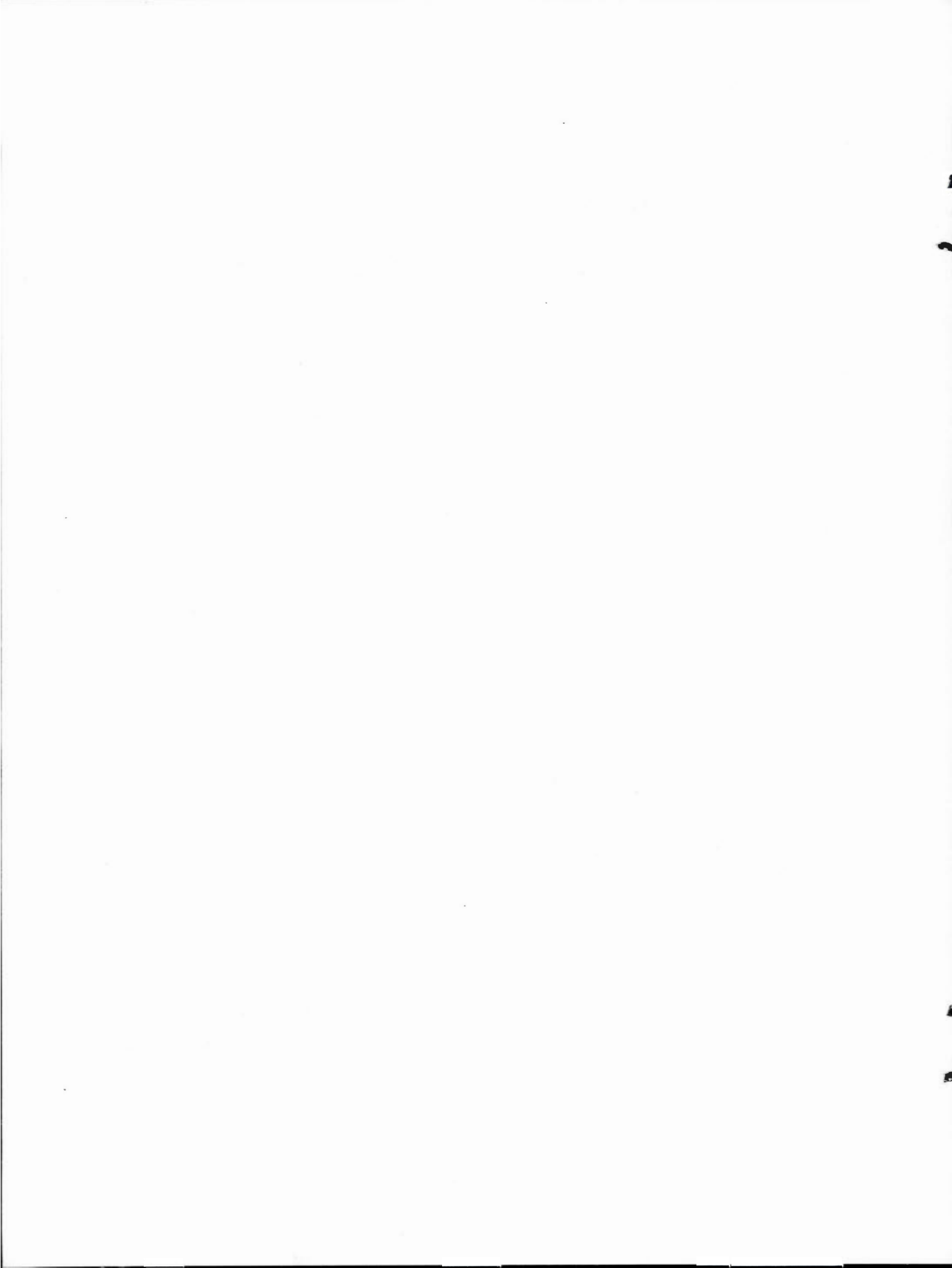
Senator Joseph L. Bubba, Chairman
Senator Peter Inverso, Vice-Chairman
Senator Gerald Cardinale
Senator William E. Schluter



ALSO PRESENT:

Joseph P. Capalbo
Office of Legislative Services
Aide, Senate State Government Committee

Hearing Recorded and Transcribed by
The Office of Legislative Services, Public Information Office,
Hearing Unit, State House Annex, CN 068, Trenton, New Jersey 08625





JOSEPH L. BUBBA
Chairman
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New Jersey State Legislature

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R E S C H E D U L E D

COMMITTEE NOTICE

TO: MEMBERS OF THE SENATE STATE
GOVERNMENT COMMITTEE

FROM: SENATOR JOSEPH L. BUBBA, CHAIRMAN

SUBJECT: RESCHEDULED COMMITTEE MEETING - October 19, 1993

The public may address comments and questions to Joseph P. Capalbo, Committee Aide, or make bill status or scheduling inquiries to Lynn Rogers, Secretary, at (609) 292-9106.

The Senate State Government Committee meeting which was scheduled for Thursday, October 7, 1993 has been rescheduled for Tuesday, October 19, 1993 at 10:00 AM, Room 319 in the State House, Trenton, New Jersey.

The committee will meet to discuss and receive testimony on the issuance of bonds by the State, State authorities and commissions, and State colleges. It will seek to develop recommendations for institutionalizing a systematic process for reviewing the State's debt profile and for planning the capital needs of the State as well as providing oversight of debt issuance practices.

Issued 10/01/93

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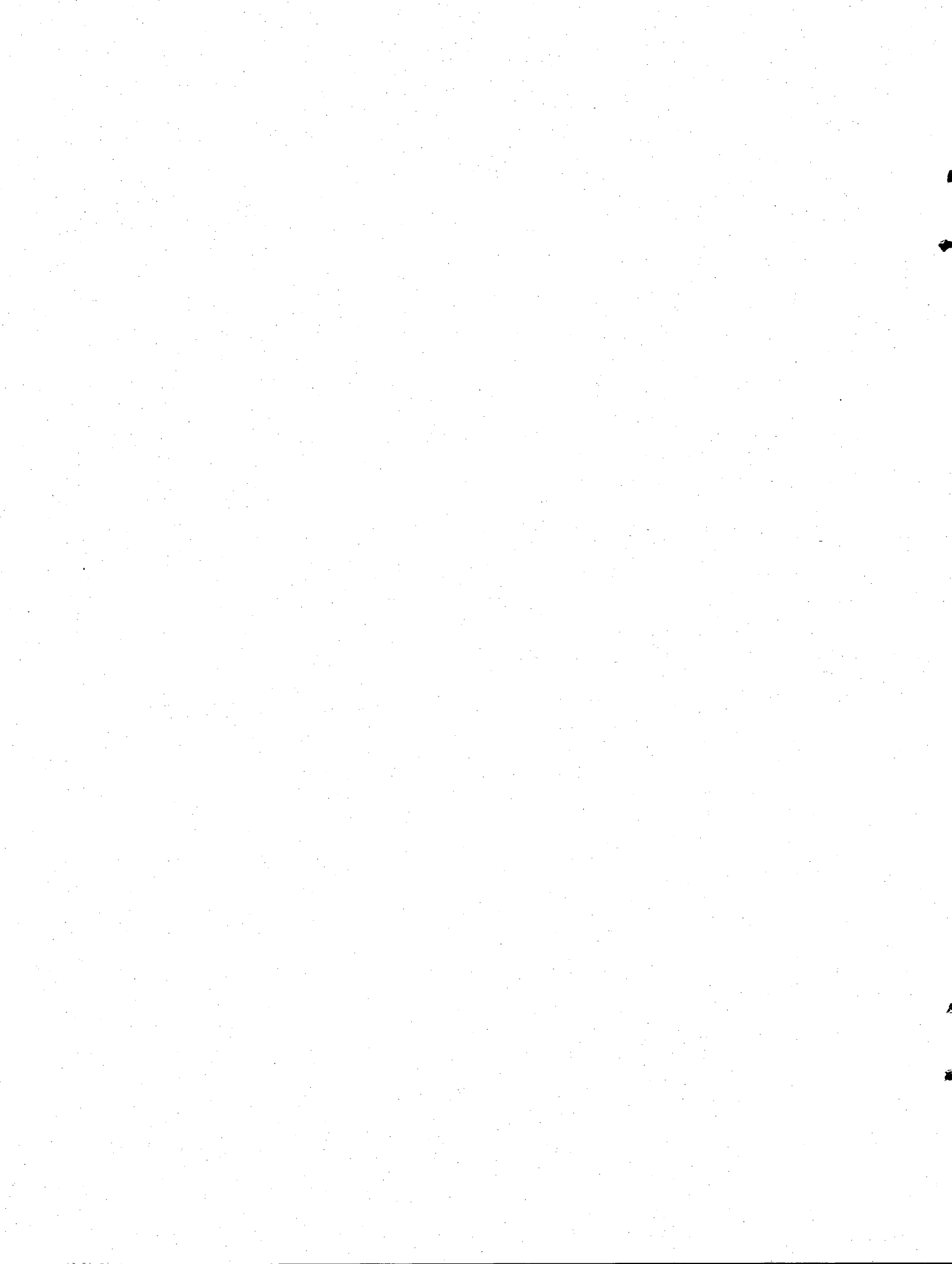


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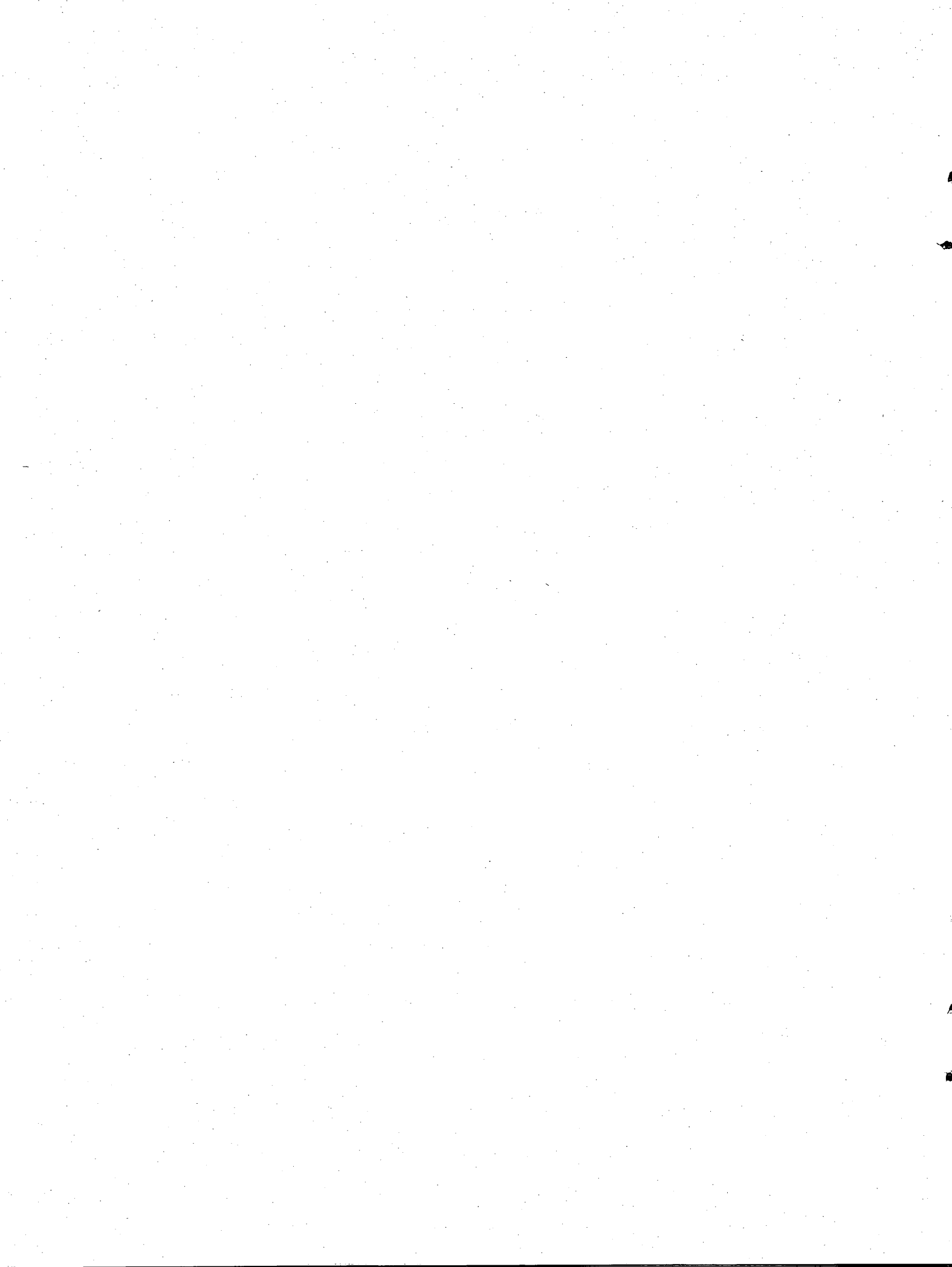


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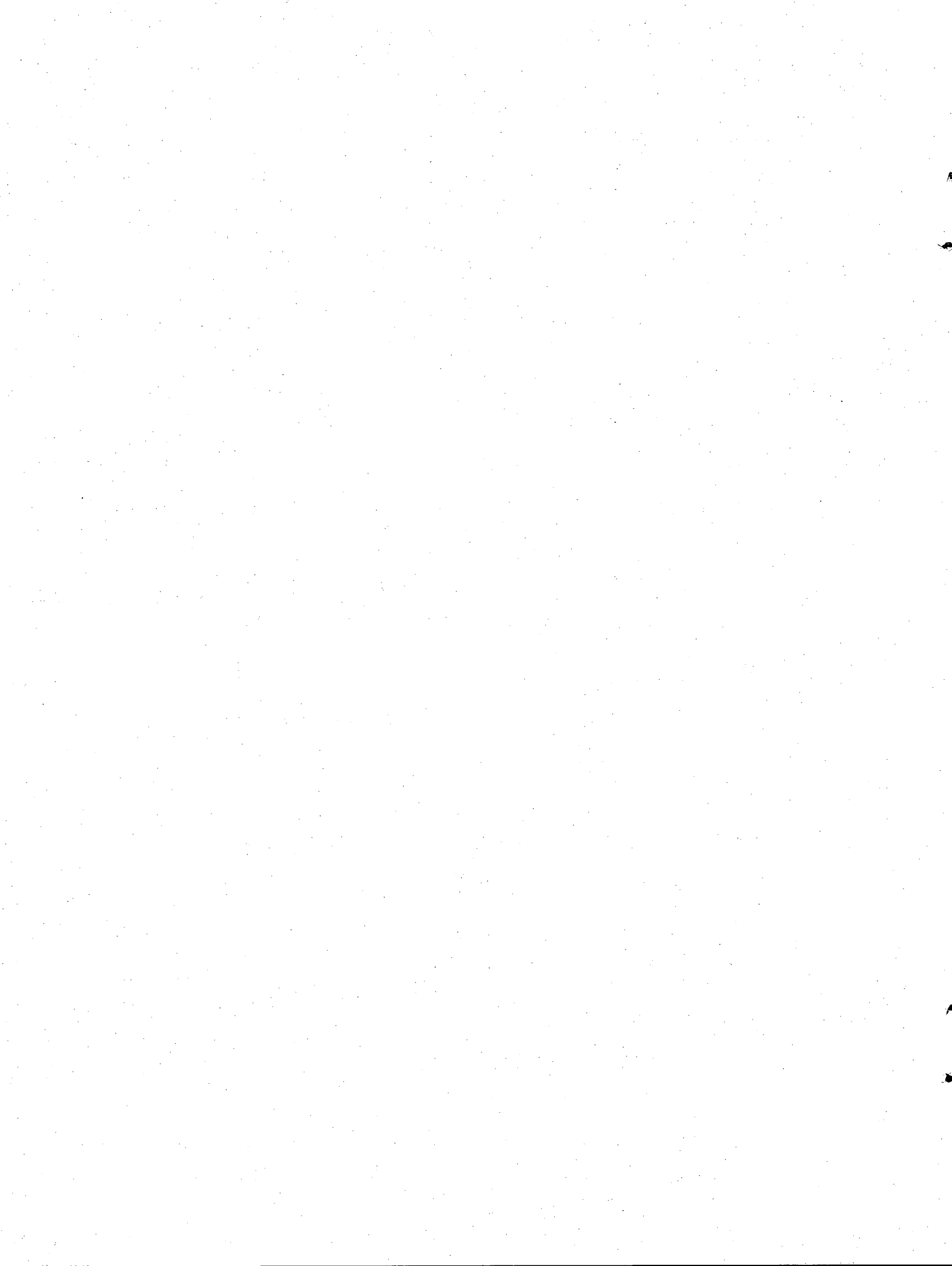


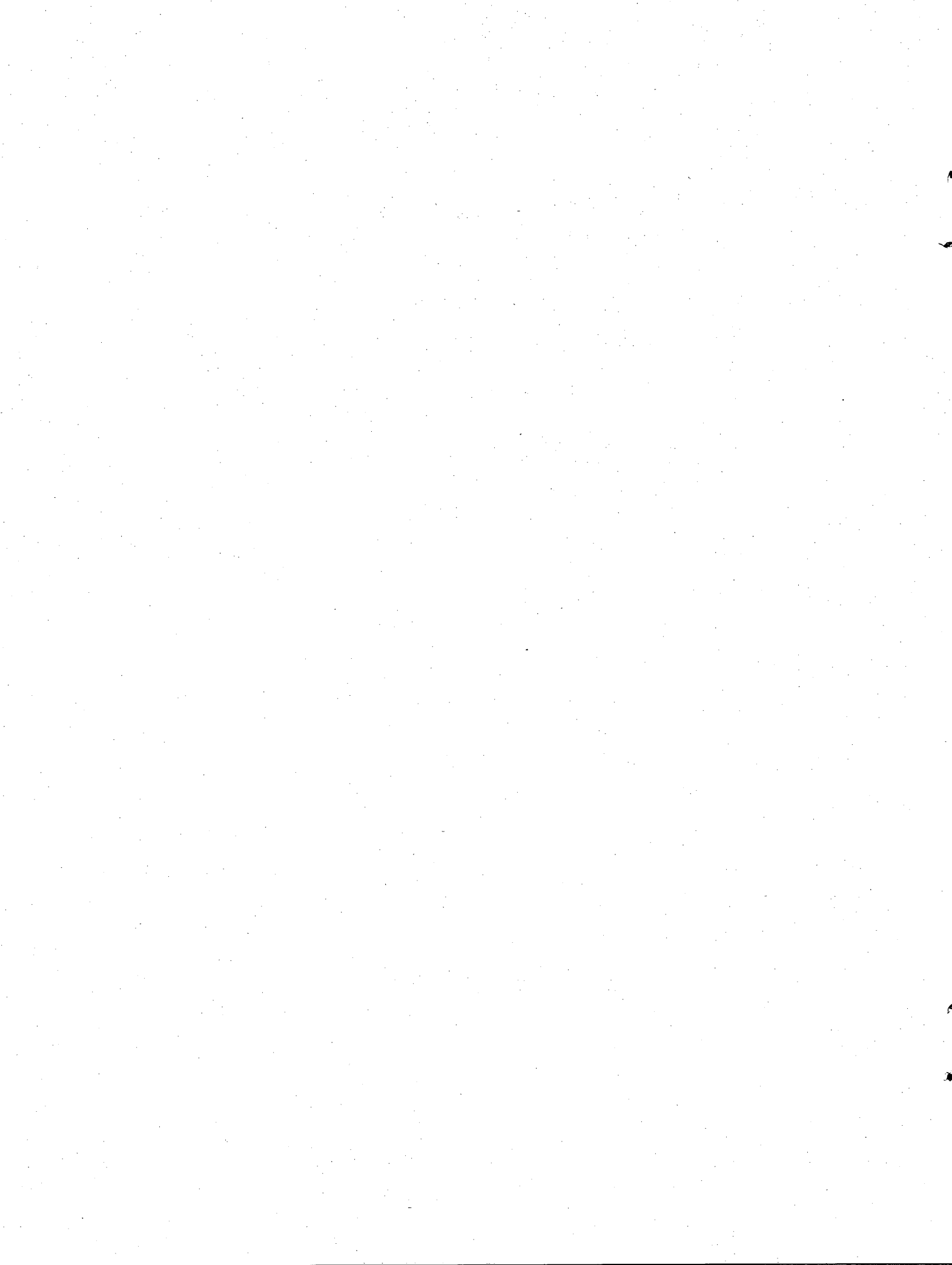
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SENATOR JOSEPH L. BUBBA (CHAIRMAN): May we have your attention, please? I thank you all for being on time. You have to understand, if you are not familiar with Trenton, that this is Trenton time, and probably we start the earliest of any committee.

We are here to begin the process on a very serious discussion. We are here today to discuss and receive testimony on the issuance of bonds by the State, State authorities, State colleges, commissions, etc. The Committee is seeking to develop a systematic process for reviewing the State's debt profile, planning the capital needs of the State, and overseeing debt issuance practices. The Legislature has no method, procedures, or requirements for reviewing the State's overall debt profile which allows for oversight, nor is there a process for planning the short-term and long-term capital needs of the State.

Today, we will examine two proposals to revise current law by:

- 1) Strengthening the New Jersey Commission on Capital Budgeting and Planning; and
- 2) Creating a new entity to review the proposed sale and issuance of bonds or other obligations of State governmental entities and the revenue bonds of the State's authorities, commissions, and colleges.

The Committee's first proposal deals with the New Jersey Commission on Capital Budgeting and Planning. The Commission is statutorily responsible for reviewing the capital expenditure requests of the various State agencies, preparing a State Capital Improvement Plan, and reviewing legislation which affects the indebtedness of the State. We will examine whether the Commission's responsibilities should be increased so that it must assess, on an annual basis, the State's current and projected debt levels, and recommend limits on new bond authorizations based on such assessments.

The Committee's second proposal deals with the issuance of bonds. We will examine whether a new entity should be created to review the proposed issuance of State general obligation bonds and the revenue bonds of the State's authorities, commissions, and colleges. The purpose of this body would not be to make a judgment on whether there is a need for a particular bond issue, but to examine if the procedures connected with the proposed sale conform with existing law and applicable regulations in order to ensure that the issuance of the bonds is handled in a fair, impartial, and equitable manner.

We intend to use and take into consideration all proposed current legislation on this subject. This meeting is the start of a process, for this is a crucial and complex issue area which cannot be dealt with in a quick and easy fashion.

The Committee is fortunate to have assembled a distinguished group of persons to speak today. Our first speakers will be Mr. Bruce Coe, former Executive Director of the New Jersey Commission on Capital Budgeting and Planning, and Mr. William Tremayne, former Chairman of the New Jersey Commission on Capital Budgeting and Planning.

We will then proceed to have three groups of speakers. Our first group, from 10:30 a.m. to 11:15 a.m., includes-- By the way, we will not be unhappy with anyone who does not take up the full allotment of their time. We want you to say what is on your mind, but be as brief and to the point as possible. From 10:30 to 11:15 will include speakers representing underwriters and advisory and rating service organizations. They are: Mr. Gerald McBride, of the Municipal Securities Division of the Public Securities Association; Mr. William Cobbs, of the Public Resources Advisory Group; Mr. Hyman Grossman, of Standard and Poor's Rating Group; and Mr. William O'Connell, of the National Association of Securities Dealers.

Our second group, from 11:15 a.m. to 12:00 noon, will include speakers representing the financial community. They are: Mr. Robert A. Rich, of J.P. Morgan & Company; Mr. Richard Raphael, of Fitch Investors; and Mr. Steven Elias, of the Municipal & Government Securities Corporation of New Jersey.

Our third group, from 12:00 noon to 1:00 p.m., will include Senators and Assemblymen who have introduced legislation in this issue area. Those invited are: Senator John H. Ewing; Senator Henry P. McNamara; Senator Bradford S. Smith; Assemblyman Richard H. Bagger; Assemblyman Rodney P. Frelinghuysen; Assemblyman Leonard Lance; Assemblyman Monroe Jay Lustbader; and Assembly David C. Russo. Did I omit anybody? (no response)

I will ask Senator Inverso to comment on the proceedings.

SENATOR INVERSO: Thank you, Mr. Chairman. Since your comments covered some of what I had intended to say, I will be rather brief.

I think today's meeting is the beginning of an endeavor to determine how best to ensure that the taxpayers of New Jersey are not burdened by more debt than they can bear. Also, we must make sure that the process of funding our capital needs is not a mechanism cleverly used for personal or political gain, but only a process which results in the lowest possible cost of funds to the taxpayers of our State.

It appears that the Legislature has no systematic means to review the State's overall debt profile, nor is there a comprehensive process for planning the capital needs of the State.

Recent revelations involving the specter of political influence and quid pro quo in the State's debt funding and refinancing have raised uncertainty regarding the State's future debt picture, and have exposed, I believe, our inability to effectively oversee the bonding procedures.

In reviewing what needs to be done to enhance the integrity of the process, I focused on the role of the New Jersey Commission on Capital Budgeting and Planning and how it could be a more involved and effective player in not only determining which capital projects to move forward, but also to look more comprehensively at the long-term debt service implications on the financial capabilities of our State.

This Commission is statutorily responsible for reviewing the requests for capital expenditure of the various State agencies. When the process is completed, the Commission prepares a State Capital Improvement Plan, which includes a list of projects and the means to finance them.

However, we understand that the Commission does not scrutinize the relationship between a particular bond issue and the entire bonded indebtedness of the State, nor does it assess the procedures and practices used in the actual issuance of bonds by the State. We believe this deprives the Legislature of a clear picture of the State's debt outlook, leaves undetermined the criteria used by the executive branch, and provides no definitive valuation criteria of the considerations employed by them in implementing, financing, and refinancing.

To correct this, I propose that the Legislature amend the responsibilities of the Commission on Capital Budgeting and Planning to require it to specifically assess the State's current and projected debt levels, and to annually recommend a limit on new bond authorizations. That limit would be based on a set of criteria that would include: debt levels of comparable states; New Jersey's capital needs; the ability of our State to support present and future debt; State operating costs; and projected State revenues.

In the process, I see a collaborative role for the counsel and economic advisers and the State's Revenue Forecasting Commission. I also believe that the composition of the Commission, the makeup of the members of the Commission,

needs to be changed. Increasing the Commission's role in this process would provide the Legislature and the administration with a resource that would help to guide them in the decisions that we will be required to make concerning the State's present and future debt policy.

I am pleased that the Chairman agreed to hold this hearing, and I certainly look forward to the input of the people with experience and expertise in this field.

Thank you, Mr. Chairman.

SENATOR BUBBA: Senator Cardinale?

SENATOR CARDINALE: Thank you, Mr. Chairman.

The Florio administration's apparent abuse of the bond process for political advantage demonstrates quite vividly the need for meaningful bond reform in New Jersey. It seems that with each passing week I read in the newspapers about another bond scandal emanating from the Governor's Office.

I was out campaigning on a Sunday, and I saw a headline in The Bergen Record about a bond scam. The following Sunday there was another headline in The Bergen Record, a front-page story about still another bond scandal. Last Thursday there was another article, a front-page story in The Bergen Record, another bond scandal. Just yesterday, there was still another front-page story in The Bergen Record, and still another bond scandal involving this administration.

It is embarrassing. It is embarrassing to have to say to people that we are part of this government. Something absolutely and definitively must be done to restore the confidence that people need to have in government, so that we can get about the business of the things that we must do in order to have this government work.

Certainly, bonding is something that we all know is part of the process. But when Randy Primas can be given a bond sales commission of \$100,000 without ever selling a single

bond, something is rotten. This series of bills is a beginning, only a beginning. I think we need to go further.

Mr. Chairman, I am very pleased to see that you have called this hearing, that we are dealing with these bills, that we will make that beginning, and that perhaps we can begin to restore some of the integrity that belongs in government. People were proud to be from New Jersey four years ago, and now we need to restore that pride, because we have become a scandal-ridden mockery.

I am not going to be repetitive of some of the things that you and Senator Inverso have already mentioned. I was going to mention some of those, but in the interest of time I will not make the rest of my remarks.

SENATOR BUBBA: Thank you very much, Senator Cardinale. Senator Schluter?

SENATOR SCHLUTER: Thank you. Very, very briefly, Senator Bubba, I want to commend you for calling this hearing. This is a very important subject.

It seems to me that there are two major themes that we will be addressing: One concerns overall debt management of the State, which is very, very important, dealing with our bond rating and so on. And the other is the process of underwriting and selling bonds to be sure that that is sanitized. Yes, they go together, but I think we are addressing them as the two main themes of this hearing.

I just want to make the point that this administration, perhaps, can be criticized justifiably on the processing of bond sales, but past administrations also could have been. We are not really saying that one is better than the other. We want to start here, and we want to be sure that the process from here on is good, sound, and without corruption.

Thank you.

SENATOR BUBBA: Thank you very much.

Mr. Bruce Coe. Bruce, you have the floor.

B R U C E G. C O E: Good morning, Mr. Chairman, members of the Committee.

Just by way of background, I once worked with Kidder Peabody, an investment banking firm. I was there for 20 years, the last 10 years as a member of the Executive Committee. I left in 1975. In '76, I came to be the first Executive Director of the Capital Budget and Planning Commission. The background of that Commission is not totally dissimilar to the reason for your meeting today.

Back then, Governor Byrne concluded that the voters had lost confidence in the capital budgeting and planning process. He created a distinguished Commission, led by then Chairman MacNaughton of Prudential, but including Dorothy Powers, head of the League of Women Voters, and really a blue-ribbon superior Commission. They concluded that the voters were right, in the sense that the State really didn't have any sort of a Capital Budgeting and Planning Commission. It was floundering; it was not well-thought-out; it needed changes. In fact, it was Bill Tremayne, who will speak next, who was the Executive Director of that so-called MacNaughton Commission back in '74 and '75.

So in '76, a permanent Commission was created at their recommendation. It had on it public members. It was clearly bipartisan. The two Republican legislative members were people named Ray Batemen and Tom Kean, both of whom attended every meeting and did an outstanding job.

I was with the Commission for two and a half years and it was fun, because the State really hadn't ever gone about thinking about, "Well, how do we prioritize our capital needs? How do we take a wish list and separate that into reality? How can we forecast time schedules of what can be done over the next three years, or the next seven years? How do we know the operating income and expenses associated with the capital expenditure," meaning that if we build that prison, or

whatever, what are the operating income and expense implications for the general State budget?

Subsequent to that, about a year and a half later, I became the Executive Director of the New Jersey Housing Finance Agency. We were selling an enormous number of bonds during that period from the middle of '79 to the end of '81. Cliff Goldman was the then State Treasurer. The way decisions were made on bond counsels, or bond firms, or what was to be done, were really made by us, with the concurrence of the Board of the Housing Finance Agency. I can remember specifically-- We, by the way, during that two and a half year period, sold in excess of \$1 billion worth of bonds -- that is a lot of bonds -- a number of issues, frequently two or three per year.

The decisions were primarily made by me and the State Treasurer. I remember in '79, or '80, when we added Salomon Brothers as a comanager. Salomon Brothers had done some unique pioneering, outstanding work, in the municipal finance housing field, and invented some new approaches towards funding housing bonds. They clearly were professionally qualified, and I made the recommendation to the State Treasurer, Cliff Goldman, who felt they were qualified, and the Board approved adding them to our comanaging group. This was not done on the basis of campaign contributions or things of that type. It was done purely on the basis of professionalism.

At the moment, I serve on the Board of the Transportation Trust Fund Authority. In fact, I have been on it since it was created, back in 1984. I can remember back when Mike Horn was State Treasurer and the question was: Who should be the lead managers for the issues of the Transportation Trust Fund Authority? He appointed several of us -- I was one -- whom he felt were qualified to make judgments. We received proposals from seven firms and, based on those recommendations, and based upon our recommendations,

which Mike Horn agreed with, the firm of Dillon Reed (phonetic spelling) was selected at that time, because they had clearly put together the best presentation.

I am just mentioning these things by way of background, because you are trying to probe for greater involvement in the capital budgeting and planning process, with some sort of, perhaps, limits on how many bonds can be sold. I think that part is easy. I think that could easily be done within the existing Capital Budgeting and Planning Commission. In fact, we really used to do it, because it is not hard to do. I mean, you are going to have, I think, Moody's and Fitch's testify here later -- Standard & Poor's and Fitch's. Moody's is the third firm that clearly you should talk to. Every State Treasurer has to talk to these firms. Clearly, preservation of bond quality and, in fact, the improvement of bond quality, is critically important to the State and the taxpayers.

It was back in 1977 that New Jersey regained its AAA bond rating from both Moody's and Standard & Poor's. If you have an AAA bond rating -- which we do not have today, although we are close-- If you have that, you are going to sell bonds at a lower interest cost than anybody else. Well, the criteria that go into how to measure that, how to quantify it, what preserves an AAA bond rating, are really the most critical things you are interested in. That is clearly something that can be accomplished.

The other part, which I understand relates to the selection of investment advisers, or managing underwriters, or bond counsels, is an area that the whole industry is in an uproar about. In fact, I do not have this morning's Bergen Record, Senator Cardinale, but I do have this morning's Star-Ledger, and the front page is about the head of the Securities and Exchange Commission, Arthur Levitt, Jr., disclosing bond firms "adopting a ban on political donations,"

both as firms and as individual members of firms. I think that is because the industry has been aware that nationally, and at local, county, and State levels, what has been going on has been going on for years and years and years. If you want to maintain your managerships, in many cases you are under enormous pressure to give campaign contributions. That is not something that is a product of the '90s or the '80s. That was going on in the '50s, '60s, and '70s, when I was on Wall Street.

We are all familiar with the selection of bond counsel firms. We are all familiar with people who leave government at some time, join a bond firm, join an underwriter, and seem to enjoy undue benefits from their former associations. That is just the way it has always been. You are trying to improve it from a credibility standpoint, and I think that is terribly important.

The reason that the Capital Needs Commission came into being -- and Bill Tremayne can speak to that in a moment -- is that the voters had lost confidence in government. They were voting no on every single general obligation bond issue in the late '60s and early '70s. It was frustrating to the State, which was trying to, you know, do things in a more intelligent manner, but the voters somehow were smarter than government. They were saying, "No, we don't believe it. We don't believe you need this transportation bond issue. You lied to us last time, and we are not going to vote for it this time."

The good news is that the Capital Needs Commission recreated credibility with voters. I remember in 1976, which was the first year we recommended three bond issues, I testified before a legislative committee that had to approve them. A couple of the Senators were saying, "Well, I will vote for them, but it is a waste of time, because the voters are going to vote these down." Well, they didn't. The voters voted all three up, as they did in '77, as they did in '78, as

they have done for all but one bond issue since then, since that moment in time. So credibility was restored.

The key question is how to do that now. I am not sure that you couldn't combine this. I don't have a specific recommendation here, but to me the qualifications that go into the decision-making process should include decisions made in public, like the Capital Budgeting and Planning Commission, which is subject to sunshine laws. It should include a highly professional staff, a very qualified staff. You have that with the staff running the State Pension Fund system today. In fact, you have had it there for a long period of time. So you need a similar, in my opinion, highly qualified, professional staff.

You also need a Commission composed of public members and legislative members as bipartisan, just like the Capital Budgeting and Planning Commission. I personally think that it might be possible to enlarge the entire scope of their work to achieve all of the goals you are talking about this morning. I would rather see you do it that way, than create some new entity that might make things kind of complicated and more difficult to achieve.

I applaud you for this effort. I think it really is important. I wish you well, and I thank you for having me this morning.

SENATOR BUBBA: Just a couple of questions, Bruce. Your comment on picking a lead manager, the process that the brokerage industry uses-- There is a special connotation, and I guess it can be spoken to by some of the representatives from the brokerage firms.

MR. COE: Right.

SENATOR BUBBA: There is a special connotation attached to the lead managing underwriter.

MR. COE: Yes.

SENATOR BUBBA: He makes more money, plainly and simply. When you went through your process to select an underwriting group-- Your comments were interesting. You said that Dillon Reed made the best presentation.

MR. COE: Right.

SENATOR BUBBA: I think the most important factor in any underwriting group is whether or not they can get rid of the bonds; whether or not they can sell the bonds. So whomever the firm is, the process is a factor of what the interest rate is, what we can make as a State, and secondly, whether or not they can place all the bonds. Those are the two key points, or two of the most important points.

On that basis then, why shouldn't we develop a process here by which we don't permit managing underwriters; say that everyone should share and share alike in the concession fee, in the underwriting fee, the commission? On that basis then, maybe we would get everybody involved, because we have no ax to grind. As a matter of fact, if I want to select a firm, I want to select a firm that is in New Jersey, as opposed to a firm that is in New York, or a firm that, you know, at least contributes to the economy in New Jersey.

Would you think that if we developed some method of saying, you know, underwriting costs should be shared equally, that we would end the competition, so to speak, and get everybody involved?

MR. COE: Yes. Well, an awful lot of bond issues are highly susceptible to competitive bidding, which is clearly the purest way for bonds to be sold. The problem with what you are suggesting, though, whether you are selecting a financial adviser and, for good reasons -- and there are occasionally good reasons when a bond sale should be negotiated, as opposed to competitive bid-- What you are really saying is, "Let's go out on the football field and each of the 11 of us can call signals." That is my analogy. You really cannot work that way.

In other words, Dillon Reed -- this is not a commercial for Dillon Reed, every firm has different strengths -- is extraordinarily strong in their knowledge and their professionalism in transportation funding issues. They have a strong infrastructure of people. They have had enormous experience. Other firms are very strong in selling bonds, and I am not here to give breakdowns of underwriting spreads. But Merrill Lynch built its underwriting prowess primarily because they were great at selling bonds.

SENATOR BUBBA: Right. Let's stay on that point for a minute. Dillon Reed -- and I do not know Dillon Reed from the man in the moon; I mean, I have never met any of their people, and I have never been in their office-- So what that Dillon Reed was extraordinarily strong in transportation financing. What does that matter to us? What matters to us is the interest rate we pay and the fee that is charged. Isn't that correct--

MR. COE: Absolutely.

SENATOR BUBBA: --or am I oversimplifying?

MR. COE: No, absolutely. But I thought you were suggesting sharing the fee equally amongst every firm that sells a bond.

SENATOR BUBBA: See, it is my understanding that-- As we are talking, I am being led away from-- There should be somebody in charge. I see what you mean there. Maybe they shouldn't make as much as they are making now. Maybe we ought to split that fee a little bit.

Still, the factors involved in bonding are, can they get rid of the bonds, what is the interest rate, basically--

MR. COE: No question about that.

SENATOR BUBBA: --and whether or not they can do the paperwork, and I presume everybody can do the paperwork.

I heard what you said about the public voting on bond issues. I don't know that that had so much to do with

contributions being received by the various people or parties, as much as it had to do with the economy. I think that is what caused a lot of the bond issues to go down.

You commented on voter confidence in, I believe, a \$900 million refinancing with no vote. What do you feel the people think about that?

MR. COE: I think that what you are seeing in the papers everyday now is the public saying, "I don't really trust politicians." There is a lack of credibility with the voters. I think it is important that government regain that credibility. You know, I think the process you are going through is going to be a key part of it. I mean, I am not saying anything that everybody in this room doesn't already know. The voters today are not-- I think they are of a similar mood. I remember as a commuter voting no on transportation bond issues, because I had been lied to eight years earlier; lied to in the sense of a wonderful train pulling into Red Bank. It had shiny new cars, and we were told how this was going to be there for us to commute on in a short period of time. That was all a pipe dream. It had no reality whatsoever.

So voters, I think, clearly are of a mood where they would like the process cleansed.

SENATOR BUBBA: May I hear your comment about refinancing \$900 million without a vote?

MR. COE: We just refinanced some Transportation Trust Fund Authority bonds within the last two weeks. We did them using Dillon Reed as a financial adviser. It was done with competitive bidding. It had to be done fairly quickly, we felt, because the market was ripe for a significant interest rate savings of \$4 billion. It was done at very low cost. The true interest rate is 3.63 percent for 10-year bonds, amortized over 10 years.

The trend of the refinancings that were-- One was rushed through by the Kean administration. I have forgotten the year, but it was rushed through because the Federal government's arbitrage rules were about to change. In other words, if you got it done by December 31, you could keep all of the positive arbitrage associated with that bond issue -- which was enormous, by the way. It was the difference between what the tax-exempt bonds cost and what the moneys could be invested in. That is why that was a "rushed through" bond sale.

Several refinancings have occurred since then. I do not have specific knowledge of any.

SENATOR BUBBA: But still, I think what you are saying, at least what I am hearing, is that there should be competitive bidding. The voters should get involved. There was a loss of voter confidence. However, when the marketplace demands, we have to act without the voters.

MR. COE: There should be competitive bidding, unless there is a strong presentation that for reasons unique to the market at that moment in time, or unique to that particular issuance -- for a really good, understandable reason we can understand, it should be negotiated. Otherwise, it should be a competitive bid.

SENATOR BUBBA: All right, thank you.

Does anyone else have any questions?

SENATOR INVERSO: Yes, I have a few.

Bruce, thanks for coming out today and sharing with us your insight into what needs to be done with the State Capital Budgeting and Planning Commission.

With regard to enhancing its staff and the resources to do its job, when you were involved with the Commission, could you give me generally the number of staff and the confidence level in the staff they had, so that going forward we can take a look at what needs to be done to provide for what appears to be an omission now?

MR. COE: When I got there a younger man named Rich Keevey, then with the State Budget Office, became the key staff person with me, and Rich and I really kind of charted how to organize it, how to put it together, and how it ought to operate. I think we were both very well-qualified to do that. He then had an enormous knowledge of State budget matters, and he also had a significant staff, of whom three or four worked with him, as well as with me on capital budgeting and planning needs. I think we were well-qualified to do that.

The staff we had at the Commission at that time really consisted of me, a Deputy Executive Director, who was well-qualified, and two secretaries, who were very well-qualified. We really had a very small staff, but at the same time, it is not a huge job. I mean, it is an important job and it takes knowledge, but it is not one that requires a huge staff. If you were to take it one step further, I still don't think it would require a large staff. I think the same number of people could take care of all the things you are talking about today.

SENATOR INVERSO: With regard to the syndication of bonds, I believe the syndicate approach to lead manager is the way it is done in the private sector. I don't see any reason why it would have to change here in the public arena. But what does cause me concern is, there is no role for the State, is there, in determining who the other members of the syndicate are? Is that true? The manager generally pulls together the syndicate and proceeds with the--

MR. COE: On a negotiated deal, the manager will put together the underwriting syndicate, but the issuer, namely the State, has strong abilities to suggest whom they would like to be comanagers, and whom they would like to participate as underwriters in the group. The State can go out of its way to do that, and has in the past.

SENATOR INVERSO: Does that change from issuance to issuance, or is that something that is consistently on the table from the State's involvement in these?

MR. COE: Well, the competitive bid side is not put together at all by the State. That is merely a function of firms. But, yes, it can change, and it has changed over the years. The State obviously has to play monitor. It cannot have stray issuers coming to market all in the same day. So it has to kind of put together who is scheduled to sell bonds when, so that they move orderly through Wall Street without conflicting with each other.

At the same time, the State has an enormous ability to decide that they would like XYZ firm to be the lead manager, but the following three other firms, for the following reasons, to be comanagers. A Commission, or an advisory group such as you are talking about, could similarly, if they were qualified, come up with recommendations of that type.

SENATOR INVERSO: With regard to the refinancing, my perspective is that I have no trouble when a refinancing involves going from a high to a low interest rate. The difficulty I have, I think, is what Senator Bubba was alluding to; that is, when you have additional debt that you are issuing as part of that process. That troubled me, and I voted against that.

But high to low, you have to take advantage of that, which is the question of expanding your debt mode without having it go through the process of taxpayer approval, which is what troubled me in this past refinancing in the State.

MR. COE: Are you speaking of the relatively recent one, a couple of years ago, the \$1.6 billion, or thereabouts?

SENATOR INVERSO: No, I am talking about the one we did last year, this past year -- this past year.

MR. COE: Yes, one of which we rolled in three years' worth of debt service into the proceeds of the bond sale.

SENATOR INVERSO: Yes. In essence, we funded it; we funded it by borrowing our debt service for the next three years.

MR. COE: Techniques that Moody's and Standard & Poor's do not welcome, yes. I think refinancings, as well as new issuances, should be reviewed by the Commission as well.

SENATOR BUBBA: Senator Cardinale?

SENATOR CARDINALE: Thank you, Mr. Chairman.

SENATOR BUBBA: Senator Cardinale, may I just interrupt you for one moment?

SENATOR CARDINALE: Surely.

SENATOR BUBBA: Bruce, could we -- I am asking your permission, Senator Cardinale's, and the rest of this Committee's permission-- If you say no, then we continue. But we have a gentleman, Hyman Grossman, from Standard & Poor's, who told our staff that he had to leave by 11:00. No one told me, or else we would have rescheduled. Can you just hang in for a minute--

MR. COE: Yes.

SENATOR BUBBA: --and let Hyman speak, because I think what he has to say is probably important. Then we will go back to the questioning. Bruce, we don't like to leave you off the hook so you can think about answers. We would rather have--

Hyman Grossman, can you come forward, please?

H Y M A N C. G R O S S M A N: Thank you. I appreciate it. I do have a long-standing commitment in Pennsylvania, and I can't break it.

We are pleased to be here this morning, Mr. Chairman and members of the Committee, concerning the State's overall debt issuance process. We received a memo from you last week concerning the overall scope of what you are interested in, so I will address that briefly.

You have already referred to the observation that the Legislature has no systematic profile for reviewing the State's

overall debt situation, or planning for the State's capital needs. In addition, the State Legislature has not been actively involved in the overall process of debt management, planning, and procedures, especially in getting issues of Treasury and other State entities to the financial markets. You feel the Legislature, at this juncture, has not met its responsibilities for its ultimate oversight of State activities.

I think we can strengthen the Commission on Capital Budgeting and Planning. This is a Commission that has been in place for a number of years; frankly, since the administration of Governor Byrne. That was the last time I am aware that we got regular, annual reports and updates concerning the Commission's activities. In the last few years, we have not received those on a regular basis. The impression out there is that the Commission, as such, really, today anyway, isn't doing that much work which is of any significance.

Clearly, the State needs to get an overall view of its capital needs and financing those capital needs on a regular basis. We think you can strengthen the Commission, assuring bipartisan, nonpartisan input, both from the executive branch and the Legislature, and strengthen it with staff people. I think you can pattern it along the lines of the Office of Legislative Services, which I think is a very fine part of State government and does a good job.

I remind you that in testimony before the Joint Budget Oversight Committee last December 7, alluding to the same financing the Senate had alluded to -- that \$900 million piece of the refunding-- Well, the State was going to do part of capital needs through that refunding, without a vote of the people, as you say. The Treasurer -- and I quote from the transcript at that point -- said he had no special "capital appropriation effectively in the 1993 budget." He was answering Senator Lynch's question at that time. He said, "We

really haven't had what I would call a capital program in about four years, of any measure, of any size to meet any needs."

With the budget getting tighter and tighter, the budget that finally was approved by the Legislature had less and less current revenues going to capital projects. That is what I think the Treasurer had in mind, saying, "We are out of money for capital projects, and we need to find some."

It is time, I think, to bring all debt having a burden on general State appropriations under one umbrella. By that I mean, not only the State Treasury that issues general obligation bonds, but your lease revenue bonds that are out there in large measure: the State Building Authority; the Sports Authority now that has arrangements with the State Treasury by contract to have money in the annual budget to support its debt directly; the Transportation Trust Fund, which, while it is self-liquidating from dedicated revenues, there is not enough money, as you saw in the last budget-- You pulled about \$300 million out of those resources to help balance the '93-'94 budget. So that has to come into the picture, too, as well as those Economic Recovery bonds that were issued earlier in the year through the Economic Development Authority.

Only by bringing together annual debt service requirements for these many debt issuing entities can you develop an appropriate measure for debt capacity and affordability. It is not only capacity that you ought to measure, the legal capacity, but affordability. You need to develop a system for saying, "So much is affordable, and so much is not."

Maryland and Georgia are two states, I think, that you can look to, which quickly come to mind when looking for better oversight of all State-related entities. I know Maryland does an annual report on affordability, which I think you can look to.

The other part of your discussion involves the debt issuing mechanism. The Texas Bond Review Board, which I think some of the pending legislation is patterned after, gets into the formal needs and approval process of all State-related debt issuance, including the reasonableness, I may say, of professional fees. The Texas Bond Review Board has a say in reasonableness in that area.

In New York, there is something called the "Public Authorities Control Board," which oversees a debt issuance calendar primarily, so that the State of New York is not overwhelming the bond market in terms of supply at any point in time.

Clearly, the New Jersey Legislature and the Capital Budgeting and Planning Commission can work effectively to achieve the necessary oversight.

As I mentioned, in a 1988 hearing by the Assembly Public Authorities Committee, chaired by Assemblyman Pat Schuber back then-- I think these agencies ought to come to the Legislature on an annual basis and report what they have done during the past year, and what they would like to do in the coming year in terms of projects, in terms of costs, in terms of borrowing plans. That way the Legislature, representing the people, can get involved in the process.

In terms of the other aspect of what you are looking at, campaign contributions, I think New Jersey can follow the example of Florida of almost three years ago. An Executive Order from Governor Chiles, then followed by legislation, prohibited anyone doing business with any state agency from making any political contributions to, or on behalf of any statewide official. I think you can look to that.

As you saw the other day, and it is in today's newspapers, the leading underwriters in the municipal industry are now voluntarily agreeing not to do any more campaign contributions. But I think that needs to be on the other side,

the government side, which ought to be prohibited from soliciting. There are always two sides to that equation. I think this alone would solve 95 percent of any recently perceived problems out there.

Strengthening legislative oversight and making the public aware of all the State's debt-like commitments will make for better budgetary decisions having long-term financial implications.

Mr. Chairman, I have a couple of minutes to answer any questions.

SENATOR BUBBA: Senator Inverso, and then Senator Cardinale.

SENATOR INVERSO: Mr. Grossman, thank you for coming out. I know how busy you are, and I appreciate your input.

I find it incredible that you were given a response that the report of the Commission was either unavailable, incomplete, or not worth the bother. That's incredible. Your agency, along with the other agencies, should have access to all information, any information that you need to make a reasonable assessment of the State's financial picture. I can't believe that.

MR. GROSSMAN: We should get that.

SENATOR INVERSO: Your request was made to whom, Mr. Grossman?

MR. GROSSMAN: Well, in the Treasury. I can't remember exactly who.

SENATOR INVERSO: In the Treasurer's Office. Okay, I will refer to the Treasury. Thank you.

SENATOR BUBBA: Senator Cardinale?

SENATOR CARDINALE: Could you explain to me -- I really don't know an awful lot about bond sales -- why we have pool commissions; why a portion of the commissions are set aside and we have pool commissions?

MR. GROSSMAN: Frankly, I am not familiar with that side of the market, Senator. You know, I am involved in evaluating the credit that gets to the market. You're talking about the process that is involved before you get to the market, preparing the bond financing to reach the market. I am not familiar with that aspect of it.

SENATOR CARDINALE: Thank you.

SENATOR BUBBA: Senator Schluter?

SENATOR SCHLUTER: Thank you, Mr. Chairman.

A brief question: Senator Bubba asked the previous witness about the desirability of the State issuing bonds and indebtedness that has not been approved by public referendum, as last year in the refinancing. I am not talking about the Highway Trust Fund, which supposedly takes care of itself internally.

We have proposed constitutional amendments which would change our Constitution to prohibit any additional debt incurred by the State through this bond refinancing, or whatever, without public -- without the approval of the voters. Would this, in your opinion, be good for our credit rating, or would it not?

MR. GROSSMAN: My personal opinion is that the more you get the public involved in the debt issuing process the better. I think people ought to have a voice in bond issues, particularly those that impact the tax structure. If you are dealing with a toll road situation, for example, that is going to be supported by those who use the facility, then perhaps you need not go to a public referendum on that. But there ought to be public input in terms of hearings before you get to the financing.

SENATOR SCHLUTER: I am not talking about the Turnpike, the tolls, but Senator Inverso before referred to the refinancing which involved, I think, \$87 million of debt

service without any income, starting in 1996, for something like 13 years. The public hasn't had a word to say about that.

MR. GROSSMAN: Well, frankly, that was part of a-- Let's be open and candid about that whole process.

SENATOR SCHLUTER: Oh, sure.

MR. GROSSMAN: That was part of a budget-balancing relief measure, as well as capital needs, as well as a portion of it went to building up reserve funds -- the Rainy Day Fund, and so forth. So the administration, you know, led that, but the Joint Budget Oversight Committee approved that whole financing package. I don't want to get involved with who was there first or second, but that did involve the legislative Committee responsible for that.

SENATOR SCHLUTER: Thank you.

SENATOR BUBBA: Mr. Grossman, I was about to say that we didn't have time to let you speak, because, you know, I like to adhere to a schedule. I am happy that we made time for you. I think your--

MR. GROSSMAN: So am I. I appreciate the other people moving their scheduling.

SENATOR BUBBA: --remarks are very germane. To acknowledge publicly, to allow the general public to have insight into how we develop our bond rating, I think is important. If this is reported tomorrow, and if people read it-- I think if they do that, they will get a better sense of what we should and should not be doing here.

We have found in the past that-- You know, I smiled when you talked about the Oversight Committee and how there were other people involved. Sometimes we in the Legislature -- and some of us did not vote for the refinancing issue-- Some of us in the Legislature sometimes think that we are getting things past people, when it is people like you who come here and let us know that it just doesn't get past anybody; that

there are people who do recognize and watch, from a financial point of view, what we are doing.

MR. GROSSMAN: Frankly, on that point affecting the State's bond rating -- if I may take 10 seconds -- we were not very happy with that whole proposal back in December. And frankly, if there wasn't a significant amount of money for legitimate capital projects and building a Rainy Day Fund, and so forth, if this went entirely, or substantially for budget relief measures, the State's rating would have gone down further at that point.

SENATOR BUBBA: You know, from time to time-- I can recall this, and I know there are other legislators here who have been around for a considerable length of time. There have been a number of issues that have come up, and we really do not have the expertise to make solid judgments based on financial footings.

It would be helpful if we could address Standard & Poor's or the other rating groups and ask questions on how something--

MR. GROSSMAN: You are welcome to do that.

SENATOR BUBBA: For example, I recall last year we voted to allow the Sports Authority to-- We, in effect, I guess, underwrite now the Sports Authority bonding, whereas we did not do that before. I was always uncomfortable with that, but I didn't know the effect that would have on, number one, our bond rating, and number two, our ability to borrow in the future, you know, what that meant to us.

On that basis, we should have some way to develop that information. I see you nodding your head, so maybe we can address those questions to you at some time in the future, if these things occur. I appreciate your coming.

Are there any other questions? (no response)

Thank you very much, and I hope you make your--

MR. GROSSMAN: Staff is welcome to contact us on any question.

SENATOR BUBBA: Thank you.

Bruce, could you come back up, please? And Mr. Tremayne, I want to personally thank you for allowing that discussion. Could you step forward, please? Maybe you can make your remarks, and then we can proceed with the questioning of both of you, since both of you are addressing principally the same realm.

W I L L I A M H. T R E M A Y N E: Than you, Mr. Chairman. It is a pleasure to be here.

Bruce indicated that the Governor was not satisfied with the capital process in 1973 and 1974. I think it was for good reason, there was no process. There was no established way of determining what the structure ought to be, where we were going, what directions we ought to take.

In 1968, there were a number of bond issues which had followed an earlier Capital Needs Commission. It had issued its report in 1968. A lot of bond issues were put up. I forget the amount, but it was significant at that time. The voters passed them and, with the exception of the Department of Higher Education, most of the executive departments got the authority to go ahead, but they did no planning. One of the reasons we had a lack of transportation facilities, as Bruce was mentioning, was that no one put a priority on spending the money that the voters had approved. Inflation was moving on, and by the time the moneys were allocated, a lot less was obtained than was anticipated when the bond issues were put forward.

The approximate cause was the failure in 1973 of a particular bond issue. I think there were several of them, but one was for schools for handicapped children. There was a lot of astonishment that such a bond issue would not readily pass. What was very interesting about that bond issue was that there

were no hearings. The bill for the bonds was put up by a legislator who was very interested in the process. The Department of Education had not participated in the process. They had absolutely no planning or no way of determining how the moneys were going to be spent. In that case, I would agree with Bruce that the voters exercised good wisdom in not passing something that wasn't well-planned.

At that time, I was President of the New Jersey Taxpayers Association, which you may know now as the Public Affairs Research Institute of New Jersey. In a meeting with Governor Byrne and then Treasurer Leone, we were very critical of the capital planning process, which had been one of our high priorities. Governor Byrne asked the Treasurer if our observations of having no process were correct. He concurred. The following week -- I was at that time a junior officer with Prudential -- the Chairman, Don MacNaughton, called me to his office, and said, "I hear you have been talking to the Governor." I allowed as much, and he said, "Well, he has asked me to be Chairman of the Governor's Commission to Evaluate the Capital Needs of New Jersey. Are you ready to put up or shut up?" I said, "What do you mean?" and he said, "I will take it if you head it as Executive Director," which is how I got myself in that spot.

But at any rate, we recommended, as did the 1968 Commission, a number of areas where capital funds were required, but we made one very overriding observation; that is, it is no good to develop these plans if you don't have a process, if you don't have cohesion, if you don't have oversight. It was for that reason that I drafted the provision for what is now the Capital Planning and Budgeting Commission. To me, that was the cornerstone of that report, that there would never again be a temporary Commission; that we would have one in place that would provide the oversight.

It is my general observation -- I have not stayed close to it -- that Mr. Grossman is correct that after a jump start, a lot of it due to Bruce's leadership, less attention has been paid to the Commission than should be. I was not aware of the reports not having been given. I am not quite sure of the frequency with which the meetings are now held. But it seems to me that the mechanism is in place to reenergize and extend the charge of that Commission, to provide many of the ends which you desire in the outline that the Chairman described.

It seems to me that it is not necessary to create a new entity to accomplish some of these things, but really to reenergize and develop interest in the existing Commission. It already has the representation of Majority and Minority members from each body of the Legislature on it. It has the executive department involved. I think that expanding it to be a larger and more responsible entity would give it a greater ability to do the analysis and not have two different, very small entities with diverse obligations. So I would suggest to you that you consider, if you do create such an entity, making it a function of the Capital Planning and Budgeting Commission.

The other question is how to address the issuance process. I am not particularly expert in that, but I would suggest to you that one of the best ways in our democracy to get the right answers is to have early dissemination of information, early notice. I would think that perhaps a process by which the State and various authorities give early notice to the Commission as to the process they are going to be following in bond issues, with perhaps much greater disclosure in the case of proposed negotiated issues, as compared to bid issues, would be a way to do that without building up an overwhelming bureaucracy that is grinding numbers, rather than doing analysis.

It seems to me that if you have a reenergized Commission, what you need is for it to have regular meetings and to have the right kind of information available to raise questions when the flags are there. But I would agree with the prior speakers that the complexities of it are such that I don't think you could have one super agency going through every detail before a bond issue is approved.

SENATOR BUBBA: Thank you, Mr. Tremayne.

Senator Cardinale, will you pick up the questioning? Thank you for your patience before.

SENATOR CARDINALE: I am interested in the subject of the pool commissions.

SENATOR SCHLUTER: Yes.

MR. TREMAYNE: I'm sorry, I cannot hear you, Senator.

SENATOR BUBBA: I'm sorry, I didn't hear you either.

SENATOR CARDINALE: I am interested in the subject of the pool commissions. I am curious why this kind of a structure exists, what purpose it serves.

MR. TREMAYNE: If I may, Senator, I am not a specialist in that industry. I never heard the words "pool commissions" before, if it was raised at this meeting.

SENATOR CARDINALE: Well, I understand that pool commissions, a certain portion of the commissions -- 10 percent, I think, in some of the cases that have been before us -- are put aside, and then divided on some sort of arbitrary basis, by whom we have not been able to really determine. But could we sell bonds if we outlawed pool commissions?

MR. TREMAYNE: I don't know. It certainly--

SENATOR BUBBA: Senator Cardinale, we are going to have representatives from the industry itself. I think they could better answer that question.

SENATOR CARDINALE: But Bruce has had wide experience in New Jersey, which he testified to. Is this pool commission

arrangement something that was common in other dealings going back in history, or do you know?

MR. COE: I don't know. I would defer to the subsequent representatives.

SENATOR CARDINALE: Okay, then we will--

SENATOR BUBBA: I think he is talking about the underwriting concession, where there is a portion of the underwriting concession that is kept for the managing underwriter and several of his friends, or the lead underwriters. I think that is what you are referring to as a "pool," a portion.

SENATOR CARDINALE: That is correct. That is what I am--

MR. COE: The management fee?

SENATOR BUBBA: Yes, yes. But let's ask that question of the industry experts.

Are there any other questions from any of the Senators? Senator Schluter?

SENATOR SCHLUTER: Thank you.

For both of you, and I think Bruce started in on this, on the Capital Needs Commission, are there legislative representatives now? (Mr. Coe nods affirmatively) How many? Is there one from each House?

MR. COE: I believe there are four, two from each party.

MR. TREMAYNE: Two from each party from each House.

MR. COE: From each House, right.

MR. TREMAYNE: I'm sorry, one from each party from each House.

SENATOR SCHLUTER: Do you believe that should be increased in any way to get legislative involvement, or are four sufficient?

MR. COE: The Commission has not been--

SENATOR SCHLUTER: How many members on the Commission?

MR. COE: --for many years, what it once was. It was kind of new and everybody went to all the meetings. We met frequently, and it was really clicking. Somehow it got lost, or at least it is diminished. I don't think the number of legislators is critical, I mean, whether it is four, six, or eight. I think their involvement, attendance, and participation are critical.

MR. TREMAYNE: If they are interested and if they show up and participate, I think you can achieve the ends you desire. If you had 15 and they didn't show up and didn't participate, you would not get what you want. It is really a question of are they interested, will they attend, and will they conduct their meetings.

SENATOR SCHLUTER: In your judgment, should they be serving on the Appropriations Committee or have some connection? Would that be an advantage?

MR. TREMAYNE: It was our original recommendation in the Capital Needs Report that there be the Chairman and the ranking Minority member of the Appropriations Committee. I believe the legislation omitted that recommendation and left it up to the Speaker and the President of the Senate to do it as they chose.

SENATOR SCHLUTER: But I take it from the testimony of both of you that you would, rather than another agency or entity -- you would favor revitalizing the Capital Needs Commission to provide better bond profiles for the Legislature, to give us more input on policy matters.

MR. TREMAYNE: Absolutely.

SENATOR SCHLUTER: My final question: Would the Capital Needs Commission also advise the Governor and the Legislature with respect to the marketing of bonds, whether they should be negotiated, whether they should be competitively bid, or would there be any direction from the Committee on that matter? Should there be? Would you recommend that there be?

MR. TREMAYNE: I would tend to say that the issuing entity, because you may have authorities or others, ought to give adequate-- There ought to be some time period in which they gave advance notice of their intention and the reasons why they were pursuing the course they were, so that the Commission would have ample opportunity to raise questions they might have. But I would not put the machinery in their hands to conduct it.

SENATOR SCHLUTER: I have one final question, Mr. Chairman, on a slightly different--

MR. TREMAYNE: Bruce, do you--

MR. COE: The Commission, you recall, has four members of the executive branch, including the Attorney General and the State Treasurer, so I would think that with the right professional staff, plus the State Treasurer, you are going to have all the professional qualifications there to apprise the Legislature, yes.

SENATOR SCHLUTER: I asked this question of Mr. Grossman. Would each of you, individually, care to comment on a proposed change in our Constitution which would limit the issuance of bonded indebtedness to any kind of a matter which had been subject -- which had to be subject to referendum of the public, as it is proposed by a couple of amendments? I don't mean with the Turnpike Authority; I don't mean with the Highway Trust Fund. I mean in the bond refinancing which took place last December, the fact that \$900 million went -- was issued, was committed for without any public vote.

MR. TREMAYNE: If I understand correctly, it was to obtain a lower rate. It was not the issuance of new debt.

SENATOR BUBBA: No, I think you are wrong there, Mr. Tremayne. I think there was new debt there. I think the new debt was about \$400 million.

MR. TREMAYNE: All right. I would have said to the extent that there is new debt, it should have voter approval.

To the extent that it is just recycling existing debt, I would not see a need for it.

SENATOR BUBBA: Thank you. Any other--

MR. COE: I think there was a loophole in the legislation that permitted the refunding, which is something which really should never have taken place. Governors and Legislatures for years have been trying to gradually figure out how to issue something that looks like long-term debt, smells like long-term debt, but the voters do not vote on it. You know, can we do that through long-term leasing, through some new Building Authority? For those of you who go back, courts used to rule, "No, that is long-term debt, and you can't do it that way." But then they switched. So we have now built up-- So that is a continuing desire of Governors and Legislatures, to not want voters to vote on long-term debt.

SENATOR BUBBA: And to get short-term expenses paid by long-term debt.

MR. COE: Right, but that refinancing was one that should never have been legally permitted, in my-- I am not a lawyer, but I think that was wrong.

SENATOR SCHLUTER: So you would be in favor of revising our Constitution to prevent it?

MR. COE: Well, if you want to revise the Constitution to really get a long-term debt, you should really analyze it just the way Moody's and Standard & Poor's do, and I defer to them. I think they capitalize long-term leases into long-term debt computations as well. So if you really want to purify it so that you would get the voters to vote on selling mortgages, taking a mortgage on a house, then you should really purify the whole thing, yes.

SENATOR BUBBA: All right. I am going to end the questioning now, with a thank you to Mr. Coe and Mr. Tremayne.

I am going to ask Group 1 to come up to the microphone. That would be: Gerald McBride, Chairman,

Municipal Securities Division of the Public Securities Association; William Cobbs, Chairman, Public Resources Advisory Group; William O'Connell, Assistant Director, National Association of Securities Dealers, New York. Could I ask you, please, to come up to the microphone together?

W I L L I A M C O B B S: I don't have any relationship to any of these people. I am with Public Resources, but I have nothing to do with PSA or any of these people.

SENATOR BUBBA: You don't even like them, right? Okay, you can sit down.

MR. COBBS: No, I don't. They are securities dealers and we are independent. Don't think that we are affiliated. I'm sorry, we stress our independence from the securities dealers.

SENATOR BUBBA: I think you have made your point. Would you like to sit down? (witness complies)

W I L L I A M O ' C O N N E L L: Although we are not affiliated, I like Gerry.

MR. COBBS: (speaking from audience) Oh, I like Mr. McBride quite a lot.

SENATOR BUBBA: Can we begin with Mr. McBride?

G E R A L D P. M C B R I D E: Good morning, Mr. Chairman; good morning, members of the Committee.

I have a prepared statement which I would like to go through, which was at the request of Mr. Callahan that we go through the explanation of what the process of the broker/dealer community is -- what it does in reference to the negotiated and competitive issues.

My name is Gerry McBride. I am Executive Vice President of Prudential Securities, Manager of the Tax-Exempt Division, but I appear before you this morning as the Chairman of the Municipal Securities Division of the PSA.

The PSA, or the Public Securities Association, is the international trade organization of banks and security firms

that underwrite and trade municipal securities, U.S. government securities, and agencies, mortgage, and other asset-backed securities and money-market instruments. PSA firms -- member firms -- account for about 95 percent of the nation's municipal securities activity.

As you are aware, municipal securities are one of the safest investment vehicles available to investors. Recent allegations related to political influence in transactions, however, particularly here in the State of New Jersey, may have cast doubt upon the integrity of the market. My testimony this morning will focus on negotiated and competitive bond sales, as was requested, and the role of political contributions made by market participants to State and local political candidates. My written statement addresses these issues in much greater detail than time allows here, and I ask that my written remarks be included in the record of today's hearing, Mr. Chairman.

Municipal securities' offerings are typically sold through either a competitive or a negotiated bidding process. The choice of either type of sale is dependent on a variety of factors, including: credit considerations, issue of preference, and market conditions. Competitive bond sales are typically used for more traditional offerings of municipal securities, such as general obligations. The issuer will typically work with a financial adviser to determine the structure and timing of the bond sale. The offering is then advertised in financial publications in order to notify municipal dealers of the terms of the offering, including information relating to structure, time, date, when the bidding will occur, and other details which are pertinent to the offering.

Municipal dealers will arrange at that time for syndicates to bid on the issue. On the date of sale, the syndicate bidding for the bonds will estimate the interest rates necessary to sell the bonds to investors, and will then

submit bids to the issuer or its agents according to the parameters. The syndicate offering to purchase the bonds at the lowest yield -- or highest price -- is named the winning bidder, and upon approval by the issuer is awarded the bonds. The syndicate then offers the bonds to their customer accounts at established reoffering yields.

Negotiated sales, on the other hand, are typically used for bond offerings which entail complicated financial planning and project management considerations, such as refunding or revenue bond issues, which are what were discussed earlier. The issuer will distribute a Request for Proposal -- known as an RFP -- solicitation, which basically asks underwriters to submit their qualifications and credentials. The issuer then reviews the RFP responses and selects a senior manager and management team for the transaction.

The senior manager works with the issuer in order to structure the financing plan for the bond sale. The underwriter provides a wide variety of services in conjunction with the sale, including: premarketing efforts, investor relation meetings, credit agency presentations, interfacing with the financial adviser, if there is a financial adviser, and other related marketing services. The manager will also advise the issuer on when the bonds should be offered for sale in order to take advantage of optimal market interest rate conditions.

On the sale date, the senior manager on the transaction will price the deal and seek orders from interested investors. After demand for the bonds is evaluated, the manager may change the structure and/or size of the deal in order to meet investor demand dictated by market parameters. The manager then sets the final terms of the offering and purchases the bonds from the issuer. The manager also provides a number of post sale services for the issuer, such as

secondary market-making activities and advice for long-term capital projects.

The "spread," which is one of the most misunderstood aspects of the municipal bond underwriting business, refers to the amount of money that the underwriting firms work for. The gross underwriting spread is simply the difference between the offering price to the public by the underwriter and the purchase price the underwriter pays to the issuer. This spread includes all expenses incurred by the dealer in bringing the bonds to market, as well as any profits earned on the issue.

Average underwriting spreads in the municipal market have declined substantially since the early '80s. Even though new issuance of municipal securities has increased steadily, increased competition among underwriters has caused spreads to remain subject to downward pressure.

Gross spreads of both negotiated and competitive issues have experienced declines since the early '80s. This trend has been especially pronounced for negotiated issues. In this category, gross spreads have fallen from \$17.31 per \$1000 in 1985 to \$9.35 in 1992. That represents a 46 percent decline in gross spreads. The spread for competitive issues, meanwhile, has dropped from \$10.79 per \$1000 in 1985 to \$8.99 in 1992, a 16.6 percent drop. As with spreads on negotiated issues, spreads on competitive issues have continued to narrow through 1993.

The bottom line is that whether looking at competitive or negotiated municipal issues, the gross spread represents less than 1 percent, a very reasonable rate for issuers of municipal securities.

It is important to note that negotiated sales are very "competitive." As I previously noted, underwriters compete vigorously for senior manager slots. PSA believes that the elimination of negotiated sales as an alternative may ultimately increase financing costs for issuers.

Considerable attention has also been focused in recent months on the issue of political contributions to State and local candidates, and the role such contributions play in the decisions regarding firms that are selected to participate in municipal bond offerings. There is a widespread consensus among PSA's membership that the current practice, where in some instances contributions essentially represent a fee to enter legitimate competition for business -- what has become known as "pay to play" -- must end, and hopefully has ended with what has happened in the last two weeks in the industry.

We commend the Municipal Securities' Rule-Making Board for its attempt, through its proposed Rule G-37, to address the issue. Until a final regulatory policy with regard to political contributions is established, however, PSA has recommended to its members a voluntary moratorium. Industry response to PSA's recommendation has been quite positive. Consequently, we call on groups representing participants in a public finance process to recommend a similar moratorium to their members. We also ask that the issuers install a moratorium until the rules have been established.

That is the end of my comments, Mr. Chairman.

SENATOR BUBBA: Mr. McBride, you set me back on my heels initially with your opening remarks. For the record, do you know me?

MR. McBRIDE: No.

SENATOR BUBBA: And I do not know you. I also work for Prudential Securities. I was just employed by them recently, and I do not want anyone to think that you are here as a result of that. I never knew you worked for Prudential.

On that basis, I would rather excuse myself from questioning this group, and I would ask my Vice-Chairman to question the group.

MR. McBRIDE: That's fine.

SENATOR INVERSO: You haven't earned a commission yet, have you, Joe.

SENATOR BUBBA: No.

SENATOR INVERSO: Well, in that case, you're unbiased.

Mr. O'Connell?

MR. O'CONNELL: Yes?

SENATOR INVERSO: Do you have any comments you care to make at this point, or would you like us to proceed with the questioning of Mr. McBride?

MR. O'CONNELL: Whichever way you prefer.

SENATOR INVERSO: Okay. Yes, Senator Cardinale?

SENATOR CARDINALE: Are you the appropriate person to discuss this pool commission aspect of what has gone on in New Jersey? You are familiar with the pool--

MR. McBRIDE: I don't know if I am the appropriate person--

SENATOR CARDINALE: You know something about it?

MR. McBRIDE: --but I am familiar with what you are talking about, yes, sir.

SENATOR CARDINALE: Okay. Is this a common practice in the industry? Is this something that is standard and is always done?

MR. McBRIDE: It is not a common practice in the industry; it is not something that is always done. I think there needs to be some more elaboration on the question you asked, Senator, so that there can be some more--

SENATOR CARDINALE: All right. Here is my concern.

MR. McBRIDE: Right.

SENATOR CARDINALE: The industry itself is taking steps and, presumably, we will take steps to eliminate one source of mischief, and that is the political contributions on the way into doing these sales. I think that is very positive. But if we had these pools, it occurs to me that that might be a second source of mischief; that a lead underwriter

or manager might indeed be persuaded to have one or another aspect of a set-aside of some of the moneys that they would normally receive to be paid at the discretion of the Governor's Office, of the Governor's Counsel, of someone in State government, thereby reopening the door for mischief. Albeit that we have both doors open now in New Jersey, can we sell our bonds if we outlaw this process by which pool commissions are available as part of the structure?

MR. McBRIDE: I would like to answer that question in two parts: One, yes, I think you could sell your bonds. Two, I think, again-- With all due respect, I think you have to get some more understanding about the pooling of commissions for me to be able to explain that -- to give you an accurate answer. I think you may be referring to, is this part of the spread that has been taken out and set aside for--

SENATOR CARDINALE: They take currently-- In one of our issues, they took 10 percent out, and then they divided it. This is what I mentioned earlier.

MR. McBRIDE: Ten percent of the spread, Senator?

SENATOR CARDINALE: They took 10 percent of what I would refer to as the commissions.

MR. McBRIDE: Okay, that is the spread.

SENATOR CARDINALE: In your parlance, you refer to it as the spread.

MR. McBRIDE: Well, see, not all of the spread goes for commissions. That's why-- If you will allow, spread is the term that is used for all of the components that are involved between where you buy the bonds and where you sell the bonds. Part of those components would be expenses to pay for legal, to pay for printing, and to pay for all the regulatory body assessments. Part of it might be for a management fee, and the other part would be for what is known as "takedown," which is the same in English, outside of Wall Street, and it

means commissions. So that commission-- If the commission was set aside, that is not a normal practice.

SENATOR CARDINALE: It is not a normal practice?

MR. McBRIDE: No.

SENATOR CARDINALE: The industry would probably be very happy -- if I can devine that from what you say -- if we outlawed this practice of set aside of commissions to be divided in some fashion by the Governor's Office at a later date.

MR. McBRIDE: Based on that--

SENATOR CARDINALE: Irrespective-- Here is my concern: One of the articles I referred to in The Bergen Record created quite an upset in my constituency, because there was a company that was newly formed by an ex-Cabinet member that was included in this pool. It was formed with capitalization of \$5000, and it indeed appears to have done no bond sales. However, it got more out of the pool than any of the other companies included in the pool, and no one seems to know on what basis that was awarded. But there were no bond sales. A \$100,000 commission was paid to a company that had a \$5000 capitalization, and apparently no previous experience in the industry.

Now, if I were to look at that-- Many of my constituents have looked at that, and they have said to me, "That doesn't spell right." It also occurs to me that if we have a practice like that in New Jersey, somewhere there is a factor being added to the costs that are being charged to the taxpayers to accommodate those increased costs for -- whatever you want to call this thing. There are people who refer to it by various names. I am not going to use those names.

Now, I think I get the impression from you that you believe the industry would be very happy if we outlawed that practice.

MR. McBRIDE: That is correct.

SENATOR CARDINALE: I think you also said that it is not a common practice in things that are done in other states.

MR. McBRIDE: That is correct.

SENATOR CARDINALE: Are you familiar with issues that have come up previously in New Jersey, let's say, 10 years ago?

MR. McBRIDE: Yes, I am.

SENATOR CARDINALE: Were there these kinds of pool commissions 10 years ago?

MR. McBRIDE: No, not that I know of.

SENATOR CARDINALE: Could you tell us when they first became part of the process?

MR. McBRIDE: Well, actually, I cannot tell you accurately when they first became part of the process, because I know exactly what you are referring to, and I do not know myself, as a member of the industry, how, in fact, that compensation has been calculated.

There is nothing wrong -- nothing wrong at all -- with having a designation rule within a takedown. Again, that is a technical-- I am getting into technicalities, and I don't mean to do that because I will lose you, and that is not my intention.

There is nothing wrong with doing that, as long as it is disclosed; as long as it is, "Shall we use the level playing ground concept?"; as long as everyone knows that in order to participate in the designation policy, you have to have some type of a relationship with the ultimate investor. You have to supply some kind of a secondary market prowess, or you have to have brought something to the table. There are too many situations that have taken place where that does not exist.

Now, there are reasons why a pool, if you will -- using your word -- has been allowed, and at times has been perfectly okay because there has been extra work done, but it has been disclosed going in.

SENATOR CARDINALE: But there is a relationship--

MR. McBRIDE: There is a relationship.

SENATOR CARDINALE: --is there not, between the work that is done and the moneys that are paid--

MR. McBRIDE: Hopefully.

SENATOR CARDINALE: --to the pool designee?

MR. McBRIDE: Yes.

SENATOR CARDINALE: If there is a pool, that is the common practice?

MR. McBRIDE: Yes, sir.

SENATOR CARDINALE: You would consider it quite uncommon that a designee that did no work got more than any other members of the pool?

MR. McBRIDE: That's right. That would be uncommon. It has become more common in the industry recently, but it is totally-- It is uncommon.

SENATOR CARDINALE: I watched at a hearing before another committee that was looking into some of the same issues that we are exploring, and I saw a representative of a major Wall Street bonding company indicate that he had submitted a bid, or an approximate estimated bid of \$200,000 for an issue. He did not understand -- I got that meaning from what he said, I don't think he used those words -- how Lazard Freres was paid \$2.5 million for the same work for which they had bid, essentially, \$200,000.

Is it common in the industry for such disparities to exist; that a company would be paid 10 or 15 times as much as another company, given the fact that they are both-- I am sure you could find some fly-by-nights somewhere that would give you a lowball bid, and I think that is common in every industry. I am not talking about those kinds of situations. I am talking about where, in fact, companies are of equal standing. Is there that kind of disparity generally engaged in by State government?

MR. McBRIDE: No, Senator, there is not. In fact, the individual you were speaking about is going to appear. He was called here, and he is sitting behind me. He said that he didn't want to sit at the dais with us because we represent the broker/dealer community, and he is an independent financial adviser -- Mr. Billy Cobbs. He will address that, I am sure, when he gets up here. But that is not common practice. In fact, it is an anomaly that remains for someone else to explain, not us.

SENATOR CARDINALE: Have you ever heard of this anywhere in the country at any time in the past, in your experience with bond sales?

MR. McBRIDE: No, I have never heard of that with that type of a spread differential.

SENATOR CARDINALE: Now, I heard the State Treasurer say that there was a good and logical reason for doing that. That good and logical reason was that Lazard Freres -- this was a specific instance -- had a very innovative approach to the structure of the bond sales, and that after all, we save money ultimately.

Is it unusual in the refinancing of bond issues today that a State government -- in refinancing an old bond issue -- would get a lower rate than on prior bond issues? Is that an extraordinary thing that would account for 10 or 15 times the normal commission?

MR. McBRIDE: Well, that is a very difficult question to answer, because it is a very convoluted question. And again, with all due respect, you're saying, is it--

SENATOR CARDINALE: Do you prefer me to make it simpler?

MR. McBRIDE: Yes, please.

SENATOR CARDINALE: Many of my constituents are refinancing home mortgages--

MR. McBRIDE: Right.

SENATOR CARDINALE: --and they understand, in analogous terms to bonding, that interest rates are lower today--

MR. McBRIDE: Correct.

SENATOR CARDINALE: --than they were a few years ago. Governments are in a similar condition. Governments borrowed money, and they borrowed money all the time. There is nothing wrong with that. They borrowed money at the then current market rates. Since the market rates are lower today, it is a general advantage to government, where it can, where it has the conditions in the bonds, to refinance those bonds at the current rates, which are very low.

MR. McBRIDE: Correct.

SENATOR CARDINALE: Now, is it your experience that governments refinance bonds -- let me break the question into two -- where, in fact, they would pay more interest?

MR. McBRIDE: No. I mean, I would see no reason why you would want to increase your debt service. There may be a reason, but I can't think of one.

SENATOR CARDINALE: Is there, within the industry, such a degree of differential in creativity in the structuring of bond sales that a particular lead underwriter or manager would be able to come up with such an innovative approach that it would warrant 10 or 15 times the commission that another reputable company in the field would, indeed, be able to offer?

MR. McBRIDE: Is it possible? It is absolutely possible, but highly improbable.

SENATOR CARDINALE: Thank you.

Are you familiar at all with the issue I am talking about, and could you render an opinion as to whether this issue would fall into the category of something that was so innovative as to, in fact, call for that kind of a differential in commission?

MR. McBRIDE: I am familiar with the issue you are speaking about, but, no, I would not want to render an opinion. It is not because I will back up, it is because I was not part of the issue, and do not really know the intricacies of what was offered by the lead manager, nor the financial adviser. So just out of due respect-- I don't know what they brought to the table.

SENATOR CARDINALE: I respect that. I have no further questions.

SENATOR BUBBA: Senator Schluter, any questions?

SENATOR SCHLUTER: No, thank you.

SENATOR BUBBA: I think we will go to the next speaker, Mr. O'Connell.

MR. O'CONNELL: Good morning, Mr. Chairman, members of the Committee. My name is William O'Connell. I am an Assistant Director with the New York District Office of the National Association of Securities Dealers.

The NASD, as it is referred to, is a membership organization made up of over 5300 broker/dealers in the securities community.

Specifically, I was asked to report on the role of the NASD in municipal securities regulation. In contrast to the over-the-counter equities markets, where the NASD both enacts and enforces rules and regulations, in the municipal securities market the MSRB enacts the rules, and the NASD enforces them. This self-regulatory structure has worked well for NASD members because of the close cooperation and working relationships between the MSRB and the NASD.

Specific duties that the NASD performs as part of its municipal securities' responsibilities include: administration of tests to qualify individuals as registered representatives or principals with municipal securities brokers and dealers; inspection of the firms doing municipal securities business, including the inspection by a NASD examiner who uncovered the

New Jersey Turnpike bond problems; investigations of special cause matters, including customer complaints and terminations of registered persons; imposition of sanctions through the NASD disciplinary process; education of municipal dealers; NASD staff participation in municipal industry forums; and semiannual provision of enforcement statistics through the MSRB.

With regard to the Field Inspection Program, approximately 25 percent, or over 1400 of the 5300 NASD members, conduct a municipal securities business. While the size, volume, and scope of municipal activity varies greatly among these members, each firm is subject to an on-site examination for compliance with MSRB and SEC rules at least once every two years. Many of these firms are examined on a routine basis annually, more frequently if problems or cause matters arise.

Through the focusing of our examination efforts, firms identified by our district offices whose activities, product line, practices, past conduct, or disciplinary history are deemed to require closer regulatory scrutiny, become top examination and regulatory priorities.

The NASD, in coordination with the MSRB staff, has developed a comprehensive examination report devoted exclusively to municipal securities, including related inspection procedures. Among other areas, the NASD's municipal examination report includes: distribution and syndicate activities; sales practices, including fair pricing, markups, adjusted trading, and churning; uniform practices in transactions between brokers and dealers; confirmation disclosures; suitability of recommendations and transactions; financial advisory services; customer complaints; and other MSRB rules.

As a general statement, the NASD has found through its field inspection, special cause, and other regulatory programs

that there is a high level of compliance by broker/dealers with MSRB and SEC rules in their municipal securities activities.

Given the size of the municipal securities market, the diverse nature of the issues traded, and the increased involvement of individual investors, problems do arise that must be addressed through enforcement initiatives. Where serious or systemic rule violations have been found to exist, the NASD, through its district Business Conduct Committees, has initiated formal disciplinary actions against members and individuals with the issuance of a written statement of charges in a formal complaint. Less serious violations have been resolved by staff taking informal disciplinary actions such as issuing cautionary letters or conducting compliance conferences.

From 1982 until 1992, the NASD, in carrying out all of its regulatory activities, conducted in excess of 100,000 routine and cause investigations, resulting in about 7600 formal disciplinary actions, and a total of informal and formal actions of almost 40,000. Cases involving municipal securities and (several words indiscernible) operate relating to sales practice supervision, registration, and operational requirements, and totaled less than 10 percent of the overall disciplinary actions taken by the NASD.

On the whole, we believe the process -- we believe good progress has been made in the improvement of the regulation of the municipal securities markets. However, we see three primary areas that need additional progress: political contributions; secondary market disclosure by issuers; and additional transparency in these markets, especially for surveillance purposes.

In addition, the MSRB has proposed several changes to improve the municipal markets, which we support. First is the interdealer transaction information pilot. The pilot program to collect and publish on a next-day basis information on transactions occurring in the interdealer market for municipal

securities is a useful first step. While this program would not supply nearly as much information as is available in the equity markets, the availability of specific price information, uncleared and compared interdealer transactions with the improvement of automated regulatory reports that would be available from clear trades for surveillance purposes, will strengthen NASD surveillance of the municipal marketplace, and assist in our review for compliance with MSRB rules, including areas such as: sales practice, pricing, markups, and fair dealing with customers.

Second is the political contribution rule. While it is difficult to promulgate rules in this area, we believe the MSRB has made an important step in addressing the problem. We hope this proposal is achieved, and believe that the NASD will be able to incorporate it in our enforcement program.

Further, the MSRB recently stated in its rule proposal that even prior to this rule, payments given to issuers must comply with the fair dealing principles in current MSRB rules. NASD examiners have, therefore, been instructed to review this area in future member examinations, even before the new rule is promulgated.

Finally, there is the continuing disclosure information rules. The NASD staff has long supported the concept of full public disclosure in the markets we regulate, because we believe that the investing public should have access to current information when making investment decisions. In general, we support greater secondary market disclosure for municipal securities, particularly those that are actively traded.

We welcome the concept introduced by the MSRB which is in its earliest phase of development. We will provide input to the MSRB, as we have on other matters in the past, and on substantial enforceability of any proposal that may develop.

In summary, we believe that the current scheme of regulation of broker/dealers by the SEC, MSRB, and NASD for the municipal securities markets works well. On the whole, our examination program has evidenced general compliance by members of the MSRB and relevant SEC rules. Where infractions have occurred, the NASD has taken decisive disciplinary actions. While our investigations confirm that compliance is the norm in the municipal securities markets, we recognize that problems do arise and must be addressed. We plan to work closely with the staffs of the MSRB and SEC over the months ahead to address solutions to the political contribution issue, to expand secondary market transaction information, and to increase the availability of current issuer information in the municipal securities markets for the benefit of the investing public.

I thank you for the opportunity to present our views on this regulation. We would be happy to answer any questions you may have.

SENATOR BUBBA: Just define secondary market disclosure. I don't think I know exactly what you mean there.

MR. O'CONNELL: Secondary market disclosure is-- Well, we have heard comments on it before. In a number of instances, municipal securities are issued and there is no follow-up through the rating agencies of information going on within the municipality. Secondary market disclosure deals with the secondary market of securities and what information is available that may have affected the credit ratings of the issuing authority, whether that be State or municipal.

SENATOR BUBBA: Well, on an ongoing basis, S&P and Moody's rate the municipality or the State. They gather this information by whatever means. I thought you were referring to who buys the bonds after the initial offering. That is what I view as a secondary market.

MR. O'CONNELL: That is the secondary market. It is the purchase after the initial distribution of the securities.

SENATOR BUBBA: Are you saying that there should be disclosure as to who purchases the bonds in the secondary market?

MR. O'CONNELL: No, not who purchases them, but what changes have taken place within the financial condition of the issuing agency.

SENATOR BUBBA: So that people in the secondary market are buying knowing more?

MR. O'CONNELL: Knowing considerably more, because these are--

SENATOR BUBBA: Well, doesn't the rating do that? Suppose S&P moved the rating from A to BBB. I mean, the secondary market would understand that that is not as good security as it was when it was an A. Isn't that good enough?

MR. O'CONNELL: If you are looking on the State level, you will have Moody's or S&P or any of the other rating agencies giving it. However, looking on a smaller scale, that is not necessarily the case.

SENATOR BUBBA: And nonrated issues?

MR. O'CONNELL: Nonrated bonds being--

SENATOR BUBBA: I understand now.

Are there any other questions?

SENATOR INVERSO: I had the same question in mind. I was going to ask: What specific type of disclosure do you feel should be available for secondary market absorption?

MR. O'CONNELL: Again, looking at it from a personal point of view, because we are not a rule-making authority for municipals -- that is the MSRB -- that would require some type of a sliding scale, depending on the size of the issuer. The smaller municipal issuers do not have the financial wherewithal. That would be the community firehouses, or something of that nature. But as the size of the issuer increases, or the financial ability-- If it is a bigger issue, maybe over \$100 million, it will require more of a disclosure

of what is taking place within that community than an issue under \$10 million.

SENATOR INVERSO: Who should provide that disclosure?

MR. O'CONNELL: In the opinion that I have heard so far from MSRB, that would be required of the issuer.

SENATOR INVERSO: Of the issuer. This would be disclosure above and beyond, say, the annual audited financial statements of the municipality or the issuer? It would be ongoing financial disclosures?

MR. O'CONNELL: Again, depending on the size or the changing conditions. If there is no foreseeability of change in the financial condition of the issuer, maybe it is not needed quite as frequently, and maybe then a single annual audit is sufficient.

SENATOR INVERSO: But who determines a perceived change, the rating agencies?

MR. O'CONNELL: Well, at this point, those are still under the rule of proposals. I assume that is still to be determined, at this point, because it is looking at a proposal really for the dealer community to stand behind. It does not necessarily have any impact, except the impact to the issuers, except in the liquidity or ability of that particular municipality to sell its bonds in the future.

SENATOR INVERSO: Sell its bonds in the future. And yet we are looking at kind of a forward-looking situation here, in terms of what this debt and any change of economic condition to the issuing entity might have on the ability to meet its debt service going forward.

MR. O'CONNELL: That is correct, yes.

SENATOR INVERSO: That is basically what we are talking about, and that is something that we, too, are looking at from the standpoint of the State's issues, whether the State should incur more debt, and to what extent it can absorb the incurrence of additional debt service going forward, apropos of

what we discussed earlier today with the State Commission on Capital Budgeting and Planning. Perhaps that agency would do that.

MR. O'CONNELL: If that agency were to make public some of its findings or the reasons behind its determination of why it should or should not issue bonds of a particular length or size, it would provide considerably more information to the investing public.

SENATOR INVERSO: I envision that information being public. I said I was shocked that the reports were not considered available or complete this morning. This could be part of the information that they would include in their report, this kind of an assessment of the State's -- I don't want to say "financial health" -- but particularly the State's ability to fund its debt requirements going forward, with the information available to it from other sources that we will have to, you know, cooperate with.

MR. O'CONNELL: One of the things that we were just discussing here previously was, it also impacts the suitability requirements of the Securities and Exchange Commission if they are looking to make sure that the investor and the investment are a match. Without the proper disclosure by municipalities of current status, whatever that particular time period might be of when you come out with a new statement, it is important to the dealer community to be able to establish whether an investment is suitable. Would you base it on rumors of where a security may be heading, whether it is moving up, down, or staying the same in its credit rating?

SENATOR BUBBA: The only caution that -- or suggestion that I would make-- I can understand why you would want the disclosure on the part of the issuer, but you have to understand that what we do here, we do for everyone in the State of New Jersey. So that first aid squad, or the firehouse that is funding a fire truck, or maybe their facility,

whatever, they are not as familiar with disclosure rules as someone else is. So while you may hold them responsible, you are really holding the CPA firm or whoever is assisting them in that bond issue responsible, or, in fact, maybe even the underwriter. Someone who knows what he is doing has to be held responsible.

MR. O'CONNELL: Absolutely. In a number of instances, whether it be that first aid station or the firehouse, it is quite possible that without any major change in a local tax base, or something, you would not want to force the requirement of additional disclosure because of the increased cost.

SENATOR BUBBA: Yes, Mr. McBride?

MR. McBRIDE: Mr. Chairman, it is not so much the first aid station or the firehouse, because they are only the recipient of the funds. That is not who we are looking to for the disclosure. We are looking for the disclosure to the entity that issued the bonds, not necessarily what the--

SENATOR BUBBA: See, in New Jersey, fire districts, in my--

MR. McBRIDE: But that is a district; that is a district. That is what we are looking for. We are not looking for the individual house. We are looking for disclosure; we are looking for information that allows us to make a determination as to whether or not there has been a material change in the financial condition, so that therefore we can abide by the SEC rules known as "Fair Dealing." We know if we sell bonds to someone as a broker/dealer that it is suitable that those bonds fit that portfolio.

SENATOR BUBBA: I express my appreciation to everyone, because we are going longer than we thought. But as you can see, the discussion is germane to what we need to do here.

Senator Cardinale?

SENATOR CARDINALE: At the beginning of your presentation, you mentioned investigation and some disciplinary

proceedings that were taken. It was not clear whether that was the SEC or the NASD.

MR. O'CONNELL: That is the NASD. We are subject to SEC oversight of our examination program, but it is the NASD that does the examinations and has the enforcement ability to take whatever disciplinary actions may be necessary at the conclusion of the examination.

SENATOR CARDINALE: How do those matters come to the attention of the NASD that would trigger such an examination, or are they automatic?

MR. O'CONNELL: Well, the examination program itself for municipal dealers is a minimum of an on-site inspection once every two years. In a number of instances, especially for the bigger dealers, it is much more frequent, at least once a year, and, in some cases, it occurs periodically throughout the year. Those on-site examinations follow procedures that have been modified a number of times in the past, but are always adjusted toward leading us toward a proper examination, not only of the financial condition of the broker selling the bonds, but also of any sales practice violations that may be taking place.

Those particular procedures are what we have used in the past to find problems on our own. However, we do also have a Customer Complaints Department that accepts calls from anyone who wants to talk to us about what they perceive as a problem. We also look toward the dismissal of sales representatives from particular firms, and we will look into that if it was for cause, or any other incident that may occur that would bring it to our attention that some type of improper sales activity is taking place.

SENATOR CARDINALE: Would it be appropriate for this Committee to refer to the NASD an investigation of an overall bond issue by the State, for the reason that we seem to believe

that there was a disparate commission being paid, or a disparate fee being paid, to any of the entities involved?

MR. O'CONNELL: As a matter of fact, without going into detail because I am not specifically involved with it, I believe part of that investigation is taking place already. However, if you are looking for a specific referral to it, we would be more than happy to accept that.

SENATOR CARDINALE: Thank you very much.

SENATOR BUBBA: If there are no further questions--

SENATOR CARDINALE: I have one other question which I forgot to put to Mr. O'Connell. In your experience -- either of you -- has any state ever barred a particular dealer from doing business in that state in the future, or for any period of time in the future, because of practices that were deemed to be suspect?

MR. O'CONNELL: Well, Gerry seems to have one specifically, but from our point of view -- the NASD -- it is not the state that has barred people. It is the self-regulatory organization. When someone is barred from the industry, or is suspended from the industry, whether it be an individual or a firm, or the firm and its individuals, whatever, the NASD has taken that action in the past. Without membership within the NASD, you cannot continue to do a securities business without violating Federal law.

SENATOR CARDINALE: Thank you very much.

MR. O'CONNELL: You're welcome.

SENATOR BUBBA: I thank you both.

MR. McBRIDE: Thank you.

SENATOR BUBBA: Next we are going to call up William Cobbs, Chairman, Public Resources Advisory Group.

Before Mr. Cobbs speaks, there is a gentleman by the name of Steve Hochman, Assistant Director, State Ratings, Moody's Investors Service, who has submitted testimony to us. He could not be here, but I think it would be worthwhile to

read two paragraphs which I feel are germane. I would like to do that right now.

"Debt limits provide important guidance to a state in preparing its capital program and debt issuance plan. For a limit to be effective, it should be comprehensive in coverage, including all tax-supported debt, and it should impose reasonable budgetary discipline to limit debt to an affordable level. But the limit should also not be so restrictive that it invites the kind of 'backdoor' financings that now characterize some states' debt structures.

"Debt management must be meaningful in establishing reasonable limits to the issuance of debt while providing a flexible means to finance the state's capital needs. The 50 states provide a spectrum of approaches to debt issuance and management, and the structure and amount of debt must address the particular needs of each state. In this way, proper debt management can help achieve annual budget balance and long-term structural balance, key ingredients for a high quality credit."

Those comments are from Steven Hochman, Assistant Director, State Ratings, Moody's Investors Service.

Mr. Cobbs?

MR. COBBS: Thank you, sir.

I am William Cobbs, Chairman of the Public Resources Advisory Group. We are independent financial advisers.

SENATOR BUBBA: Could you please bring the microphone closer to you, sir?

MR. COBBS: (witness complies) I'm sorry.

We are independent financial advisers to State and local governments and public authorities. We are independent, and that is why I didn't feel comfortable being on a panel, or being in testimony with dealers.

For the last three years, we have been the largest financial adviser, especially to states. We represent: the State of New York, California, Virginia, Maryland -- we are

having our first issue for Massachusetts as we speak -- New Hampshire, Nevada -- about 10 states.

I do not have any written remarks. When I spoke to Mr. Callahan of your staff, he said you wanted to have a discussion on debt management. I will be glad to answer questions, or I can comment on what has been said before by these other folks.

SENATOR BUBBA: Well, we prefer you making some sort of a statement, you know, and then if anyone has questions, fine. If not--

MR. COBBS: Then I will address what these other people have said.

Basically, I endorse what the two rating agencies have said, and what Mr. Raphael of Fitch is going to say, since I happened to see his testimony -- his statement.

In the letter that has been sent on the proposals, we feel debt management is a crucial area. We think you should focus on affordability. As one financial analyst says, "That goes to the heart of the rating process." Indeed, you may consider establishing policies, so you do not get into the type of situation where you had the advance refunding, which Fitch has said represents, in effect, deficit financing, where you defer a debt service. If you had policies that came out of the affordability study, you would avoid deferring that. This is certainly not consistent with the high-grade borrowing like New Jersey has traditionally been, even to the AA+ level, much less the AAA.

In this connection, we would endorse what Mr. Grossman said, that you should look at the Maryland example. I have a copy of the Maryland "Debt Affordability Study" I would like to leave here. They have a Debt Affordability Commission. They make an advisory report to the legislature. The legislature does not have to adhere to it. They do. It is generally

credited with having helped Maryland keep its AAA ratings, because they did have high debt ratios. I really do think this is the best example you could follow.

I would, however, like to add one thing: Debt has really not been New Jersey's problem. If you look at New Jersey's debt ratio -- I would use Moody's for the median -- although New Jersey's ratios have gone up slightly over the last 10 or 15 years, they are still really not out of line with the median. Debt to personal income for New Jersey is 3 percent now, and the state leading is 2.2. The debt burden, that is, debt to personal property -- the property tax base -- is 1.2 versus 0.9 for the median. Indeed, that ratio, as well as the debt to personal income, has actually improved somewhat since 1977, because the financial resources in New Jersey have gone up more than the debt.

The real problem in New Jersey, frankly, has been--

SENATOR BUBBA: Excuse me. Before you put those numbers away--

MR. COBBS: Sir?

SENATOR BUBBA: Before you put those numbers away, I think you just said that-- Tell us again the ratio with property taxes to--

MR. COBBS: The full value of the property tax base and personal income-- Those are two important measures that financial analysts look at.

SENATOR BUBBA: All right. Personal income, we're where?

MR. COBBS: Second in the country.

SENATOR BUBBA: Second in the country with respect to--

MR. COBBS: Personal income -- per capita personal income.

SENATOR BUBBA: All right.

MR. COBBS: I don't know where your property tax base is. I am sure it is not as high as California, because they are so much bigger.

SENATOR BUBBA: Well, you--

SENATOR BUBBA: But, I mean, per capita-- I do not know that one.

SENATOR BUBBA: --said the mean is 0.9.

MR. COBBS: I said, "the ratio." The ratio is 0.9, and New Jersey is 1.2.

SENATOR BUBBA: All right, so what do you mean by the ratio?

MR. COBBS: I am saying you are right at the median.

SENATOR BUBBA: The median is 0.9?

MR. COBBS: Yes, sir.

SENATOR BUBBA: And we are at 1.2?

MR. COBBS: Yes, 1.2.

SENATOR BUBBA: So that, to me, is what, 30 percent higher than the median.

MR. COBBS: Well, there are people who are much higher than that, sir. I don't really-- If you look at all the rating write-ups by Fitch, Moody's, and Standard & Poor's, each one of them characterize your debt as moderate.

SENATOR BUBBA: Well, those people can say it, because they don't pay it. Go ahead.

MR. COBBS: Debt is not an-- There are some states, like Oklahoma, that have low debt, and others like Connecticut and Massachusetts that have high debt. So I say, I don't think the financial pressure on New Jersey comes from the debt side. It comes from the operating budget side and engaging in these nonrecurring things like refundings, selling the highways, these sorts of things. Nonrecurring issues are what put the pressure on New Jersey's ratings. It is not the debt management. You actually have pretty good debt management.

The one thing that has been noticeable about your debt management lately is that you used to sell most of your debt through the general obligation, about three-quarters of it, which the rating agencies prefer. Now you sell less than 60

percent. As a result, you do not pick up all that, even though your debt service burden in your budget is low -- under 4 percent. That does not include leases, as other people have mentioned. When you do your debt studies, you need to go to net tax-supported debt, the way Moody's and Fitch do. That is also what Maryland has done. That throws out a much bigger net, and that gets all your debt. You just can't look at GO debt. You have to look at everything that is supported by taxes.

SENATOR INVERSO: I would like to inject a question here with regard to debt management: Statistics, unfortunately, are after the fact. Do you think there is an effective model, or an approach that could be used to try to project, to try to look beyond just the current budget cycle, so that those statistics and ratios don't get us away from the norm significantly? That is the concern I have.

I understand that government-- See, government is very myopic. It is like the 12-month budget-- You have to come up with a balanced budget. You can have a balanced budget, but you can have deficit financing from the debt activities.

MR. COBBS: Yes, sir. I do think-- Maryland was the one that pioneered in this. You should know that that really came from the legislature there. A friend of mine was a legislative budget officer back in the mid-'70s, and he started that. But that was kind of a formulistic approach. They would only issue-- They would only retire some existing debt, and they would have new debt equal to about 75 percent, 80 percent retirements, which automatically drives, then, the ratios.

We did a refinement for the Controller of the City of New York, which I would also like to leave for you, which precisely addresses your question. We went on the basis that just not needs can drive the capital budget. You also have to look at resources; that is, things like personal income, the

property tax base, population, tax revenues. Maryland has adopted our refinement. They do exactly now what we started doing for the State of New York about 10 years ago. Here is the last one we did for New York. It was in 1992. Like Maryland, they now do it internally, and they do projections out for five years. You need a capital budget to do this, but you can get projections, the best of the blue-chip indicators, which is about 50 well-recognized economies -- DRI, Wharton, WEA, I guess they are called now -- and use that as the basis for your economic projections. Then look at your debt over time to see where your ratios come out.

You have kind of two measures: how you do over time, and then how you do next to the Moody's median. You can do that, yes, sir.

SENATOR INVERSO: So it is not just an exercise in number crunching and crystal balling. You think it is an effective tool that can be used to monitor debt--

MR. COBBS: That is the question. New York does not use this, and they have very high debt ratios. Maryland does use this. They adhere to it. So it is a little bit like in "The Tempest," where the character says, "I can call serpents from the deep." The question is, will they come? So anybody can do these numbers. It is a question of adhering to them.

So when this report from Maryland goes to the legislature, the legislature adheres to it. As a result, they have kept their AAA, and now New York State has the second lowest ratings of any state, because they have had this wild proliferation of debt.

SENATOR INVERSO: Great. Thank you.

SENATOR BUBBA: Senator Cardinale?

SENATOR CARDINALE: Mr. Cobbs, I do not want to ask you to rehash all of the testimony you gave to the other committee. However, I am aware of that testimony, where you indicated you would have done what Lazard Freres did for

\$200,000 or so, and offered that to the State Treasurer. I subsequently heard the State Treasurer testify that there was some innovative characteristic to the procedures that were presented by Lazard Freres, and that that warranted the extra moneys they were paid on the order of magnitude of 10 or 15 times what you had bid.

Now, I would like to give you an opportunity here, having heard that testimony by the State Treasurer--

MR. COBBS: I did not hear it. I did not hear his testimony.

SENATOR CARDINALE: You didn't hear it?

MR. COBBS: No, sir.

SENATOR CARDINALE: I characterized it. I have given it very briefly. What would be your comment with respect to the work that was actually prepared by Lazard Freres? Were there any extraordinary innovative approaches that resulted in a benefit to the State of New Jersey which would warrant a \$2.5 million payment?

MR. COBBS: I don't know enough about what Lazard Freres-- I did not know it was a brand-new approach. As I said at the time-- I really did not understand that was a purpose of my being here today, to go back into this. I was told by Mr. Callahan it was to talk about debt management practices.

The reason I agreed to testify originally was that we were surprised by the size of their compensation. We were told it was \$50,000, and we said, "Well, we cannot do it for \$50,000. It would be more like"-- I think we said \$300,000 -- \$200,000 to \$300,000 probably. As an example for that, we did a start-up toll road in Orange County, California. We worked several years on that, and we made about \$700,000.

SENATOR CARDINALE: Who told you \$50,000?

MR. COBBS: The people we interviewed with the Turnpike Authority. They have subsequently said they do not

recall that. We have nothing in writing, as I said under oath. That is what my partner, David Rush, told me he said, that we couldn't do it for \$50,000; it would be more like \$300,000, or something.

We have done several innovative things. Indeed, we did a note sale similar to the one that New Jersey did. We thought we did a good innovation, but we didn't get \$2.1 million from California for that innovation, and it saved them quite a lot of money.

SENATOR CARDINALE: Just from your experience in the industry, is innovation generally--

MR. COBBS: I'm sorry?

SENATOR CARDINALE: Just from your general experience in the industry, does innovation generally warrant the payment of 10 or 15 times what someone else has bid, or 5 times what someone else has bid?

MR. COBBS: Well, that has not been our experience in the public sector. We did a crossover refunding for the State of New York, and we came up with-- Only one of the existing firms could match ours, and only four of the existing firms could even do it. And we didn't get a lot of compensation for that. It was just part of a job.

SENATOR CARDINALE: Thank you very much.

SENATOR BUBBA: Give us a percentage, in your experience, what the total underwriting concession would be on, let's say, a million dollars. What percentage--

MR. COBBS: This was financial advisory.

SENATOR BUBBA: Excuse me?

MR. COBBS: This was financial advisory, rather than underwriting.

SENATOR BUBBA: Oh, this was financial advisory, okay. Thank you.

MR. COBBS: Again, as I said in my testimony, we were surprised at the size, because even though we have been the

largest financial advisory firm for three straight years now, our annual revenues aren't a whole lot bigger than what they were paid for that transaction. We would have been very happy with that compensation.

SENATOR BUBBA: Thank you very much.

SENATOR CARDINALE: Mr. Cobbs, I would have been, too.

MR. COBBS: May I say just one more thing about what Mr. Grossman said on contributions? (no response)

We agree with what Mr. McBride said, that everybody should adopt these. We have adopted a resolution where we do not do contributions, and we discourage individuals. We talked about it for a year. I wish we had done it sooner, but frankly, it is the kind of a thing where everybody gets in the boat at the same time so it doesn't tip over.

I think that is what is happening now. I think it is a welcome advance. Florida, as I indicated in my testimony, is a very good place to look, but it is also true -- which somebody else said -- that you folks have to-- People who receive contributions have to do the same thing. I recommend Kathleen Brown, the State Treasurer of California. She will not accept any contributions from anyone in the "Red Book," which is the guide of-- It includes dealers, financial advisers, bond lawyers, and everything. We hope that Kathleen Brown's policy can be adopted.

SENATOR BUBBA: In New Jersey -- in case you don't know how it works -- everybody gives money to the President.

MR. COBBS: Is there anything else?

SENATOR BUBBA: No. Thank you very much for your testimony.

May we have Robert Rich, Richard Raphael, and Steven Elias? Do you fellows like each other? Will you sit at the same table? (laughter) There is not enough room for three? All right. There are two microphones, so let's bring a chair up. Thank you.

First of all, let me thank you for being patient with us. You are about an hour and 15 minutes behind, or you were an hour and 15 minutes behind, and you had to wait for us.

Because you are first on the schedule, Robert Rich, would you like to open?

R O B E R T A . R I C H: Thank you. Good afternoon, Mr. Chairman, members of the Committee. My name is Robert Rich. I was born and raised in New Jersey, and currently reside in Milltown in Middlesex County. I am a Vice President in the Public Finance Department at J.P. Morgan Securities.

By way of background, J.P. Morgan is a diversified global financial services institution with three principal subsidiaries: J.P. Morgan Securities, Morgan Guaranty Trust Company -- the nation's fourth largest bank -- and J.P. Morgan Investment Management. The firm is involved in securities underwriting, investment advisory, lending, and other credit products and in purchasing securities for its own account. Our institution has served as a manager on several transactions for the New Jersey Healthcare Facilities Finance Authority, provided \$200 million in loans to New Jersey hospitals, and established a \$400 million standby note purchase agreement for the State's \$1 billion tax and revenue anticipation note financing. Our firm also won the recent competitive offering by the New Jersey Highway Authority.

New Jersey remains one of the highest rated states in the Northeast, the region which experienced probably the worst of the national recession. Despite the severity of the recession, New Jersey's credit standing is among the elite of the states. At Aal from Moody's, there are only eight states rated higher, and at AA+ from S&P, only five states are rated more highly, and six states on par. Moody's Investors Service ranks New Jersey's tax-supported debt 14th among states as a percent of personal income, and 11th on a per capita basis and,

as was stated earlier, has always referred to New Jersey's debt burden as "moderate."

As I understand the proposal summary I was given, the Legislature wishes to provide the Commission on Capital Budgeting and Planning with the additional mandate to assess the State's debt position based upon prescribed criteria, and to recommend a limit on new bond authorizations. This limit, presumably, is only a recommendation and could be overridden by the Legislature.

Examining this need for additional bonding authorization in the context of some of the criteria described in the proposal, such as debt levels of comparable states, New Jersey's capital needs, the ability of the State to support its debt burden, and the fiscal position of the State, can be important in maintaining the State's credit rating. The process can also balance the burden of this debt on the taxpayer. The review process, however, would fall somewhat short in that the Commission would not decide whether debt already authorized should be issued in light of the criteria which has been examined.

Also, changes which may have occurred during the fiscal year that warrant an increase or reduction in the amount of debt to be sold by the State seem to be outside the description of what the Commission's charge might be. Will the Commission have the ability to review and assess debt issuance plans during the fiscal year and make a recommendation as to whether or not that debt should be issued? Will authorities, agencies, or others that issue tax-supported debt come under the Commission's oversight role, and what about refunding issues?

The State of Texas has established the Texas Bond Review Board, which is empowered to authorize or disapprove the sale of bonds by all Texas state authorities and agencies. The Bond Review Board is comprised of the Governor, Lieutenant Governor -- who is also the Senate President -- the State

Comptroller, State Treasurer, and the Speaker of the House. All of these are elected officials. All bonds issued by state agencies and authorities, with the exception of those constitutionally mandated, must be approved by the Texas Bond Review Board. This review process can take an average of two weeks.

Whether the Commission functions under the proposed changes or additional powers you are planning to give it, the time frame in which it makes its decisions can be important. A significant delay in the issuance of bonds due to the examination process may result in some lost opportunities in the market.

With respect to a new authority to reduce State debt, the time consideration seems to be more a factor for an entity like this, which is proving sort of -- what I call "live deals." Making the review process as streamlined as possible should be an important consideration.

One question I have about this new entity is whether or not the construct of the Capital Budgeting and Planning Commission doesn't lend itself to undertaking the responsibilities of this new entity? The Commission does have representation from the executive and legislative branches and public members. Perhaps the role of the Commission could be further broadened to include the powers of this new entity.

Could an Office of the Attorney General be established which could determine if the proposed sales conform to applicable laws and regulations, rather than a new entity or even the Commission?

Some states have enacted appeals processes for firms which believe they have not been treated fairly by the selection process, to which the firms may avail themselves. But it is my doubt that they actually do, because they fear they may be worse off in the next financing. The appeals process also seems to be reactive, rather than proactive.

A mechanism which oversees the procedures used in the selection of underwriters, counsel, and financial advisers would provide to these firms a proactive mechanism to ensure a fair hearing. The underwriting community and, more importantly, the public may be more confident in the selection process if there are articulated standards and oversight to ensure that those standards are upheld.

All of us in the municipal industry would like to see the reputation of the industry restored. Municipal professionals working with officials throughout this nation have made major contributions not only to the financing of this country's infrastructure, but to the fiscal health of its states and local governments. The infrastructure needs are substantial throughout the nation, and a strong and credible municipal market remains the most cost-effective way to finance those needs.

That concludes my remarks. Thank you.

SENATOR BUBBA: Thank you, Mr. Rich.

Before our next speaker-- Gerry -- Senator Cardinale, do you want to make a resolution prior to the next speaker?

SENATOR CARDINALE: Yes. While we have as many members of the Committee here as we still do, and before people begin to drift off, I would make a motion, Mr. Chairman, that we refer the matter of the Lazard Freres' \$2.1 million, or \$2.5 million commission, in the case where Mr. Cobbs' group had offered to do it for between \$200,000 and \$300,000, to the NASD, which we have learned today will investigate such matters; that they investigate it to the extent that they are capable of investigating it; and that they let us know what the results of that investigation are. We respectfully request that they let us know what the results of that investigation are.

Prior to knowing that, I had intended to become a sponsor of legislation that would have barred Lazard Freres

from doing business in the State of New Jersey for a period of years, but I think that since we know that there is an investigatory agency that can conduct an investigation and give us some expert opinion, and appears willing to do so, that prior to the introduction of such legislation, I think it is reasonable to ask the NASD to investigate the matter for us.

I would make that in the form of a motion, Mr. Chairman.

SENATOR BUBBA: I will entertain the motion.

SENATOR SCHLUTER: Second.

SENATOR BUBBA: Second.

SENATOR INVERSO: A comment?

SENATOR BUBBA: Comment?

SENATOR INVERSO: Yes. I am glad to hear that you have taken this approach, as opposed to the initial approach. I think it would have been, perhaps, a bigger chore for us -- at least from my standpoint -- to vote to bar a firm like Lazard Freres, or any other firm, just on the basis of the data that is available to us, which is primarily data gleaned from newspapers and from some testimony today from Mr. Cobbs. I have not been privy to the other testimony, but I do think the disparity in the fee certainly raises doubt and the specter of concern in my mind, and I would support the motion.

SENATOR BUBBA: Would you take the vote, please?

MR. CAPALBO (Committee Aide): Senator Schluter?

SENATOR SCHLUTER: Yes.

MR. CAPALBO: Senator Cardinale?

SENATOR CARDINALE: Yes.

MR. CAPALBO: Senator Inverso?

SENATOR INVERSO: Yes.

MR. CAPALBO: Senator Bubba?

SENATOR BUBBA: Yes.

First of all, are there any questions of Mr. Rich?

SENATOR INVERSO: Not a question, but I do have a comment. I thought your presentation was very good. It was on target, as far as I was concerned, with regard to what I envisioned in terms of the restructuring and reformation, and the additional responsibilities I would like to see the Commission obtain.

I do think we have in place a structure with the Commission that can be used for not only capital needs assessment and decisions in that regard, but in the debt management area. I do appreciate, I do -- I am a CPA, and we work with time lines all the time -- the importance. Particularly in the area of funding, the response and turnaround time has to be as short and as brief as possible. That is the emphasis we are going to have to place on whatever criteria we develop, because a board or a commission we are presuming to support to do so, would have to comply with the criteria.

Thank you.

SENATOR BUBBA: Yes, Senator-- I made you a Senator, Mr. Raphael.

R I C H A R D R A P H A E L: That was a first. I appreciate it.

SENATOR BUBBA: I don't know, you may not.

SENATOR INVERSO: Right, exactly.

MR. RAPHAEL: Actually, the first for me was the Student Center at Drew University, and I am a resident now of Maplewood, New Jersey. I am Rich Raphael, from Fitch Investors Service.

A lot of mention has been made of Moody's and Standard & Poor's. Fitch is another bond rating agency. Actually, it has been around a very long time, I believe since 1913. However, in the last three years, it has been recapitalized, rejuvenated, and it has brought a lot of people in from all over, including Clare Cohen, who is head of the Municipal

Department, and also is the lead analyst in all state ratings. Unfortunately, she was not able to make it here today, and she sends her regrets. I am Managing Director of the Tax-Supported Group for Local Units, and I work very closely with Clare. I will proceed from there.

Thank you very much for inviting Fitch to comment on debt management and other related matters. Fitch considers debt management, an implementation of appropriate controls, as an important component of credit worthiness. Long-range capital planning is a desirable goal and an essential part of good debt policy. An equally desirable goal is establishing policy limits as to the affordability of tax-supported debt relative to resources.

Any limits set forth should be realistic. It should be flexible enough to allow for unexpected occurrences, but not too loose as to be meaningless. Conversely, the limits should not be too tight as to be too restrictive, leading to circumvention, or doing indirectly what cannot be done directly. The limits should apply broadly to all forms of debt supported by State taxation. This would include general obligation bonds, and also State lease and contract financing. This would include debt issued through the EDA, the Building Authority, and other State authorities where debt repayment derives from State tax revenues, and not specific user-based enterprise operations. Such enterprise debt need not fall under such affordability calculations.

We recommend a range when setting debt limits, or at least establishing targets and upper limits. New Jersey debt ratios are considered very moderate at about 740 per capita, and under 3 percent is expressed as a percentage of personal income. I agree with Mr. Cobbs' statement, and others, that the debt is moderate and has not been the issue in terms of the rating actions. Expressed as a percentage of personal income-- State debt as a percentage of personal income

generally ranges on an average from 2 percent to 6 percent. By comparison, Massachusetts and Connecticut are about 8 percent and 9 percent, respectively. New York State is about 6 percent; California is a low 2.6 percent; and North Carolina very low at less than 1 percent.

Debt Service, that is, the annual payment of principal and interest measured against general State revenues, is another indicator used. There are certainly other indicators as well. Whichever you use, though, it is preferable that the limit take the form of a policy, and not as a statutory or a constitutional limit, since it would be difficult to change if they were no longer appropriate and circumstances changed over time.

Debt affordability can be an effective means of debt management and control and has been successfully adopted in such states as: Maryland, Virginia, New Hampshire, and Vermont. As mentioned, it does not encompass debt payable for nontaxed resources. Some oversight, however, can be advantageous in the scheduling and coordination of nontax-supported debt to avoid competition in the marketplace between various state borrowers. Some states have created oversight boards to take a more active role in tax-supported debt issuance, such as in Texas, as mentioned, and Florida. In these states, tax-supported debt is incurred and payable from specific departments. Therefore, oversight boards take on an important centralization role.

In summary, methods and level of debt management vary in each state. I have discussed the affordability approach and have mentioned oversight boards and long-range capital planning -- multiyear capital plans, which is very common on the local level particularly. Legislative control is also exercised through the authorization process by which agencies and departments are given the authority to undertake capital projects and enter into contractual types of financings. And

of course, the voters exercise ultimate control of general obligation debt issuance.

The methods you use to manage debt issuance should fit your goals and needs. From our standpoint, we look to see that the policies and practices are cohesive and effective.

I will be glad to entertain any questions.

SENATOR BUBBA: Thank you.

Let us hear from Steven Elias.

S T E V E N E L I A S: Thank you for inviting me here. I do have a prepared statement.

My name is Steven Elias. I am President and CEO of Municipal and Government Securities Corporation of New Jersey. Our firm is a member of the NASD, as well as the New Jersey Bureau of Securities. We have been located in Freehold, New Jersey since we opened in 1986.

I have been in the municipal bond business as a salesman, trader, and in the operations area for over 20 years. While I know our name is not nearly as well-known throughout the industry as many of the other distinguished firms in attendance, we nonetheless have strong opinions about the issuance of new bonds in New Jersey, as well as in municipalities.

First of all, it is our opinion that any attempt by most smaller firms to solicit legitimate retail orders on new issues is just about a waste of time. What is a legitimate retail order? Well, let me tell you what I believe it is not. It is not an order by a hedge fund or trading account that intends to do nothing more than play the market and sell the securities right back on or before settlement date. It is not, and should never be, an order that does not get filled because the underwriters want to hold the securities for a market move. A retail order, whether it be for five bonds or one million bonds, should be considered first as a going-away order.

Now, I realize that there are many institutional accounts -- bond funds, pension funds, etc. -- that are very legitimate accounts to which the underwriter should give priority treatment when allotting these new issues. We realize that these accounts are very large and help to properly bring deals to market. On the other hand, if so-called hedge funds and trading accounts get allotted large amounts of securities, these are not going away, but coming right back into the market.

Many times we have seen a new issue that has been oversubscribed and no more bonds were available, suddenly reappear up in price. Amazing! I don't have an objection to any firm buying a portion of a deal for inventory, but not at the expense of an unfilled retail order.

With this in mind, I make the following suggestions:

- 1) The name of any account that buys more than 250,000 of any security should be made available to the State Committee. This should be provided by every firm in the underwriting.

- 2) The amount of bonds purchased for inventory by all members of the underwriting should also be known to this Committee.

Now, I know this recommendation is very radical, but it certainly would help to know why certain orders continually go unfilled.

On another matter, I strongly recommend that the book entry system of issuance of tax-exempt bonds be discontinued in New Jersey. This would avoid unnecessary monthly brokerage fees that many firms charge to maintain the accounts, as well as late payments on interest to the customer that many times have to wait for the brokerage firm to receive the money. Of course, we should also take under advisement that the market has seen registered bonds outtrade book entry bonds, thus a low interest rate could be credited to the municipality bringing this issue to market.

Thank you very much.

SENATOR INVERSO: May I ask a question of Mr. Elias?

SENATOR BUBBA: Surely.

SENATOR INVERSO: Why do you think--

MR. ELIAS: I'm sorry?

SENATOR INVERSO: I would like to ask you a question. This may be my lack of familiarity with the industry, but why do you think your two proposals are so radical?

MR. ELIAS: I'm sorry, I do have a problem hearing.

SENATOR INVERSO: Why do you think your two proposals are so radical?

MR. ELIAS: Well, I know how the industry kind of looks upon perhaps letting people know what accounts are purchasing securities. I would consider them relatively normal, but I think the industry might consider them to be rather radical.

My problem has been, and has been ever since we opened our firm in 1986, that any attempt to get involved in any new issue has just been a waste of time, because our small orders of 10, 20, and 30 bonds are never able to get filled until the bonds are up in price.

SENATOR INVERSO: But your number one suggestion would imply that if-- I can't afford \$250,000, but Senator Bubba can. If he bought \$250,000, his name would be revealed by the manager of the syndicate?

MR. ELIAS: Yes. The reason behind this is--

SENATOR INVERSO: Now, I guess there is a question of privacy there?

MR. ELIAS: No, the reason behind this is very simple. If you are continually seeing XYZ Company purchasing, or getting allocated a million bonds by one of the underwriters, lo and behold those bonds come back into the market on or before settlement date because the market has moved up. Now, these securities many times are either never paid for or get delivered to a bank versus payment and come

right on back to the brokerage firm, where they have total control of the securities.

Now, a lot of this type of dealing probably never gets to this level, but the fact of the matter is, it is continually happening. Consequently, the retail order is not getting filled at the original price, and we are seeing the trading accounts-- You know, we are talking about how compensation is taking place, or overcompensation, or additional compensation is being made to some of the underwriters. Well, here is an area where the compensation is certainly being increased, because they have total control of the securities. Perhaps the day after the deal comes out the bonds are up a point in price. Now, a point is a tremendous amount of money on these deals.

SENATOR BUBBA: Mr. Elias, I have to interrupt you here for a moment.

I am going to turn this testimony over to the NASD -- your testimony to the NASD -- and also any other regulatory bureau, because it is my understanding that no underwriter can take bonds into inventory prior to retail orders being filled. That is my understanding. Now, if that is happening, then you ought to let the proper authorities know. That is number one.

Secondly, you might have a point with respect to an account that purchases "X" number of bonds. I don't think that number is 250. There are certain regulations in the commodity industry with respect to numbers of contracts. There are certain limitations in the option industry with a certain number of contracts, so one or another person doesn't corner the market.

This isn't quite the same case that you are talking about. However, I think what you're saying is that large purchasers receive precedence over small purchasers. Generally speaking in the industry, I think that is the case, and for

good reason. However, maybe that should be looked into, but I don't think it is within the realm of this Committee to look into that.

MR. ELIAS: I don't think that is really the point I was trying to make. Without appearing to be stubborn on this, my point is primarily geared towards the securities that are really not purchased by a legitimate account. I am talking about--

SENATOR BUBBA: That is what I am interested in. It is my understanding that in an underwriting there is always full disclosure; that the allocation in an underwriting is always disclosed. There is a pecking order of allocation. Now, if you are saying that that pecking order of allocation has been subverted by the bonds being held in one or another hands, even for a short period of time to do whatever, I think what you are saying is that the bonds are being held for market purposes for a period of time to make money off an increase, or what have you.

If that is occurring, Mr. Elias, I think that is in absolute direct violation of Federal regulation. On that basis, if you have information about those occurrences, I think the NASD needs to know, or the MSRB, or whatever agency would investigate that.

Mr. Capalbo, I would ask that his testimony be given over to the Securities and Exchange Commission, so that they might investigate those procedures. I don't think it is this Committee's responsibility to investigate that. I would like to, but I don't think it is.

MR. ELIAS: I think where it may perhaps be involved in this Committee -- and again, it is just a matter of the different areas we have discussed, or heard discussed today -- whether it be in the matter of additional compensation-- Where did this firm which had \$5000 in capital suddenly start to make all this money? Well, it could very well be in these types--

SENATOR BUBBA: Are you referring to the Salema case?

MR. ELIAS: That is correct.

SENATOR BUBBA: All right. Well, that is under investigation right now. I don't know if this Committee can add to that.

Suffice it to say this: If something occurred there, it will be dealt with and adjudicated by the proper means. But I don't think the only guilty party in the history of this State has been-- If Salema is guilty, I don't think he is the only one that has ever--

MR. ELIAS: That is correct.

SENATOR BUBBA: I want to be careful about how I say this, because I am not prejudging the Salema case, because I know nothing about it. There have been occasions where other people have received directed business--

MR. ELIAS: Understood.

SENATOR BUBBA: --of one or another sort.

MR. ELIAS: Sure.

SENATOR BUBBA: And I certainly don't think it is exclusively this administration or the previous administration. I think this has been going on for a long time, and this is what we are addressing here.

Are there any other questions? (no response)

Thank you very much for your testimony, and thank you for being patient with us.

Now, in deference to the pecking order of this Committee, we will hear from Senator Smith, who has been very patient with us, has sat through this whole meeting, and is on our schedule. Senator Smith?

SENATOR BRADFORD S. SMITH: Thank you.

HEARING REPORTER: Mr. Chairman?

SENATOR BUBBA: Yes?

HEARING REPORTER: Could you ask the Senator to hold off for a moment, please? (Senator Smith complies; pause for setting up of additional microphone)

SENATOR BUBBA: While we are waiting, Senator Smith, I want to place on the record that I met a fraternity friend of yours, Walt Garner, yesterday. He told me that he was in your college class. We worked together at the telephone company years ago.

SENATOR SMITH: Walter was, in fact, a pledge brother of mine, if you know what that is like.

Mr. Chairman, thank you for having me here this morning. I made the mistake of coming a little earlier than I was scheduled, but it is a mistake I am glad I made because I found the testimony this morning to be extremely interesting, and I am glad I had the opportunity to sit through it and listen to it.

I have proposed a piece of legislation which really-- It doesn't deal directly with fees or how bond business is given out, but it deals directly with disclosure to the taxpayers. As a matter of fact, you could probably term the bill the "Taxpayers' Debt Disclosure Act," if you wanted to put a label on it.

For years -- and I don't remember-- Someone testified earlier today that back in the '70s all these bond issues were continually being defeated. I don't remember that far back, quite frankly. In my memory, it seems like just about every bond issue that went on the ballot was passed, because the way it was presented, it was always presented in a very positive fashion, and it simply said what the amount of debt was proposed to be for the particular issue, whether it was \$30 million or \$300 million.

When I have gone into the voting booth to vote on these bond issues, I have often asked myself, "Gee, I wonder what this is really going to cost us. You know, it says \$30 million, or it says \$300 million, but what is the cost really going to be?" So I started some discussions with OLS about having a more complete disclosure on these ballot questions, so

Statement of:

Hyman C. Grossman, Managing Director,

Standard & Poor's Rating Group

To: New Jersey State Government Committee

October 19, 1993

We are pleased to be here this morning as part of your deliberations concerning the state's overall debt issuance process. You have laid out the problem and background as follows:

The legislature has no systematic profile for reviewing the state's overall debt profile nor planning for the state's capital needs. In addition, the state legislature has not actively participated in the overall process of debt management, planning and procedures especially in getting debt issues of treasury and other state entities to the financial markets. In this respect, the legislature has not met its responsibilities to the people in its ultimate oversight responsibilities.

Strengthening The Commission On Capital Budgeting And Planning

You have on paper, at least the framework, for an effective oversight mechanism --- that is New Jersey's Commission on Capital Budgeting and Planning. The Commission can be strengthened by assuring joint executive legislative representation with the majority and minority

legislative leadership and a professional staff. In some aspects, its organization might be patterned after the Office of Legislative Services. The commission currently is statutorily responsible for reviewing the requests for capital expenditures of the various state agencies. After the review process is completed, the commission prepares a state capital improvement plan, listing projects that are recommended to be financed as well as their respective funding sources.

When asking for a copy of the Commission's last report in recent years, we have been told that it was either unavailable, incomplete, or not worth the bother. In testimony before the Joint Budget Oversight Committee last December 7, concerning the Treasury's planned large general obligation refunding package, Treasurer Crane said (p.24 of transcript) - " We have no capital appropriation effectively in the '93 budget, Senator. We really haven't had what I would call a capital program in about four years of any measure, of any size to meet any needs." Responding to Senator Lynch.

It is time to bring all debt having a burden on general state appropriations under one umbrella. Measuring debt affordability and capacity needs to include not only direct state general obligation bonds but leases, the Transportation Trust Fund, Sports and Exhibition Authority, Economic Recovery Bonds and the many other entities whose debt and or operations, have an impact on the state's own budget. Only by bringing together annual debt service requirements for these many debt issuing entities, can you develop an appropriate measure for debt capacity and affordability. Maryland and Georgia are two states that quickly come to mind when looking for better oversight of all state related entities. The Texas Bond Review Board

is a formal entity that needs to approve all state related debt issuance, including reasonableness for professional fees. The Public Authorities Control Board in New York State oversees a debt issuance calendar to avoid overloading the financial markets with supply, but has had little effectiveness in reviewing affordability.

Clearly, the New Jersey legislature and the Capital Budgeting and Planning Commission can work effectively to achieve the necessary oversight.

Other Recent Events-Campaign Contributions

New Jersey can follow Florida's example of almost three years ago. Governor Chiles by executive order and then legislation, prohibited anyone doing business with any state agency from making any political contributions to or in behalf of any state-wide official. This alone would solve 95% of any recently perceived problems.

Strengthening legislative oversight and making the public aware of all of the state's debt-like commitments will make for better budgetary decisions having long-term financial implications.

I'll do my best to answer any questions at this point.

STATEMENT OF
GERALD P. MCBRIDE-CHAIRMAN
MUNICIPAL SECURITIES DIVISION
PUBLIC SECURITIES ASSOCIATION
BEFORE THE
NEW JERSEY SENATE
STATE GOVERNMENT COMMITTEE

OCTOBER 19, 1993

Thank you and good morning. My name is Gerry McBride. I appear before you this morning in my capacity as Chairman of the Public Securities Association (PSA) Municipal Securities Division. I am also Executive Vice President, Tax Exempt Division of Prudential Securities Incorporated. PSA is the international trade organization of banks and securities firms that underwrite and trade municipal securities, U.S. Government and agency securities, mortgage-backed securities and money-market instruments. PSA's member firms account for about 95 percent of the nation's municipal securities activity.

The municipal securities market is the most important capital financing mechanism available to state and local governments. Every day, states and localities issue millions of dollars of bonds - \$235 billion total in 1992 - to finance a wide variety of public investment. Bonds are issued to build roads and bridges, water and sewer systems, schools and other public buildings, airports, colleges and universities and public and non-profit hospitals, among many other uses. The safety and efficiency of the municipal bond market help to ensure that public borrowers are able to finance debt at the lowest possible cost.

Municipal securities are one of the safest investment vehicles available to investors. Historical default rates among municipal issuers are second lowest only to securities issued by the U.S. government. However, recent allegations related to

political influence in the market may cast doubt upon the safety and soundness of municipal securities as investments. PSA is concerned that such a loss of confidence among investors, even if unfounded, could lead to a significant loss of market liquidity and efficiency and ultimately to higher financing costs for state and local government borrowers who benefit from the market. Focusing this Committee's attention on municipal regulatory issues through this hearing will help maintain public confidence in such a vital market. We are pleased to participate.

My testimony this morning will focus on roles of underwriters and other participants in the market, competitive and negotiated sales, the role of political contributions made by market participants to state and local elected officials and the role of such contributions in awarding business to firms.

Participants in the Financing Process

Like most industries, the municipal bond industry enlists the various skills of many participants. Distinct parts are played in the market by brokers, bankers, salesmen, traders, underwriters, lawyers, financial advisors, accountants, state and local governmental treasurers and directors of finance, and institutional and individual investors. But all are employed to one end: to raise money and to support a secondary market for debt securities of state and local governmental units.

Issuers

The starting point for any municipal security is, of course, the issuer. Municipal securities are issued pursuant to express state and local laws authorizing their issuance. Moreover, each new issue usually requires the approval of the legislative body of the issuer. In the case of general obligation bonds, approval by voter referendum is often required. With the advent of many kinds of revenue bonds, state and local governments have established many new governmental units to issue bonds.

Bond Counsel

Essentially every municipal security issued is accompanied by an opinion of bond counsel. That opinion addresses the main legal issues: that the bonds constitute legal, valid, and binding obligations of the issuer and that interest on the bonds is exempt from federal income taxation under applicable tax laws.

Financial Advisors

State and local governments may often seek the advice of a financial advisor or other professional experts. Financial advisors perform a variety of tasks: analyze the financing needs of the community, structure an issue, help choose an underwriter or organize a competitive sale, deal with the rating agencies, and advise on other matters of importance.

Accountants

The accountants conduct a professional examination and verification of an issuer's financial statements for the purpose of rendering an opinion as to their fairness, consistency, and conformity with accounting principles.

Engineering Consultants

Engineering consultants perform feasibility studies on state and local projects to ensure that the projects are capable of being accomplished.

Rating Agencies

Because of the large number of different issues in the marketplace, bond ratings (or debt ratings) often play a greater role in the municipal securities market than in the corporate market. The two dominant agencies in the ratings field are Moody's Investors Service, Inc. and Standard & Poor's Corporation. The agencies assign a rating to the issue which reflects the likelihood that the issuer will be able and willing to support future debt service payments.

Bond Insurers

The bond insurers analyze municipal credits to determine their insurability. This involves evaluation of financial reports, demographics, legal issues and feasibility studies. Insured issues automatically receive one or more Triple-A rating, thereby reducing the issuer's borrowing costs over the life of

the issue. Bond insurance helps bond issuers gain market access, especially if they are small or infrequent borrowers. The municipal bond marketplace is dominated by individual investors who value knowing that principal and interest payments will always be made in full.

Underwriters

The enormous task of underwriting, marketing, and trading municipal securities is undertaken by the dealer departments of commercial banks and securities firms. A typical underwriting department employs one or more individuals whose full-time responsibility is to work on competitive and negotiated underwritings. These individuals are primarily responsible for setting prices and yields on the new issues their firm underwrites each week. Underwriters work closely with traders and salesmen to determine the marketability and appropriate yields for an issue. Traders maintain the secondary market for securities by actively buying bonds and selling them to other dealers and investors in the secondary market. Dealer firms frequently employ a large staff of salespeople who are responsible for making direct contact with investors. They often sit at the trading desks with the underwriters and traders and attempt to arrange sales of securities during the underwriting of a new issue.

Senior Managers

The senior manager is the underwriter that serves as the lead underwriter for an account. The senior manager generally negotiates the interest rate and purchase price in a negotiated transaction or serves as the generator of the consensus for the interest rate and purchase price to be bid in a competitive bidding situation. The senior manager signs the contracts on behalf of the account and generally receives either a fee or slightly larger spread for its services in this capacity.

Investors

Three classes of investors dominate the municipal marketplace: (1) retail, consisting of individuals acting directly or through the agency of trust companies and investment counsel; (2) retail proxies, that is, bond funds consisting of managed closed-end funds, open-end funds, and unit investment trusts; and (3) institutional, particularly commercial banks and property and casualty insurance companies. The principal characteristic of all buyers of municipal bonds is that they are in a sufficiently high tax bracket that they can benefit from the tax exemption.

Negotiated and Competitive Bid Process

Municipal securities offerings are typically sold through either a competitive or negotiated bidding process. The choice of either type of sale is dependent on a variety of factors

including credit considerations, issuer preference, and market conditions.

Competitive Sales

Competitive bond sales are typically used for more traditional offerings of municipal securities. The issuer will typically work with a financial advisor to determine the structure and timing of the bond sale. The offering is then advertised in financial publications in order to notify municipal dealers of the terms of the offering including information relating to structure, the time and date on which bidding will occur, and other details which are pertinent to the offering.

Municipal dealers will line up syndicates to bid on the bonds. On the date of sale the syndicates bidding for the bonds will estimate the interest rates necessary to sell the bonds to investors and will then submit bids to the issuer or its agent. The syndicate offering to purchase the bonds at the lowest yield (or highest price) is named the winning bidder and upon approval by the issuer is awarded the bonds. The syndicate then offers the bonds to their customer accounts at established reoffering yields.

Negotiated Sales

Negotiated sales are typically used for bond offerings which entail complicated financial planning and project management considerations, such as refunding or revenue bond issues. The

issuer will distribute a "Request for Proposal" (RFP) solicitation which basically asks underwriters to submit their qualifications and credentials. The issuer then reviews the RFP responses and selects a senior manager team for the transaction.

The senior manager works with the issuer in order to structure the financing plan for the bond sale. The underwriter provides a wide variety of services in conjunction with the sale including pre-marketing efforts, investor relation meetings, credit agency presentations, and other related marketing services. The manager will also advise the issuer on when the bonds should be offered for sale in order to take advantage of optimal market interest rate conditions.

On the sale date the senior manager on the transaction will price the deal and seek orders from interested investors. After demand for the bonds is evaluated the manager may change the structure and/or size of the deal in order to meet investor demand. The manager then sets the final terms of the offering and purchases the bonds from the issuer. The manager also provides a number of post sale services for the issuer such as secondary market-making activities and advice for long-term capital projects.

Gross Underwriting Spreads

The "spread" is one of the most misunderstood aspects of the municipal bond underwriting business. The gross underwriting

spread is simply the difference between the offering price to the public by the underwriter and the purchase price the underwriter pays to the issuer. This spread includes all expenses incurred by the dealer in bringing the bonds to market, as well as any profits earned on the deal.¹

Average underwriting spreads in the municipal market have declined substantially since the early 1980's. Even though new issuance of municipal securities has increased steadily, increased competition among underwriters has caused spreads to remain subject to downward pressure. In 1985, the average gross spread for all long-term municipal issues was \$16.61 per \$1,000 par value. By 1992, gross spreads had fallen to \$9.32 per \$1,000, a 43.8% reduction. The decline continued into 1993. Gross spreads for all long-term municipals averaged \$8.62 in the first half of 1993, a decline of 7.5% from the 1992 level.

¹ Components of the Spread

The gross spread has several components: the management fee, underwriters' risk, takedown and expense. These are explained below.

Management fee - This fee compensates managers for their work in structuring negotiated issues. It is split among the entire management group based upon percentages determined by the issuer. The senior manager that runs the book typically receives a substantial portion of this fee.

Underwriters' risk - This component compensates managers for market-related risk involved in underwriting the issue and the use of the firms' capital. It is split among the underwriters according to the percentage of participation in the financing.

Takedown - This represents compensation for the cost of selling the securities and increases with longer maturities. Takedown is apportioned on a per-bond basis to any firm that actually sells bonds.

Expense - This is basically reimbursement of out-of-pocket expenses, such as underwriters' counsel travel, syndicate expenses, DTC charges, dealer fees, communication expenses and postage, etc.

Gross spreads of both negotiated and competitive issues have experienced declines since the early 1980's. This trend has been especially pronounced for negotiated issues. In this category, gross spreads have fallen from \$17.31 per \$1,000 in 1985 to \$9.35 in 1992, a decline of 46%. The spread for competitive issues, meanwhile, had dropped from \$10.79 per \$1,000 in 1985 to \$8.99 in 1992, a 16.6% drop.

As with spreads on negotiated issues, spreads on competitive issues have continued to narrow during the first half of 1993. They averaged \$8.64 per \$1,000 in the first half of 1993 versus \$8.99 in 1992.

The bottom line is that whether looking at competitive or negotiated municipal issues, the gross spread represents less than one percent, a very reasonable rate for issuers of municipal securities.

It is important to note that negotiated sales are very "competitive". As I previously noted, underwriters compete vigorously for senior manager slots. PSA believes that the elimination of negotiated sales as an alternative may ultimately increase financing costs for issuers.

Political Contributions

Recent developments in the municipal market have focused considerable attention on the role of political campaign

contributions made by securities firms, financial advisory firms, bond counsel firms, consulting firms, and other professionals engaged in the municipal finance business to elected officials who can influence the awarding of service contracts related to bond offerings.

The problem of political contributions and perceptions about the influence that contributions have on the decisions of public officials go far beyond the municipal bond market. American voters expect and deserve to hear the views and positions of candidates for public office in order to make informed decisions, and in the American electoral system, the responsibility for disseminating candidates' positions falls to the candidates themselves. As elected officials, you know well that running a political campaign has become an extremely expensive undertaking, one that, for most people, requires outside sources of funding. In addition, all individuals, regardless of whether they work in the municipal finance industry, have a civic right to influence the political process and support candidates of their choice by contributing to political campaigns.

After numerous meetings and discussions with my colleagues from across the country, it is clear to me that municipal securities dealers would like to see an end to political contributions to public officials as a factor, actual or apparent, in the selection of underwriters, the maintenance of business relationships or any other influence with respect to

obtaining securities business from public entities. The current practice, where in some jurisdictions, contributions essentially represent a fee to enter intense and legitimate competition for business - what has become known as "pay to play" - must stop. Most dealers freely admit that they make contributions to state and local officials principally because their competition does the same. Many dealers would welcome an outright ban on contributions to officials that can influence the bond financing process.

In general, political contributions made by potential bond underwriters, financial advisors, bond counsel, engineers and others do not serve as the basis for the final decision of an issuer as to which firms participate in an offering. Members of Congress similarly accept political contributions from individuals and organizations with interests in the legislation on which they work. However, contributions to Members of Congress do not serve as the basis for their voting decisions on particular legislation, in spite of general public perception. Most state and local officials are generally concerned with one primary and overriding goal in issuing debt: to secure the lowest cost of borrowing for their tax- and rate-payers.

Nevertheless, the mere appearance of impropriety can have devastating effects on public confidence in the municipal market. For this reason, last July PSA proposed that issuers be required to disclose political campaign contributions they receive from

private-sector participants in the municipal finance process. To ensure ready access and minimize additional costs on any market participants, including issuers, PSA recommended that these disclosures be filed with a centralized repository capable of disseminating the information in a useful format to the public.

Recipients of political contributions are best suited to make these disclosures because only they can be assured of possessing all the relevant information. These disclosures should cover contributions made by all underwriters and other participants (i.e., financial advisors, attorneys, engineers, accountants and others) competing in the selection process for roles in municipal securities offerings to any public official having influence in that process. Everyone that does business with a public entity should be covered. In addition to contributions from corporate entities and partnerships, contributions from employee political action committees and from officers, partners and employees of organizations competing in a municipal securities offering should be included.³ All

²We do not believe such information should be included in primary market disclosure documents - official statements - because the disclosure PSA seeks should encompass market participants who are not participating in any specific bond offering (those who competed but did not secure positions related to the underwriting, for example). In any case, information related to political contributions is principally of interest to taxpayers and the public at large, not merely to investors. PSA would not object, however, to a requirement that reference be made in official statements to where information regarding political contributions can be obtained, such as at a specified central repository.

³It is understood that in many states this will require elected officials to obtain more information about the employer, business sector and professional responsibilities of campaign contributors than is currently required by state law. While all states and the District of Columbia already require that recipients of election campaign contributions for state office report these contributions through filings with designated state officials, less than a

participants should also be required to disclose potential conflicts of interest. It is likely that the appropriate regulatory and enforcement agencies would require legislative authority to require such disclosure. PSA would strongly support such legislation.

The Municipal Securities Rulemaking Board (MSRB) recently issued for public comment draft rule G-37 related to political contributions made by municipal underwriting firms to state and local officials. This week, PSA submitted formal comment to the MSRB on that rule. A copy of our comment letter is available for your review. In our letter, we point out what in our opinion are serious problems that would make it extremely difficult for dealers to interpret and comply with the MSRB's proposal. PSA's members agree with the general principle espoused by the MSRB that political contributions made solely for the purpose of securing or retaining business with a state or local issuer are improper and should not be permitted. However, complying with the proposed rule would prove onerous.

First, we are concerned that by banning only contributions made to solicit or retain business, the rule would result in considerable confusion as to which contributions were permitted and which were not. In addition, the rule would require dealers

third require that occupation and business of the contributor be included in the filing. Federal Election Commission, *Campaign Finance 92*, current through December 1991.

to prove that certain contributions were made for reasons other than to solicit underwriting business, an onerous burden of proof. It would also essentially prohibit municipal finance firms and their employees from contributing to certain political campaigns for civic or other non-business reasons if the candidate in question could conceivably influence decisions on a bond offering where the firm does business. Such a prohibition would raise serious questions regarding the ability of municipal bond professionals to exercise their civic rights to support political candidates and could be challenged on constitutional grounds.

In order to address problems with the interpretation, compliance and enforcement of the proposed rule, PSA recommended in its comments to the MSRB that for the purpose of the rule, total annual contributions below some *de minimis* amount, on the order of \$100 to \$250 per candidate per year, be deemed too small to influence the decisions of state and local officials. Such contributions would be permitted regardless of the relationship between a firm or its employees and a candidate. Donors would not be required to demonstrate that such contributions were not made to secure or retain business. In addition, in order to prevent firms from skirting the spirit of the rule by "bundling" several contributions to a single candidate, a separate, annual, per-candidate limit would be established to be applied to all contributions from a firm and its municipal finance employees.

In its comments to the MSRB, PSA suggested that the MSRB redefine to whom limitations and reporting rules should apply. PSA believes that limitations and reporting requirements should apply only to municipal finance professionals engaged in the solicitation and conduct of municipal finance business and their direct supervisors, up to and including the CEOs of firms. However, using other employees of firms as conduits for political contributions intended to influence municipal finance decisions should be explicitly prohibited. Finally, we recommended that whatever limitations are finally imposed on municipal dealers also be applied to other private-sector participants who are engaged in the municipal finance business.

We are also concerned about the potential exposure of firms to liability as a result of the lack of clarity in the proposed rule. In light of the August 1993 MSRB release, political contributions made today, before the issue is resolved, could be found to be in violation of existing MSRB rules, and such rules could be enforced by the NASD, banking regulators or the SEC. Therefore, PSA has recommended to its members that, in order to mitigate the risk of such liability, until a clear and final regulatory policy with regard to political contributions is decided, each firm institute a moratorium on all political contributions by municipal finance professionals and their supervisors to state and local officials or to candidates for such offices in jurisdictions where they currently do or expect

to do municipal finance business, and refrain from directing other employees to donate to such officials or candidates.

Finally, as stated above, we are also concerned that, because the MSRB's jurisdiction does not extend to bond counsel, financial advisors, consulting engineers, accountants and others that participate in bond offerings, the contribution limitations and disclosure provided under the proposal would be incomplete and misleading. The non-dealer participants in the municipal finance industry all compete for business awarded by state and local officials. These non-dealers also participate actively in the political process at the state and local level. PSA believes that new political contribution limitations and disclosure requirements applicable to dealers should apply to all other participants in a municipal bond issue. The only parties in a position to provide such comprehensive disclosure of political contributions are the recipients of such contributions themselves. For this reason, PSA recommends that state and local candidates and incumbents who can potentially influence the award of municipal finance business be required to disclose political contributions received from all participants in the municipal finance process. If legislation is deemed necessary to implement such a requirement, we urge Congress to consider and pass such a bill promptly.

Summary

We believe that the municipal securities market continues to play an important role in raising the necessary capital for state and local governments across the nation. The market is efficient and continues to function well. Restrictions on the use of negotiated sales may ultimately result in increasing, rather than decreasing, the cost of financing for issuers of municipal securities.

Promulgation of the regulations recommended here may in itself serve to moderate excesses in political campaign contributions. It is in the interests of issuers and members of the municipal finance community to preserve public confidence in the municipal securities market. PSA believes that promulgation of these regulations will accomplish this goal, and we look forward to working with this Committee, Congress, the SEC, bond issuers and others in that regard. Thank you for the opportunity to present our views.

**Statement of Steven H. Hochman
Assistant Director of State Ratings, Moody's Investors Service**

**presented to the State Senate Government Committee,
New Jersey State Legislature**

October 19, 1993

Mr. Chairman and members of the committee, I would like to thank you for inviting me to offer testimony on the issuance of bonds by the state. Because of a prior commitment, I am unable to do so in person, but I am offering these written comments in response to your invitation.

I am the Assistant Director of State Ratings for Moody's Investors Service. The State Ratings Group is responsible for conducting the research in support of ratings assigned to state government obligations.

The 1980s was the decade of debt. The federal government, private corporations, and individuals incurred huge amounts of new debt to finance deficit spending, leveraged buyouts, and consumer spending. According to the Federal Reserve Board of New York, the debt of households, businesses, and the federal government grew by fivefold or more from 1980 through 1992. This huge buildup of debt is viewed by many as a burden that even in today's low interest rate environment is inhibiting growth and economic recovery.

Through this period, state debt also grew, although much more modestly. As the economic recession of the late 1980s and 1990s reduced state revenue growth,

some states turned to debt as a way to address spending pressures while minimizing their impact on taxes and new revenue sources.

Some states bonded out deficits, and some decreased the pay-as-you-go component of their capital spending plans, substituting debt financing. Some states turned to public authorities to finance and administer programs that previously were state general fund and state agency responsibilities. Some turned to back-bonding and asset sales and refinancings to generate short term cash and avoid the need for draconian spending cuts or unpopular tax increases. Some states did more than one of these things, and at least one state has done all of these things, and more.

Nonetheless, overall, states have been remarkably responsible and conservative in their use of debt. During the period from 1982 to 1993, Moody's median ratio of state debt to personal income actually declined from 2.5% to 2.2%, showing that state debt obligations relative to their wealth and resources did not grow disproportionately during this period of rapid debt buildup by the federal government, private corporations, and households. In New Jersey, the corresponding ratio, which was 3.0% in 1984, was still 3.0% in 1993. (As in most other states, New Jersey's ratio had dropped in the 1980s before rising again in the early 1990s).

The creation of debt management and affordability committees in some states and the discussion and establishment of debt limitations in others, have created a sensitivity to proper use of debt for public sector capital needs. States, for the most part, have managed their debt prudently and conservatively and avoided abuse.

States maintain a very high and respected status among government debt issuers of all types. The rating distribution for states is extremely positive: 33 of the 41 states that issue general obligation bonds are currently rated Aa or better. This pattern is reflective of the scope of economic resources available to states and their sovereignty over tax structures. However, it is also indicative of the quality and professionalism of state budgeting and debt managers and the efforts that are made to balance capital needs with the prudent use of debt.

Rethinking borrowing practices to better plan and control the issuance of state debt is an important priority in light of the many claims against limited state resources. Over the last five years, most of the states in the nation have experienced severe economic and financial strain. During this period many states either strengthened existing debt affordability plans (Maryland, Delaware) or established new ones (Texas, Virginia).

While Moody's Investors Service recognizes that making plans to better manage state debt is an important policy initiative, it is the "results" of debt management -

- long term balance and fiscal stability -- that remain the primary determinants of a good credit rating.

Ratings, as most of you know, are arrived at through the analysis of four factors: the economy, financial operations, administrative or governmental factors, and debt, the subject of today's session. In reviewing debt, we at Moody's look to several guideposts which we compile and publish.

First, we add up a state's "net tax-supported debt," which includes all debt obligations met from tax and other general revenue sources, regardless of who the issuer is. Self-supporting debt from enterprise activities, sinking funds and debt supported by other entities is excluded from this determination. But special tax debt issued, for example, for highway purposes, lease debt and similar commitments is counted.

Tax-supported debt is then evaluated in terms of its structure, maturity, pledged sources of repayment, and any unusual features which need further study. We also attempt to measure the burden which the debt puts on the state's resources by considering debt per capita, debt as a percent of personal income, and a new measure, debt service as a percent of annual budgeted revenues. In order to assess the relative burden, we calculate medians of these measures for the 50 states.

The latest measure we have developed seeks to gauge the stress debt service imposes on a state's revenues. A debt service ratio below 2% of revenues is low, the mid-range is between 2% and 5%, and levels over 5% are high, with the upper limit currently measured at 11%. Collectively, these measures gauge the ability of a state's economic resources as well as budgetary resources to support its debt, when placed in the context of other states' efforts.

In reviewing these measures, Moody's does not rely on fixed, rigid rules. Rather, these ratios are considered in an overall assessment of what most states find affordable, given other expenditure priorities and the need to maintain budget balance.

In our discussions with states on debt management, we consider the overall budget position and think of affordability not just in terms of debt service obligation, but also in the context of the larger operating requirements which may be associated with capital projects.

Improving the linkage between capital borrowing and its attendant operating requirements is an important area. Long after the bonds issued for facilities such as prisons are paid, operating and maintenance requirements will continue. Careful planning to ensure that facilities and program initiatives can be sustained by available resources is part of good debt and financial management.

Debt limits provide important guidance to a state in preparing its capital program and debt issuance plan. For a limit to be effective it should be comprehensive in coverage, including all tax-supported debt, and it should impose reasonable budgetary discipline to limit debt to an affordable level. But the limit should also not be so restrictive that it invites the kind of "back-door" financings that now characterize some states' debt structures.

Debt management must be meaningful in establishing reasonable limits to the issuance of debt while providing a flexible means to finance the state's capital needs. The fifty states provide a spectrum of approaches to debt issuance and management, and the structure and amount of debt must address the particular needs of each state. In this way, proper debt management can help achieve annual budget balance and long-term structural balance, key ingredients for a high quality credit.

REPORT OF THE
CAPITAL DEBT AFFORDABILITY COMMITTEE
ON
RECOMMENDED DEBT AUTHORIZATIONS

FOR FISCAL YEAR 1995

SUBMITTED TO
THE GOVERNOR AND GENERAL ASSEMBLY
OF MARYLAND

September 10, 1993

Honorable William Donald Schaefer
Governor of Maryland
State House
Annapolis, Maryland 21404

Honorable Thomas V. M. Miller, Jr.
President of the Senate
State House
Annapolis, Maryland 21404

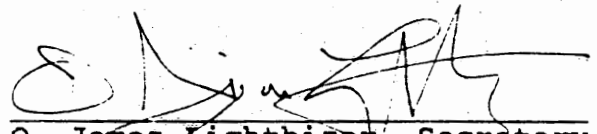
Honorable R. Clayton Mitchell, Jr.
Speaker of the House
State House
Annapolis, Maryland 21404

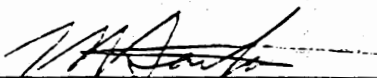
Gentlemen:

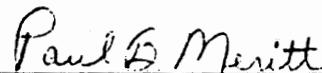
Chapter 43, Laws of Maryland, 1978 (currently State Finance and Procurement Article, Section 8-104, et seq.), created a Capital Debt Affordability Committee. This Committee is required to submit to the Governor and the General Assembly an estimate of the maximum amount of new general obligation debt that prudently may be authorized. Pursuant to Chapter 93, Laws of Maryland 1989, relating to higher education debt, the Committee is also submitting an estimate of the amount of new bonds for academic facilities that prudently may be authorized.


We are pleased to present to you for your consideration our annual report, with recommendations relating to the fiscal 1995 capital program.


Louis L. Goldstein
State Comptroller


O. James Lighthizer, Secretary
Department of Transportation


Charles L. Benton, Secretary
Budget and Fiscal Planning


Paul B. Meritt
Public Member


Lucille Maurer
State Treasurer
Chair

cc: William S. Ratchford, Director
Department of Fiscal Services

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EXECUTIVE SUMMARY

The Capital Debt Affordability Committee, established by Chapter 43 of the Laws of Maryland 1978, is required to review annually the size and condition of the State debt and to submit to the Governor and the General Assembly an estimate of the maximum amount of new general obligation debt that prudently may be authorized for the next fiscal year. Pursuant to Chapter 93, Laws of Maryland 1989, relating to higher education debt, the Committee is also required to submit an estimate of the amount of new bonds for academic facilities that prudently may be authorized.

During its 1993 meetings, the Committee addressed a number of other related issues in addition to developing its primary recommendation with respect to general obligation authorizations and authorizations for higher education academic facilities. The Committee conducted its usual affordability risk analysis -- the risk that subsequent events might absorb the projected unused debt capacity. The Committee also discussed the possibility of including the Baltimore City Community College in their charge.

Consistent with the affordability risk analysis, the Committee recommends a \$380 million limit for new general obligation debt authorizations by the 1994 General Assembly to support the fiscal 1995 capital program (page 32). This \$380 million recommended level reflects a revised personal income base. The Committee's projections for the following five years continue to reflect the 3% annual increase adopted last year, an inflation rate of 2% plus 1% real growth. Actual and revised personal income data have provided a higher base than was anticipated last year. The recommended \$380 million level represents a 3% increase over the \$370 million that had been originally contemplated as last year's recommendation before that recommendation was reduced.

This year, unlike last year, the affordability capacity provides a modest margin for contingencies. The Committee formally evaluated the risk of piercing the affordability criteria if various components of tax supported debt were expanded.

The four basic risk components were analyzed and four conclusions reached. It was concluded that (a) while the Committee believes the current projections of personal income adequately discount the effect of economic conditions, there still remains some risk that growth in personal income may not achieve even the modest growth rates assumed; (b) although changes in standards of outside entities, such as rating agencies, regarding the components of tax supported debt could have a major impact on measured affordability, such changes are

apt to occur with sufficient lead time for the Committee to adjust the program of authorizations; (c) no real risk exists resulting from changes within the general obligation capital plan unless specific action is taken either by the Committee or the General Assembly to alter the program of authorizations; and (d) while changes in the issuance plans for other new or altered components of tax supported debt have generally presented the greatest risk to the eventual affordability of a specific five year program, the only known change at this time is one with a positive effect on affordability (the possibility of refunding additional series of County Transportation Bonds).

Last year, potential changes in the issuance plans of other components of tax supported debt included the structure of the County Transportation Bond program, a convention center bond program, and the cost of a new football stadium. A new program was authorized for county transportation projects, and a combination of general obligation and revenue bonds was authorized for the convention center; both have been incorporated into the base analysis. The Stadium Authority is committed to funding the football stadium without any increase in authorizations for revenue bonds; that potential change, therefore, was not considered an affordability risk.

The Committee reviewed and analyzed higher education debt to derive its recommendation of new bonds for academic debt in keeping with the charge enacted in 1989. The proposed capital financing programs of the three systems result in a debt burden level well below the established threshold and generally below last year's level. The Committee reached the same conclusion as last year, that there is no basis to deviate from the academic debt programs proposed by each of the systems as long as those programs result in prudent levels of debt. The committee recommends a limit of \$40 million of new bonds for academic facilities that prudently may be authorized in the aggregate for the next fiscal year. This amount represents financing of academic facilities by the University of Maryland (page 53).

The Committee considered the issue of including the Baltimore City Community College in its statutory charge. While the Committee's broad scope embraces any unit of State government, the Committee believes that the community college should not be excluded from specific mention. Because BCCC does not have the authority to issue bonds for academic facilities, BCCC would not be included in the Committee's higher education recommendation, but the Committee recommends that the Baltimore City Community College be added to the specific listing of higher education institutions subject to review by the Committee (page 54).

I. INTRODUCTION

A. Background

The creation of the Capital Debt Affordability Committee was an outgrowth of two events: the dramatic increase in outstanding debt during the mid-1970's and the release of the Department of Fiscal Services' two year study on the State's debt picture, titled "An Analysis and Evaluation of the State of Maryland's Long-Term Debt: 1958 - 1988."

In response to this study and the rising level of State debt, the 1978 session of the General Assembly enacted the current State Finance and Procurement Article, Section 8-104, et seq., which created the Committee as a unit of the Executive Department. The members currently are the Treasurer (Chair), the Comptroller, the Secretaries of the departments of Budget and Fiscal Planning and Transportation, and one person appointed by the Governor. The Committee is required to review the size and condition of the State debt on a continuing basis and to submit to the Governor, by September 10 of each year, an estimate of the total amount of new general obligation debt that prudently may be authorized for the next fiscal year. Although the Committee's estimates are advisory only, the Governor is required to give due consideration to the Committee's findings in determining the total authorizations of new State debt and in preparing a preliminary allocation for the next fiscal year. The Committee is required to consider:

- The amount of general obligation debt that will be outstanding and authorized but unissued during the next fiscal year;
- The capital program and the capital improvement and school construction needs during the next five fiscal years;
- Projected debt service requirements for the next ten years;
- Criteria established or used by recognized bond rating agencies in judging the quality of State bond issues;
- Other factors relevant to the ability of the State to meet its projected debt service requirements for the next five years or relevant to the marketability of State bonds; and
- The effect of new authorizations on each of the factors enumerated above.

In addition to these tasks, the Committee has generally reviewed, and made recommendations concerning, other types of public debt issued by State or State-created authorities or agencies.

In keeping with a narrow interpretation of its statutory charge, the Committee's efforts through 1986 focused mainly on bringing the State's general obligation debt in line with certain parameters. In 1987, however, the Committee began to adopt a more comprehensive view of State debt that included all tax supported debt in addition to general obligation debt.

The main basis for adopting this broader view was that the rating agencies and investment community take a more comprehensive view of a state's debt when analyzing that state's obligations. Many discussions with rating analysts over several years in conjunction with the reviews associated with the savings and loan program and concerning stadia and infrastructure financing all indicated that rating analysts were interested in all tax supported debt. Summaries of rating agency reports indicate that the measure of debt used is "net tax supported debt" - the sum of general obligation debt, consolidated and county transportation debt (net of sinking funds), capital lease commitments, and bond anticipation notes.

A second reason for adopting a more comprehensive view of debt was that other forms of long-term commitments were becoming more common. Lease, particularly lease purchase, obligations were at least more visible, if not more widely used. The bonds to be issued by the Maryland Stadium Authority for the Baltimore stadia were to be supported by lease arrangements; the State had consolidated a significant amount of equipment lease obligations; and the Motor Vehicle Administration was using the capital lease method for expanding or relocating its service center network. Although these leases do not represent debt in the constitutional sense, any default on these leases would be viewed by the market in the same light as a default on State bonds.

This broader view was ultimately codified and included in the Committee's statutory charge by Chapter 241, Laws of Maryland, 1989.

The 1989 General Assembly further expanded the Committee's charge as part of legislation relating to higher education debt (Chapter 93, Laws of Maryland, 1989). As enacted, the statute directs the Committee to review on a continuing basis the size and condition of any debt of the University of Maryland System, Morgan State University, and St. Mary's College of Maryland; take any debt issued for academic facilities into account as part of the Committee's affordability analysis with respect to the estimate of new authorizations of general obligation debt; and, finally, to submit to the Governor and the General Assembly an

estimate of the amount of new bonds for academic facilities that prudently may be authorized in the aggregate for the next fiscal year by the University of Maryland System, Morgan State University, and St. Mary's College of Maryland.

B. 1992 Recommendations and Subsequent Events

The following lists the recommendations of the 1992 Capital Debt Affordability Committee and subsequent events related to those recommendations.

o The Committee recommended that new authorizations of general obligation debt should be limited to \$350 million.

....The 1993 General Assembly authorized \$370 million of new general obligation debt, which includes \$20 million for the Convention Center. In addition to the \$370 million, \$30 million in general obligation bond funding for the Convention Center was authorized with an effective date of June 1, 1995. See II.E. Maryland Stadium Authority for a discussion of the Convention Center funding and V. Other Issues for a discussion of the effect of the delayed authorization.

o The Committee recommended that new authorizations for academic facilities at the three university systems should be limited to an aggregate of \$40 million.

....The 1993 General Assembly authorized new academic facility bonds to be issued by the University of Maryland System in the amount of \$24.455 million for a variety of capital projects, the largest of which was \$4.127 million for a new campus maintenance facility at the University of Maryland Baltimore County. No academic bonds or projects were authorized for the other two university systems.

o The Committee recommended that the State's liability for future issues of County Transportation Bonds should be eliminated and an alternative be provided that embodies the key aspects of the program.

....Legislation was enacted that establishes a financing program to enable the counties to finance the cost of transportation facilities without the issuance of State or Department of Transportation debt. See V. Other Issues for a more detailed discussion of the County Transportation Bond program.

o In addition to authorizing bonds to finance academic facilities in the amount of \$24.5 million, Chapter 372 increased the maximum allowable net amount of debt outstanding for the University of Maryland System from \$542.7 million to \$605.6

million. The maximums for Morgan State University and St. Mary's College of Maryland remain unchanged (at \$28 million and \$15 million, respectively).

o Legislation enacted last year authorized the General Assembly to establish in the State budget each year the maximum allowable Consolidated Transportation Bonds outstanding for each next fiscal year (limited to an overall maximum aggregate of \$1.2 billion). The fiscal 1994 budget contains language limiting to \$1.025 billion the amount outstanding at June 30, 1994. See V. Other Issues for a discussion of language in the Joint Chairmen's Report relating to the amount of consolidated bonds issued.

II. TAX SUPPORTED DEBT - TRENDS AND OUTLOOK

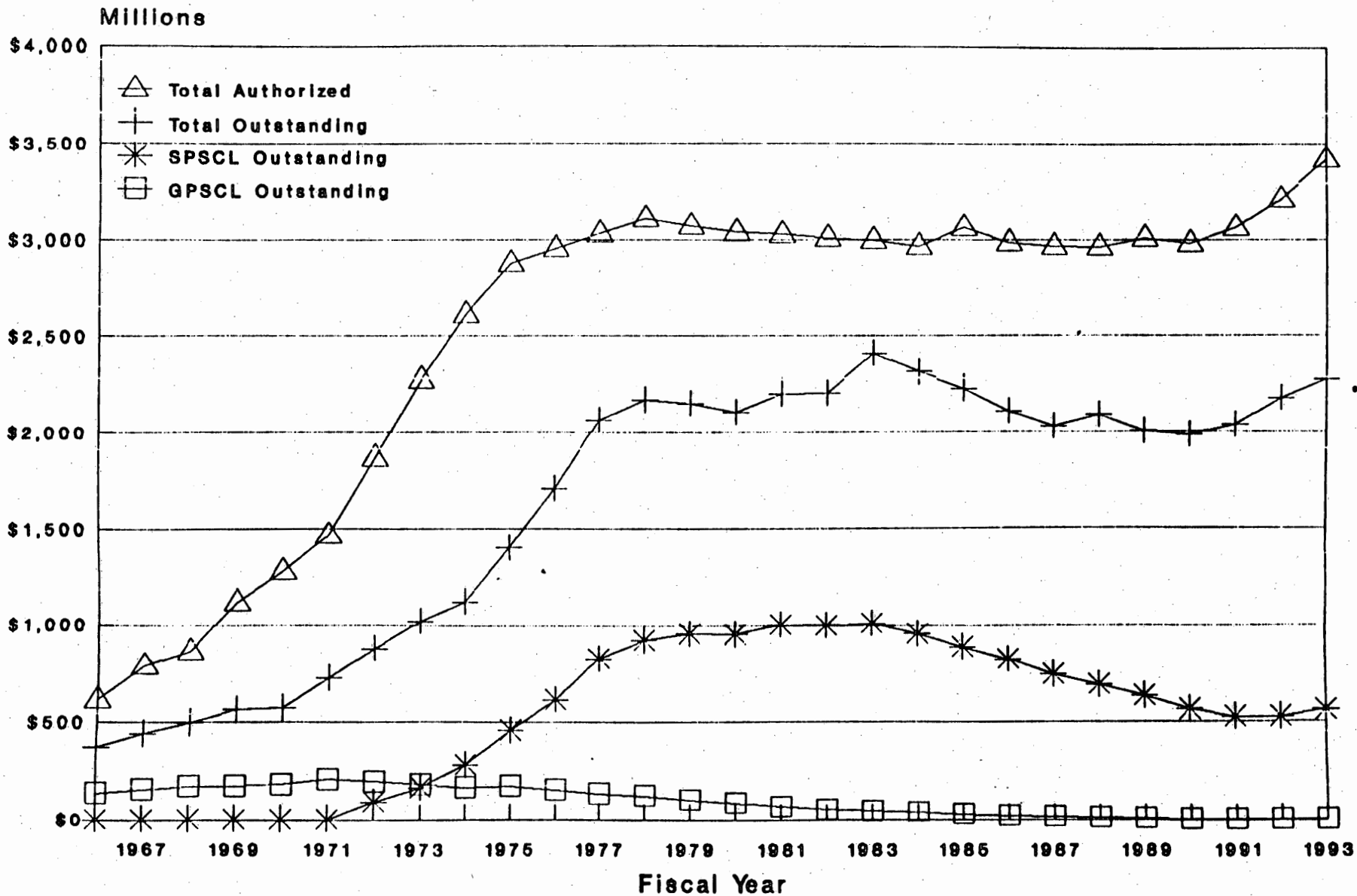
The State of Maryland has issued in recent years five types of tax supported debt: (1) general obligation debt, which pledges the full faith and credit of the State; (2) bonds and notes issued by the Department of Transportation and backed by the operating revenues and pledged taxes of the Department; (3) Bond Anticipation Notes (BANs) issued in support of the savings and loan program; (4) capital leases; and (5) revenue bonds issued by the Maryland Stadium Authority secured by a lease with the State.

A. General Obligation Bonds

Structure. General obligation bonds are authorized and issued to provide funds for general construction of, and capital improvements to, State-owned facilities, including institutions of higher education; grants to local educational authorities for construction of, and capital improvements to, public schools; and financial assistance in the form of both repayable loans and grants to local governments and the private sector for special capital projects where a State interest or need has been demonstrated. Financial assistance to local governments and the private sector is provided for capital projects related to water quality improvements, jails and detention facilities, community colleges, economic development, nursing home construction, community health facilities, historic preservation, private higher education, and other community projects.

Trends in Outstanding General Obligation Debt. Both Graph 1 and the following table depict the substantial growth between 1966 and 1978 in the State's general obligation debt. During the 1971-1978 period, the growth in general obligation debt accelerated principally as a result of the large authorizations for State Public School Construction Loans (SPSCL) made during the 1971-1975 sessions of the General Assembly after the State assumed in 1971 an expanded role in financing the construction of new elementary and secondary schools. Between 1978 and 1987 the level of authorizations and issuances, particularly authorizations and issuances of SPSCL bonds, fell substantially; and, consequently, the level of outstanding debt grew modestly and then declined. Since 1987, the level of new authorizations and issuances has increased significantly, redemptions have dropped dramatically and, as a result, the level of outstanding general obligation debt has stopped declining and resumed growing.

General Obligation Debt Outstanding at June 30



GRAPH 1

39X

(thousands)

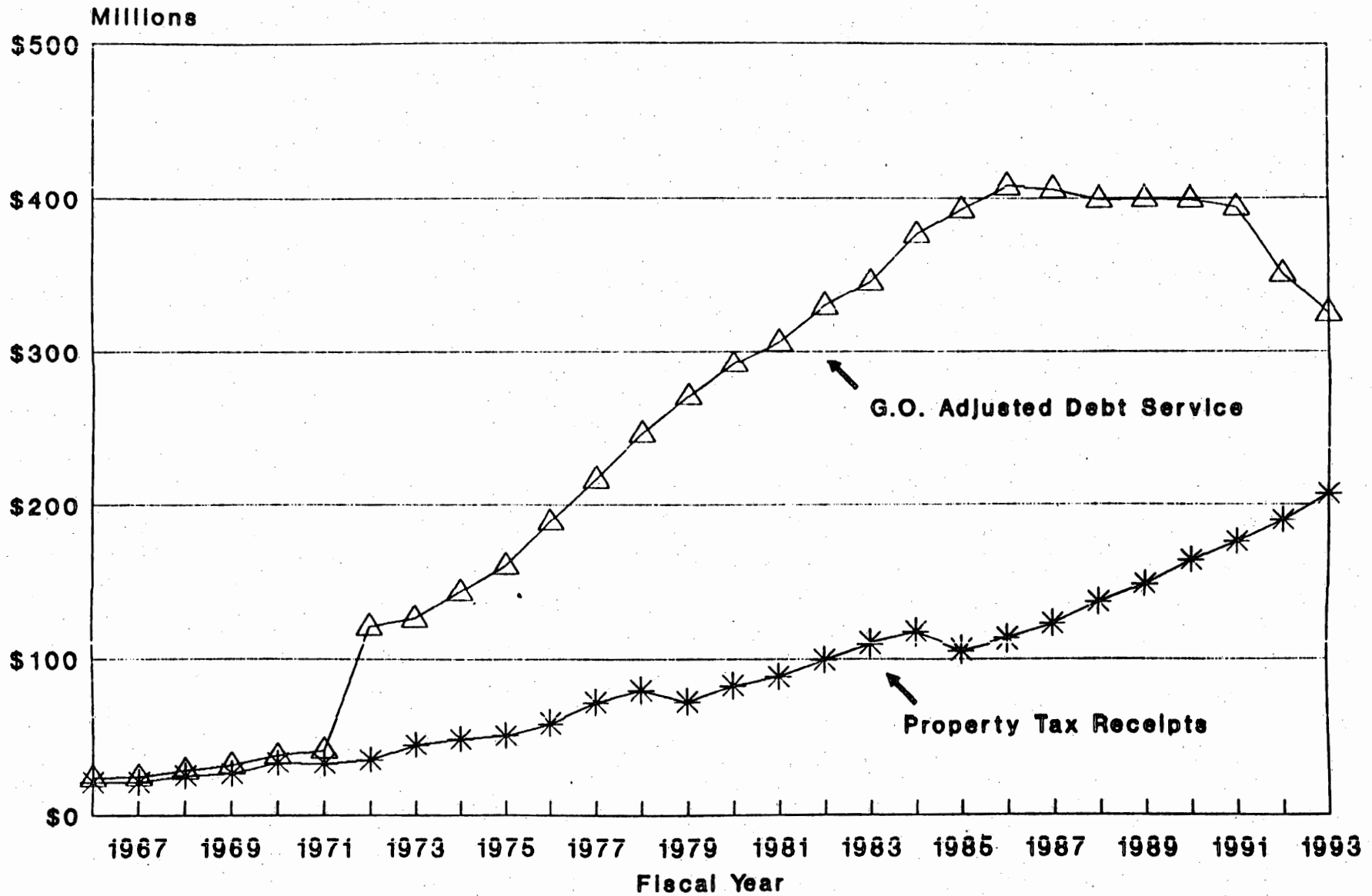
<u>Fiscal Period</u>	<u>Average Annual General Obligation Debt</u>		<u>Average Annual SPSCS Debt</u>	
	<u>Authorized</u>	<u>Issued</u>	<u>Authorized</u>	<u>Issued</u>
1966-1970	\$180,905	\$80,104	\$ -0-	\$ -0-
1971-1978	316,540	270,747	152,250	122,374
1979-1987	211,509	181,006	42,033	57,172
1988-1993	321,103	266,047	59,800	61,927

As depicted in Graph 2, adjusted general obligation debt service grew annually from a level of \$24 million in fiscal 1966 to \$408 million in fiscal 1986 and then declined to \$324 million in fiscal 1993. Adjusted general obligation debt service represents the burden on the general fund and State property tax for debt service. Adjusted debt service is total principal and interest payments on general obligation bonds with two adjustments, both of which are related to the funding of local public schools. First, general obligation debt service is reduced by the amount of debt service on "repayable" loans that is recovered by the State from the local subdivisions on the loans, principally loans to local governments for the construction of local schools under the General Public School Construction Program (GPSCL). (Typically, this repayment is made in advance of the payment due date of the related debt service.) Second, general obligation debt service is increased by the amount of non-State local school debt service that was assumed by the State in 1971 with the advent of the new school construction program.

Also depicted in Graph 2 is the dramatically increasing reliance on general funds to support general obligation debt service from 1971 to 1986. After increasing to \$270.9 million in fiscal 1986, the general fund requirement has fallen to a low of \$116.5 million in fiscal 1993. While State property taxes are constitutionally pledged to the payment of debt service, it has been the State policy for many years to maintain a stable property tax rate and rely on general funds, appropriated either to the Annuity Bond Fund or to the Aid to Education program of the State Department of Education, to provide the majority of funding for general obligation debt service. In fiscal 1966, property tax revenues provided the funding for 89% of the general obligation debt service; by fiscal 1986, property taxes provided only 27%. By fiscal 1993, the share of property taxes had increased to 64% as the property taxes continued to grow while the debt service required dropped 20%.

General Obligation Debt Service

Adjusted for Assumed Debt and Repayables



The growth in debt service (Graph 2) reflects both the increase in debt outstanding through 1978 (Graph 1) and dramatic increases in interest rates in the early eighties. Graph 3 depicts the average interest rates paid on State general obligation debt (derived by dividing interest paid in a fiscal year by the average debt outstanding during that year) and the average rates of interest incurred on new issues during each fiscal year. The average interest rate paid on outstanding debt ranges from a low of 2.75% in fiscal 1966 to a high of 7.26% in fiscal 1987. The average of interest rates on all new issues during a year ranged from a low of 3.25% in 1966 to a high of 10.27% in 1982; most recently, it was 5.24% in fiscal 1993 -- the lowest since 1979.

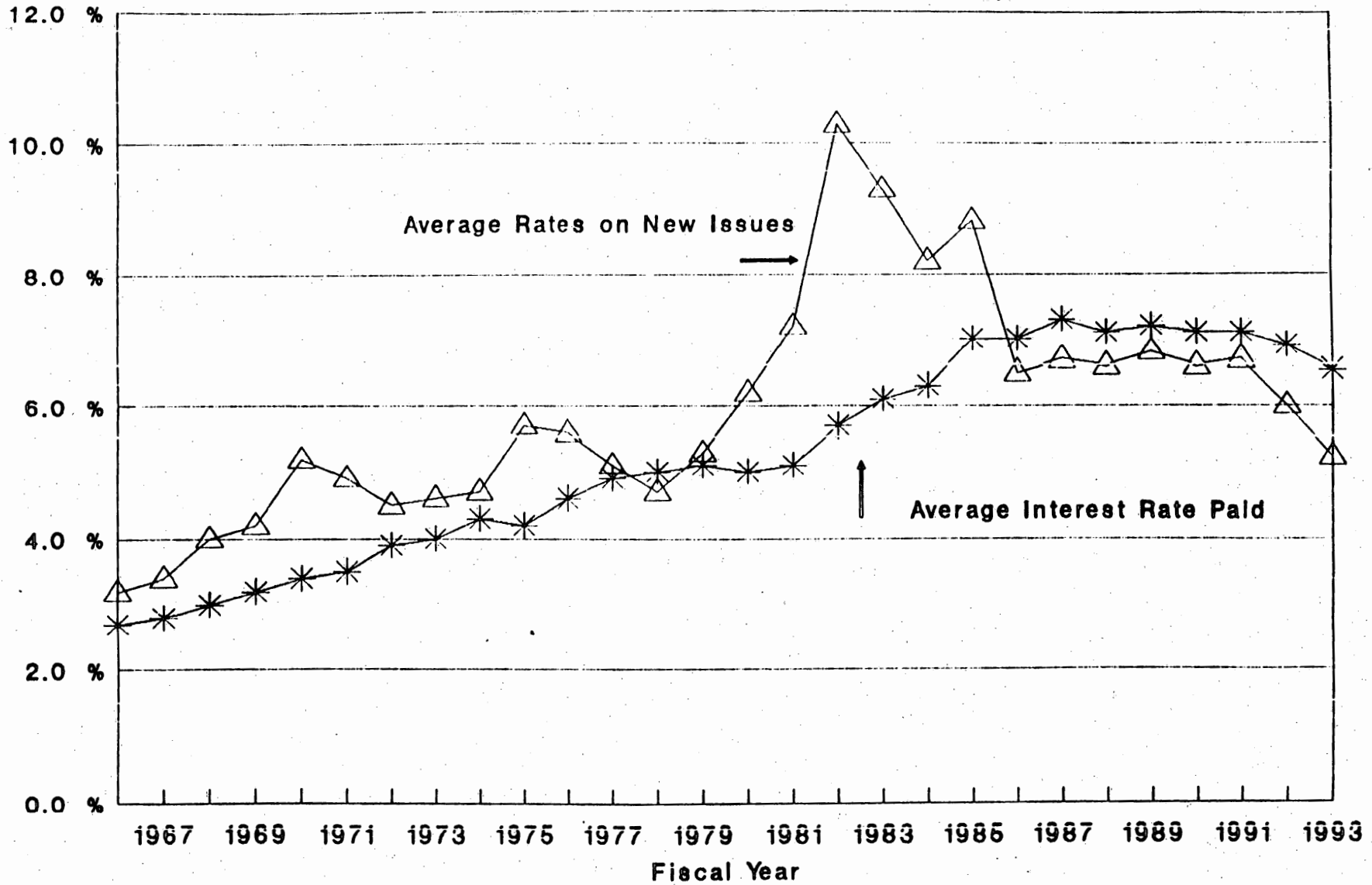
Capital Program Structure The State's annual capital program includes projects funded from State general funds, State general obligation bonds, certain special and federal funds appropriated in the State's annual operating budget, and bonds and other financing obligations issued by State agencies including the Department of Transportation and higher education systems.

The general obligation bond-financed portion of the capital program consists of an annual Maryland Consolidated Capital Bond Loan (MCCBL) and other initiatives. The MCCBL is a consolidation of projects formerly authorized by the general construction loans and various Administration-sponsored bond bills. The general construction loan projects are typically State-owned. The Administration-sponsored bond bills typically authorize capital grants and loans for locally-owned projects.

General obligation bond funds have traditionally been supplemented with State general fund capital appropriations authorized in the annual operating budget. The use of operating funds to finance capital projects can reduce debt issuance as well as expand capital programs. The use of operating budget funds, moreover, enables the State to avoid unnecessary expenses or burdensome prohibitions associated with compliance with restrictive federal statutes. For example, the Tax Reform Act of 1986 imposes certain constraints that either limit the degree of tax exemption or restrict arbitrage earnings for bonds issued to establish insurance reserves, subsidize industrial development, or provide the equity contribution to a revolving fund such as the Maryland Water Quality Financing Fund.

Although the State's policy may be to provide additional capital funding in the operating budget, the financial reality is that in certain years the operating budget does not have the flexibility to fund a significant share of the capital program.

Average Interest Rates on General Obligation Debt



GRAPH 3

43x

For example, for fiscal year 1990, the general fund capital appropriation (PAYGO) was \$212 million; for fiscal year 1994, the PAYGO appropriation was slightly more than \$26 million virtually all of which was associated with programs where tax exempt bond financing is difficult.

The operating budget also traditionally includes capital programs funded with (i) a broad range of dedicated taxes and bonds such as the transportation program, (ii) individual dedicated revenue sources such as Program Open Space, (iii) and specific federal grants such as armory and mass transit construction.

State-Owned Facilities. Requests for improvements to State-owned facilities to be financed with either general obligation bonds or general funds are expected to total \$1.5 billion over the next five years. Correctional facilities, higher education projects, and State office projects comprise the bulk of these requests.

Agency requests for State-owned construction projects are distributed as follows:

(millions)

<u>Agency</u>	<u>FY 95</u>	<u>FY 96</u>	<u>FY 97</u>	<u>FY 98</u>	<u>FY 99</u>	<u>Total</u>
Balt. City Comm. College	\$19.9	\$ 3.4	\$ 0.3	\$ 15.3	\$ 6.7	\$ 45.6
Education	0.1	0.0	1.0	0.0	13.0	14.1
Environment (Asbestos)	2.8	4.3	4.3	2.8	2.8	17.0
General Services	62.7	41.3	47.4	53.0	58.4	262.8
Health & Mental Hygiene	15.1	18.4	5.3	7.0	2.1	47.9
Housing & Comm. Develop.	10.1	5.0	3.2	2.5	2.1	22.9
Indiv's w/ Disabilities	1.5	2.0	2.5	3.0	3.5	12.5
Judiciary	16.0	15.6	19.8	8.3	11.1	70.8
Juvenile Services	1.3	34.8	11.2	4.8	11.4	63.5
Military Department	12.2	4.9	5.9	0.3	0.4	23.7
Morgan State University	23.8	43.4	91.2	62.7	6.9	228.0
Natural Resources	4.5	4.0	4.9	4.1	5.4	22.9
Md. Environmental Serv.	3.2	3.6	5.6	2.3	2.0	16.7
Public Broadcasting	1.1	0.2	2.0	0.0	0.0	3.3
Public Safety & Cor. Serv.	65.9	48.6	27.2	15.0	7.3	164.0
MSA	0.0	30.0	0.0	0.0	0.0	30.0
St. Mary's College of Md.	0.5	10.5	0.5	0.0	0.0	11.5
Univ. of Md. System	98.6	109.3	121.0	114.5	114.7	558.1
Veterans Commission	0.2	0.0	0.2	0.0	0.0	3.5
Total	\$346.8	\$384.0	\$369.3	\$306.7	\$240.5	\$1647.1

Capital Grants and Loans. There are many different Administration-sponsored capital grant and loan programs through which the State agencies provide financial assistance to non-State entities. Grants and loans are made to local governments,

44X

private non-profit institutions, and private organizations and individuals for various purposes including economic development, environmental control, and housing and community facilities.

Prior to the 1990 session of the General Assembly, most capital grants and loans for projects not owned by the State were authorized by separate bond bills. In 1990, most of the Administration-sponsored capital grant and loan programs were consolidated into the MCCBL; however, State capital grants for local jails and private higher education facilities continued to be authorized by separate bond bills. In 1992, even the capital grants for local jails and private higher education facilities were consolidated into the MCCBL.

There has been an increase in the capital grants and loans authorized in recent years. Future funding is expected to increase most rapidly for environmental programs, community colleges, and jails. The increase in environmental programs is the result of major initiatives to continue improving Chesapeake Bay water quality. The significant increase in the demand for Community College projects stems from a combination of rising enrollments and aging facilities. The \$127.6 million of local jail projects reflects a statutory mandate for the State to assist local governments in building facilities for prisoners with sentences of 12 months or less.

Requests for bond-funded capital grants and loans are expected to exceed \$1.3 billion in the next five years, an average of almost \$269 million per year. In addition, funds will be needed in the operating budget to finance the purchase of the Peabody art collection and many programs of the departments of Economic and Employment Development, the Environment, and Housing and Community Development. Many of these programs were previously funded with general obligation bonds; current federal regulations governing tax exempt financing; however, limit the State's ability to issue tax exempt bonds for such programs.

Anticipated requests for non State-owned Administration-sponsored programs are as follows:

(millions)

	<u>FY 95</u>	<u>FY 96</u>	<u>FY 97</u>	<u>FY 98</u>	<u>FY 99</u>	<u>Total</u>
<u>Aging</u>						
Elderly Citizen Centers	\$ 1.0	\$ 1.0	\$ 1.0	\$ 1.0	\$ 1.0	\$ 5.0
<u>Economic and Empl. Dev.</u>						
Nat'l Infor. Tech. Ctr.	4.0	0.0	0.0	0.0	0.0	4.0
Silver Spring Redevel.	7.0	3.0	1.0	0.0	0.0	11.0
<u>Energy</u>						
Energy Conversation	0.2	0.2	0.2	0.2	0.2	1.0
<u>Environment</u>						
Hazardous Substance Control	5.3	5.0	5.6	5.6	5.6	27.1
Water Supply	4.2	4.7	5.2	5.2	5.2	24.5
Water Quality	16.9	18.5	20.0	21.5	23.0	99.9
<u>Health & Mental Hygiene</u>						
Community Mental Health Facil.	3.2	3.2	3.2	3.2	3.2	16.0
Adult Day Care	1.0	1.0	1.0	1.0	1.0	5.0
<u>Housing & Comm. Develop.</u>						
Md. Historical Trust	0.5	0.5	0.5	0.5	0.5	2.5
Partnership Rental Hsng.	7.0	7.0	7.0	7.0	7.0	35.0
<u>Juvenile Services</u>						
Juvenile Residential Facil.	1.2	1.2	1.2	1.2	1.2	6.0
<u>Local Schools</u>						
Public School Construction	200.0	160.6	159.1	131.8	110.6	762.1
<u>Miscellaneous</u>						
U. Md. Medical System	15.0	15.0	10.0	10.0	10.0	60.0
Public Community Colleges	10.8	14.0	20.0	20.0	20.0	84.8
Private Higher Education	5.5	5.5	6.0	6.0	6.0	29.0
Local Jails	17.6	15.0	20.0	35.0	40.0	127.6
Baltimore Zoo	.8	5.9	3.2	3.3	6.0	19.2
Hopkins Oncology Center	6.0	6.0	6.0	0.0	0.0	18.0
Total	\$308.5	\$268.6	\$271.5	\$253.8	\$241.8	\$1344.2

School Construction. The Governor's Task Force on School Construction, after reviewing the existing needs, program changes, and projected increases in enrollment, recommended an increase in the level of funding for public school construction of at least \$85 million in fiscal 1995 and phased in to reach \$100 million annually over the next five years.

Other Initiatives. Funding requests are also submitted each year by members of the General Assembly to provide financial support for local programs or projects of Statewide interest. These bond requests include capital grants to local governments and private non-profit sponsors to support construction for local public and private facilities.

While it is difficult to predict the amount of legislative initiatives that will be requested in any given year, it is fair to estimate that the requests will average approximately \$100 million annually, or \$500 million over the next five years.

Summary of Capital Program: Fiscal Years 1995-1999. The total capital requests are estimated at \$3.5 billion for the next five years. The Department of Budget and Fiscal Planning anticipates recommending a five-year capital improvement program including \$2.0 billion in general obligation bonds. The total capital program will depend on the amount of general funds and other non-general obligation sources available for capital funding. The level of general funds available to supplement the bond-funded program will be largely dependent on the State's financial condition.

	(millions)	
	<u>FY 1995-1999 Requests</u>	<u>FY 1995-1999 Anticipated Capital Programs</u>
General Construction Projects	\$1,647	\$ 943
Administration Capital Programs	1,344	954
Legislative Initiatives	<u>500</u>	<u>75</u>
Total	<u>\$3,491</u>	<u>\$1,972</u>

B. Transportation Bonds

Consolidated Transportation Bonds are limited obligations issued by the Department of Transportation, the principal of which must be paid within 15 years from the date of issue, for highway and other transportation projects. Prior to July 1, 1992, the gross outstanding aggregate principal amount of Consolidated Transportation Bonds was limited by statute to \$950 million. Debt service on Consolidated Transportation Bonds is payable from the Department's shares of the motor vehicle fuel tax, the motor vehicle titling tax, all mandatory motor vehicle registration fees, and a portion of the corporate income tax, plus all Departmental operating revenues and receipts. The holders of such bonds are not entitled to look to other sources for payment.

The Department has covenanted with the holders of outstanding Consolidated Transportation Bonds not to issue additional bonds unless the excess of revenues (credited to the Transportation Trust Fund) over expenses (of departmental operations) in the preceding fiscal year, which is available for debt service, is equal to at least twice the maximum amount of debt service for any future fiscal year (including debt service on the additional bonds to be issued) and total proceeds from taxes pledged to debt service for the past fiscal year equal at least twice such maximum debt service.

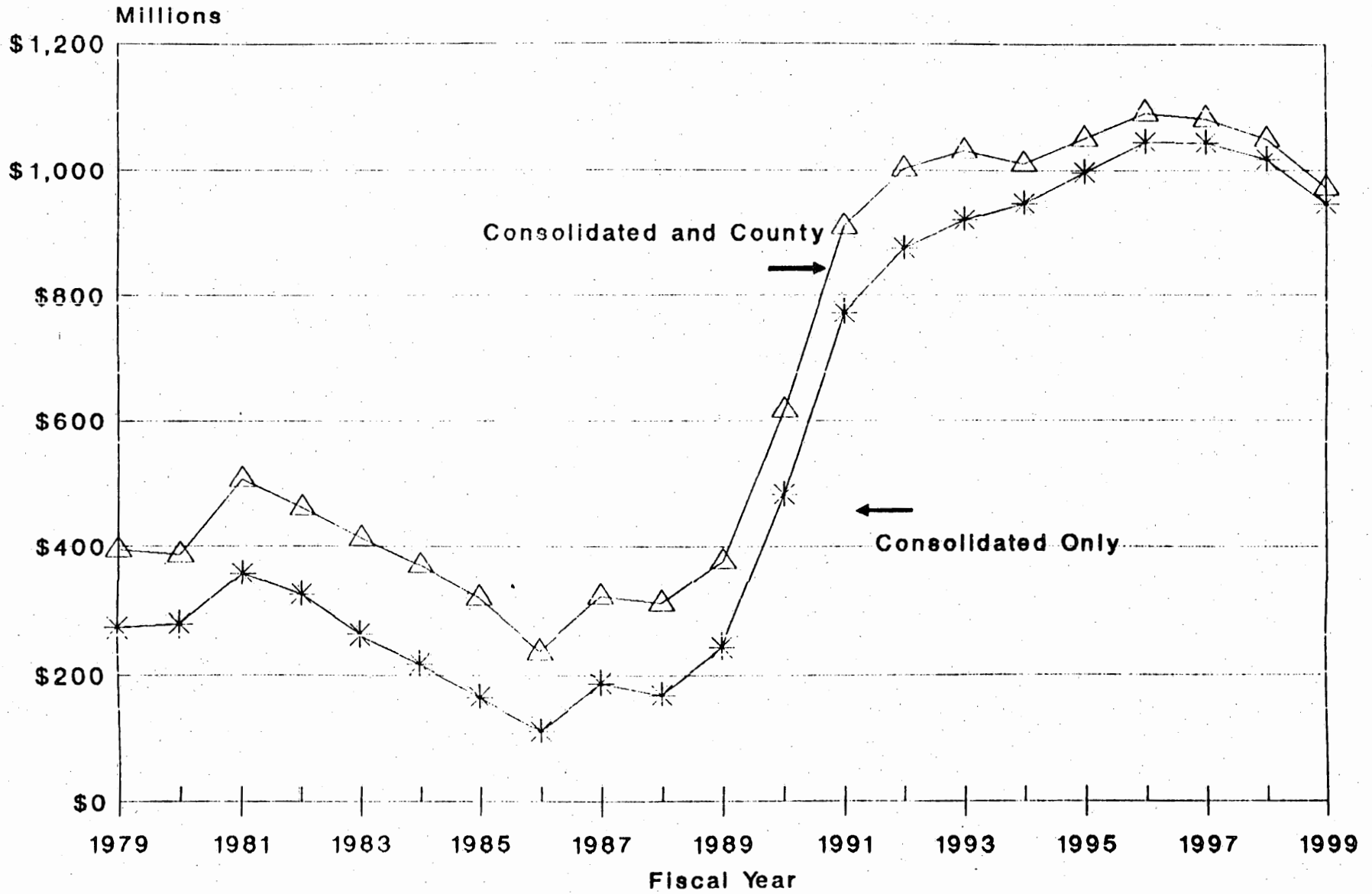
Existing County Transportation Bonds are also 15 year limited obligations of the Department of Transportation issued on behalf of the counties and Baltimore City for local transportation projects; the debt service on the county bonds is recovered from the local units by the State through deduction from amounts otherwise due them from State-collected shared highway user revenues. Debt service on County Transportation Bonds is secured by revenues distributed by law to the subdivisions from Transportation Trust Fund sources. These sources include shares of the corporate income tax, titling tax, motor fuel taxes, and vehicle registration fees.

Both Consolidated and County Transportation Bonds issued before June 1, 1989, utilized sinking funds with respect to the payment of debt service. In the case of Consolidated Transportation Bonds, at the time of issue, debt service due on that issue in the current calendar year and in the following calendar year was placed in the sinking fund. Thereafter, on each January 1, an amount equal to the debt service due for the following calendar year is placed in the fund. For County Transportation Bonds, the practice was identical, with the exception that debt service reserved is on a fiscal year basis. In measuring debt outstanding, most credit analysts reduce gross debt outstanding by the amounts in sinking funds and by the amounts of defeased bonds, if any.

As a result of State legislation enacted in 1989, advance funding of future debt service requirements is no longer mandatory with respect to consolidated and county bonds issued after June 1, 1989. As a matter of policy, however, the Department continued the practice of advance funding of future debt service on County Transportation Bonds.

Graph 4 depicts outstanding Consolidated and County Transportation Bonds (after being reduced by the amounts in the two sinking funds) for the historical period fiscal years 1979 through 1993 and the Department's current projections for fiscal years 1994 through 1999. During the ten years from fiscal 1979 to fiscal 1988, departmental revenues were of a magnitude such that new consolidated bond issues of only \$245 million, excluding short term notes, were needed to augment operating revenues to fund the transportation capital program. This modest level of issuance reflects, among other factors, the impact on customary transportation revenues of several gas tax increases

Transportation Debt Outstanding Net of Sinking Funds



Fiscal years 1994-1999 are estimated

(from 9 cents per gallon in fiscal 1982, to 13.5 cents in fiscal 1984 and to 18.5 cents per gallon effective June 1, 1987) and of permanent allocations to the Transportation Trust Fund of a portion of corporate income tax receipts and the balance of the titling tax. In the most recent years, the level of new issuances has accelerated to \$100 million in 1987, \$260 million in 1990, and \$310 million in 1991; however, the statutory cap of \$950 million in outstanding bonds limited new issuances in 1992 to \$120 million.

At its 1992 session, the General Assembly enacted legislation that increased motor vehicle and motor fuel taxes, raised the limit on outstanding Consolidated Transportation Bonds from \$950 million to \$1.2 billion, and specified that a limit of less than \$1.2 billion could be imposed for the next fiscal year in the annual State operating budget. The General Assembly, in fact, did insert language in the 1993 budget that limited the level of outstanding bonds in fiscal 1993 to \$960 million which served to limit new issues in fiscal 1993 to \$75 million. The fiscal 1994 budget incorporates a limit in the level of outstanding bonds to \$1.025 billion at June 30, 1994.

The Department will issue \$40 million in Consolidated Transportation Bonds in September, 1993 (along with approximately \$204 million in refunding Consolidated Transportation Bonds), and does not expect to issue additional consolidated bonds during fiscal 1994, resulting in bonds outstanding of \$975.7 million at June 30, 1994. During the five year period 1995 -1999, the Department expects to issue an additional \$360 million which will result in bonds outstanding of \$945 million at the end of the period. The Department's plan of bond financing and revenues is sufficient to provide financing for the Vehicle Emissions Inspection Program (VEIP).

The Department did not issue County Transportation Bonds during fiscal 1993. Legislation was enacted by the 1993 General Assembly that provides a new non-State tax supported County Transportation Bond program; future issuances of County Transportation Bonds are anticipated to be under this new program and will not, therefore, constitute State tax supported debt. Additionally, the Department plans to issue refunding County Transportation Bonds under the new program which will serve to eliminate four existing series of County Transportation Bonds from State tax supported debt. Graph 4 reflects the effect of the new program; a discussion of the new program and its impact is in Section V.C. of this report.

C. Bond Anticipation Notes

In response to the savings and loan crisis in May, 1985, the General Assembly authorized \$100 million in general obligation bonds that could be used, among other purposes, to facilitate mergers or to make capital investments in State chartered savings and loan associations when such investment would assure that the association would receive federal insurance. Chapter 452, Laws of 1990, cancelled the authorization.

Three-year Bond Anticipation Notes (BANs) were issued to associations in connection with pending insurance applications. In exchange for the BANs, the State received Net Worth Certificates representing an equity share in the participating associations. The dividend rate on the Net Worth Certificates was in all cases 1 1/2% higher than the interest rate on the BANs. The following table summarizes activity with the BANs that were issued in exchange for Net Worth Certificates.

(in thousands)

<u>Fiscal Year</u>	<u>Outstanding Beginning of Fiscal Year</u>	<u>Issues</u>	<u>Redemptions</u>	<u>Outstanding End of Fiscal Year</u>
1986	\$	\$26,410	\$11,250	\$15,160
1987	15,160	746		15,906
1988	15,906		7,758	8,148
1989	8,148		7,402	746
1990	746		746	
1991				
1992				

Two additional BAN's were issued in connection with the savings and loan program. One for \$46.7 million, subsequently cancelled, was issued to the Maryland Deposit Insurance Fund in connection with the purchase of deposits; one for \$15 million, subsequently redeemed, was issued as security for a short-term bank loan to facilitate a distribution to depositors.

Since the bond authorization has been cancelled and since all insured deposits have been paid, there will be no additional BAN's issued under this program.

D. Lease and Conditional Purchase Financings

The State's capital funding program over the past several years has included the use of capital lease financings in which the State earns an equity interest in the leased property and gains title to such property at the end of the leasing period. Such capital leases are considered debt of the State by financial analysts and under generally accepted accounting principles.

For financial statements to reflect generally accepted accounting principles, leases that are in essence a vehicle for financing assets must be "capitalized" - i.e., reflected on the balance sheet. To the extent that meaningful financial reporting requires this, rating agencies and credit evaluators will incorporate leases of this nature into their overall calculation of the State's debt burden.

Under generally accepted accounting principles, if a lease financing meets one or more of the following four criteria at its inception, the lease shall be classified as a capital lease by the lessee:

- The lease transfers ownership of the property to the lessee (user) by the end of the lease term.
- The lease allows the lessee (user) to purchase the property at a bargain price.
- The term of the lease is 75% or more of the estimated useful economic life of the property.
- The present value of the lease payments is 90% or more of the fair value of the property.

If State leases meet any of these four criteria, the State's audited financial statements will reflect the capitalization of those leases, and the State will be judged by knowledgeable reviewers as having incurred debt. The additional State liability and debt service resulting from financing leases currently is not large relative to the State's general obligation debt liability and debt service.

Capital leases are used for the acquisition of both real property and equipment. Under current practice, capital leases for equipment, primarily data processing and telecommunications equipment, are generally for periods less than five years. Real property capital leases, on the other hand, have tended to be longer term -- in the range of 20 to 30 years -- and have been used to acquire a wide variety of facilities such as regional motor vehicle service centers, a highway support center, an upgraded environmental facility for a state prison and multi-service centers.

The following table summarizes tax supported capital lease financings for the fiscal years 1984 through 1992 and estimated amounts for fiscal 1993.

Tax Supported Capital Leases

(thousands)

<u>Fiscal Year</u>	<u>Present Value of Minimum Lease Payments</u>
1984	\$ --
1985	--
1986	--
1987	12,062
1988	47,580
1989	45,026
1990	43,602
1991	73,257
1992	101,968
1993	111,918

The future use of capital leases for acquiring real property is not well defined. On the one hand, there are no programs to develop State facilities under a capital lease either by private investors or local governments. On the other hand, there continue to be proposals put forth under which the State would acquire real property through a capital lease arrangement. Since the Committee's last report, the State acquired a new District Court facility in Towson through a capital lease with the Baltimore County Revenue Authority.

For purposes of this report, it is assumed that \$10 million annually in real property projects will be financed by capital leases. It is further assumed that these projects are not projects for which general obligation bonds are authorized; hence, there will be no offset in the amount of general obligation bonds issued or outstanding. It is also believed that future capital leases for equipment will be reasonably constant over time, averaging about \$15 million a year.

E. Maryland Stadium Authority

The Maryland Stadium Authority was created in 1986 for the purpose of proposing a site for one or more new professional sports facilities in Maryland and financing and directing the acquisition and construction of such facilities. The Authority is authorized to issue revenue bonds, subject to prior approval of the Board of Public Works. The 1987 General Assembly placed an aggregate limit of \$235 million on the issuance of such bonds,

of which \$200 million may be issued as tax exempt securities prior to January 1, 1991, under a transitional provision of the Tax Reform Act of 1986.

On May 10, 1989, the Authority issued \$60.8 million in taxable lease revenue notes for the acquisition and preparation of the property site of new sports facilities. The Authority also entered into a lease arrangement with the State whereby the State will lease the facilities from the Authority. The Authority's note and subsequent bond issues are secured by the lease with the State, and the State's rental payments to the Authority approximate the debt service on the authority's notes and bonds. The State will sublease the facilities back to the Authority and the Authority's rental payments to the State approximate the Authority's net income. At the conclusion of the lease term, title to the facilities will transfer to the State.

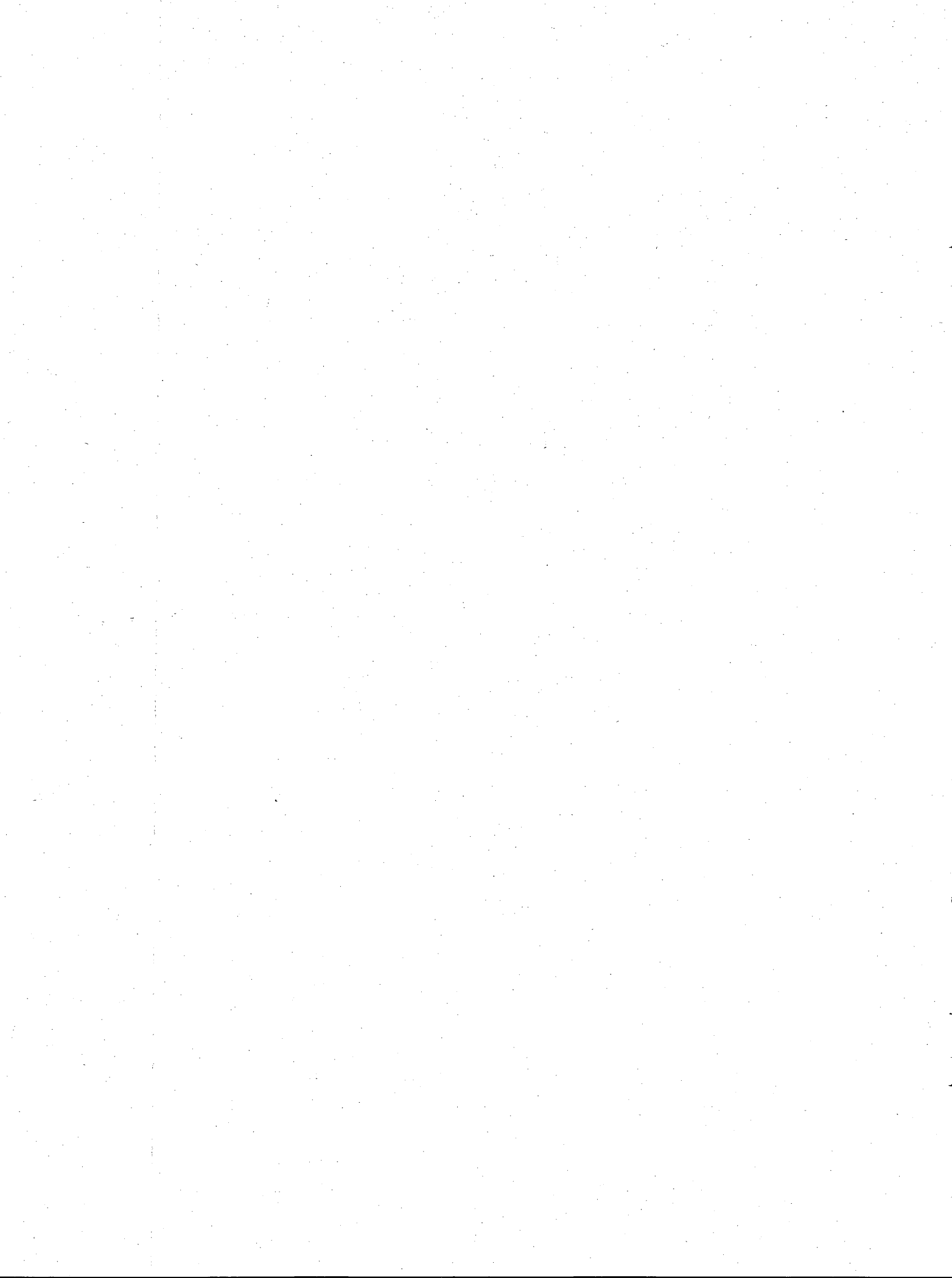
On October 25, 1989, the Authority issued \$137.5 million of tax exempt lease revenue bonds to finance the construction of a baseball stadium; a portion of the proceeds was used to defease \$43.4 million of the first issue due in December of 1989 and December of 1990.

Funds for the lease of the baseball stadium are provided by (1) two to four annual sports lotteries; (2) an annual payment of \$1 million from Baltimore City; (3) interest earnings on the Facilities Fund and on any debt service reserve fund; and (4) net operating revenues of the Authority.

For purposes of this report, it is assumed that the Stadium Authority will issue an amount of additional debt that will fully utilize the maximum debt outstanding allowed in order to finance a football stadium. It is currently anticipated that the National Football League will select the expansion cities in the fall of 1993, and that the Stadium Authority will issue bonds for the football stadium in the summer of 1994 (fiscal 1995). It is also assumed that the bonds issued will be taxable, since the transitional provision permitting the issuance of tax exempt bonds for the project has expired.

The 1993 General Assembly enacted legislation that provides for the expansion of the Baltimore Convention Center by the Maryland Stadium Authority to be funded with \$105 million in State funds and \$50 million from the City of Baltimore. The State funding consists of two State general obligation loans - one for \$20 million (the Baltimore Convention Center loan of 1993) and one for \$30 million (the Baltimore Convention Center loan of 1995) - and up to \$55 million of revenue bonds to be issued by the Stadium Authority. The section authorizing the Baltimore Convention Center loan of 1995 has an effective date of June 1, 1995. The legislation also stipulates that bonds issued by the Stadium Authority for either sports or convention

facilities constitutes State tax supported debt, which is consistent with the approach taken by the Committee. The general obligation portion has been incorporated into the assumed issuance stream of general obligation bonds in the base analysis; the issuance of the revenue bonds has been included in the Stadium Authority component of the base analysis, See V. Other Issues for a discussion of the treatment of the delayed effective date of the \$30 million Convention Center Loan of 1995.



III. AFFORDABILITY ANALYSIS

The objective of an affordability analysis is to draw a proper balance between two basic considerations: the State's capital needs and its ability and/or willingness to repay the debt issued to finance those capital needs.

A. The Concept of Affordability

The ultimate test of affordability is the willingness and ability of the State to pay the resulting debt burden when due. Apart from revenue sources which are dedicated by law, the allocation of future resources between debt repayment and other program needs is a matter of judgement. The whole issue of affordability is, therefore, a judgmental one, dependent upon complex considerations such as perceived needs, the relationship between debt authorization and debt issuance, available and potential funding mechanisms, overall budgetary priorities, and revenues.

The Committee believes that the crux of the concept of affordability is not merely whether or not the State can pay the debt service; rather affordability implies the ability to manage debt over time to achieve certain goals. Maryland has a long tradition of effectively managing its finances and debt. The challenge of debt management is to provide sufficient funds to meet growing capital needs within the framework of the State's debt capacity, thereby maintaining the triple-A credit rating.

B. History of Affordability Criteria

Based upon an analysis of available material (including the responses to a questionnaire sent to a number of experts on Maryland's finances in 1979 and subsequently updated in 1984), the following affordability criteria were developed and employed in the 1979 and subsequent reports:

- That outstanding debt be reduced toward a target level of 3.2% of State personal income as rapidly as practical;
- That adjusted debt service be reduced toward a target level of 8% of State general fund and property tax revenues as rapidly as practical; and
- That new authorizations be kept in the range of redemptions of existing debt over the near term.

These criteria were adopted by the Committee solely for the analysis of general obligation debt. The Committee had considered its major task to be primarily the analysis of general obligation debt in keeping with the tenor of the statute establishing the Committee.

Criteria 1 and 2 represented traditional measures and criterion 3 reflected a discretionary policy position that the State should "get out of debt." Given the Committee's view that the first two criteria were goals to be achieved over time, the final criterion became controlling over the short term.

In 1987, while retaining the first and second criteria for evaluating the expanded definition of debt and debt service, the Committee concluded that the third criterion was no longer an applicable guideline. The basis for its conclusion was threefold. First, there were legislative and executive commitments to provide an increase in the level of bonded debt to finance needed transportation projects and the new stadia. Second, the high ratings of the State's general obligation and transportation bonds indicated that the existing level of debt and the planned increase were acceptable to the rating agencies. Third, adherence to the criterion tied yearly authorizations to events of 15 years before, thereby producing highly variable bond authorizations which are inconsistent with either good debt management or a stable capital program.

In 1988, a detailed survey of credit analysts was undertaken to obtain their views on the Committee's comprehensive approach to reviewing debt and to the criteria the Committee had been using for 10 years. The survey affirmed the Committee's decision to take an expanded view of debt; in addition, criteria 1 and 2 were almost universally approved.

C. 1993 Affordability Recommendation

The Committee recommends a \$380 million limit for new general obligation debt authorizations enacted by the 1994 General Assembly for the fiscal 1995 capital program.

In its 1988 reports, the Committee proposed a six-year program of new authorizations based on a view that the State clearly needed more capital investment. The program recognized a combination of factors that increased pressure on the capital budget (growth in State clients and populations, aging infrastructure, and retreat by the federal government as a provider of capital) and also reflected the growth in tax supported debt capacity that could accommodate increased levels of new authorizations.

In its 1992 report, while reaffirming its beliefs in the theories underlying its prior recommendations, the Committee recognized that the five year program originally recommended in 1988 should be adjusted. The 1992 recommendation acknowledged the persistent recession that had depressed the levels of personal income and the structural changes in Maryland's economy that would deter any near term resumption of the State's previous pattern of rapid growth in personal income. The 1992 program also recognized that, although there had been no abatement in the population growth and demand for services, cost inflation had been lower than originally projected.

In 1992, therefore, the Committee recommended that the level of new authorizations for fiscal 1994 be \$350 million - the same as the level for fiscal 1993 rather than \$370 million as had been envisioned in prior years' reports - and that the annual increase be reduced from 5% to 3% - retaining the 1% increase in real purchasing power but reducing the inflation rate to 2%.

The Committee's new program continues to retain the annual increase of 3% adopted last year. Actual and revised personal income data, however, have provided a higher base than was anticipated last year and indicate that the downward revisions to personal income adopted last year may have been a bit precipitous. As a result, the Committee's recommendation for new authorizations for fiscal 1995 is \$380 million. This represents a 3% increase over the \$370 million that had been originally contemplated as the recommendation for fiscal 1994 before that recommendation was reduced.

D. Comparison of Recommendation and Criteria

To analyze the relationship of the Committee's recommendation for general obligation debt to the affordability criteria, each component of tax supported debt and debt service is projected.

The assumptions for the growth in non-general obligation components of tax supported debt and debt service are as described in Part II. The Department of Transportation consolidated debt is expected to rise moderately and then decline over the next five years as reported in Section II.D.; the Department's county transportation debt will, of course, decline because an alternate program will be utilized. The Maryland Stadium Authority's issuance of debt is as projected in Section II.F. No new BANS will be issued over the forecast period, since the authorization has been cancelled. It is assumed that approximately \$10 million in new capital leases for real property and \$15 million in new capital leases for equipment will be executed in each year.

With respect to general obligation debt, it is necessary to project the pattern of issuance of both new and current authorizations. Newly authorized bonds are not immediately issued; in fact, less than half of the bonds authorized in a year are typically issued within the next two fiscal years. Consequently, the impact of a limit on any year's debt authorizations translates slowly into issuances and affects the outstanding level of debt with a substantial lag. Appendix B-1 converts the recommended levels of new general obligation bond authorizations into a projected level of annual issuances and assumes all authorized debt, with the exception of \$8 million authorized in 1969 for Program Open Space, will be issued. Certainly, some projects currently authorized to be financed by bonds may be abandoned or completed for a lesser amount than authorized; however, it is assumed that any such unnecessary authorization will be re-appropriated into new projects. Although some authorizations may ultimately be cancelled rather than re-appropriated, such cancellations are expected to be immaterial to the analysis.

Current authorizations represent the bulk of the near term need for bond issuances; in fact, the main determinate of near term issuances is the current level of spending. In 1993, capital projects spending was \$305 million including operating budget expenditures for Program Open Space and PAYGO. Bond sales in fiscal 1993, however, totaled only \$260.410 million (not including \$147 million issued to refund \$130.475 million of outstanding general obligation bonds), because of delays as a result of budgetary problems. Bond sales in fiscal 1994, therefore, will include an additional \$40 million to make up for the slippage in fiscal 1993 as well as an additional \$20 million for the Convention Center, for a projected total of \$380 million.

Adjusted general obligation debt service is as displayed in Appendix B-4 and assumes a pattern of future interest rates similar to that projected by the DRI forecasting service.

Based on the Committee's projections, outstanding tax supported debt rises steadily over the near term reflecting growth of approximately \$160 million per year in the level of general obligation bonds, very moderate growth in the level of transportation bonds, and the construction of the football stadium at Camden Yards and the Convention Center (Table 1). Continuing the trend begun in 1990, the growth in debt outstanding through 1995 is slightly greater than the growth in personal income; consequently, the ratio of debt outstanding to personal income rises from 2.66% in 1990 to 3.10% in 1995. After 1995, the growth in personal income is greater than the growth in debt. As a result, the key ratio drops modestly throughout the remainder of the forecast period to 2.86% in fiscal 1999. This

**STATE TAX SUPPORTED DEBT OUTSTANDING
COMPONENTS AND RELATIONSHIP TO PERSONAL INCOME**

Fiscal Year	General Obligation (a) (b)	Department of Consolidated	Transportation County	(c) Total	Capital Leases	Stadium Authority	BAN's	Total Tax Supported Debt	
State Tax Supported Debt Outstanding (\$ in thousands)									
1989	2,005,360	241,838	133,266	375,104	45,026	60,845	746	2,487,081	1989
1990	1,986,906	482,691	133,727	616,418	43,602	155,000	-	2,801,926	1990
1991	2,038,437	773,671	135,841	909,512	73,257	155,000	-	3,176,206	1991
1992	2,178,199	874,770	127,926	1,002,696	101,968	154,880	-	3,437,743	1992
1993	2,279,405	919,899	111,541	1,031,440	111,918	153,160	-	3,575,923	1993
1994	2,476,470	947,170	63,904	1,011,074	133,145	206,325	-	3,827,014	1994
1995	2,609,253	996,477	55,506	1,051,983	136,047	290,000	-	4,087,283	1995
1996	2,772,715	1,045,345	46,541	1,091,886	136,113	287,895	-	4,288,609	1996
1997	2,931,140	1,044,955	37,733	1,082,688	136,162	285,013	-	4,435,003	1997
1998	3,098,165	1,018,060	32,802	1,050,862	136,538	280,932	-	4,566,497	1998
1999	3,294,023	945,230	27,395	972,625	140,535	276,549	-	4,683,732	1999

**State Tax Supported Debt Outstanding as a Percent of Personal Income
(Affordability criteria standard = 3.2%)**

1989	2.03%	0.24%	0.13%	0.38%	0.05%	-	0.00%	2.51%	1989
1990	1.89%	0.46%	0.13%	0.59%	0.04%	0.15%	-	2.66%	1990
1991	1.88%	0.71%	0.13%	0.84%	0.07%	0.14%	-	2.93%	1991
1992	1.92%	0.77%	0.11%	0.88%	0.09%	0.14%	-	3.03%	1992
1993	1.93%	0.78%	0.09%	0.87%	0.09%	0.13%	-	3.03%	1993
1994	1.99%	0.76%	0.05%	0.81%	0.11%	0.17%	-	3.07%	1994
1995	1.98%	0.76%	0.04%	0.80%	0.10%	0.22%	-	3.10%	1995
1996	1.99%	0.75%	0.03%	0.78%	0.10%	0.21%	-	3.08%	1996
1997	1.99%	0.71%	0.03%	0.74%	0.09%	0.19%	-	3.02%	1997
1998	2.00%	0.66%	0.02%	0.68%	0.09%	0.18%	-	2.94%	1998
1999	2.01%	0.58%	0.02%	0.59%	0.09%	0.17%	-	2.86%	1999

(a) Reflects presumed new authorizations as follows:

General Assembly Session:	1994	For Fiscal Year	1995	\$380 million
	1995		1996	390 "
	1996		1997	400 "
	1997		1998	415 "
	1998		1999	430 "
	1999		2000	445 "

(b) Assumes debt service on minibonds is paid at maturity and no minibond put options are exercised.

(c) Net of sinking funds or debt service reserve funds.

(d) Assumptions: (millions)	1994	1995	1996	1997	1998	1999
G.O. issues (incl Conven Cntr)	\$380	\$350	\$390	\$400	\$420	\$435
DOT issues (Consoli new money)	40	100	115	70	55	20
Stadium Authority issues	55	86				
Capital Leases - Equipment	27	15	15	15	15	15
- Real Property	10	10	10	10	10	10

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is in contrast to last year, when the ratio of debt outstanding to personal income was extremely close to the affordability criterion of 3.2% for a major portion of the forecast period.

With respect to the other affordability criterion, the ratio of debt service to revenues, the pattern is distinctly different (Table 2). This ratio, which is a proxy for the burden of the debt on the operating budget, drops to a low of 5.65% in fiscal 1994, rises to 6.72% by 1997, and then drops to 6.27% at the end of the forecast period. As in the past, the ratio remains significantly below the affordability criterion of 8.0%.

The Committee's total program is expected to result in a pattern of debt issuances, debt outstanding, and debt service payments that are within the affordability standards. The State is no longer in the same posture as it was in the early years of the Committee when the Committee was recommending a policy that would bring debt and debt service within affordability limits over time; rather the State meets the accepted affordability standards and the goal is to maintain those standards with a margin for contingencies. The margin for contingencies, while not excessive, is considerably more comfortable than last year.

E. Comparison of Recommendation and Capital Program

The Committee's projections of tax supported debt fully incorporate the most current capital program proposed by the Department of Transportation. The Committee's projections of tax supported debt also incorporate issuance of all \$235 million available to the Maryland Stadium Authority for the construction of sports stadia as well as the issuance of bonds for the expansion of the Convention Center. In addition, the Committee's recommendation of general obligation authorizations provides for full funding of the planned general obligation capital program.

The general obligation capital program funding requirements as presented in Section II.A are \$2.0 billion for fiscal years 1995 through 1999; for the same period, the Committee proposes \$2.0 billion in new general obligation bond authorizations. In terms of expected level of requests for capital funding by State agencies and legislative sponsors, the Committee's plan would provide bonds sufficient to finance 57% of the total requests. The Committee recognizes that the affordable amount may fall short if new capital demands occur, either as new programs emerge or as the federal government continues to reduce its support for state and local programs.

There are basically only two options for meeting the capital needs normally funded by general obligation bonds while staying within debt affordability limits. The State can commit a level of funds in the operating budget sufficient to fund unmet general obligation capital needs. Such a commitment is difficult with

STATE TAX SUPPORTED DEBT SERVICE
COMPONENTS AND RELATIONSHIP TO REVENUES

Fiscal Year	General Obligation (a)	Department of Transportation Consolidated County Total		Capital Leases	Stadium Authority	BAN's (b)	Total Tax Supported Debt Service	
		(b)						
State Tax Supported Debt Service (\$ in thousands)								
1989	399,441	35,195	35,195	8,423	-		443,059	1989
1990	399,175	48,842	48,842	8,544	11,113		467,674	1990
1991	393,598	64,261	64,261	9,149	11,984		478,992	1991
1992	350,192	80,211	80,211	14,110	12,104		456,617	1992
1993	324,050	117,645 (c)	117,645	20,400	13,650		475,745	1993
1994	329,929	79,545	79,545	23,074	13,648		446,196	1994
1995	375,252	104,825	104,825	27,375	20,915		528,367	1995
1996	386,651	129,056	129,056	30,438	24,056		570,201	1996
1997	399,684	148,428	148,428	30,621	24,684		603,417	1997
1998	413,070	158,489	158,489	25,497	25,635		622,691	1998
1999	407,857	150,838	150,838	30,079	25,725		614,499	1999

State Tax Supported Debt Service as a Percent of Revenues
(Affordability criteria standard = 8%)

1989	7.15%	3.72%	3.72%	0.15%	-		6.78%	1989
1990	6.80%	5.16%	5.16%	0.15%	100.00% (d)		6.85%	1990
1991	6.35%	7.19%	7.19%	0.15%	100.00%		6.74%	1991
1992	5.50%	8.62%	8.62%	0.22%	100.00%		6.25%	1992
1993	4.86%	11.07%	11.07%	0.31%	100.00%		6.15%	1993
1994	4.86%	7.32%	7.32%	0.34%	100.00%		5.65%	1994
1995	5.31%	9.21%	9.21%	0.39%	100.00%		6.42%	1995
1996	5.24%	11.01%	11.01%	0.39%	100.00%		6.65%	1996
1997	5.16%	12.25%	12.25%	0.40%	100.00%		6.72%	1997
1998	5.09%	12.77%	12.77%	0.31%	100.00%		6.64%	1998
1999	4.80%	11.83%	11.83%	0.35%	100.00%		6.27%	1999

- (a) Assumes debt service on minibonds is paid at maturity and no minibond put options are exercised.
- (b) Repayments from counties and from savings and loan institutions equal or exceed debt service requirements.
- (c) Includes \$30 million early redemptions of Series 1979 and 1980.
- (d) Transfers from the Stadium Facilities Fund to the Stadium Authority are assumed to be just sufficient, when coupled with the Authority's own-source revenues, to meet debt service requirements.

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the current pressure exerted on the operating budget by formula growth in aid to local government programs, entitlements, and slowly growing revenues. Alternatively, the State can shift priorities among the components of tax supported debt, thereby allowing for a greater level of new general obligation authorizations.

F. Affordability Risk Analysis

Background. In its 1989 report, the Committee observed that the previous year's general obligation bond authorization plan, deemed barely affordable in its 1988 analysis, was not only "affordable" one year later but provided a significant margin for expansion. This improvement was almost entirely the result of new, table 2 higher personal income numbers. Also in the same report, the Committee observed that capital needs changed from year to year. Hence, a capital program undertaken within the Committee's recommended limit with respect to new authorizations might need to be cut back if a new program is authorized that was not factored into the Committee's analysis.

As a result of the experience in 1988-89, the Committee has included in its 1990 and subsequent reports an affordability risk analysis -- the analysis of the risk that a particular five year general obligation bond authorization plan, if followed over time, leads to a breach of the Committee's affordability limits, even though the plan was deemed affordable at the time it was proposed. The concept of affordability risk arose because the Committee was faced with what appeared to be substantial unused affordability capacity. Again this year as in the Committee's recent reports, the Committee's five year general obligation debt to personal income is at or below the 3.2% affordability limit in each year of the forecast period.

Components of Risk. There appear to be four basic risk components in making a judgement about the ultimate affordability of a five year general obligation program of authorizations:

- changes in personal income;
- changes in the definition of tax supported debt;
- changes within the general obligation bond program; and
- changes in the bond issuance plans of other, including new, components of tax supported debt.

Changes in Personal Income. Over the past decade, there has been substantial change in personal income estimates. These changes result from (1) after-the-fact measurement changes by the federal statisticians and (2) revised projections by the Committee. The former risk is clearly beyond the Committee's control. Although the federal estimates of personal income for a year may change by

material amounts in the first two years after the close of the year, subsequent adjustments generally have been small. Through the 1988 report, the Committee's projections of the six year growth in personal income, on the whole, had been conservative and, therefore, subsequent reports tended to portray an increase in affordable capacity.

While the depth of the most recent recession was not reflected in the Committee's projections in their 1989-1991 reports, its effect appears to have been somewhat overstated in last year's projections of personal income. The forecasts of Maryland personal income in last year's report were considerably below the levels projected in the report of the year before and reflected a loss of almost two year's growth in personal income. This year the projected levels of personal income are higher than those projected last year, primarily because of increases to the base combined with slightly increased projections of growth. Personal income for 1992, which was projected at \$116.1 billion in the 1991 report and reduced to \$109.3 billion in last year's report, is actually \$113.5 billion. Growth from 1992 to 1998 was projected last year to average 5.1% per year; current projections are that personal income will grow at an annual rate of 5.35% over that period. This upward revision of projected personal income is reflected in the improved ratio. Table 1 indicates that the ratio of debt outstanding to personal income at June 30, 1995, and June 30, 1998, is projected to be 3.10% and 2.86%, respectively. If last year's estimates of personal income were used, the ratios would be 3.25% and 3.10%, respectively.

Clearly, there remains risk associated with reductions in anticipated levels of personal income particularly in an uncertain economic climate. The Committee's estimate of personal income is significantly lower than the 7.8% average growth rate for the ten years ending with the depressed 1991; however, persistence of the recession, an extension of the depressed condition of the commercial real estate market, and the uncertain outlook for defense-related industries could result in further changes to the State's economy. Although the Committee believes that the current projections adequately discount the effect of these changes on the growth of Maryland personal income, growth rates of 3%, 4%, and 5% for 1993, 1994, and 1995, respectively, instead of the 3.9%, 5.6%, and 5.8% growth currently projected for those years would result in the ratio of debt outstanding to personal income reaching 3.2% in 1995.

Changes in the Definition of Tax Supported Debt. Changes in the definition of tax supported debt will typically only occur whenever an outside authoritative group changes definition. To be sure, there may be State reviews of individual transactions that prompt the reclassification of a specific transaction or set of transactions. Such internally initiated reclassifications, however, are apt to be minor. On the other hand, there would be a major impact if, for example, the bond rating agencies would

decide to count State housing agency debt as tax supported debt or if the Governmental Accounting Standards Board would require long term operating leases to be included on the State's balance sheet. Although changes in standards of outside authoritative groups might have a major impact on measured affordability, such changes are likely to be implemented with ample lead time and would either only affect the out years of the program or provide the Committee with time to adjust its program.

Changes within the General Obligation Bond Program. Changes within the general obligation bond program may arise because of changes in (1) the types and costs of facilities and other projects financed by general obligation bonds, or (2) changes in the speed with which authorized bonds are issued.

Changes of the first variety do not of themselves affect affordability but rather may lead to a re-allocation of resources. The Committee's recommendations are made in terms of a specific dollar amount of bonds and not in terms of a specific set of programmatic facilities, grants, or other capital projects. Changes in construction costs, the availability of PAYGO funding, the need for new prisons or hospitals, federal tax laws, and a host of other variables will certainly influence both the need for general obligation bonds and the Committee's view of the appropriate share of the affordability limit that is to be used; such changes affect the amount of real assets that can be acquired within a specific dollar amount of program. Such changes by themselves, however, affect neither the dollar amount of the Committee's five year plan nor the ratio of debt outstanding associated with that specific plan to personal income. Therefore, without Committee or General Assembly action to alter the dollars to be authorized in the Committee's five year plan, there is no affordability risk resulting from such changes within the general obligation plan.

Changes in the speed with which authorized bonds are issued, however, may affect affordability. Bonds authorized by the General Assembly at any session are not immediately sold. Rather the bonds are sold over an extended period of time as the projects are developed and cash is required to pay property owners, consultants, contractors, and equipment manufacturers. Any systematic force that would accelerate or retard the speed with which bonds are brought to market will increase or decrease the amount of bonds outstanding and affect the ratio of debt outstanding to personal income.

In the 1991 report, the Committee noted that the then pending federal regulations on the use of the proceeds of tax exempt debt to reimburse the issuer for prior expenses might well lead to an acceleration of the issuance of general obligation debt. Fortunately, both the U.S. Treasury and Internal Revenue Service were responsive to many of the concerns expressed by

state and local governments. As discussed in last year's report, the revised reimbursement regulations and new components of the final regulation on arbitrage will not require an additional acceleration of issuances.

Changes in the Bond Issuances Plans of Other Components of State Tax Supported Debt. Changes in the bond issuance plans for other components of tax supported debt probably present the greatest risk to the eventual affordability of a specific five year program. These changes can take the form of expansion of existing programs, as was the case with the expanded Consolidated Transportation debt issuance associated with the 1992 gas tax increase, or a totally new program, such as the Maryland Stadium Authority in 1987.

There are basically four classes of changes. (1) There are changes in existing programs associated with external events. For example, the NFL may once again delay the designation of the expansion cities and, as a result, the "projected" sale of bonds for the football stadium may be delayed. (2) There are known proposals to alter existing programs or create new programs that the Committee may believe to have a high probability of enactment, but the exact timing of the enactment and the amount of new debt are less certain. For example, the 1991 General Assembly authorized design funding for expanded convention facilities in Baltimore City; the 1993 General Assembly authorized State tax supported bonds for new facilities. (3) There are known proposals that the Committee may believe to have a low probability of enactment. For example, in both 1990 and 1991, the General Assembly considered a large bond authorization for accelerating land purchases under Program Open Space and directed the Department of Budget and Fiscal Planning and the Department of Natural Resources to study the proposal. The proposal is similar to the original design of Program Open Space which was abandoned when transfer tax receipts were more than adequate to meet the acquisition program's cash needs. (4) There are bond programs that are not known at the time the Committee develops its plan and analyzes it for conformity with affordability standards. Several years ago when the Committee was considering its plan for 1990-1994, there was no proposal for State assistance for an expanded convention center; tax supported debt related to the convention center will, in fact, be outstanding by 1994. Clearly, this fourth type of risk is most likely to affect the last two years of any five year period as opposed to the first two years of the period.

FY 1995 - 1999 Risks. In considering the affordability risk associated with the 1995-1999 plan in this year's report, the major risk appears to be related to the growth in personal income (discussed above); potential changes in other components of tax supported debt appear to be limited to one with a positive effect on affordability and, as is always the possibility, any bond

programs not now envisioned. There do not appear to be any federal regulatory changes that might lead to an acceleration of general obligation debt issuances; in fact, the regulatory climate, for the first time in a number of years, appears more favorable. Also, there is no evidence that the rating agencies or the Governmental Accounting Standards Board are contemplating changes in standards that would expand the definition of tax supported debt.

The changes in the issuance plans of other components of tax supported debt are related to the possibility of refunding additional series of County Transportation Bonds which would have a slightly positive effect on affordability. Other programs considered in past reports, Program Open Space and the lease conversion plan, do not appear to increase affordability risk. The General Assembly continues to include funding for both program Open Space and lease conversion as general obligation bond items within the amount recommended by the Committee. The Committee's base analysis anticipates that \$86 million will be issued for a new football stadium in 1995. Because a football stadium is certain to cost more than that, possibly as much as \$150 million, past affordability risk analyses have included an amount representing additional State tax supported bonds to fund the difference. The Stadium Authority, however, is committed to raising the additional funding from private sources or accumulated lottery revenues rather than seeking an increase to the Authority's bond authorization. All anticipated State tax supported debt to finance the expansion and renovation of the convention center has been fully incorporated into the base analysis.

In its past three reports, the Committee recommended that the General Assembly consider replacing the County Transportation Bond Program with an alternative that would not be characterized as State tax supported debt. The 1993 General Assembly enacted such an alternative. The base analysis reflects the fact that there will be no new issues of County Transportation bonds under the old program; future issues of County Transportation bonds will not constitute State tax supported debt. The base analysis also reflects the effect of the proposed advance refunding of four series of County Transportation Bonds (the Third, Sixth, Seventh, and Eighth) which achieve both debt service and present value savings. The recent favorable movement of interest rates provides the potential to advance refund an additional three series (Ninth, Tenth, and Eleventh). Refunding the additional series would reduce State tax supported debt by approximately \$23 million in 1994 and \$12 million 1999. The 1994 reduction is equivalent to almost .02% of the Committee's estimate of 1994 personal income.

Conclusion. The analysis suggests that the Committee's projection of general obligation bond authorizations is not only currently affordable, but also that the risk of exceeding the affordability limits are limited. For the first time since adopting an affordability risk analysis, there appear to be no potential changes in the bond issuance plans of other components of State tax supported debt that would have an adverse effect on affordability other than some future bond program unidentified at this time. The Committee, therefore, believes that adjusting the level of the recommendation in the first year of the current five year program, and continuing the annual increase adopted last year, is prudent and consistent with current projections of capacity.

IV. HIGHER EDUCATION DEBT

A. Background

Chapter 93, Laws of Maryland 1989, altered the revenue bonding framework and authority of the University of Maryland System, Morgan State University, and St. Mary's College of Maryland and also assigned certain duties relevant to those alterations to the Capital Debt Affordability Committee.

The statute provided a framework for the issuance of higher education debt. In particular, the statute distinguished between auxiliary facilities (which generate fees or income arising from the use of the facility) and academic facilities (which are used primarily for instruction of students and any facilities which are not auxiliary). The statute also authorized institutions to issue bonds to finance either auxiliary or academic facilities (maximum terms of 33 and 20 years, respectively) with the stipulation that any academic facilities so financed must first be expressly approved by an act of the General Assembly as to both project and amount.

Furthermore, the statute specified fund sources that could be pledged as security as well as those that could be used for debt service payments. Specifically available to be pledged as security are auxiliary fees (defined as fees and rents arising from the use of the auxiliary facility) and academic fees (defined as tuition and student fees). The systems specifically cannot pledge: a State appropriation; contracts, grants, or gifts; or any other source not expressly authorized by the General Assembly. Debt service on bonds for either or both auxiliary or academic facilities is payable solely from auxiliary fees, academic fees, a State appropriation expressly authorized for that purpose, or revenues from contracts, gifts, or grants.

The statute and subsequent annual amendments to the statute establish the maximum allowable amount of outstanding debt for the University of Maryland System at \$605.6 million, Morgan State University at \$28 million, and St. Mary's College of Maryland at \$15 million. Debt for both academic and auxiliary facilities, including capital leases for real property, are subject to the maximum.

The General Assembly, at its 1989-1992 sessions, authorized academic facilities with a total project cost of \$175.4 million to be financed with bonds in an amount of \$187.1 million. The 1993 General Assembly authorized academic facilities to be financed with bonds in an amount of \$24.5 million.

In addition to defining higher education bond authority and authorizing certain projects, Chapter 93 directs the Capital Debt Affordability Committee to:

"...review on a continuing basis the size and condition of any debt of" the University of Maryland System, Morgan State University, and St. Mary's College of Maryland;

"In preparing an estimate with respect to the authorization of any new State debt" [i.e., general obligation debt] to "take into account as part of the affordability analysis any debt for academic facilities to be issued by a system"; and

"...submit to the Governor and the General Assembly the Committee's estimate of the amount of new bonds for academic facilities that prudently may be authorized in the aggregate for the next fiscal year by..." the University of Maryland System, Morgan State University, and St. Mary's College of Maryland.

The charges pose two basic questions for the Committee. How is higher education debt to be "taken into account" in the Committee's affordability analysis? How is the Committee to determine a "prudent" amount of new academic debt that may be authorized?

B. Incorporating Higher Education Academic Debt into the Affordability Analysis

The language in the statute expanding the Committee's charge states: "In preparing an estimate with respect to the authorization of any new State debt [i.e., general obligation debt], the Committee shall take into account as part of the affordability analysis any debt for academic facilities to be issued by a system." This language is somewhat ambiguous as to what constitutes "to take into account".

Neither the statute nor subsequent "Committee Narrative" in the report of the chairmen on the Capital Budget specifically directed the Committee to include higher education debt as a component of State tax supported debt for purposes of the capacity criteria or affordability analysis or the Committee's recommendation relating to new authorization of general obligation debt.

Secondly, during their February, 1989, presentation to the joint fiscal committees, both attending rating agencies were quite explicit in describing their approach to debt measurement that debt issued by institutions of higher education was not considered by them to be State tax supported debt. The debt of the three systems, either currently outstanding or related to future issuances, would not, under current rating agency policy, be counted by the rating agencies in determining the rating of the State's general obligation bonds.

Third, both the statutory structure of higher education debt and the current budgetary policies related to higher education debt underscore the separation of higher education debt and tax supported debt. The statute provides that higher education debt may not be secured by a pledge of the issuer's general fund appropriation. The statute further provides that no general funds may be used to pay debt service unless specifically authorized in the budget. Not only has no budget included such authorization, but also the Secretary of Budget and Fiscal Planning has stated in a letter to the Committee that there is no commitment on the part of the Administration to provide general fund support for higher education debt service.

Fourth, the revenue sources that secure the bonds are under the direct control of the systems and not directly subject to the approval of either the governor or the General Assembly.

There appears, therefore, to be no standard of analysis commonly used by rating agencies that would suggest that higher education debt should be included as a component of State tax supported debt. At the same time, however, the Committee must in some way "take into account" higher education academic debt. The Committee believes that through careful analysis, discussions, and deliberations of higher education debt levels, capacity, and needs it is meeting legislative intent. It should be noted that outstanding higher education debt, including both academic and auxiliary debt as projected, is 0.45% of projected personal income in fiscal year 1995 and each year thereafter.

C. Recommending a Prudent Level of New Higher Education Academic Debt to be Authorized

The Committee's charge is to submit an "estimate of the amount of new bonds for academic facilities that prudently may be authorized in the aggregate for the next fiscal year by the University of Maryland System, Morgan State University, and St. Mary's College of Maryland." This charge, therefore, requires the Committee to distinguish between burdens imposed by academic debt as opposed to those imposed by auxiliary debt in arriving at a recommendation for academic debt alone. From a credit analyst's point of view, the aggregate level of a system's debt is critical, while the type of debt (academic versus auxiliary) has less relevance to the credit analysis.

One approach to determining a prudent amount of new academic debt to be authorized is to start with the aggregate level of debt that each system anticipates issuing. If it is estimated that level of debt is prudent over time, then it is reasonable for the Committee to accept that aggregate total and to also accept the breakdown (between academic and auxiliary) proposed by a system.

This approach does not address the issue of the maximum level of debt outstanding allowed by statute for each system. While the Committee believes that "caps" on amount of debt outstanding are outside the statutory charge of this Committee, the analysis of system debt capacity may prove useful to the Governor and General Assembly in setting limits for debt outstanding.

The guidelines initially adopted by the Committee to judge debt manageability are those contained in the rating methodology used by one of the major rating agencies. Standard and Poor's uses five factors to rate a public institution's debt (over a time frame of several years): (1) the rating of the State, (2) the State's general financial support for higher education as a whole, (3) the State's financial support for the particular institution, (4) the institution's demand and financial factors, and (5) the security pledge.

The first, second, and fifth factors are the same for all three systems. All systems benefit from the State's triple-A rating; all are part of public higher education in Maryland; and all can offer the same types of security.

The third factor is only relevant to Morgan State University and St. Mary's College of Maryland since the University of Maryland System, as now constituted, receives approximately 93% of the State general funds appropriated to the three systems.

The fourth factor, the institution's demand and financial factors, encompasses a host of data dealing with the student body, financial performance, and components of debt. The specific guideline related to debt burden is twofold. First, the most accurate measure of debt burden is judged to be debt service as a percent of the sum of unrestricted current fund expenditures plus mandatory transfers. Second, if that ratio exceeds 10%, the institution is considered highly leveraged. Comparisons of public institutions in one state to those in another state may not be meaningful, since the level of state support varies so widely. The ratios range from below 2% to over 10% and do not necessarily correlate to ratings, since many other factors are taken into account in evaluating credit worthiness.

Table 3 displays various components of debt for each of the three higher education systems. In analyzing the data, it is important to recognize that there are two levels of higher education debt measurement. One consists of the sum of the components that count toward the statutory ceiling, and the other measure consists of the sum of the components that count for the purpose of credit analysis. It is presumed for purposes of this analysis that the relevant measure is the one that encompasses all components of debt - one that mirrors the measure used by credit analysts - and Table 3 reflects that.

TABLE 3

HIGHER EDUCATION DEBT
Total Auxiliary and Academic

(\$ in thousands)

	Projected Issuances		Debt Outstanding	Debt Service	Unrestricted Current Fund Expenditures plus Mandatory Transfers	Ratio of Debt Service to UCF Expenditures plu Mandatory Transfers
	Auxiliary	Academic				
University of Maryland Systems:						
1994	40,000		496,184	52,496	1,225,098	4.29%
1995	30,000	40,000	539,038	54,273	1,282,363	4.23%
1996	30,000	40,000	580,677	58,030	1,344,976	4.31%
1997	30,000	40,000	619,416	63,351	1,412,670	4.48%
1998	30,000	40,000	659,689	64,698	1,484,513	4.36%
1999	30,000	40,000	696,660	70,607	1,559,673	4.53%
Longwood State University:						
1994	- None Anticipated -		30,199	1,727	58,365	2.96%
1995			30,470	1,514	64,250	2.36%
1996			30,885	1,386	68,100	2.04%
1997			31,324	1,386	73,200	1.88%
1998			31,637	1,606	77,000	2.09%
1999			31,725	1,896	79,800	2.38%
St. Mary's College of Maryland:						
1994			8,728	399	21,754	1.83%
1995	5,500		13,956	664	23,560	2.82%
1996			13,647	1,018	25,515	3.99%
1997			13,251	1,092	27,633	3.95%
1998			12,843	1,086	29,926	3.63%
1999			12,567	934	32,410	2.88%

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Two of the three systems anticipate issuing new debt over the next six years. The University of Maryland System anticipates issuing \$40 million in auxiliary debt during fiscal 1994; bonds will not be needed in fiscal 1994 to finance academic projects. The System plans to issue \$30 million in auxiliary debt and \$40 million in academic debt in fiscal 1995 and each year thereafter. St. Mary's College of Maryland issued \$5.1 million in auxiliary bonds in April, 1993, for student housing and anticipates issuing \$5-\$6 million in auxiliary debt during fiscal 1995 for a student center. Morgan State University issued \$25.2 million in auxiliary bonds in May, 1990, for a project to rehabilitate existing dormitories and add approximately 600 new dormitory beds. In July 1993, Morgan issued \$27.9 million in refunding bonds to advance refund the 1990 dormitory bonds. Morgan currently has no plans to issue additional debt.

As can be seen from the final column of each panel in the table, each system is well within the criteria suggested by Standard & Poor's for measuring debt burden. The debt burden ratios are less favorable than displayed last year for the University and more favorable for Morgan and St. Mary's. The less favorable ratios for the University reflect reduced levels of capacity for each fiscal year. Unrestricted Current Fund Expenditures plus Mandatory Transfers are currently estimated to be approximately 10% below the levels projected in last year's report. The more favorable ratios for Morgan are the result of a combination of reduced debt service - because of the lower interest rates associated with the refunding bonds - and higher levels of Unrestricted Current Fund Expenditures plus Mandatory Transfers; for Saint Mary's, it is a result of slightly higher levels in Expenditures plus Transfers.

Since each of the system's debt issuance plans would result in a debt burden level well below the 10% "highly leveraged" threshold established by Standard & Poor's, there appears to be no basis for the Committee's recommendation to differ from the systems' plans at this time. The Committee recommends a limit of \$40 million of new bonds for academic facilities that prudently may be authorized in the aggregate for the next fiscal year. This amount represents financing of academic facilities by the University of Maryland System.

D. Baltimore City Community College

The Committee's responsibility for reviewing higher education debt was originally enacted in 1989 and enumerated the debt of the three systems then in existence as the subject of the Committee's review.

In 1990, the General Assembly enacted legislation transferring management responsibility for the Community College of Baltimore to the State and renaming the institution as the New Community College of Baltimore. The legislation did not grant the institution the authority to issue debt. Legislation enacted by the 1992 General Assembly, however, granted the authority to issue debt for auxiliary facilities only, limiting the aggregate principal amount of bonds outstanding to \$15 million, and renamed the institution the Baltimore City Community College.

Although the analysis of the debt of the BCCC was not added to the Committee's charge, the Committee reviewed the debt program of the institution. The Committee's charge includes the review of debt of any State unit and, therefore, its scope includes debt of the Baltimore City Community College. The Committee believes, however, that Baltimore City Community College should be not excluded from the specific listing of higher education institutions but should be mentioned as are the other three systems. Needless to say, BCCC would not be included in the Committee's estimate of the amount of new bonds for academic facilities that prudently may be authorized for the next fiscal year, because the BCCC does not have the authority to issue bonds for academic facilities but only for auxiliary facilities. The Committee recommends that the Baltimore City Community College be added to the specific listing of higher education institutions subject to review by the Committee.

The BCCC does not now have any debt outstanding. It is currently exploring the feasibility and desirability of various capital projects that might be funded by the issuance of auxiliary bonds or through capital leases during the next several fiscal years. The Committee expressed concern that some of the projects under consideration by the BCCC might fall outside the definition of auxiliary faculties for which it has the authority to issue debt.

V. OTHER ISSUES

A. Committee Authorization of Additional Issues by the Department of Transportation

In addition to establishing the maximum amount of Consolidated Transportation Bonds that could be outstanding for the next fiscal year to \$1.025 billion, as required by Chapter 3, Laws of Maryland 1992 Special Sessions, the Joint Chairman's Report also stated that:

"The Department of Transportation's capital program as presented in the Consolidated Transportation Program is based on a bond sale of \$55 million in FY 1994. If authorized by the Capital Debt Affordability Committee, the Department may issue an additional \$30 million in debt in order to replace lost revenue upon which the original program was based or to complete the noise barrier program with a 20 percent local match."

The Department of Transportation's Consolidated Transportation Bond program includes an issue of \$40 million in September, 1993 (sold in conjunction with some level of refunding bonds). The Department does not plan to issue any additional Consolidated Transportation Bonds in fiscal 1994. The program of anticipated issuances over the five-year forecast period, when coupled with other components of State tax supported debt, results in levels of debt outstanding that are compatible with the Committee's affordability criteria of 3.2% of personal income.

B. Treatment of Authorization Effective June 1, 1995

Chapter 400, Laws of Maryland 1993, authorized State funding for the Convention Center in the form of general obligation bonds in the amounts of \$20 million (Section 2) and \$30 million (Section 3). All sections of Chapter 400 except Section 3 took effect on June 1, 1993; Section 3 takes effect on June 1, 1995. Section 4, moreover, contained the following language:

"...that the Capital Debt Affordability Committee, in preparing a recommendation for the limit on the amount of general obligation bonds to be submitted to the General Assembly no earlier than the 1995 Session, shall include the \$30 million of general obligation bonds authorized in Section 3 of this Act as part of the limit on the amount of general obligation bonds. Additionally, the Committee shall take into consideration the \$30 million in deferred general obligation bonds authorized in Section 3 of this Act in all calculations of the total tax supported debt of the State."

The intent of the General Assembly is for the \$30 million authorization not be deemed an authorization of the 1993 General Assembly but rather an authorization of the 1995 General Assembly. Characterization in that fashion serves to absorb the first \$30 million of whatever amount of new general obligation authorizations the Capital Debt Affordability Committee recommends for the 1995 General Assembly/fiscal 1996 capital program. The current general obligation authorization bond program anticipates a recommendation of \$390 million for the 1995 General Assembly/fiscal 1996 capital program - a 3% increase over the \$380 million limit for new general obligation debt authorizations the Committee will recommend in this year's report for the 1994 General Assembly/fiscal 1995 capital program. As directed by Section 4 of Chapter 400, that \$390 million includes the \$30 million.

C. County Transportation Bonds

Although County Transportation Bonds have been used exclusively to make loans to counties and are secured by taxes imposed and collected by the State but otherwise payable to the counties, the original authorizing statute (Section 3-309 of the Transportation Article) state that "Bonds issued under this subtitle are the obligations of the Department and may not be considered to constitute a debt of a county for the purposes of determining its debt limitation."

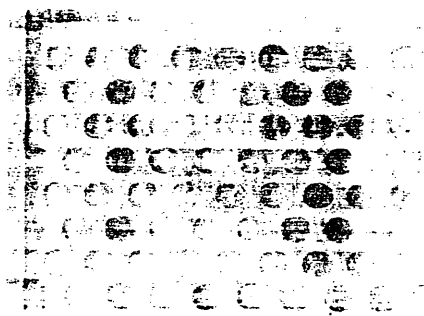
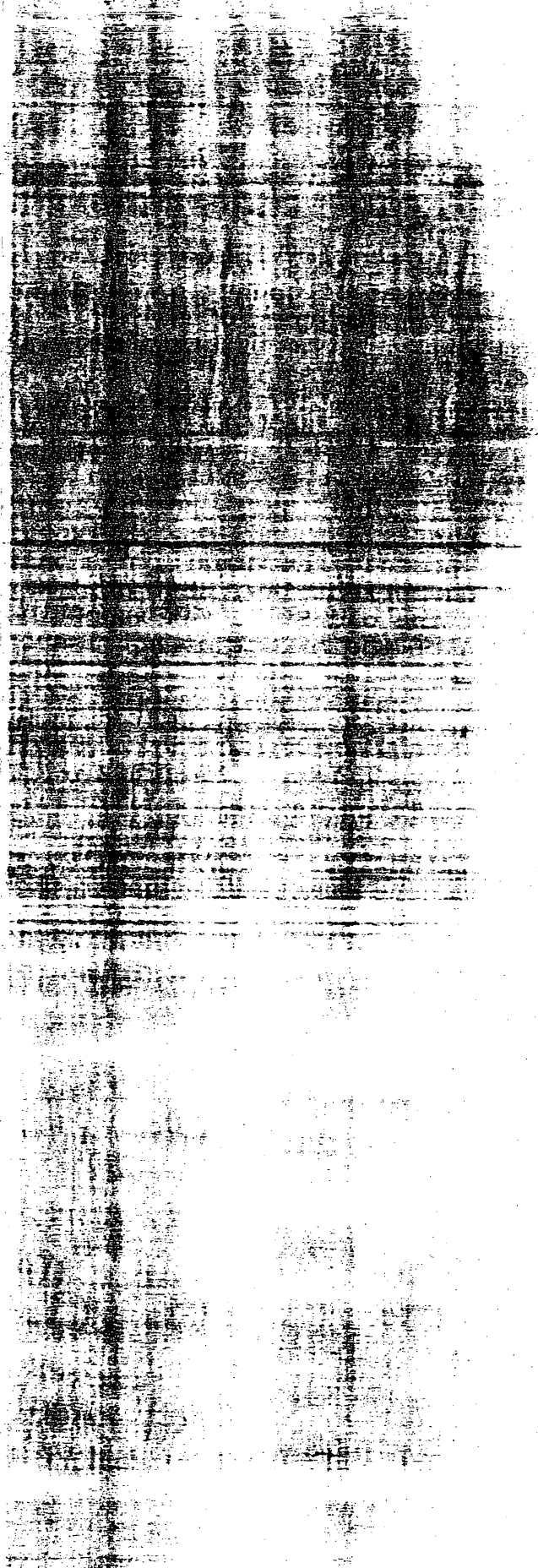
As Departmental debt paid from State tax revenues, the County Transportation bonds have been considered State tax supported debt and, as such, use up State debt capacity that could be used for other State projects. As a consequence, for the past three years the Committee has recommended that the General Assembly consider alternatives to the County Transportation Bonds that were established in State law.

Chapter 539, Laws of Maryland 1993, authorizes the Department of Transportation to establish a financing program to enable the counties to finance the cost of transportation facilities without the issuance of State or Departmental debt. The new statute specifically states that (a) the bonds shall be payable solely from the revenues received by the Department from the participating counties for that purpose, and (b) neither revenues of the State, the revenues of the Department, nor the Transportation Trust Fund can be pledged nor be used to pay debt service. Additionally, the statute states that bonds issued under this program are neither debt of the State nor the Department but are obligations of the participating counties.

With the exception of refunding bonds issued under the new program, counties may participate in the new program only after

approval by any required local ordinance or resolution; the bonds issued under the program are subject to any local referendum requirements or local tax limits.

As noted in earlier sections of this report, the base analysis assumes no future issuances of county bonds under the old program and assumes as well an advance refunding of certain of the currently outstanding County Transportation Bonds. The county bonds to be refunded are those issues the refunding of which will generate both positive present value and debt service savings for all county participants - the Third, Sixth, Seventh, and Eighth series. This refunding has effectively eliminated approximately \$30 million in State tax supported debt in fiscal 1994 - since refunding replaces State tax supported debt (the currently outstanding county bonds) with non-State tax supported debt (the new county bonds). Because the Committee's base analysis last year was based on current law, that analysis incorporated a continuation of the old State tax supported county bond program. The combination of the effect of not issuing any additional bonds under the old program plus refunding four existing series with county bonds under the new program results in a total increased debt capacity of approximately \$50 million. With continued improvement in interest rates, it is possible that an advance refunding of additional series (most likely are the Ninth, Tenth, and Eleventh) will provide present value and cash savings for all participants; the refunding of this second group, however, has not been incorporated into the base analysis. Table 4 compares State tax supported debt outstanding under the old and new programs.



State Tax Supported County Transportation Bonds Outstanding
 - Comparison of Old County Bond Program with New County Bond Program

----- Country Transportation Bonds Outstanding (net of Sinking Fund) -----

Fiscal	1992 CDAC Report Old Program Continues	Old Program Eliminated	Change in Debt Outstanding	Old Program Eliminated and Refund & Issues under New Program	Additional Change in Debt Outstanding	TOTAL Change in Debt Outstanding
1993	120,725	111,541	(9,184)	111,541	0	(9,184)
1994	112,005	93,908	(18,097)	63,904	(30,004)	(48,101)
1995	101,438	74,853	(26,585)	55,506	(19,347)	(45,932)
1996	96,014	61,453	(34,561)	46,541	(14,912)	(49,473)
1997	89,554	47,502	(42,052)	37,733	(9,769)	(51,821)
1998	86,040	36,968	(49,072)	32,802	(4,166)	(53,238)

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LOUIS L. GOLDSTEIN
COMPTROLLER OF THE TREASURY
LOUIS L. GOLDSTEIN TREASURY BUILDING
P.O. BOX 466
ANNAPOLIS, MARYLAND 21404-0466
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September 9, 1993

Honorable Lucille Maurer
State Treasurer
Chair, Capital Debt Affordability Committee
State Treasury Department
Goldstein Treasury Building
Annapolis, Maryland 21401

Dear Treasurer Maurer:

As per our discussion on Tuesday, September 7, 1993, I would like a copy of this letter to be attached to the annual report of the Capital Debt Affordability Committee with reference to the need for the construction of public school facilities throughout Maryland in anticipation of an unusual growth of students.

The latest reports show that there will be an additional 100,000 students throughout Maryland by the year 2000, and in Calvert County alone, they anticipate an additional 17,000 students by the year 2000. In my opinion, now is the time to start building these school facilities so they will be in place when the need exists. Time is of the essence.

Respectfully yours,


Louis L. Goldstein

LLG:dlv

APPENDIX A-1

MARYLAND PERSONAL INCOME AND POPULATION
HISTORICAL DATA AND PROJECTIONS

Calendar Year	Personal Income (millions)	% Change	Population (thousands)	% Change
1983	59,019		4,301	
1984	65,432	10.9%	4,349	1.1%
1985	71,290	9.0%	4,393	1.0%
1986	77,100	8.1%	4,461	1.5%
1987	83,586	8.4%	4,536	1.7%
1988	91,282	9.2%	4,622	1.9%
1989	98,915	8.4%	4,694	1.6%
1990	105,236	6.4%	4,781	1.9%
1991	108,363	3.0%	4,860	1.6%
1992	113,481	4.7%	4,908	1.0%
1993	117,953	3.9%	4,957	1.0%
1994	124,558	5.6%	5,006	1.0%
1995	131,782	5.8%	5,056	1.0%
1996	139,360	5.5%	5,109	1.0%
1997	147,025	5.5%	5,162	1.0%
1998	155,111	5.5%	5,216	1.0%
1999	163,642	5.5%	5,271	1.0%

Personal Income:

1983 - 1991: Official Statement State and Local Facilities Loan of 1993 -
Second Series (U.S. Department of Commerce, Bureau of Economic Analysis)
1992: U.S. Department of Commerce, Bureau of Economic Analysis
1993 - 1999: Bureau of Revenue Estimates

Population:

1983 - 1989: Official Statement State and Local Facilities Loan of 1991 -
Fourth Series (U.S. Department of Commerce, Bureau of Census)
1990 - 1999: Office of Planning/Bureau of Revenue Estimates
1993 - 1999: Bureau of Revenue Estimates

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APPENDIX A-2

MARYLAND STATE REVENUE PROJECTIONS (\$ in millions)

Fiscal Year	General Fund Revenue	Property Taxes	Total	Transportation Revenues	Stadium Related Revenues	Total Revenues
1983	3,096.5	109.2	3,205.7	531.9		3,737.6
1984	3,416.8	116.1	3,532.9	660.5		4,193.4
1985	3,809.2	104.8	3,914.0	689.8		4,603.8
1986	4,164.1	112.2	4,276.3	730.7		5,007.0
1987	4,642.0	121.2	4,763.2	780.5		5,543.7
1988	5,093.2	134.9	5,228.1	892.5		6,120.6
1989	5,442.3	147.0	5,589.3	945.3		6,534.6
1990	5,705.2	162.5	5,867.7	946.1	11.11	6,824.9
1991	6,027.5	174.9	6,202.4	893.9	12.0	7,108.3
1992	6,172.7	189.2	6,361.9	931.0	12.1	7,305.0
1993	6,453.0	209.9	6,662.9	1,063.0	13.7	7,739.6
1994	6,574.4	216.9	6,791.3	1,086.0	13.6	7,891.0
1995	6,840.8	225.1	7,065.9	1,138.0	20.9	8,224.8
1996	7,148.0	236.3	7,384.3	1,172.0	24.1	8,580.4
1997	7,491.1	248.1	7,739.2	1,212.0	24.7	8,975.9
1998	7,850.7	260.5	8,111.2	1,241.0	25.6	9,377.9
1999	8,227.5	273.6	8,501.1	1,275.0	25.7	9,801.8

General Fund: 1983 - 1991, Supplemental Financial Data of the Comptroller
 1992 - Board of Revenue Estimates, December 10, 1992 report
 1993 - 1999, Bureau of Revenue Estimates

Property Tax Revenues: 1982 - 1991, Supplemental Financial Data of the Comptroller
 1992 - Draft of Supplemental Financial Data of the Comptroller
 1993 - Preliminary Data of the Comptroller
 1994 - Commission on State Debt
 1995 - 1989 - State Treasurer's Office

Transportation Revenues: Department of Transportation, Office of Asst Secy, Finance

Stadium Revenues: Transfers from the Stadium Facilities Fund to the Stadium Authority are assumed to be just sufficient, when coupled with the Authority's own-source revenues, to meet debt service requirements.

PROPOSED GENERAL OBLIGATION AUTHORIZATIONS AND ESTIMATED ISSUANCES

(\$ in millions)

General Assembly Session	Proposed Authorizations (b)	Estimated Issuances During Fiscal Year (a)										Total Issue
		1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	
1994	380	0	95	95	76	76	19	19	0	0	0	380
1995	390		0	98	98	78	78	20	20	0	0	390
1996	400			0	100	100	80	80	20	20	0	400
1997	415				0	104	104	83	83	21	21	415
1998	430					0	108	108	86	86	22	409
1999	445						0	111	111	89	89	401
2000	460							0	115	115	92	322
2001	475								0	119	119	238
2002	490									0	123	123
2003	505										0	0
Total		0	95	193	274	358	388	420	435	450	465	3,076
Current Authorizations (b)	1,131	380	255	198	127	62	47	25	25	13		1,131
Total Issuances		380 (c)	350	390 (c)	400 (c)	420	435	445	460	463	465	4,207

Notes:

(a) Percentage issuance assumptions by fiscal years:

Fiscal year following year of authorization	1st	2nd	3rd	4th	5th	6th
Percent of original authorization issued:	25%	25%	20%	20%	5%	5%

(b) Net of \$8 million - the remaining bonds authorized by the Outdoor Recreation Loan of 1969 which are unissued at June 30, 1993. This amount will be cancelled.

(c) Includes \$20 million in fiscal 1994, \$20 million in fiscal 1996, and \$10 million in fiscal 1997 for the Convention Center.

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PROJECTED GENERAL OBLIGATION DEBT - AUTHORIZED BUT UNISSUED

Fiscal Year	Authorized but Unissued Debt at Beginning of Year	Bond Issues (a)	New Debt Authorizations	Projected Cancellations (b)	Authorized but Unissued Debt at End of Year
1994	1,139,018	380,000	380,000	1,000	1,138,018
1995	1,138,018	350,000	390,000	1,000	1,177,018
1996	1,177,018	390,000	400,000	1,000	1,186,018
1997	1,186,018	400,000	415,000	1,000	1,200,018
1998	1,200,018	419,750	430,000	1,000	1,209,268
1999	1,209,268	435,000	445,000	1,000	1,218,268
2000	1,218,268	445,250	460,000	1,000	1,232,018
2001	1,232,018	459,750	475,000	1,000	1,246,268
2002	1,246,268	462,500	490,000	1,000	1,273,768
2003	1,273,768	464,500	505,000	1,000	1,314,268

(a) As projected in Appendix B-1.

(b) Projected cancellations are \$1 million per year for Outdoor Recreation.

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PROJECTED GENERAL OBLIGATION DEBT OUTSTANDING

(\$ in thousands)

Fiscal Year	Outstanding at Beginning of Year	New Issues (a)	Redemptions (b)	Outstanding at End of Year
1994	2,279,405	380,000	182,935	2,476,470
1995	2,476,470	350,000	217,218	2,609,253
1996	2,609,253	390,000	226,538	2,772,715
1997	2,772,715	400,000	241,575	2,931,140
1998	2,931,140	419,750	252,725	3,098,165
1999	3,098,165	435,000	239,142	3,294,023
2000	3,294,023	445,250	270,203	3,469,070
2001	3,469,070	459,750	286,544	3,642,276
2002	3,642,276	462,500	306,849	3,797,927
2003	3,797,927	464,500	328,792	3,933,635

(a) As projected in Appendix B-1.

(b) Assumes debt service on minibonds is paid at maturity and no minibond put options are exercised.

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PROJECTED GENERAL OBLIGATION DEBT SERVICE

(\$ in thousands)

Fiscal Year	Gross Debt Service			Adjustment		Adjusted General Obligation Debt Service
	Bonds Currently Outstanding (a)	New Issues	Total	Debt Service on "Repayable" Bonds (b)	Non-State Debt Service Assumed (c)	
1994	325,287	3,150	328,437	(654)	2,146	329,929
1995	353,118	21,325	374,443	(653)	1,462	375,252
1996	344,005	41,938	385,943	(652)	1,360	386,651
1997	318,858	81,126	399,984	(647)	347	399,684
1998	294,289	119,360	413,648	(642)	64	413,070
1999	242,860	165,121	407,981	(124)	0	407,857
2000	243,195	212,207	455,403	0	0	455,403
2001	217,749	259,472	477,221	0	0	477,221
2002	195,190	308,193	503,384	0	0	503,384
2003	176,470	357,624	534,093	0	0	534,093

- (a) Assumes debt service on minibonds is paid at maturity and no minibond put options are exercised.
- (b) Represents debt service which is repaid to the State by local subdivisions prior to the debt service payment due date.
- (c) Represents debt service assumed by the State on bonds issued by local subdivisions for public schools.

HISTORICAL DATA - GENERAL OBLIGATION DEBT
(\$ in thousands)

Fiscal Year	Authorized (a)	Cancelled	Issued		Outstanding	Authorized but Unissued	Gross Total	Adjustment (b)			Adjusted Debt Service
			New	Refunding				Redeemed	Refunded	Repay		Assumed	Net
1965	157,250	818	69,290		329,651	252,377	35,070	(13,608)	0	(13,608)	21,462
1966	57,067	396	73,795		374,559	235,233	38,519	(16,661)	0	(16,661)	23,858
1967	207,122	2,680	95,785		442,168	363,890	39,690	(15,311)	0	(15,311)	24,379
1968	113,754	4,414	86,235		696,854	366,994	65,498	(16,628)	0	(16,628)	28,870
1969	322,388	34,857	99,505		562,181	555,021	50,986	(18,561)	0	(18,561)	32,425
1970	204,216	1,589	65,200		568,215	712,446	58,277	(19,672)	0	(19,672)	38,605
1971	268,203	40,358	194,720		720,832	745,571	64,854	(22,047)	0	(22,047)	42,807
1972	470,786	17,065	204,040		876,176	995,251	80,138	(7,309)	46,608	39,299	119,437
1973	463,565	9,152	193,505		1,018,664	1,256,159	88,836	(9,912)	45,766	35,854	124,690
1974	412,827	16,058	162,150		1,120,991	1,490,778	105,394	(9,405)	45,684	36,279	141,673
1975	375,956	35,267	353,615		1,402,154	1,477,852	125,787	(11,581)	44,674	33,094	158,881
1976	180,181	20,465	391,605		1,710,353	1,245,963	155,462	(11,072)	44,186	33,114	188,576
1977	169,908	653	448,200		2,065,910	967,018	184,751	(11,963)	43,425	31,462	216,213
1978	190,896	4,577	218,145		2,172,960	935,192	216,797	(14,066)	42,459	28,353	245,190
1979	155,887	61,422	115,350		2,154,075	914,307	244,653	(14,503)	39,599	25,096	269,749
1980	205,510	72,819	117,310		2,109,130	929,688	269,054	(15,052)	37,425	22,373	291,427
1981	182,418	16,335	271,065		2,204,055	824,706	286,003	(15,946)	35,841	19,895	305,898
1982	184,998	22,391	188,180		2,207,660	799,133	311,372	(16,253)	33,967	17,694	329,066
1983	190,250	8,851	392,230		2,409,890	588,301	350,491	(14,062)	28,328	14,266	344,757
1984	203,150	24,467	116,700		2,316,315	650,284	361,279	(12,750)	27,209	14,459	375,738
1985	331,387 (c)	11,187	138,990		2,231,295	831,495	380,089	(11,809)	24,146	12,337	392,426
1986	219,034	49,892	124,585		2,110,075	876,052	396,768	(9,204)	20,227	11,023	407,791
1987	230,950	7,575	164,645		2,030,415	934,782	394,568	(5,104)	16,441	11,337	405,905
1988	254,228	13,601	306,860		2,090,820	870,549	389,993	(4,649)	13,635	8,986	398,979
1989	294,997	3,545	160,000		2,005,360	1,002,000	393,388	(4,240)	10,293	6,053	399,441
1990	328,219	103,063 (c)	236,227		1,986,906	992,930	395,118	(4,260)	8,317	4,057	399,175
1991	329,200	2,570	296,787		2,038,437	1,022,773	388,400	(1,349)	6,547	5,198	393,598
1992	349,979	1,000	340,000		2,178,199	1,031,752	345,897	(1,353)	5,648	4,295	350,192
1993	369,995	2,320	260,410	147,740	2,279,405	1,139,018	322,245	(1,358)	3,163	1,805	324,050

- (a) Authorizations for a fiscal year represent those authorizations effective for that fiscal year; therefore, authorizations for FY 1988 exclude \$15 million for the Salisbury Multi-Service Center which authorization is effective 7/1/88.
- (b) Adjustment to debt service: 'repayable' represents debt service on loans the repayment of which is received by the State, from non-State entities, concurrently with, or prior to, debt service payment dates. 'Assumed' debt represents payments made by the State for debt service on non-State debt.
- (c) Includes \$100 million authorized in the Special Session of 1985 for the savings and loan crisis; no bonds were issued and the authorization was cancelled in 1990.

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HISTORICAL DATA - SCHOOL DEBT
(\$ in thousands)

- STATE PUBLIC SCHOOL CONSTRUCTION AND CAPITAL IMPROVEMENT LOANS

- GENERAL PUBLIC SCHOOL CONSTRUCTION LOANS

- SUPPLEMENTAL PUBLIC SCHOOL CONSTRUCTION LOANS

Fiscal Year	Authorized						Authorized/ (Cancelled)	Authorized						Authorized						Fiscal Year
	Authorized (a)	Issued	Redeemed	Out-standing	But Unissued	Debt Service		Issued	Redeemed	Out-standing	But Unissued	Debt Service	Authorized	Issued	Redeemed	Out-standing	But Unissued	Debt Service		
1965	0	0	0	0	0	0	50,000	20,910	10,511	122,597	74,975	13,608	0	0	0	0	0	0	1965	
1966	0	0	0	0	0	0	0	26,570	10,926	138,241	48,405	14,661	0	0	0	0	0	0	1966	
1967	0	0	0	0	0	0	50,000	28,380	10,922	155,699	70,025	15,311	0	0	0	0	0	0	1967	
1968	0	0	0	0	0	0	0	28,110	11,755	172,054	41,915	16,628	0	0	0	0	0	0	1968	
1969	0	0	0	0	0	0	0	11,405	12,796	170,663	30,510	18,561	0	0	0	0	0	0	1969	
1970	0	0	0	0	0	0	50,000	24,380	14,042	181,001	56,130	19,672	0	0	0	0	0	0	1970	
1971	150,000	0	0	0	150,000	0	0	40,105	15,453	205,653	16,025	22,047	0	0	0	0	0	0	1971	
1972	300,000	90,340	0	90,340	359,660	1,986	0	4,580	16,406	193,827	11,445	24,080	0	0	0	0	0	0	1972	
1973	220,000	73,000	0	163,340	506,660	5,218	0	3,770	16,561	181,036	7,675	23,903	25,000	0	0	0	25,000	0	1973	
1974	212,000	114,400	0	277,740	604,260	9,154	0	0	18,125	162,911	7,675	25,064	0	0	0	0	25,000	0	1974	
1975	160,000	186,000	5,170	458,570	578,260	20,623	0	5,830	18,651	150,090	1,845	25,100	0	20,000	0	20,000	5,000	0	1975	
1976	50,000	162,700	9,685	611,585	465,560	34,242	0	0	18,241	131,849	1,845	24,222	0	0	0	20,000	5,000	1,113	1976	
1977	69,000	230,900	16,590	825,895	303,660	52,119	0	0	18,384	113,465	1,845	23,713	0	0	0	20,000	5,000	1,113	1977	
1978	57,000	121,650	27,240	920,305	239,010	70,941	0	1,695	17,465	97,695	150	22,172	0	5,000	1,060	23,940	0	2,289	1978	
1979	62,000	70,750	37,285	953,770	230,260	85,335	0	0	16,890	80,805	150	20,981	0	0	1,125	22,815	0	2,409	1979	
1980	45,000	48,210	52,195	949,785	227,050	99,952	0	0	16,085	64,720	150	19,551	0	0	1,190	21,625	0	2,412	1980	
1981	45,000	111,200	61,860	999,125	160,850	111,679	(150)	0	14,875	49,845	0	17,707	2,000	0	1,540	20,085	2,000	2,688	1981	
1982	32,000	65,500	69,120	995,505	127,350	124,968	0	0	13,040	36,805	0	15,291	2,000	0	1,630	18,455	4,000	2,694	1982	
1983	22,000	86,350	75,410	1,006,445	63,000	134,258	0	0	10,605	26,200	0	12,337	900	4,000	1,725	20,730	900	2,810	1983	
1984	36,000	36,500	87,025	955,920	62,500	146,099	0	0	8,515	17,685	0	9,765	0	900	1,825	19,805	0	2,985	1984	
1985	34,600	24,000	94,685	885,235	73,100	153,339	0	0	7,765	9,920	0	8,623	0	0	1,935	17,870	0	3,187	1985	
1986	44,300	38,000	103,545	819,690	79,400	149,417	0	0	5,375	4,545	0	5,845	0	0	2,215	15,655	0	3,359	1986	
1987	57,400	34,040	111,190	742,540	102,760	163,947	0	0	1,465	3,080	0	1,691	0	0	2,395	13,260	0	3,413	1987	
1988	53,000	55,750	109,295	688,995	100,010	157,696	0	0	1,085	1,995	0	1,235	0	0	2,535	10,725	0	3,414	1988	
1989	44,000	52,000	110,090	630,905	92,010	155,959	0	0	725	1,270	0	817	0	0	2,695	8,030	0	3,424	1989	
1990	53,000	35,300	106,395	559,810	109,710	148,422	0	0	775	495	0	824	0	0	2,870	5,160	0	3,437	1990	
1991	60,000	57,000	94,910	521,900	112,710	133,620	0	0	155	340	0	175	0	0	780	4,380	0	1,174	1991	
1992	69,000	76,510	76,725	521,685	105,200	113,813	0	0	165	175	0	177	0	0	835	3,545	0	1,176	1992	
1993	80,000	95,000	58,520	558,165	90,200	93,822	0	0	175	0	0	179	0	0	895	2,650	0	1,179	1993	

(a) FY 1987 authorizations include \$3,500,000 for Systemic Renovations

HISTORICAL DATA - DEPARTMENT OF TRANSPORTATION DEBT

Consolidated Transportation Bonds
(\$ in thousands)

Fiscal Year	Gross Debt Outstanding				Gross Debt Outstanding End of Year	Sinking Fund(s) Balance (c)	Net Debt Outstanding End of Year	Debt Service (d)			
	Beginning of Year	Issued	Defeased	Redeemed				Deposits to Refunding Sinking Fund	Principal Redeemed	Interest	Total
1979	354,900			35 (b)	354,865	85,727	269,138	30,491	35	19,076	49,602
1980	354,865	45,000			399,865	125,826	274,039	27,924		20,559	48,483
1981	399,865	120,000 (a)			519,865	165,346	354,519	22,924		23,943	46,867
1982	519,865	60,000		60,000	519,865	198,770	321,095	20,924		28,945	49,869
1983	519,865	40,000		60,000	499,865	240,601	259,264	20,924	60,000	32,884	113,808
1984	499,865				499,865	283,617	216,248	20,924		29,219	50,143
1985	499,865				499,865	335,241	164,624	20,924		29,219	50,143
1986	499,865		354,865	3,000	162,000	29,299	112,701	10,462	3,000	19,547	33,009
1987	142,000	100,000		7,000	235,000	48,317	186,683		7,000	12,919	19,919
1988	235,000			8,000	227,000	58,953	168,047		8,000	15,685	23,685
1989	227,000	100,000		17,000	310,000	68,162	241,838		17,000	18,195	35,195
1990	310,000	260,000		20,000	550,000	67,309	482,691		20,000	28,842	48,842
1991	550,000	310,000		18,000	842,000	68,329	773,671		18,000	46,261	64,261
1992	842,000	120,000		21,000	941,000	66,230	874,770		21,000	59,211	80,211
1993	941,000	75,000		56,200	959,800	39,901	919,899		56,200 (e)	61,445	117,645

Note: On 2/15/78, \$354.9 million of refunding bonds were issued that refunded \$346.9 million in outstanding State Highway Construction Bonds (\$99.4) and Consolidated Transportation Bonds (\$247.5 million). Therefore, at 6/30/78, \$354.9 million was outstanding. These bonds were fully defeased by the end of fiscal 1986.

- (a) Includes \$60 million Consolidated Transportation Bonds plus a one-year Bond Anticipation Note for \$60 million. The one-year BAN was re-issued the following year.
- (b) Specifications for the use of certain federal funds received by the Department required retiring debt; therefore, during fiscal 1979, the Department purchased \$35,000 of the refunding bonds on the open market.
- (c) For those bonds issued prior to 7/1/89, sinking fund balances reflect the net effect of: deposits into the fund, one calendar year in advance, of debt service; fund earnings; and payments, from the sinking fund, to bondholders. Bonds issued after 7/1/89 do not require such a sinking fund.
- (d) Represents payments to the refunding bond sinking fund plus payments of principal and interest to the bondholders. Amounts may differ from budgetary amounts (budgetary amounts represent payment to sinking funds).
- (e) Includes early redemptions of \$30 million.

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HISTORICAL DATA - DEPARTMENT OF TRANSPORTATION DEBT

County Transportation Bonds
(\$ in thousands)

Fiscal Year	Gross Debt Outstanding Beginning of Year	Issued	Defeased or Refunded	Redeemed	Gross Debt Outstanding End of Year	Sinking Fund(s) Balance (c)	Net Debt Outstanding End of Year	Debt Service (d)			Total
								Deposits to Refunding Sinking Fund	Principal Redeemed	Interest	
1979	156,595	4,645		655	160,585	35,898	124,687	9,832	655	8,708	19,195
1980	160,585			215	160,370	48,491	111,879	9,882	215	8,822	18,919
1981	160,370	59,270			219,640	67,056	152,584	9,473		11,187	20,660
1982	219,640	5,700		255	225,085	85,295	139,790	9,266	255	13,843	23,364
1983	225,085	34,875		2,625	257,335	104,373	152,962	9,216	2,625	15,681	27,522
1984	257,335	22,270		2,985	276,620	124,619	152,001	8,749	2,985	18,061	29,795
1985	276,620	24,210		4,435	296,395	144,595	151,800	7,214	4,435	19,591	31,240
1986	296,395	8,795		5,720	299,470	177,185	122,285		5,720	12,099	17,819
1987	299,470	40,590 (a)	180,405 (b)	7,090	152,565	21,479	131,086		7,090	12,336	19,426
1988	152,565	18,255		8,920	161,900	21,599	140,301		8,920	11,766	20,686
1989	161,900	7,285		9,895	159,290	26,024	133,266		9,895	11,931	21,826
1990	159,290	9,950		11,535	157,705	23,978	133,727		11,535	11,695	23,230
1991	157,705	16,550		12,875	161,380	25,539	135,841		12,875	11,619	24,494
1992	161,380	8,300		14,440	155,240	27,314	127,926		14,440	11,383	25,823
1993	155,240			16,405	138,835	27,294	111,541		16,405	10,454	26,859

Note: On 5/25/78, \$155.725 million of refunding bonds were issued that refunded \$153.685 million in outstanding County Highway Construction Bonds and County Transportation Bonds. At 6/30/78, \$155.725 million of the refunding bonds were outstanding. These bonds were fully defeased by the end of fiscal 1986. Also outstanding at 6/30/78 was \$870 thousand in old County Highway Construction Bonds that were not refunded.

- (a) Represents the Ninth Series issue of \$11.415 million plus a refunding series of \$29.175 million issued to refund \$24.680 million. The \$29.175 million will mature from fiscal 1988 through fiscal 1998.
- (b) Represents the defeasance of \$155.725 million and the refunded \$24.680 million.
- (c) Sinking fund balances reflect the net effect of: deposits into the fund, one fiscal year in advance, of debt service; fund earnings; and payments, from the sinking fund, to bondholders.
- (d) Represents payments to the refunding bond sinking fund plus payments of principal and interest to bondholders. Amounts may differ from budgetary amounts (budgetary amounts represent payments to sinking funds).

State of New York

Debt Capacity and Control Analysis

*An Update from the
Office of the State Comptroller*

Edward V. Regan

January 6, 1992

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THE STATE OF NEW YORK

UPDATED DEBT CAPACITY AND CONTROL ANALYSIS

Preface

For the 1990-91 update of this Debt Capacity and Control Analysis, a major change in the calculation of net tax-supported debt has been implemented as a result of the establishment of the New York Local Government Assistance Corporation ("LGAC"). The State developed the LGAC bonding program as a major component of a fiscal reform agenda for the purpose of replacing its annual operating borrowings ("Spring Borrowing") with long-term bonds, in order to eliminate the State's dependence on seasonal short-term borrowings. In 1990, LGAC was authorized to issue up to \$4.7 billion of bonds and notes for the purpose of making payments to local governments and school districts. During the State's 1990-91 fiscal year, LGAC issued \$909 million of bonds in order to fund \$800 million in payments to school districts. LGAC, which was viewed favorably by the credit rating agencies and the financial community, includes a bond covenant which places a cap on future intra-year cash flow borrowings.

Under LGAC's program, it is anticipated that the State's annual Spring Borrowing will be eliminated by the 1994-95 fiscal year. As LGAC issues its bonds, outstanding long-term tax-supported debt will rise substantially, but short-term seasonal borrowing will at the same time be reduced to zero. For comparability purposes, this Office has determined to include short-term operating borrowings in the 1990-91 Analysis. This change is consistent with recent comments by financial rating analysts stating that short-term debt for operating purposes which is issued each year should be included in the calculation of an issuer's debt position and debt ratios. Moreover, prior years have been restated in this Update to include the Spring Borrowing in order to facilitate year-to-year comparisons.

THE STATE OF NEW YORK
UPDATED DEBT CAPACITY AND CONTROL ANALYSIS

Introduction and Findings

Introduction

In August 1984, this Office issued a paper entitled New York State: Debt Capacity and Control Analysis. That study established, on both a current and projected basis, the level of New York's long-term debt on which the State's taxpayers must pay principal and interest and projected the financial and economic resources available to pay such debt in the future.

The amount of debt supported by State taxpayers was \$20.8 billion for fiscal year 1990-91, including \$16.7 billion of long-term debt and the \$4.1 billion of short-term debt for operating purposes. This amount of debt is a larger amount than the traditionally issued general obligation debt, but a smaller amount than any listing that includes all public authority debt. It is the debt that this study determined is actually paid out of State tax receipts.

This Analysis serves as the update of the original study, modified for the change indicated in the Preface, and establishes the State's net tax-supported debt position and the resources available to pay that debt. The study is based on the Quarterly Confirmations of Outstanding Debt collected by the State Comptroller and the State's Financial Projections and Capital Plan for fiscal years 1991-92 through 1995-96.

Findings

Net tax-supported debt for the fiscal year 1990-91 was found to be \$20.8 billion, an increase of 67.8% over the past five years. Long-term net tax-supported debt was found to be \$16.7 billion at March 31, 1991, a 106.3% rise since March 31, 1986, and the Spring Borrowing was \$4.1 billion during the year. Even adjusted for a reclassification of bonds issued for State University of New York ("SUNY") educational facilities by the Dormitory Authority to refinance outstanding Housing Finance Agency ("HFA") bonds for such purposes, net tax-supported debt increased 47.0% from 1986 (adjusted to include the Spring Borrowing).⁽¹⁾

When this Office issued its report in 1986, the amount of net tax-supported debt projected to be outstanding on March 31, 1991 was \$13.6 billion (adjusted to include the Spring Borrowing) -- just 65.2% of the amount actually outstanding at March 31, 1991. (Absent the SUNY educational facilities reclassification, the amount of net tax-supported debt outstanding at March 31, 1991 was still 34.3% above the amount projected in 1986.) The Capital Plan prepared in 1986 did not anticipate debt issuances by the Medical Care Facilities Finance Agency ("MCFFA") for certain hospital projects and by the Metropolitan Transportation Authority ("MTA"). In addition, issuances by the Urban Development Corporation ("UDC") were projected to be significantly less than the amount that has been issued over the period. Finally, the 1986 Capital Plan did not anticipate the refinancing of SUNY educational facilities financings by the Dormitory Authority.

Similarly, the Capital Plan prepared in 1986-87 was projected to result in net tax-supported debt (adjusted to include the Spring Borrowing) at 3-31-91 that was 75.6%⁽²⁾ of the amount

⁽¹⁾ In 1985-1986, debt for SUNY educational facilities was issued by the Housing Finance Agency and was supported by tuition and student fees and therefore was not included in this Office's definition of tax-supported debt. All of this debt was refinanced through issuances by the Dormitory Authority with debt supported by State tax receipts.

⁽²⁾ Projections under the Capital Plan developed in 1986-87 resulted in a long-term net tax-supported debt position of \$11.625 billion, plus the \$4.1 billion Spring Borrowing.

actually outstanding at 3-31-91 and the Capital Plan developed in 1987-88 projected debt outstanding at 3-31-91 to be only 76.1%⁽¹⁾ of what was actually outstanding at that date.

If this pattern persists, it can be anticipated that the amount presently projected to be outstanding at 3-31-96, \$24.289 billion, will be significantly less than the amount that will actually be outstanding at that time. As noted on page 14 of the Analysis, the current Capital Plan is heavily weighted toward the front end with very few issuances projected in the last two years of the Plan. This occurs for three main reasons: (i) the level of authorized general obligation debt will decrease; (ii) the bonding program for LGAC is expected to be completed during fiscal year 1994; and (iii) issuances by the Thruway Authority for highway repairs and improvements (see below) and by the Dormitory Authority for City University of New York programs are projected to end. The amount of issuance forecast for fiscal year 1995-96 is only 19.5% of the amount projected to be issued in fiscal year 1991-92. Based on prior years' patterns, this does not appear to be realistic. Thus, the projected debt ratios in this Analysis are likely to be below the actual results for fiscal year 1995-96.

Currently, the State projects issuances of \$11.8 billion of long-term net tax-supported debt during the next five years, according to the Financial Projections and Capital Plan prepared by the Division of the Budget and updated through October 1991. At the same time, the Spring Borrowing is expected to be reduced by an amount equal to LGAC issuances each year, which are projected to total \$3.9 billion. As a result, the State's net tax-supported debt position would rise to \$24.3 billion at March 31, 1996, an increase of 16.7% over the March 31, 1991 level. A comparison of the change in the debt position and the debt ratios resulting from the Capital Plan versus the period ending March 31, 1991 and a comparison with industry standards for states are shown below.

State of New York Debt Position and Debt Ratios

	<u>Actual</u>		<u>Industry Standards</u>		<u>Ratio of State to Industry Standards</u>	<u>Projected 3-31-96⁽⁵⁾</u>	<u>Percent Change</u>	
	<u>3-31-86⁽²⁾</u>	<u>3-31-91</u>	<u>Median⁽³⁾</u>	<u>Warning Level⁽⁴⁾</u>			<u>3-31-86 to 3-31-91</u>	<u>3-31-91 to 3-31-96</u>
Net Tax-Supported Debt (millions)	\$12,398	\$20,809	—	—	—	\$24,289	67.8%	16.7%
Debt Per Capita	\$697	\$1,157	\$345	—	3.35X	\$1,350	66.0	16.7
Debt to Personal Income	4.3%	5.2%	2.2%	—	2.36X	4.9%	20.9	(5.8)
Debt Service to Tax Receipts	4.1%	5.1%	—	10.0%	0.51X	7.9%	24.4	54.9

(1) The Capital Plan prepared in 1987-88 projected long-term net tax-supported debt to be \$11.746 billion, plus the \$4.1 billion Spring Borrowing.

(2) Restated to include the Spring Borrowing.

(3) Median levels for all states in 1991, as calculated by Moody's Investors Service, Inc.

(4) Credit analysts view the 10% level as a rule-of-thumb indication of an excessive debt burden.

(5) Projected as a result of the debt issuances and growth in personal income and general fund tax receipts over the period which are included the Financial Projections and Capital Plan provided by the Division of the Budget. Population is projected to be constant over the period, which is consistent with the Division of the Budget's statement in the Financial Projections and Capital Plan that there would be little or no growth in population over the next five years.

All of the State's debt ratios increased over the past five years, although the growth in indebtedness was offset somewhat by the growth in the State's economy. While total net tax-supported debt rose 67.8% from March 31, 1986 to March 31, 1991, each of the ratios rose by less than that amount. Debt per capita rose nearly as much -- 66.0% -- but debt to personal income rose 20.9% and debt service to tax receipts rose 24.4%. During the upcoming five-year period, the increase in both total and per capita debt is projected to be slower than during the five previous fiscal years, at 16.7%. The ratio of debt to personal income is expected to fall 5.8%, due to the completion of the bonding out of the Spring Borrowing and the projected rise in personal income over the period.

The ratio of debt service to tax receipts is projected to rise much more rapidly over the next five years than in the past because of the heavy debt issuance in recent years and the projected slowdown in tax receipts. In addition, there were several debt service deferrals taken in fiscal years 1990 and 1991 and principal repayments have been postponed on several authority issues. These actions, while providing budgetary relief in the short run, will produce greater debt service obligations for future years. As a result, the ratio of debt service to tax receipts is expected to be 7.9% at March 31, 1996, an increase of 54.9% over the fiscal year 1991 ratio. Such a level approaches the 10% rule-of-thumb warning level used by credit analysts as an indication of excessive debt burden.

The credit agencies that assess the State's bonds have commented that New York's debt ratios are high and growing, especially when compared to the ratios of other states. However, because a large portion of the projected debt issuances are for the purpose of lessening the State's reliance on short-term debt for operating purposes (to be issued by LGAC), these increases are not expected to adversely affect the State's credit ratings.

In fact, the LGAC program has, from a credit standpoint, more than offset the rise in debt by addressing Moody's Investors Service, Inc. ("Moody's") past concerns about the State's high use of short-term debt for operating purposes. This program is viewed favorably by financial analysts because the State will be significantly less dependent on short-term debt for operations after the bonding out. As noted in the most recent credit report released by Moody's, however, the continuing sale of deficit notes (\$460 million in fiscal year 1988-89, \$775 million in fiscal year 1989-90 and \$1,081.5 million in fiscal year 1990-91) has undercut some of the benefit of the LGAC program.

With the institution of the LGAC program to "bond out" the Spring Borrowing, this Office determined, in its annual review of the State's net tax-supported debt position, that it would be appropriate to change the calculation of the State's debt to include the Spring Borrowing. Prior years have also been restated to include the Spring Borrowing ⁽¹⁾ in order to make them comparable and to more accurately reflect the effect of the LGAC program. This change is consistent with recent comments by financial analysts stating that short-term debt for operating purposes which is issued each year should be included in the calculation of an issuer's debt position.

In addition to the sale of deficit notes, the rating agencies have been concerned in recent years about the growth in lease purchase and contractual obligation debt, which is often used to avoid obtaining voter approval on certain bonding programs. Although total debt has risen 67.8%

⁽¹⁾ Deficit notes have not been included in calculating the State's debt position because they are expected to be eliminated during the current Capital Plan so that inclusion would make future years not comparable.

in the past five years, an examination of the change in net tax-supported debt by component is informative: general obligation debt rose only 24.5%, moral obligation debt actually declined 43.1% and short-term operating debt declined 4.7%; lease purchase and contractual obligation debt, on the other hand, rose 265.4% from fiscal year 1986 to fiscal year 1991. The increasing use of bond issues to provide one-time relief from budgetary stress, such as the sale of Attica prison and the rescheduling of debt service payments on the Albany Mall, has also been cited as a negative credit factor in recent years.⁽¹⁾ Indeed, in its review of the State dated December 2, 1991, Standard & Poor's Corporation ("S&P") stated: "the continued use of temporary or one-shot solutions could have a negative effect on the State's 'A' G.O. rating."

In view of the rating agencies' comments about the size of the State's debt position and their remarks about "one-shot solutions" and deficit notes, continued additions of large bonding programs could cause negative credit implications at some point. For that reason, new bonding proposals must be examined closely to determine if they can be supported within the State's available economic and financial resources. In particular, the infrastructure needs of the State must be weighed against the increasing burden of debt service and overall budgetary outlays being placed on New York taxpayers.

⁽¹⁾ Another financing providing "one-shot" budgetary relief is the proposed \$80 million Thruway Authority service contract bonds. The State Comptroller has filed a lawsuit challenging the legality of this financing.

Calculation of Debt Position

The point of departure for this Analysis is a determination of the amount of debt for which the State's taxpayers are responsible. Once the calculation has been defined, the amount of debt can be compared with the resources that the taxpayers provide to service the debt. In this way, an analysis can be made of the ability of the taxpayers of the State to afford the debt that must be paid for.

Amount of Indebtedness

The State's debt position, as indicated in the Preface, consists of two principal elements: long-term indebtedness and the amount of short-term operating debt issued each year (the "Spring Borrowing"). At March 31, 1991 the amount of long-term State, authority and local government debt for which the State itself had direct or indirect responsibility amounted to \$27.669 billion, consisting of the following: general obligation debt -- \$4.649 billion; guaranteed debt -- \$0.535 billion; contractual obligation debt -- \$3.976 billion; lease-purchase debt -- \$8.604 billion; and moral obligation debt -- \$9.905 billion (including \$6.705 billion issued by the Municipal Assistance Corporation).

Because the State is ultimately responsible for its indirect as well as its direct obligations, it could be argued that New York's long-term debt position consists of these five components and thus totals \$27.669 billion. Such a debt position does not, however, take into account the fact that most of New York's indirect obligations are serviced by non-tax revenues, such as highway tolls, dormitory room rentals or local revenues. Accordingly, these obligations do not place a burden, in the form of annual debt service, on the State's direct resources. On the other hand, New York's taxpayers are responsible for more than just the \$4.649 billion of general obligation debt -- the debt approved by the voters.

The calculation of indebtedness that is used most frequently among municipal credit analysts is the one that takes into account all issues supported by State-imposed tax revenues. This debt position shows the amount of indebtedness serviced from the general government fund; that is, it reflects the debt service payments made directly from tax revenues. That debt is known as net tax-supported debt. All three of the rating agencies, Fitch Investors Service ("Fitch"), Moody's and S&P employ net tax-supported debt in their analyses.

Although a consensus seems to exist among credit analysts as to the appropriateness of using net tax-supported debt, there is less unanimity about the precise calculation, other than the inclusion of direct general obligation indebtedness. For instance, in a recent report on New York (dated August 6, 1991) Moody's calculated the State's long-term debt position to be \$20.1 billion, or \$2.4 billion greater than the Office of the State Comptroller's ("OSC") calculation of long-term net tax-supported debt on June 30, 1991 because Moody's includes several items (Dormitory Authority issues for health facilities and SUNY dormitory facilities and MCFFA issues for mental health services) that OSC views as self-supporting. On the other hand, Moody's does not include short-term operating debt when calculating the State's debt ratios, so that the State's overall calculation of net tax-supported debt is \$1.7 billion greater than that of Moody's. Appendix A compares the State's calculation to the Moody's calculation.

The decision as to which indirect obligations to include in net tax-supported debt is, therefore, somewhat judgmental. For example, most of the items that carry the moral obligation provision (e.g., Housing Finance Agency issues for housing and hospitals) are now self-supporting. Similarly, non-tax revenues support certain lease-purchase debt, such as that issued by the

Dormitory Authority to finance portions of the State University System which is serviced by dormitory room rentals. To include such issues in New York's tax-supported debt position would be a mismatch of obligations and resources; it would add obligations to the State's debt position that are only contingent liabilities, but not a direct drain, on its tax resources.

Conversely, including only debt for which New York is legally liable, directly or indirectly, overlooks the fact that certain obligations (such as bonds issued by the Dormitory Authority to finance capital improvements at the State University of New York and the City University of New York) are supported by tax revenues although there is no legal requirement, even indirect, for the State Legislature to appropriate the debt service for such obligations. Disregarding these items in calculating New York's debt burden would also be a mismatch of obligations and resources.

For these reasons, the \$27.7 billion of long-term State-level debt noted earlier was examined to determine those items supported by tax receipts. All State-level debt was reviewed, including guaranteed debt (debt that is guaranteed by the State); lease-purchase and contractual obligation debt (debt that is serviced by the State in accordance with the terms of specific contracts and leases, subject to annual legislative appropriations); and moral obligation debt (debt for which the State agrees, subject to legislative appropriations, to make up any deficiency in a debt service reserve fund set up for the purpose of securing payment on the bonds). To the extent that any of these items becomes self-supporting, or debt deleted as self-supporting becomes dependent on State tax revenues, the item should be added to or subtracted from the State's debt position.

During the review of items included in net tax-supported debt prepared for fiscal year 1990-91, this Office has determined that the State's annual Spring Borrowing should be included in the calculation, as explained in the Preface. This debt issue has occurred annually since 1959-60 and it is the largest single financing that the State undertakes each year. For these reasons, and because the State developed the LGAC bonding program with the purpose of replacing annual operating borrowings with long-term bonds in order to eliminate over time the State's dependence on short-term debt, it was deemed appropriate to include short-term operating debt in the calculation. This approach is consistent with recent remarks by rating agency officials who have indicated that short-term debt that is never really retired, but is reissued each year, should be included in debt calculations.

As noted in recent credit reports issued by Moody's, however, the continuing sale of deficit notes has undercut some of the benefit of the LGAC program. Although the State Constitution provides that deficit notes must be paid off in the succeeding fiscal year and may not be rolled over, the amount of deficit notes has increased annually over the past three years. To the extent that this practice becomes an annual occurrence, deficit notes might also be judged for inclusion in the calculation of net tax-supported debt in future years.

Calculation of Net Tax-Supported Debt

The State's calculation of net tax-supported debt outstanding at March 31, 1991 is shown below:

NET TAX-SUPPORTED DEBT

***Outstanding as of March 31, 1991
(dollars in millions)***

Short-Term Operating Debt (1)		\$4,100
General Obligation Debt		
Bonds (2)	\$4,402	
Commercial Paper	223	
Bond Anticipation Notes	24	
Total		\$4,649
Contractual Obligation Debt (3)		
Dormitory Authority (4)	\$ 19	
Housing Finance Agency (5)	192	
Local Government Assistance Corporation (6)	909	
Medical Care Facilities Finance Agency (7)	450	
Metropolitan Transportation Authority (8)	1,749	
Triborough Bridge & Tunnel Authority (9)	449	
Urban Development Corporation (10)	206	
Total		3,974
Lease-Purchase Debt (3)		
Certificates of Participation (11)	655	
County of Albany-Empire State Plaza (12)	354	
Dormitory Authority-CUNY (13)	2,107	
Dormitory Authority-SUNY (14)	2,589	
Other Office Buildings (15)	11	
Thruway Authority (16)	168	
Urban Development Corporation (17)	1,485	
Total		7,369
Moral Obligation Debt (3) (18)		713
Other Debt (19)		4
Total Net Tax-Supported Debt		<u>\$20,809</u>

Notes on Net Tax-Supported Debt Calculation

- (1) Repaid on March 29, 1991.
- (2) Excludes \$1,081.5 million of outstanding tax and revenue anticipation notes and \$236.99 million of \$404.69 million of State General Obligation Refunding Bonds dated August 1, 1986 to advance refund an equal amount of general obligation bonds that are included in this table. Debt service on the refunding bonds will be paid from an escrow fund established with the proceeds of the refunding bonds until the refunded bonds are redeemed from the balance of the proceeds of the escrow fund.
- (3) Payments made by the State used to pay debt service on contractual obligation, lease-purchase obligations and moral obligations are subject to annual appropriations by the Legislature and the availability of moneys to the State for the purposes of making such payments.
- (4) Issued to finance a library for the blind and handicapped.
- (5) Issued to finance various housing programs.
- (6) Issued to finance certain assistance payments to local governments; secured by a portion of certain sales and use taxes.
- (7) Issued to finance certain hospital projects; secured by service contracts providing for payments by the State if necessary, subject to annual appropriations for up to 30 years.
- (8) Issued to finance transit improvements; secured by service contracts providing for payments by the State over a 35-year period.
- (9) Issued to finance construction of the New York City Convention Center.
- (10) Issued to finance construction of high technology centers at certain universities, Ten Eyck Plaza in Albany and the Onondaga County Convention Center.
- (11) Issued to finance the acquisition of certain equipment and facilities.
- (12) Issued to finance the State's office complex in Albany. Of this amount, \$232 million relates to debt issued by Albany County for construction of the complex and \$123 million relates to lease rental bonds issued by UDC to restructure debt service payments totalling \$126.7 million in fiscal years 1989, 1990 and 1991 on the Albany County bonds.
- (13) Issued to finance capital improvements at City University of New York. Of this amount, \$1,753 million relates to obligations for Senior Colleges on which the State contributes funds that pay 100% of debt service and the remainder (\$354 million, equal to 50% of the total of \$708 million) relates to obligations for Community Colleges on which the State contributes funds that pay 50% and New York City pays 50% of debt service.
- (14) Issued to refund debt issued by HFA for educational facilities.
- (15) Issued to finance construction of State office buildings.
- (16) Issued to finance highway reconditioning and preservation and construction and reconstruction.
- (17) Issued to finance correctional facilities and state capital construction costs.
- (18) Issued by the Urban Development Corporation ("UDC") to finance housing projects. Although no funds appropriated by the State and paid to UDC in recent years have been for administration or funding of housing programs, there are no assurances that these programs can remain self-sustaining in view of their past difficulties. For that reason, the Comptroller's Office has made a judgment that UDC debt issued (and outstanding) for housing programs should be included in New York's net tax-supported debt position.
- (19) Issued by Erie County to finance its convention center. The amount of debt shown in the table is the portion of debt for which the State contributes debt service (50% of \$7.9 million).

Source: Office of the State Comptroller.

Evaluation of Debt Position

Trend in Debt Ratios

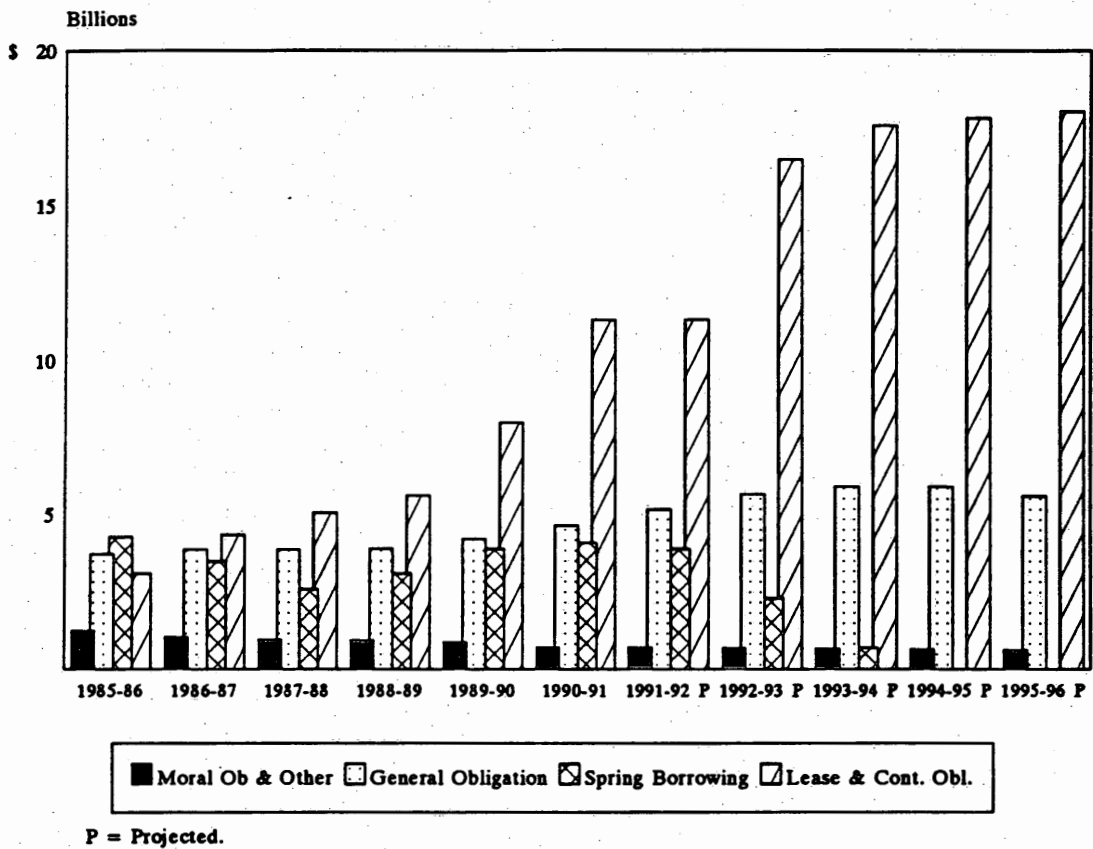
One way in which credit analysts evaluate an issuer's debt position is by examining trends in debt levels. The following graph shows the rise in net tax-supported debt over the past five years. For the three fiscal years ending March 31, 1989, the growth in net tax-supported debt averaged only 3.1% per year, largely because the Spring Borrowing decreased during that time from \$4.3 billion to \$3.1 billion; long-term net tax-supported debt increased \$2.4 billion over the period, equal to an average annual rate of 9.0%. In fiscal year 1990, the growth in debt began to escalate substantially, with net tax-supported debt increasing 29.9% from 3-31-89 to 3-31-90 and 22.4% from 3-31-90 to 3-31-91. During that time, long-term net tax-supported debt rose by 24.9% and 27.5%, respectively, while the Spring Borrowing increased to \$4.1 billion.

The largest addition to long-term net tax-supported debt in fiscal year 1990 was Dormitory Authority debt for SUNY, totalling \$1.8 billion at 3-31-90. This debt, which is supported from State tax receipts, was issued to refinance debt issued by HFA that was supported by tuition and student fees. In fiscal year 1991, the refinancing plan was completed and this item increased further, to \$2.589 billion.

During fiscal year 1991, the largest new item in New York's net tax-supported debt position was the LGAC financings to bond out the Spring Borrowing, totalling \$909 million at 3-31-91. Because the LGAC issuances are for the purpose of lessening the State's reliance on short-term debt for operating purposes, increases due to this item have not adversely affected the State's credit ratings. In fact, the LGAC program has, from a credit standpoint, more than offset the negative impact of the rise in debt by addressing Moody's past concerns about the State's high use of short-term debt for operating purposes. This program is viewed favorably by financial analysts because the State will be significantly less dependent on short-term debt for operations after the bonding out. The legislation creating LGAC limited the amount of operating debt that the State may issue in any one fiscal year to \$4.7 billion less the aggregate amount of LGAC debt outstanding (excluding bonds issued to finance the capital reserve fund and to pay costs of issuance). This limit can only be exceeded if the Governor, the Temporary President of the Senate and the Speaker of the Assembly certify (i) that there are emergency or extraordinary factors or factors unanticipated at the time of adoption of the budget causing a need for the notes and (ii) the amount of notes issued in excess of the limit will be eliminated within three fiscal years.

The rating agencies have, however, been concerned in recent years about the growth in lease purchase and contractual obligation debt, which is often used to avoid obtaining voter approval on certain bonding programs. The following graph breaks out the State's debt position into four categories: (i) general obligation debt; (ii) contractual obligation and lease purchase debt; (iii) moral obligation and other debt and (iv) the Spring Borrowing. As can be seen, general obligation debt has risen only slightly since 1985-86, while moral obligation debt and short-term operating debt have fallen. Contractual obligation and lease purchase debt, however, is more than three times the level in 1985-86. Overall, the State's net tax-supported debt position has increased 67.8% since 1985-86, while general obligation debt has risen 24.5%, moral obligation debt has fallen 43.1%, lease purchase and contractual obligation debt have risen 265.4% and the Spring Borrowing has fallen 4.7%. Current projections show that lease purchase and contractual obligation debt are expected to continue to increase substantially over the next few years although the overall level of debt is currently projected to increase less rapidly than during the previous five fiscal years. In addition, the Spring Borrowing is expected to be eliminated by the 1994-95 fiscal year as a result of issuance of LGAC debt.

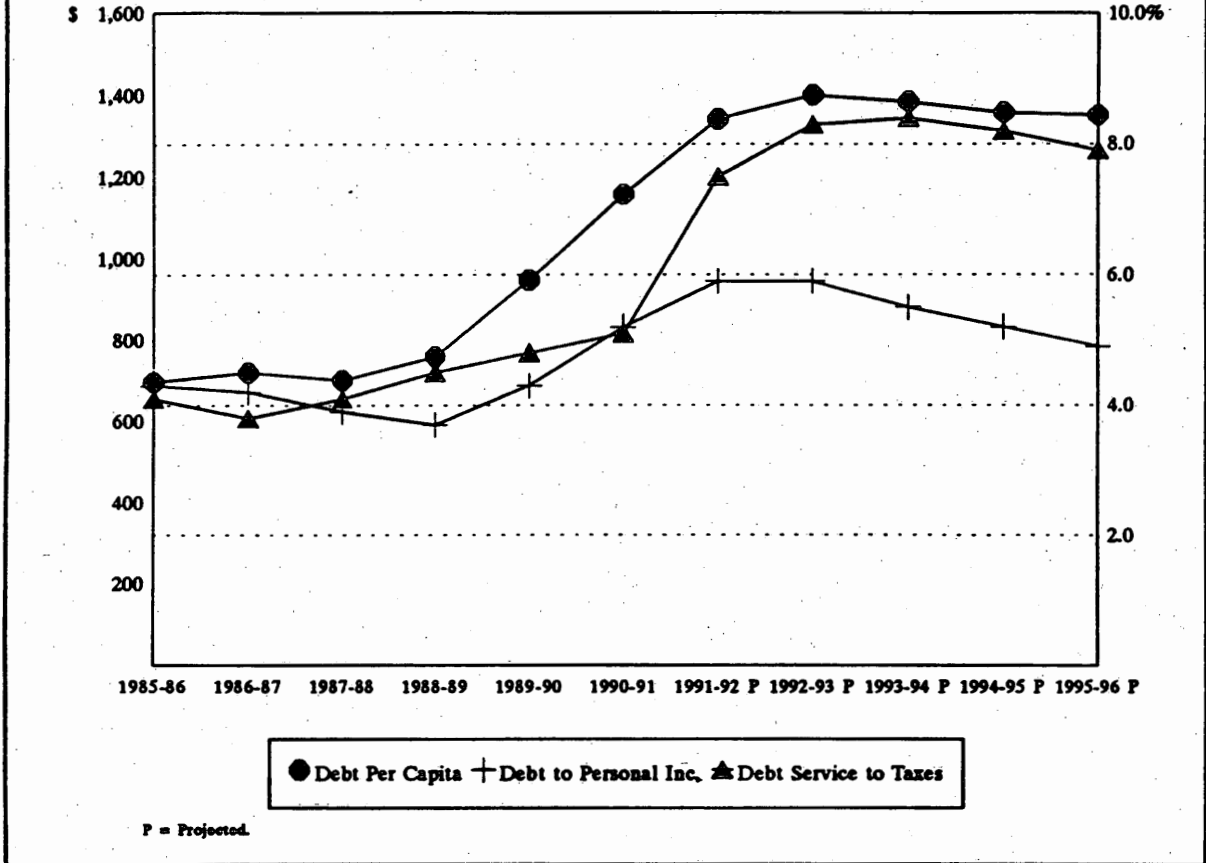
Net Tax-Supported Debt



Although the amount of debt outstanding has increased over the past five years, the trend in the State's debt ratios has been mixed during this time, due in part to the strength of the State's economy that somewhat offset the rise in debt. As can be seen in the following graph, prior to fiscal year 1990 the level of debt to personal income had been declining, while debt per capita had increased moderately each year. Debt service to tax receipts ranged from 3.8% to 4.5% during the period. In fiscal years 1990 and 1991, all of the State's debt ratios rose substantially.

Total net tax-supported debt is expected to rise 16.0% in 1991-92 and 4.3% in 1992-93, and then decrease in the last three fiscal years of the current Capital Plan. Debt per capita and debt to personal income are forecast to follow the same pattern: in fiscal year 1991-92 both ratios are expected to experience a substantial rise and in fiscal year 1992-93 debt per capita is projected to rise slightly and debt to personal income to level out. In fiscal years 1993-94 through 1995-96, debt per capita and debt to personal income are expected to decline modestly each year. Debt service to tax receipts, however, is expected to rise during the next three fiscal years at a much greater rate than the other ratios largely due to deferrals of debt service and postponement of principal repayments on several authority issues during fiscal year 1990-91.

Net Tax-Supported Debt Ratios



Over the past five fiscal years, the increase in net tax-supported debt (as adjusted for short-term cash flow borrowings) has been much greater than the rise projected when this Office prepared the Debt Capacity and Control Analysis in fiscal year 1985-86. At that time, the State's net tax-supported debt position, after adjustment to include short-term operating debt, was \$12.398 billion and it was projected to rise \$1.169 billion over the period to \$13.567 billion by March 31, 1991. However, the State's net tax-supported debt position, after adjustment to include short-term operating debt, actually rose \$8.411 billion over the five year period, to \$20.809 billion.

The State's projected five-year Capital Plan in 1985-86 totalled \$3.491 billion and consisted of the following: \$2.255 billion of general obligation bonds, \$805 million of Dormitory Authority issuances for CUNY Senior Colleges, \$81 million for UDC issuances for university high-tech facilities, \$218 million for UDC correctional facilities and \$132 million of debt issued by the Dormitory Authority for CUNY community colleges. The Spring Borrowing was not included in the State's five-year Capital Plan, but it totalled \$4.3 billion in fiscal year 1985-86.

Actual issuances since 1986 include several financing programs that were not anticipated when the 1985-86 Capital Plan was developed. For instance, it was stated that debt might be issued for special hospital projects by the Medical Care Facilities Finance Agency although such

a bonding program was not certain; the State currently has outstanding \$450 million for this program. In addition, at March 31, 1986 outstanding debt issued by the Housing Finance Agency for SUNY educational facilities was supported by tuition and student fees (and was therefore not included in the net tax-supported debt calculation). All of this debt was refinanced through issuances by the Dormitory Authority with debt supported by State tax receipts and debt for this purpose totalled \$2.589 billion at March 31, 1991. There were no issuances contemplated by the MTA in 1985-86 although the tax-supported portion of MTA debt increased \$866 million over the period. In addition, issuances by LGAC were not included in the five-year Capital Plan developed in 1985-86, but there was \$909 million outstanding for that program at the end of fiscal year 1990-91. Finally, there was projected to be only \$218 million of debt issued by UDC for correctional facilities during this time, but the actual increase in this debt was \$1.19 billion.

The table below compares the projections made in the 1985-86 Analysis, adjusted to include the Spring Borrowing, with actual results for March 31, 1991. As can be seen, the actual outcomes were significantly higher than projections from five years ago in all cases. Contributing to the greater than expected rise in debt ratios was the less than expected growth in total personal income and General Fund Tax Receipts over the period: in 1985-86, total personal income was projected to be \$414.7 billion at 3-31-91, while actual personal income was \$397.6 billion; and General Fund Tax Receipts were projected to be \$30.883 billion in fiscal year 1990-91 but were actually \$26.118 billion, primarily as a result of income tax rate reductions. On the other hand, growth in population was more than projected, which helped to temper the rise in debt per capita: population was projected to be 17,872,000 in 1991 but actual population in 1990 was 17,990,000.

Comparison of Projected to Actual Debt Position at March 31, 1991

	Actual At 3-31-86 ⁽¹⁾	Debt Position at March 31, 1991	
		Projected in 1985-86 Capital Plan ⁽¹⁾	Actual ⁽²⁾
Total Debt Outstanding (000,000's)	\$12,398	\$13,567	\$20,809
Debt Per Capita	\$697	\$759	\$1,157
Debt to Personal Income	4.3%	3.3%	5.2%
Debt Service to Tax Receipts	4.1%	4.3%	5.1%

Comparison of New York to Industry Standards

Credit analysts also evaluate the State's net tax-supported debt ratios in comparison to those of other state issuers. New York's current net tax-supported debt ratios compare to industry standards for states as follows:

⁽¹⁾ Restated to include the Spring Borrowing.

⁽²⁾ If SUNY educational facilities bonds are excluded in order to make 1990-91 comparable to 1985-86, total net tax-supported debt outstanding on 3-31-91 would be \$18,220 million, debt per capita would be \$1,012, debt to personal income would be 4.6% and debt service to tax receipts would be 4.6%.

Net Tax-Supported Debt Ratios

At March 31, 1991

	<u>New York</u>	<u>Industry Standards</u>		<u>New York to Industry Standards</u>
		<u>Medians⁽¹⁾</u>	<u>Warning Level⁽²⁾</u>	
Debt Per Capita	\$1,157	\$345	--	3.35X
Debt to Personal Income	5.2%	2.2%	--	2.36X
Debt Service to Tax Receipts	5.1%	--	10.0%	0.51X

As these ratios indicate, New York's ratio of debt per capita and debt to personal income are worse than the median for all states, but the level of debt service to tax receipts is within the acceptable range. Based on data from Moody's regarding the debt ratios of all other states, New York's net tax-supported debt per capita of \$1,157 ranks fifth highest and debt to personal income of 5.2% ranks New York eighth. On the basis of Moody's calculation of New York's net tax-supported debt, which differs from the State's calculation as previously mentioned, New York's debt per capita ranks fifth among the states at \$993 and debt to personal income ranks eighth at 4.7%. See Appendix B for information on New York's ranking among the states.

The rise in New York's ratios has been much faster than the rise in median levels over the past five years. The State's debt per capita increased 66.0% from 1985-86 to 1990-91, while the median increased only 25.5% during this time. More importantly, the median level of debt to personal income decreased 8.3% in the past five years, while this ratio increased 20.9% for New York.

Moody's has characterized the State's debt levels as "high and growing" in recent credit reports. Moody's notes that the amount of pay-as-you-go financing in the State has declined substantially in recent years, to be replaced with agency and authority debt subject to annual appropriation of payments. In this regard, Moody's noted in its November 12, 1991 report:

One reason for this great influx of agency borrowing is that it has become the source for nonrecurring revenues with the proceeds providing budgetary relief in the year of issuance but increasing debt service over the long-term. Such financings have included refundings of outstanding debt to defer debt service payments and release funds from debt reserves, as well as borrowing for certain capital outlays previously paid from current revenues. Debt service, from both lease obligations and general obligations, has been increasing dramatically in the past few years, and is projected to continue to grow further.

In June of this year when the Spring Borrowing was issued, S&P changed the outlook on the State's long-term debt from "stable" to "negative". This change was due to: "continued economic volatility, further erosion of the state's fiscal condition, and uncertainty about the state's ability to maintain balanced operations through a full fiscal year." In a report on the State published on December 2, 1991, S&P noted that the State's debt burden is "manageable" but "high relative to other states."

(1) Median levels for all states in 1991, as calculated by Moody's Investors Service Inc.

(2) Credit analysts view the 10% level as a rule-of-thumb indication of an excessive debt burden.

Future Needs and Resources

This section of the Analysis identifies issuances of net tax-supported debt expected over the next five years ending March 31, 1996, based on information contained in the current Financial Projections and Capital Plan, as updated through October 1991. These issuances are then compared to growth in economic and demographic resources to determine the effect of such issuances on the State's debt ratios.

Assumptions

In order to perform this Analysis, the economic and demographic assumptions shown below were developed based on projections prepared by the Division of the Budget. The growth rates used for population and personal income, as well as the amount of tax receipts, are taken from the Financial Projections and Capital Plan. Principal retirements and debt service payments on debt outstanding at September 30, 1991 are shown in Appendix C and Appendix D, respectively.

- No growth in population during the period;
- Growth in personal income averaging 4.4% per year;
- Growth in tax receipts averaging 4.2% per year;
- General obligation debt issues are assumed to have an interest rate of 7.50% with principal retirement schedules based on purpose of debt and ranging from 10 to 30 years;
- The Spring Borrowing is assumed to be outstanding for eleven months at an interest rate of 5.5%;
- Debt service on Certificates of Participation are assumed to stay at the 1991 level throughout the period;
- Local Government Assistance Corporation debt issues are assumed to have an interest rate of 8.00% with level debt service over 30 years; and
- Repayments on other lease purchase and contractual obligation debt issuances projected in the Financial Projections and Capital Plan are not included due to the low retirements in the early years.

Current Capital Plan

The State is expected to issue \$11.8 billion of tax-supported debt over the next five years, including \$3.9 billion of debt to be issued by LGAC to "bond out" the Spring Borrowing. Projected issuances of net tax-supported debt through March 31, 1996 are set out in the table on the following page.

It should be noted that the Capital Plan projects the heaviest debt issuances during the next three fiscal years. This occurs for three main reasons: (i) the level of authorized general obligation debt will decrease; (ii) the bonding program for LGAC is expected to be completed during fiscal year 1994; and (iii) issuances by the Thruway Authority for highway repairs and improvements (see below) and by the Dormitory Authority for City University of New York programs are projected to end. The projected issuances in fiscal year 1994-95 are 44.3% of the issuances projected for fiscal year 1991-92, after subtracting out issuances projected for LGAC. Similarly, issuances projected for the last year of the Capital Plan, fiscal year 1995-96, are just 31.7% of the issuances projected for the current fiscal year, after subtracting out issuances projected for LGAC. Based on prior years' patterns, as discussed earlier in this report, a drop-off in debt issuance during the later years of the Capital Plan does not appear to be realistic.

The Capital Plan includes issuance of \$80 million of service contract bonds by the Thruway Authority in fiscal year 1991-92. Under the Capital Plan, the Thruway Authority would issue the bonds and use the proceeds for repairs to roadways. The Authority would then transfer \$80 million of toll and other revenues to the State's general fund in order to provide budget relief in fiscal year 1991-92. That program essentially uses the most recent toll increases, which were instituted in order to fund a pay-as-you-go capital program for the Authority, to finance the State's operations. The financing has been challenged by this Office in a lawsuit filed in August. As a result of the lawsuit, this financing might not take place. Although it has been suggested that this program might be carried into future fiscal years, the official Capital Plan projections by the Division of the Budget show this item only in fiscal year 1991-92. Moreover, the legal challenge by the State Comptroller's Office to the issue scheduled for fiscal year 1991-92 would indicate that it is not appropriate to show financing beyond the amount included in the Capital Plan at this time.

Current Capital Plan
(dollars in millions)

	<u>1991-92</u>	<u>1992-93</u>	<u>1993-94</u>	<u>1994-95</u>	<u>1995-96</u>	<u>Totals</u>
General Obligation						
Bonds	\$834,520	\$923,704	\$712,970	\$498,608	\$228,618	\$3,199,239
Commercial Paper	70,000	--	--	--	--	70,000
Contractual Obligation						
Housing Finance Agency	188,000	176,000	168,000	119,000	119,000	770,000
Local Government Assistance Corp.	1,600,000	1,600,000	700,000	--	--	3,900,000
Medical Care Facilities						
Finance Agency	140,000	--	--	--	--	140,000
Metropolitan Transportation Authority ⁽¹⁾	155,000	155,000	155,000	155,000	155,000	775,000
Thruway Authority						
Service Contract	80,000	--	--	--	--	80,000
Consolidated Highway Improvements	192,000	160,000	--	--	--	352,000
Urban Development Corporation - Universities	20,000	--	--	--	--	20,000
Lease-Purchase						
Certificates of Participation	105,000	95,000	100,000	105,000	110,000	515,000
Dormitory Authority						
SUNY Educational Facilities	250,000	150,000	150,000	120,000	100,000	770,000
SUNY Athletic Facility	27,000	--	--	--	--	27,000
State Education Department	24,000	--	--	--	--	24,000
Department of Health	10,000	12,500	12,500	--	--	35,000
Thruway Authority						
Repairs & Reconditioning	135,000	--	--	--	--	135,000
Suburban Transportation	11,000	37,300	45,700	20,100	--	114,100
Westway Buyback	40,100	--	--	--	--	40,100
Urban Development Corporation						
Correctional Facilities	150,000	100,000	100,000	100,000	100,000	550,000
Division for Youth	50,000	--	30,000	--	--	80,000
Environmental Facilities Corporation						
Riverbank Park	51,000	--	--	--	--	51,000
Revolving Fund Loans	28,000	43,500	27,200	17,000	--	115,700
TOTALS	<u>\$4,161,439</u>	<u>\$3,453,004</u>	<u>\$2,201,370</u>	<u>\$1,134,708</u>	<u>\$ 812,618</u>	<u>\$11,763,139</u>

⁽¹⁾ The current MTA capital plan ends on December 31, 1991. The issuances projected in fiscal years 1993 through 1996 are estimated by the Office of the State Comptroller to continue at current levels.

Source: Financial Projections and Capital Plan, as adjusted through October 1991.

Effect of Capital Plan on Debt Ratios

Under the Capital Plan, the State's total net tax-supported debt, after taking into account retirements of debt, is expected to rise by \$3.48 billion from \$20.809 billion on March 31, 1991 to \$24.289 billion on March 31, 1996, as shown below.

	<u>Change in Net Tax-Supported Debt</u> (dollars in millions)					<u>Totals</u>
	<u>1991-92</u>	<u>1992-93</u>	<u>1993-94</u>	<u>1994-95</u>	<u>1995-96</u>	
Outstanding	\$20,809	\$24,133	\$25,178	\$24,899	\$24,419	--
Issuances	4,161	3,453	2,201	1,134	813	\$11,763
Retirements	<u>(637)</u>	<u>(808)</u>	<u>(880)</u>	<u>(914)</u>	<u>(943)</u>	<u>(4,182)</u>
Net New Debt	3,524	2,645	1,321	220	(130)	7,580 ⁽¹⁾
Less: Change in Spring Borrowing	<u>(200)</u>	<u>(1,600)</u>	<u>(1,600)</u>	<u>(700)</u>	--	(4,100)
Outstanding	\$24,133	\$25,178	\$24,899	\$24,419	\$24,289	--

Based on the assumptions set out above, issuances under the Capital Plan are projected to have the following effect on the State's debt ratios at March 31, 1996. Appendix F sets out the year-by-year effects of such issuances on the State's debt ratios.

Impact of Capital Plan On Debt Ratios Base Case

	<u>New York State</u>		<u>Industry Standards</u>		<u>Ratio of State to Industry Standards</u>	
	<u>1990-91</u>	<u>1995-96</u>	<u>Moody's Median⁽²⁾</u>	<u>Warning Level⁽³⁾</u>	<u>1990-91</u>	<u>1995-96</u>
Debt Per Capita	\$1,157	\$1,350	\$345	--	3.35X	3.91X
Debt To Personal Income	5.2%	4.9%	2.2%	--	2.36X	2.23X
Debt Service to Tax Receipts	5.1%	7.9%	--	10.0%	0.51X	0.79X

The current Capital Plan is expected to produce a rise in net tax-supported debt of 16.7%. This increase would result in a rise in debt per capita to \$1,350, a rise in debt to personal income

⁽¹⁾ Totals may not add due to rounding.

⁽²⁾ Median for all states in 1991, as calculated by Moody's Investors Service, Inc.

⁽³⁾ Credit analysts view the 10% level as a rule-of-thumb indication of an excessive debt burden.

to 4.9% and a rise in debt service to tax receipts to 7.9%. The change in debt per capita represents a 16.7% increase, debt to personal income a 5.8% decrease and debt service to tax receipts a 54.9% rise. The projected increase in the debt service to tax receipts ratio would bring this ratio close to the 10% rule-of-thumb warning level used by credit analysts to indicate excessive debt levels.

If economic projections are not met, the State's debt ratios could rise further, as shown below. This case assumes a population decline of 0.1% per year, personal income growth averaging 2.2% per year, or one-half the growth projected in the Five-Year Financial Projections and Capital Plan, and one-half the projected growth in tax receipts. Using these reduced performance assumptions, debt per capita would not rise significantly over the Base Case, but debt to personal income would be 5.5%, versus 4.9% in the Base Case, a small rise over the current ratio. The ratio of debt service to tax receipts would be 8.6%, versus 7.9% if the State's financial projections were met. The debt ratios in 1995-96 as a result of reduced economic and financial growth are set out below and the year-by-year changes are shown in Appendix G.

Impact of Capital Plan On Debt Ratios
Reduced Economic and Financial Performance

	<u>Projected 3-31-96</u>		<u>Ratio to Industry Standards</u>	
	<u>Base Case</u>	<u>Reduced Performance</u>	<u>Base Case</u>	<u>Reduced Performance</u>
Debt Per Capita ⁽¹⁾	\$1,350	\$1,357	3.91X	3.93X
Debt To Personal Income ⁽²⁾	4.9%	5.5%	2.23X	2.50X
Debt Service To Tax Receipts ⁽³⁾	7.9%	8.6%	0.79X	0.86X

⁽¹⁾ Assuming population decline of 0.1% per year.

⁽²⁾ Assuming personal income growth of one-half that projected in the Financial Projections and Capital Plan.

⁽³⁾ Assuming growth in tax receipts of one-half that projected in the Financial Projections and Capital Plan.

Conclusion

The burden that New York State's debt position places on the taxpayers at the current time is heavier than that of most other states, with debt per capita more than three times the Moody's median for all states and debt to personal income 2.36 times the median. Both of these ratios place New York among the states with the highest relative debt positions. In past years, the State has had a relatively low level of debt service to tax receipts, but this ratio is beginning to rise rapidly. In a credit report on the State, Moody's characterized New York's debt levels as "substantial" and "high" and its overall debt structure as "negative" due to the methods of borrowing and the heavy use of short-term debt for operating purposes. S&P has also noted that while the State's debt levels are "manageable," they are high in comparison to other states.

The State is projected to issue \$11.8 billion of net tax-supported debt during the upcoming five year period (ending March 31, 1996). The resulting debt position of \$24.3 billion would be a rise of 16.7% in five years, which is much less than the rise over the previous five years of 67.8%. The projected change in net tax-supported debt for the five-year period 1986 through 1991 was 9.4%, far below the actual increase. (Even after adjusting for the reclassification of SUNY educational facilities bonds, the rise in net tax-supported debt during this time was 47.0%.) As a result of these projected issuances, the State's debt ratios would show a 16.7% rise in debt per capita and a 5.8% decrease in debt to personal income. The largest increase would be the 54.9% rise in debt service to tax receipts, which is expected to occur due to heavy debt issuance in recent years and the slowdown in tax revenues. This ratio is currently forecast to exceed 8% in fiscal years 1992-93 through 1994-95. As this ratio approaches 10%, the rule-of-thumb warning level used by credit analysts, there might be concern about the high level of fixed obligations in the State's budget.

The Local Government Assistance Corporation is expected to issue \$3.9 billion over the next three fiscal years to complete the bonding out of the Spring Borrowing. Because this debt is being issued to lessen the State's reliance on short-term debt for operating purposes, these issuances are generally viewed favorably by financial analysts. However, some credit analysts have expressed concern about the State's reliance on deficit notes in recent years and the sharply increased use of lease purchase and contractual obligation debt to provide "one-time" budgetary relief.

For these reasons, the continued addition of large bonding programs could at some point cause negative credit implications. Therefore, new bonding proposals must be examined closely to determine if they can be supported within the State's available economic and financial resources. In particular, the infrastructure needs of the State must be weighed against the increasing burden being placed on New York taxpayers.

Moody's Calculation of New York State's Debt Position

In its report on the State dated August 6, 1991, Moody's calculated the State's net tax-supported debt position to be \$20,088.0 million⁽¹⁾ at June 30, 1991, as opposed to the State's pro-forma calculation of \$21,810 million. Moody's includes several items that the State does not, as shown below. Since the debt service on these issues are projected to be serviced by non-tax revenues, such as dormitory room rentals and Medicaid payments, and are therefore self-supporting, the State has determined that these items are not tax-supported debt. On the other hand, the State has determined that the Spring Borrowing should be included in its calculation of net tax-supported debt this year, an item which Moody's does not include.

In addition, Moody's double-counted the \$243 million of certificates of participation issued by CUNY for John Jay. The \$654.7 million shown as outstanding for certificates of participation in the general obligation debt section included this amount. This inclusion has been brought to their attention and should be corrected in the future.

Moody's calculation of the State's debt position at June 30, 1991, after giving effect to subsequent issuances and refundings, is shown on the following page together with a comparison to the State's calculation.

(1) Adjusted for mathematical errors.

Moody's Calculation of New York State's Debt Position
At June 30, 1991 After Giving Effect to Subsequent Issues and Refundings
From the Credit Report Dated August 6, 1991
(in millions)

	<u>Moody's</u>	<u>State</u>	<u>Difference</u>
General Obligation Bonds ⁽¹⁾	\$4,527.4	\$4,527.4	-
General Obligation Commercial Paper BANs	317.2	317.2	-
General Obligation TRAns and Deficit Notes ⁽²⁾	<u>4,981.5</u>	<u>4,981.5</u>	-
Gross General Obligation Debt	9,826.1	9,826.1	-
Certificates of Participation	<u>654.7</u>	<u>654.7</u>	-
Gross Direct Debt	10,480.8	10,480.8	-
Less: TRAns and Deficit Notes	<u>4,986.0</u>	<u>1,086.0</u>	<u>\$(3,900.0)</u>
Net Direct Debt	5,494.8	9,394.8	(3,900.0)
Lease Purchase and Contractual Commitments			
Local Government Assistance Corporation	1,468.1	1,468.1	-
MCFFA - Mental Health Services	1,426.0	-	1,426.0
MCFFA - Special Hospital Project	450.0	450.0	-
Dormitory Authority - Health Facilities	117.0	-	117.1
Dormitory Authority - City University of New York ⁽³⁾	2,461.0	2,107.0	354.0
Dormitory Authority - SUNY Dormitory Facilities ⁽⁴⁾	271.0	-	271.0
Dormitory Authority - Library for the Blind	19.0	18.5	0.5
Dormitory Authority - SUNY Educational Facilities ⁽⁵⁾	2,589.0	2,589.0	-
Dormitory Authority - Education Department Revenue	24.0	24.0	-
Dormitory Authority - Community Colleges ⁽⁶⁾	64.4	-	64.4
Albany County - Empire State Plaza	244.0	231.7	12.3
Municipalities - State Office Buildings	11.0	11.2	(0.2)
New York State Thruway Authority - R&P, C&R	168.1	168.1	-
MTA - Service Contract Bonds	1,749.0	1,749.3	-
TBTA - New York City Convention Center	449.0	448.9	0.1
UDC - Technology Development Centers	155.0	151.3	3.7
UDC - Empire State Plaza	123.0	122.6	0.4
UDC - State Facilities	123.0	241.8	(118.8)
UDC - Correctional Facilities	1,485.0	1,480.1	4.9
UDC - Onondaga Convention Center	45.0	45.2	(0.2)
CUNY (John Jay) Certificates of Participation	243.0	⁽⁶⁾	243.0
Erie County Convention Center ⁽⁷⁾	3.9	4.0	(0.1)
Housing Finance Agency - Service Contract Obligations	<u>191.7</u>	<u>191.7</u>	-
Total Lease-Purchase and Contractual Commitments	13,880.2	11,502.5	2,377.7
Other Commitments:			
Urban Development Corporation	<u>713.0</u>	<u>713.0</u>	-
NET TAX-SUPPORTED DEBT	<u>\$20,088.0⁽⁹⁾</u>	<u>\$21,810.3</u>	<u>\$(1,722.3)</u>

⁽¹⁾ Excludes the crossover refunding bonds issued in 1986, debt service on which will be paid from earnings on escrowed proceeds until refunded bonds are called.

⁽²⁾ \$3.9 billion of TRAns; \$1,081.5 million of deficit notes.

⁽³⁾ Includes City University System's senior colleges, community colleges, and consolidated revenue bonds. Excludes \$352 million total crossover refunding bonds issued in 1984, 1986 and 1988 debt service on which will be paid from earnings on escrowed proceeds until refunded bonds are called. New York excludes 50% of New York City Community College debt as the City pays 50% of the debt service on these bonds.

⁽⁴⁾ New York considers this self-supporting from dormitory revenues.

⁽⁵⁾ Excludes special obligation bonds. Gives effect to Series 1990 B refunding of July 1990.

⁽⁶⁾ Excludes \$277 million issued for CUNY community colleges.

⁽⁷⁾ Moody's double-counted this item; it is included in the COPs figure under Gross Direct Debt.

⁽⁸⁾ Represents portion of debt for which state is responsible: 50% of Erie County debt service (\$8.6 million).

⁽⁹⁾ After adjusting for mathematical errors.

Debt Rankings Among the States

Set out below is New York's ranking among the states for debt per capita and debt to personal income, as calculated in this report using the definition of net tax-supported debt set out on page 7 of this report. This definition differs from Moody's definition of net tax-supported debt, as shown in Appendix A. The data on other states was compiled by Moody's Investors Service.

Net Tax-Supported Debt Per Capita

<u>Rank</u>	<u>State</u>	<u>Amount</u>	<u>Credit Ratings</u> (Moody's/S&P)	<u>Rank</u>	<u>State</u>	<u>Amount</u>	<u>Credit Ratings</u> (Moody's/S&P)
1	Hawaii	\$1,910	Aa/AA	26	South Dakota	\$333	NR/NR
2	Massachusetts	1,756	Baa/BBB	27	Georgia	316	Aaa/AA+
3	Connecticut	1,565	Aa/AA-	28	California	297	Aaa/AAA
4	Delaware	1,297	Aa/AA+	29	New Mexico	275	Aa/AA
5	NEW YORK	1,157 ⁽¹⁾	A/A	30	Oregon	266	Aa/AA-
6	Louisiana	991	Baa1/A	31	South Carolina	264	Aaa/AAA
7	Washington	761	Aa/AA	32	Mississippi	234	Aa/AA-
8	Rhode Island	721	Aa/AA-	33	Virginia	232	Aaa/AAA
9	Kentucky	697	Aa/AA	34	Arizona	214	NR/NR
10	Maryland	694	Aaa/AAA	35	Missouri	204	Aaa/AAA
11	Alaska	667	Aa/AA-	36	Michigan	199	A1/AA
12	Vermont	645	Aa/AA-	37	Texas	186	Aa/AA
13	West Virginia	643	A1/A+	38	North Dakota	184	Aa/AA-
14	New Jersey	550	Aaa/AA+	39	Utah	171	Aaa/AAA
15	Illinois	525	Aa1/AA+	40	Tennessee	101	Aaa/AA+
16	Florida	466	Aa/AA	41	Kansas	94	NR/NR
17	New Hampshire	449	Aa/AA	42	Indiana	90	NR/NR
18	Pennsylvania	426	A1/AA-	43	North Carolina	78	Aaa/AAA
19	Ohio	405	Aa/AA	44	Colorado	75	NR/NR
20	Wisconsin	403	Aa/AA	45	Oklahoma	65	Aa/AA
21	Minnesota	394	Aa/AA+	46	Idaho	54	NR/NR
22	Alabama	370	Aa/Aa	47	Arkansas	46	Aa/AA
23	Maine	365	Aa1/AA+	48	Iowa	42	NR/NR
24	Montana	359	Aa/AA-	49	Nebraska	32	NR/NR
25	Nevada	356	Aa/AA	50	Wyoming	0	NR/NR
MEDIAN						\$345	

⁽¹⁾ Moody's calculated the State's debt per capita at \$993, for a rank of 5th, which was 2.88 times the median versus 3.35 times calculated in this report.

Net Tax-Supported Debt to Personal Income

<u>Rank</u>	<u>State</u>	<u>Amount</u>	<u>Credit Ratings</u> (Moody's/S&P)	<u>Rank</u>	<u>State</u>	<u>Amount</u>	<u>Credit Ratings</u> (Moody's/S&P)
1	Hawaii	10.4%	Aa/AA	26	New Mexico	2.1%	Aa/AA
2	Massachusetts	8.1	Baa/BBB	27	Nevada	2.0	Aa/AA
3	Louisiana	7.4	Baa1/A	28	Georgia	2.0	Aaa/AA+
4	Delaware	7.0	Aa/AA+	29	Mississippi	2.0	Aa/AA-
5	Connecticut	6.5	Aa/AA-	30	South Carolina	1.9	Aaa/AAA
6	Kentucky	5.8	Aa/AA	31	Oregon	1.7	Aa/AA-
7	West Virginia	5.2	A1/A+	32	California	1.5	Aaa/AAA
8	NEW YORK	5.2 ⁽¹⁾	A/A	33	Utah	1.5	Aaa/AAA
9	Washington	4.4	Aa/AA	34	Arizona	1.4	NR/NR
10	Rhode Island	4.6	Aa/AA-	35	North Dakota	1.3	Aa/AA-
11	Vermont	3.9	Aa/AA-	36	Virginia	1.2	Aaa/AAA
12	Maryland	3.4	Aaa/AAA	37	Missouri	1.2	Aaa/AAA
13	Alaska	3.2	Aa/AA-	38	Texas	1.2	Aa/AA
14	Illinois	2.7	Aa1/AA+	39	Michigan	1.1	A1/AA
15	Florida	2.7	Aa/AA	40	Tennessee	0.7	Aaa/AA+
16	Alabama	2.7	Aa/AA	41	Indiana	0.6	NR/NR
17	Montana	2.5	Aa/AA-	42	Kansas	0.6	NR/NR
18	Wisconsin	2.5	Aa/AA	43	Oklahoma	0.6	Aa/AA
19	Ohio	2.5	Aa/AA	44	North Carolina	0.5	Aaa/AAA
20	Pennsylvania	2.4	A1/AA-	45	Colorado	0.4	NR/NR
21	South Dakota	2.4	NR/NR	46	Idaho	0.4	NR/NR
22	New Jersey	2.3	Aaa/AA+	47	Arkansas	0.3	Aa/AA
23	Maine	2.3	Aa1/AA+	48	Iowa	0.3	NR/NR
24	Minnesota	2.3	Aa/AA+	49	Nebraska	0.2	NR/NR
25	New Hampshire	2.2	Aa/AA	50	Wyoming	0.0	NR/NR
					MEDIAN	2.2%	

⁽¹⁾ Moody's calculated the State's debt to personal income at 4.7%, for a rank of 8th, which is 2.14 times the median versus 2.36 times calculated in this report.

Trend in State Debt Ratios and Median Ratios**Trend in New York State Net Tax-Supported Debt and Debt Ratios⁽¹⁾**

	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>	<u>1988-89</u>	<u>1989-90</u>	<u>1990-91</u>
<u>Net Tax-Supported Debt</u> (in 000's)						
Long-Term Net Tax-Supported Debt	\$8,098	\$9,289	\$9,888	\$10,489	\$13,104	\$16,709
Plus: Short-Term Operating Debt ⁽²⁾	<u>4,300</u>	<u>3,500</u>	<u>2,600</u>	<u>3,100</u>	<u>3,900</u>	<u>4,100</u>
Total Net Tax-Supported Debt	<u>\$12,398</u>	<u>\$12,789</u>	<u>\$12,488</u>	<u>\$13,589</u>	<u>\$17,004</u>	<u>\$20,809</u>
Debt Per Capita	\$697	\$720	\$701	\$759	\$947	\$1,157
Debt to Personal Income	4.3%	4.2%	3.9%	3.7%	4.3%	5.2%
Debt Service to Tax Receipts	4.1%	3.8%	4.1%	4.5%	4.8%	5.1%

Trend in Moody's State Median Debt Ratios

	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>	<u>1988-89</u>	<u>1989-90</u>	<u>1990-91</u>
Debt Per Capita	\$275	\$293	\$300	\$339	\$349	\$345
Debt to Personal Income	2.4%	2.4%	2.3%	2.3%	2.2%	2.2%

⁽¹⁾ Restated to include the Spring Borrowing.

⁽²⁾ There were also deficit notes outstanding in certain years, as follows: \$460 million at March 31, 1989, \$775 million at March 31, 1990 and \$1,081.5 million at March 31, 1991.

Retirements of Existing Net Tax-Supported Debt
 Outstanding at September 30, 1991
 (in thousands)

	Fiscal Year Ending March 31				
	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>
General Obligation					
Bonds	\$381,100	\$391,520	\$362,120	\$354,620	\$347,520
Contractual Obligation					
Dormitory Authority - Library	215	230	245	260	280
Housing Finance Agency - Housing	790	2,230	2,450	2,685	2,950
Local Government Assistance Corp	--	27,835	29,330	30,950	32,735
Medical Care Facilities Finance Ag	--	3,400	7,930	9,325	9,885
Metropolitan Transportation Authority					
1981 Service Contract Bonds	12,675	13,585	14,570	15,660	16,855
1986-87 Service Contract Bonds	3,950	9,585	10,205	20,885	11,635
Thruway Authority					
Consolidated Highway Improvement Program	--	--	6,740	7,130	7,565
TBTA - NYC Convention Center	13,900	15,255	16,210	17,230	18,345
UDC - University High-Tech	5,242	9,158	5,732	5,599	5,511
Lease-Purchase					
Certificates of Participation	109,089	108,107	99,767	55,592	43,155
Dormitory Authority					
CUNY Senior	13,340	33,421	38,542	42,892	47,770
CUNY Community Colleges (50	770	7,518	9,103	9,708	10,915
SUNY	14,810	52,155	56,375	59,130	63,205
SUNY Athletic Facility	--	290	310	330	355
State Education Department	--	--	265	280	300
Empire State Plaza					
Office of General Services	32,780	29,790	29,890	29,890	26,530
Urban Development Corporation	--	--	--	--	--
Other Office Buildings	2,735	2,725	2,575	2,050	1,100
Thruway Authority					
Highway Repairs & Reconditioni	16,970	17,940	18,980	20,100	21,300
Urban Development Corporation					
Prisons	23,730	27,680	29,485	31,480	33,650
Capital Purposes	--	2,700	2,850	3,030	3,225
Moral Obligation					
UDC - Housing	4,775	18,995	20,340	21,795	23,365
Other - Erie County Convention Ce	<u>394</u>	<u>394</u>	<u>380</u>	<u>375</u>	<u>381</u>
TOTAL	<u>\$637,265</u>	<u>\$774,513</u>	<u>\$764,394</u>	<u>\$740,996</u>	<u>\$728,532</u>

Debt Service on Existing Net Tax-Supported Debt
 Outstanding at September 30, 1991
 (in thousands)

	Fiscal Year Ending March 31				
	1992	1993	1994	1995	1996
General Obligation					
Bonds	\$675,558	\$710,005	\$654,412	\$622,918	\$592,725
Contractual Obligation					
Dormitory Authority - Library	1,498	1,508	1,526	1,505	1,507
Housing Finance Agency - Housing	19,859	23,726	23,508	23,562	23,925
Local Government Assistance Corp	52,853	156,989	154,528	154,447	154,354
Medical Care Facilities Finance Ag	36,603	45,530	49,764	51,563	53,294
Metropolitan Transportation Authority					
1981 Service Contract Bonds	79,992	79,985	79,993	79,984	79,988
1986-87 Service Contract Bonds	64,523	70,777	70,776	70,773	70,776
Thruway Authority					
Consolidated Highway Improve	5,533	14,646	21,386	21,385	21,385
TBTA - New York City Conventio	41,433	41,835	41,841	41,836	41,837
UDC - University High-Tech	19,288	24,051	20,832	20,859	20,895
Lease-Purchase					
Certificates of Participation	152,697	152,697	152,697	152,697	152,697
Dormitory Authority					
CUNY Senior	141,844	163,096	165,864	167,472	169,328
CUNY Community Colleges (50	24,925	28,773	28,569	28,228	28,129
SUNY	275,982	222,656	223,819	223,200	223,346
SUNY Athletic Facility	882	2,125	2,205	2,204	2,207
State Education Department	1,259	2,075	2,076	2,074	2,075
Empire State Plaza					
Office of General Services	48,673	43,494	41,631	39,661	37,742
Urban Development Corporation					
Other Office Buildings	3,288	3,134	2,851	2,197	1,162
Thruway Authority					
Highway Repairs & Reconditio	27,950	27,255	27,255	27,256	27,248
Urban Development Corporation					
Prisons	125,948	132,661	132,796	132,980	133,163
Capital Purposes	17,838	20,374	20,337	20,310	20,275
Moral Obligation					
UDC - Housing	51,837	65,616	65,604	65,601	65,610
Other - Erie County Convention Ce	630	625	585	556	538
TOTAL	\$1,870,893	\$2,033,633	\$1,984,854	\$1,953,268	\$1,924,205

**Impact of Debt Issuances Under the Five-Year Financial Projections and Capital Plan
Base Case**

	<u>1990-91</u>	<u>1991-92</u>	<u>1992-93</u>	<u>1993-94</u>	<u>1994-95</u>	<u>1995-96</u>
Net Tax-Supported Debt Outstanding at April 1 (000's)		\$20,808,896	\$24,133,070	\$25,177,562	\$24,896,757	\$24,414,688
Issuances		4,161,439	3,453,004	2,201,370	1,134,708	812,618
Retirements		<u>637,265</u>	<u>808,512</u>	<u>882,175</u>	<u>916,778</u>	<u>944,805</u>
Net New Debt		3,524,174	2,644,492	1,319,195	217,930	(132,187)
Less: Change in Spring Borrowing		(200,000)	(1,600,000)	(1,600,000)	(700,000)	--
Net Tax-Supported Debt Outstanding at March 31	<u>\$20,808,896</u>	<u>\$24,133,070</u>	<u>\$25,177,562</u>	<u>\$24,896,757</u>	<u>\$24,414,688</u>	<u>\$24,282,501</u>
Population (1)	17,990	17,990	17,990	17,990	17,990	17,990
Debt Per Capita	\$1,157	\$1,341	\$1,400	\$1,384	\$1,357	\$1,350
Total Personal Income (2)	\$397,602	\$410,723	\$430,027	\$451,098	\$470,946	\$493,081
Debt to Personal Income	5.2%	5.9%	5.9%	5.5%	5.2%	4.9%
Debt Service (3)	\$1,336,442	\$2,050,383	\$2,359,923	\$2,461,898	\$2,515,347	\$2,539,221
General Fund Tax Receipts (4)	\$26,118,000	\$27,436,000	\$28,359,000	\$29,398,000	\$30,549,000	\$32,085,000
Debt Service to Tax Receipts	5.1%	7.5%	8.3%	8.4%	8.2%	7.9%

(1) In thousands. Assumes no growth, based on the 1990 Census figure.

(2) In billions. Assumes growth in personal income averaging 4.4% annually, as estimated in the Financial Projections and Capital Plan. Figures are based on preliminary estimate for 1990 by the Bureau of Economic Analysis of \$397,602 billion.

(3) In thousands. Figures for 1991-92 through 1995-96 are based on debt outstanding at 3-31-91 plus general obligation and LGAC debt expected to be issued under the Financial Projections and Capital Plan, as updated through October 1991.

(4) In thousands. Cash-basis projections from the Financial Projections and Capital Plan, as updated through October 1991. Average annual growth in tax receipts from 1991 to 1996 equals 4.2%.

**Impact of Debt Issuances Under the Five-Year Financial Projections and Capital Plan
Reduced Economic and Demographic Growth**

	<u>1990-91</u>	<u>1991-92</u>	<u>1992-93</u>	<u>1993-94</u>	<u>1994-95</u>	<u>1995-96</u>
Net Tax-Supported Debt Outstanding at April 1 (000's)		\$20,808,896	\$24,133,070	\$25,177,562	\$24,896,757	\$24,414,688
Issuances		4,161,439	3,453,004	2,201,370	1,134,708	812,618
Retirements		<u>637,265</u>	<u>808,512</u>	<u>882,175</u>	<u>916,778</u>	<u>944,805</u>
Net New Debt		3,524,174	2,644,492	1,319,195	217,930	(132,187)
Less: Change in Spring Borrowing		(200,000)	(1,600,000)	(1,600,000)	(700,000)	—
Net Tax-Supported Debt Outstanding at March 31	<u>\$20,808,896</u>	<u>\$24,133,070</u>	<u>\$25,177,562</u>	<u>\$24,896,757</u>	<u>\$24,414,688</u>	<u>\$24,282,501</u>
Population (1)	17,990	17,972	17,954	17,936	17,918	17,900
Debt Per Capita	\$1,157	\$1,343	\$1,402	\$1,388	\$1,363	\$1,357
Total Personal Income (2)	\$397,602	\$404,162	\$413,660	\$423,795	\$433,118	\$443,297
Debt to Personal Income	5.2%	6.0%	6.1%	5.9%	5.6%	5.5%
Debt Service (3)	\$1,336,442	\$2,050,383	\$2,359,923	\$2,461,898	\$2,515,347	\$2,539,221
General Fund Tax Receipts (4)	\$26,118,000	\$27,436,000	\$27,897,500	\$28,408,546	\$28,964,676	\$29,692,846
Debt Service to Tax Receipts	5.1%	7.5%	8.5%	8.7%	8.7%	8.6%

(1) In thousands. Assumes decline of 0.1% per year, based on the 1990 Census figure.

(2) In billions. Assumes one-half of the growth in personal income estimated in the Financial Projections and Capital Plan, which averages 2.2% over the period. Figures are based on preliminary estimate for 1990 by the Bureau of Economic Analysis of \$397,602 billion.

(3) In thousands. Figures for 1991-92 through 1995-96 are based on debt outstanding at 3-31-91 plus general obligation and LGAC debt expected to be issued under the Financial Projections and Capital Plan, as updated through October 1991.

(4) In thousands. Assumes one-half the growth in tax receipts between fiscal year 1992 and 1996 as projected in the cash-basis projections from the Financial Projections and Capital Plan, as updated through October 1991. Average annual growth in tax receipts from 1991 to 1996 equals 2.6%.

DEBT and DUTY

Accountability and Efficiency in State Debt Management



*The Results of a 50-State Survey Sponsored by
The Council of State Governments, the National Association of State Treasurers,
and the Martin School of Public Administration (University of Kentucky)*

Foreword

State government faces increasingly complex and difficult choices as it seeks to finance the needs of its citizens. State government begins the last decade of the twentieth century with more demands for highways, schools and prisons — all needs traditionally met in most states by debt financing.

Debt and Duty: Accountability and Efficiency in State Debt Management brings together invaluable information on who in each state is charged with addressing these needs and how they are doing it.

Public finance at the state level is explored in this publication in an interesting and informative manner. The Council of State Governments and the National Association of State Treasurers are pleased to have sponsored this study in the hope that it expands the base of knowledge and understanding of this vital topic.

Daniel Sprague
Executive Director
The Council of State Governments

Jimmie Lou Fisher
President
National Association of State Treasurers

Acknowledgment

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Introduction

During the past decade, states have taken on dramatically increased levels of responsibility. The number and cost of state programs in education, health and human resources, transportation, environmental protection and other areas is growing rapidly, putting an unprecedented strain on state coffers.

For most states, one answer to this financial squeeze is borrowing. Departments, agencies, boards and state offices of all kinds are going into debt to pay for needed programs. The total state debt in 1988 reached \$276 billion, according to *The Book of the States 1990-91*. While this may seem miniscule compared to the national deficit, its growth is of concern to state officials who have a long tradition of conservative fiscal policies and balanced budgets.

Despite the increased borrowing activity, little is known about state debt management policies. In fact, no comprehensive study has been made of the planning, preparation, sale and repayment of tax-exempt public debt for which states consider themselves responsible. Too few resources have been devoted to the systematic collection and analysis of comparative state data on debt management policy. As a consequence, the management of state borrowing remains a mysterious process, unlike other state financial activities, such as capital budgeting, which have been the subject of extensive, recent research.

Recent federal attempts to limit the tax-exempt status of certain state debt instruments make it doubly important to bring state management policies into focus. As the states move boldly into the 1990s, taking the lead in new areas of public concern, their success will, in a large part, be determined by their ability to borrow and to manage debt wisely.

This paper seeks to help clarify the current situation by summarizing and analyzing the results of a national survey, undertaken in 1988, on state debt management policies. The survey was a cooperative effort on the part of The Council of State Governments, the National Association of State Treasurers and the Martin School of Public Administration at the University of Kentucky.

The survey was conducted in four phases. The first phase was a telephone survey of all 50 states to obtain initial information concerning offices or agencies with debt management oversight responsibility. A second phase of the survey consisted of a pilot survey of eight states to test the survey instrument, particularly in terms of definitions and terminology. A third phase of the survey consisted of a written questionnaire sent to all 50 states. A fourth phase of the survey involved two rounds of telephone follow-up to all 50 states to solicit information from nonrespondents and clarify and supplement responses, particularly to open-ended survey questions. Forty-one states responded to the mailed questionnaire, and all 50 states were included in the telephone surveys.

The Executive Summary that follows lists findings and emerging issues of concern to state officials that are discussed in more detail in subsequent sections. The comparative base data produced by this survey is designed to provide a reference point from which to formulate policy and process changes that can enhance the efficiency and accountability of state capital acquisition, debt management, and capital budgeting.

PART ONE

Patterns in State Debt Management Policy

EXECUTIVE SUMMARY

Findings:

Finding #1:

The task of managing the issuance and repayment of state debt has grown precipitously in size and complexity over the last decade.

Finding #2:

Principal constraints on the formulation and implementation of state debt management include state constitutional restrictions on borrowing, and recent changes in the federal tax structure.

Finding #3:

States typically issue a variety of different kinds of long-term tax-exempt debt obligations; there is, however, considerable disagreement among state officials regarding definitions of terms. For example, do lease-backed obligations constitute "long-term state debt?" Is there a difference between state revenue debt and special authority revenue debt?

Finding #4:

Most states have centralized the process of structuring and selling state GO and revenue debt, but continue to allow some or all of their special authorities to handle these responsibilities themselves.

Finding #5:

Voters and/or legislative bodies typically authorize the issuance of state GO bonds; legislative bodies or central executive finance offices authorize the issuance of state revenue bonds, rather than the agencies or departments issuing the debt. But in most states, special authorities authorize their own debt issues.

Finding #6:

The issuance of state GO and revenue debt is typically subjected to oversight by a variety of elected and appointed officials of regular state government. Most debt-issuing state special authorities appear to be relatively free from oversight other than that exercised by their boards of directors.

Finding #7:

States can be said to tend toward either one of two extremes with regard to their organizational arrangements for planning, preparing, selling and repaying long-term, tax-exempt debt obligations.

ISSUES OF CONCERN TO STATE OFFICIALS

Issues:

Issue #1:

How can cost savings be promoted in the preparation, sale, and repayment of public debt?

Issue #2:

How can state credit standing be protected or improved at a time when credit standing seems increasingly vulnerable?

Issue #3:

To what extent can and should state capital planning and debt management include participation of local governments?

Issue #4:

What are the implications of the continuing search by states for new kinds of debt instruments?

FINDINGS

Finding #1:

The task of managing the issuance and repayment of state debt has grown precipitously in size and complexity over the last decade.

The growth is evident in the amount of debt outstanding, the level of issuing activity, the type of debt issued and the number of separate issuing entities. For example, the amount of debt issued by state governments has grown by over 203 percent during the last decade. As shown in Figure 1, outstanding long-

FIGURE 1

State Long-Term Debt Outstanding 1977-78 & 1987-88 (in millions)

	1976-77	1987-88
Full Faith & Credit	\$ 42,913	\$ 66,758
Nonguaranteed	44,271	197,314
Total:	\$ 87,184	\$264,071

Source: U.S. Bureau of the Census, *1977 Census of Governments, Compendium of Government Finances*, Vol. 4, No. 2, Series GC 77(4)-5 (Washington: U.S. Government Printing Office, 1979); *Government Finances in 1986-1987*, Series GF-87-5 (Washington: U.S. Government Printing Office, 1988).

FIGURE 2

State Long-Term Debt Issued & Retired 1977-78 & 1987-88 (in millions)

	1976-77	1986-87
Issued	\$12,377	\$49,782
Retired	4,016	33,194
Change:	\$ 5,392	\$ 16,570

Source: U.S. Bureau of the Census, *1977 Census of Governments, Compendium of Government Finances*, Vol. 4, No. 2, Series GC 77(4)-5 (Washington: U.S. Government Printing Office, 1979); *Government Finances in 1986-1987*, Series GF-87-5 (Washington: U.S. Government Printing Office, 1988).

term tax-exempt state debt grew from \$87.2 billion in 1977 to \$264.1 billion in 1987.

Along with growth in outstanding debt, the level of issuing activity increased as well. Figure 2 indicates that the amount of long-term state debt issued in 1977 was \$12.4 billion; in 1987, the amount of such debt issued was almost \$50 billion. Although over \$33 billion in state long-term debt was retired in 1987 (as opposed to just \$4 billion in 1977), the total outstanding balance of state debt increased by \$16.6 billion in 1987, over three times the 1977 increase.

The type of state debt making up the national total also shifted dramatically over this period. As Figure 1 indicates, in 1977 outstanding "full faith and credit" debt roughly equaled outstanding "non-guaranteed" debt (long-term debt payable solely from pledged specific revenues). By 1987, the amount of state non-guaranteed debt outstanding was almost three times the size of total full faith and credit debt outstanding.

Finally, the number of separate governmental entities issuing and guaranteeing state long-term debt also increased significantly over this period. In addition to executive agencies or departments that issue full faith and credit (or general obligation) debt, many states also allow the issuance of nonguaranteed (or revenue-backed) debt by regular line departments or agencies, educational institutions, as well as special purpose governments known variously as authorities, commissions, corporations, boards, districts, etc. Figure 3 indicates that, over the 1977-87 period, the number of state-level entities issuing revenue-backed debt not directly guaranteed by state government grew from 272 to 416, a 53 percent increase.

Such growth in the level and complexity of state debt issuance has occurred largely because borrowing is emerging as the only realistic way for state governments to finance many public purpose activities, including especially the acquisition, construction or renovation of public facilities. Contributing to this need to borrow have been various interrelated factors, including declining federal infrastructure assistance,

statutory and constitutional limits on public taxing and spending, shrinking budgetary surpluses, and rapidly growing needs to repair, replace, and add to aging capital stock. As a result of these factors, levels of outstanding state debt have grown precipitously over the last decade, as have the number and types of problems associated with state borrowing, including rising issuance costs and threats to credit standing.

Finding #2:

Principal constraints on the formulation and implementation of state debt management include state constitutional restrictions on borrowing and recent changes in the federal tax structure.

States face a variety of constraints on the formulation and implementation of debt management. These are constraints over which state policy makers have relatively little control, in contrast to state statutes or regulations that manifest the debt policies themselves. Constraints range from conditions in the capital markets, which determine the interest rates at which state debt may be sold, to federal regulations regarding what kinds of debt states may sell and how they may sell it.

All respondents cited two very different kinds of constraints having significant impacts on state debt management. The first, state constitutional restrictions on borrowing, vary considerably from state to state. They represent efforts on the part of state officials to ensure fiscal discipline in the future, and may reflect state or regional views of government as well as philosophies regarding capital formation. As constitutional amendments, they are typically difficult to change. The second constraint, mentioned by all respondents, involved recent changes in the federal tax structure, embodied in the Tax Reform Act (TRA) of 1986. These changes apply to all states, and include new, stricter requirements to provide information on public borrowing activity, limits on some debt financing techniques, as well as new definitions of what may be considered tax-exempt debt obligations of state and local governments.

Constitutional limits. Figure 4 categorizes state constitutional limits on full faith and credit borrowing by purpose, and by approval process requirements. The figure illustrates the variety of constitutional approaches to debt limitation, and suggests some explanations for state borrowing behavior. Forty states are not limited as to borrowing purpose, but face a variety of limitations in the form of approval process requirements, including specific dollar limits on outstanding debt, by referendum, by extraordinary legislative majorities, and flexible debt limits tied to revenue collection, property values, etc.

Ten states are limited in their borrowing activities to the financing of casual deficits or extraordinary expenses, and eight of these 10 also face limitations in the form of approval process requirements. Of these eight, all but one face specific dollar limits on the amount of debt outstanding, ranging from \$100,000 in Nebraska to \$1,000,000 in Missouri. Four of these states no longer actively issue full faith and credit debt, citing "constitutional restrictions." In all, eight of the 11 states not currently issuing full faith

FIGURE 3

State-Level Special Purpose Governments* with Debt Outstanding 1977, 1987

	1977	1987
Authority	131	213
Commission	36	43
Corporation	18	40
Board	16	20
Other**	23	38
Total:	224	354

Key:

* Exclusive of educational institutions

** Other names include administration, association, bank, center, company, cooperative, council, district, fund, hospital, port, system, turnpike.

Sources: Moody's Investors Service, *Moody's Municipal and Government Manual* (New York: Moody's Investors Service, 1977); *Moody's Municipal and Government Manual* (New York: Moody's Investors Service, 1987).

and credit bonds have some kind of dollar limit on debt, suggesting that this variety of debt limit may severely constrain borrowing behavior.

States may circumvent restrictive constitutional limits on full faith and credit debt by foregoing full faith and credit debt completely and issuing nonguaranteed or revenue-backed debt, as in Arizona or Colorado. States may also create semi-autonomous government corporations to issue such nonguaranteed debt, as is the case in Indiana and Kentucky. Finally, states may simply change their constitutions periodically. For example, Texas is restricted to casual deficit borrowing, a \$200,000 ceiling with no constitutionally detailed avenues for authorizing additional debt. In that situation, each state bond issue is authorized via constitutional amendment.

Tax Reform. All respondents also reported that TRA significantly changed many aspects of the tax-exempt debt issuing process, and states have had to adapt their policies and procedures accordingly. Under TRA, all states must maintain more detailed records on public debt issued by government agencies and must make annual reports to the U.S. Treasury regarding every governmental transaction involving tax-exempt interest, including bank loans, leases and bond issues. New rules limiting arbitrage and advance refundings also require much more detailed record keeping.

In addition to new reporting requirements, TRA drastically reduced the volume of public debt that may be issued, by instituting tests that bonds must meet in order to be considered tax exempt, and by means of a unified volume limit or cap on the amount of debt that may be issued in each state for "qualified private activity" purposes. Beginning in 1988, Title XIII of TRA set the volume cap for each state at the greater of \$150 million or \$50 per capita., beginning in 1988. Categories of "private activity" bonds subject to the cap include those for single and multifamily housing, certain water facilities, mass commuting facilities, sewage and solid waste disposal facilities, certain energy utilities, hazardous waste facilities, redevelopment bonds, small issue manufacturing and student loans.

Vague and somewhat impractical TRA provisions for distributing this debt issuing capacity among state and local level issuers have prompted most states to make their own distributions via legislation or executive orders. States also have designated officials or created new offices to oversee the specifics of the allocation process and to make policy decisions regarding allocation. For example, the California Debt Limit Allocation Committee is responsible for allocating private activity bonding capacity under the limit defined by TRA. All California localities, counties, state agencies and local development authorities

FIGURE 4

State Constitutional Limits on State General Obligation Borrowing

Limitation by Approval Process Requirements	Limitation By Purpose	
	<i>No Limit on Purpose</i>	<i>Limited to Casual Deficits or Extraordinary Expenses Only</i>
<i>Voter Approval Required for Borrowing:</i>		
Referendum	AK, AR, NY, PA, OK	
With Legislative Approval	HI, WA	
Within Flexible Limits	FL, NM, VA	
<i>Extraordinary Legislative Majority Approval Required*</i>	DE, IL, LA, MA, MN, MT	
<i>Flexible Debt Limit:**</i>		
Referendum Required to Exceed Limit	NJ, NC, WY	
Other Conditions for Exceeding Limit	SC	
No Additional Debt Allowed	CT, GA, HI, NV, SD, UT, WI	MS
<i>Dollar Limit on Debt:</i>		
Referendum Required to Exceed Limit	CA, CO, ID, KS, ME, RI	IA, KY, MO
Other Conditions for Exceeding Limit	ND, OR	OH
No Additional Debt Allowed	AL	AZ, NE, TX
<i>Simple Legislative Majority Approval</i>	MD, NH, TN, VT	
<i>No Borrowing Limit Specified</i>		IN, WV
Total Number of States	40	10

Key:

* 3/5 to 3/4

** Limits tied to revenue collection, property values, etc.

Sources: The Council of State Governments National Survey, 1988; Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism*, 1988 Edition, Vol. 1 (Washington, U.S. Government Printing Office, 1988).

must apply to the Committee for a private activity bond allocation. The California Mortgage Bond and Tax Credit Allocation Committee distributes private activity mortgage bond and housing tax credit allocations to state and local agencies.

4
Finding #3:

States typically issue a variety of different kinds of long-term tax-exempt debt obligations; there is however, considerable disagreement among state officials regarding definitions of terms. For example, do lease-backed obligations constitute "long-term state debt"? Is there a difference between state revenue debt and special authority revenue debt?

For the purposes of this survey, long-term, tax-exempt debt obligations of state government were classified into the following four categories:

- **General obligation (GO) debt is backed with an unconditional pledge by state government of any and all sources of revenue — including the state's taxing power — for the repayment of the debt.**

- **State revenue debt is "nonguaranteed debt" in the sense that it is backed solely by specific, pledged revenue sources (e.g., user fees, special assessments, limited taxes), and does not constitute an obligation against any other resources of government.**

- **Special authority debt is issued as debt obligations of special purpose government units (which may be identified in state statutes as public authorities, special districts, associations, boards, corporations, commissions, bond banks, etc.), rather than as a direct obligation of the state. Such debt may be backed by specific, pledged revenue sources (e.g., public utility user fees) or by any and all revenue sources of the special purpose government unit, including tax revenues in many cases. (Such debt may also enjoy secondary backing by state government, including moral obligation pledges to replenish deficiencies in debt service reserves.)**

- **Lease-backed debt is structured like revenue bond issues, with "certificates of participation" or "lease revenue bonds" secured by lease payments. The kinds of state-level government entities issuing this form of debt include universities, special authorities and regular line agencies of state government. This category of debt was distinguished from traditional revenue bonds because some states do not recognize lease-backed obligations as state debt.**

Figure 5 indicates states actively issuing the various kinds of long-term tax-exempt municipal debt. Thirty-nine states currently issue GO debt guaranteed with the "full faith and credit" of the state. Of the remaining 11, nine have no GO debt outstanding; two states, Kentucky and North Dakota, are still responsible for outstanding GO debt, but have made relatively recent decisions to stop issuing this form of debt.

Currently, 34 states issue nonguaranteed revenue debt backed by specified revenues. This is considered "state debt" in the sense that it is a direct liability of state government, but it is not secured with any and all state revenues as is the case with full faith and credit debt. This kind of nonguaranteed debt may be issued as "special obligations of the state" (e.g., Ohio,

Oregon), "departmental revenue bonds" issued by regular line departments of state government (e.g., Utah, Wyoming), "special tax revenue bonds" (e.g., "sales tax revenue bonds" in Illinois), or simply state revenue bonds secured with dedicated taxes or specified user fees (e.g., "liquor store revenue bonds" in Iowa).

Of the 16 states reporting that they do not actively issue state revenue bonds, 10 have no such debt outstanding. Idaho, Indiana and South Dakota do not actively issue either state GO or state revenue debt, and have neither kind of debt outstanding.

Every state but Nevada has authorized state-level special purpose governments to issue debt. Usually quasi-independent corporate entities, these entities are known by a variety of names, but are probably most familiar as public or special authorities. Occasionally these entities enjoy the power to levy taxes and they may refer to debt secured with taxing power as full faith and credit or guaranteed debt. Large, non-taxing entities, such as the Port Authority of New York and New Jersey, are authorized to issue GO bonds in the sense that all project revenues are pledged to support debt service for a given issue.

Most state level special purpose governments issue non-guaranteed bonds backed by specific, limited project revenues. These bonds may be self-supporting in the sense that they are not guaranteed in any way by state government and exist as indirect or contingent liabilities of the state. However, much of this debt enjoys specially arranged, secondary backing by the state. This backing is in the form of the state's full faith and credit guarantee, "moral obligation" pledges on the part of states to insure that debt service reserves remain at required levels, as well as other state support mechanisms such as reserve fund backups, lease arrangements, contractual obligations or dedicated taxes.

Finally, 23 states reported using some variety of lease-backed financing in 1988 (e.g., "certificates of participation" and "lease-purchase revenue bonds"). California, New York, Ohio and Michigan appear to be among the most active current users of this technique. As noted above, states may not consider these obligations to be direct state liabilities, even when they are issued by executive departments or agencies. For example, officials of New York State reported that the state does not issue revenue bonds. Standard & Poor's reports, however, that New York is the second leading issuer of certificates of participation, most of which are sold through the State Department of General Services. In Arizona, the State Department of Administration issues lease-purchase debt, but these financings are not subject to the sort of debt restrictions applied by the legislature to other kinds of state revenue bonds.

In a narrow legal sense, lease-backed debt is indeed distinct from state GO or revenue debt. But the ultimate backing for such debt typically is state general revenues. Most investors view such debt as another variety of state borrowing.

Finding #4:

Most states have centralized the process of structuring and selling state GO and revenue debt, but

FIGURE 5

Types of Long-Term Tax-Exempt Municipal Debt Actively Issued by State Governments

State	Types of Debt			
	General Obligation	State Revenue	Special Authority	Lease-Backed
Alabama	★	...	★	...
Alaska	★	★	★	...
Arizona .....	...	★	★	★
Arkansas	★	★	★	...
California	★	★	★	★
Colorado .....	...	★	★	★
Connecticut	★	★	★	...
Delaware	★	...	★	...
Florida	★	★	★	★
Georgia	★	...	★	...
Hawaii	★	★	★	...
Idaho .....	...	...	★	...
Illinois	★	★	★	★
Indiana .....	...	...	★	★
Iowa .....	...	★	★	...
Kansas .....	...	★	★	★
Kentucky .....	...	★	★	★
Louisiana	★	...	★	...
Maine	★	...	★	★
Maryland	★	...	★	★
Massachusetts	★	★	★	★
Michigan	★	★	★	★
Minnesota	★	...	★	★
Mississippi	★	★	★	...
Missouri	★	★	★	★
Montana	★	★	★	...
Nebraska .....	...	★	★	...
Nevada .....	★	★	...	...
New Hampshire	★	★	★	...
New Jersey	★	★	★	★
New Mexico	★	★	★	...
New York	★	...	★	★
North Carolina	★	★	★	★
North Dakota .....	...	★	★	★
Ohio	★	★	★	★
Oklahoma	★	...	★	...
Oregon	★	★	★	...
Pennsylvania	★	...	★	...
Rhode Island	★	★	★	★
South Carolina	★	★	★	...
South Dakota .....	...	...	★	★
Tennessee	★	...	★	...
Texas	★	★	★	...
Utah	★	★	★	★
Vermont	★	...	★	...
Virginia	★	★	★	★
Washington	★	...	★	...
West Virginia	★	★	★	...
Wisconsin	★	★	★	...
Wyoming .....	...	★	★	...
Total:	39	34	49	23

Source: The Council of State Governments National Survey, 1988.

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continue to allow some or all of their special authorities to handle these responsibilities themselves.

The process that culminates with the sale of state debt is actually a series of processes, including decisions regarding the use of bond proceeds (e.g., as part of the capital budgeting process), the authorization of specific proposals to issue debt, the assembly of a team of expert advisors (e.g., bond counsel, financial advisor, other legal advisors, accountants, auditors and other experts), the design and structuring of the bond issue (decisions regarding the size, timing, nature of the debt instrument used, whether or not to insure the issue, etc.), selection of an underwriter or underwriting syndicate (via negotiation or formal competition), arrangements for credit ratings, etc.

The entity that structures and sells state debt may be different from the entity that issues the debt, in the sense of being responsible for paying it back. This is true, for example, in states where central finance offices structure and sell revenue debt of which state departments will be primarily responsible for paying back.

Figure 6 classifies states according to the type of entity that structures and sells each of the three principal kinds of state debt. As the figure indicates, 27 of the 39 states actively selling GO debt do so through

central finance offices. In Connecticut, for example, the Division of Debt Management in the Treasurer's Office structures and sells all state general obligation bonds. In Illinois, GO bonds are structured and sold by the Bureau of the Budget. Executive branch boards, commissions, or committees and their technical staffs, sell such debt in nine states. In Alaska, for example, the State Bond Committee sells such debt. In New Mexico, the Board of Finance issues such debt. Three states report that the structuring and sale of GO debt is managed by a joint executive/legislative entity.

Figure 6 indicates that most states follow a similar pattern with regard to the sale of state revenue debt. In 17 of the 34 states actively selling this kind of debt, the sale is carried out through a central state finance office, such as the treasurer's office, even when the debt is "issued" by some other executive department or agency. In nine states, an executive branch board or commission sells such debt. Finally, in eight states, the issuing agency or department is authorized to structure and sell their own revenue debt issues, suggesting a decentralized approach to at least these aspects of debt management.

Only a handful of states maintain control over the structuring and sale of debt for which special purpose governments (such as authorities, districts,

FIGURE 6

**States Classified According to Types of Entities
With Principal Roles in Structuring and Selling State Debt**

Type of Authorizing Entity	Type of Debt Issued		
	State General Obligation Debt (39 states)	State Revenue Debt (34 states)	Special Authority Revenue Debt (49 states)
Central Executive Branch Finance Office	AL, AR, CA, CT, DE, HI, IL, ME, MD, MA, MI, MN, MS, MT, NV, NH, NJ, NY, NC, OK, OR, PA, RI, SC, UT, VT, WI	AR, CA, HI, IL, KY, MS, MT, NV, NH, NJ, NC, OR, RI, SC, UT, WI, WY	NY, NC, OR
Executive Branch Commission, Authority or Board	AK, FL, MO, NM, OH, TX, VA, WA, WV	AK, FL, KS, MO, NE, NM, TX, VA, WV	KS
Joint Legislative/Executive Commission or Board	GA, LA, TN		GA, TN
Individual Departments, Agencies or Authorities		AS, CO, CT, IA, MA, MI, ND, OH	AL, AK, AZ, AR, CA, CO, CT, DE, FL, HI, ID, IL, IN, IA, LA, ME, ND, MA, MI, MN, MS, MO, MT, NE, NH, NJ, NM, NY, ND, OH, OK, PA, RI, SC, SD, TX, UT, VT, VA, WA, WV, WI, WY

Source: The Council of State Governments National Survey, 1988.

boards, etc.) are primarily responsible. The Kentucky Office of Investment and Debt Management, in the State Finance Cabinet, sells all bond issues formally issued by state authorities. The North Carolina Treasurer's Office sells debt in the names of state authorities. In 43 states, these entities structure and sell their own debt obligations without involvement by central state finance offices, executive branch boards or commissions, or joint executive/legislative boards. This highly decentralized approach to the sale of these kinds of bonds is consistent with general lack of direct supervision of the financing activities of these entities, described in more detail below.

Figure 3 (see page 2) categorizes by name the state-level special purpose governments with outstanding debt in 1977 and 1987. As the figure indicates, the vast majority of these entities are known as authorities, but these names rarely reflect accurately fundamental differences between entities. Figure 3 does illustrate, however, the growth in the number of all of these semi-autonomous debt issuing entities at the state level. From 1977 to 1987 the total number of these entities increased by 130 or 58.3 percent.

Finding #5:

Voters and/or legislative bodies typically authorize the issuance of state GO bonds; legislative bodies or central executive finance offices authorize the issuance of state revenue bonds, rather than the agencies or departments issuing the debt. But in most states, special authorities authorize their own debt issues.

The authorization of specific state debt issues is a distinct step in the process that culminates with the sale of a bond issue. But the governmental entity authorizing the sale may or may not be distinct from the entity that structures and sells the debt or the entity that formally issues the debt, in the sense of being responsible for repayment. The constitutional restrictions on the issuance of GO debt, listed in Figure 4 (see page 3), require that in 20 states the legislature or the general electorate must authorize GO bond sales. In other cases, and with regard to other kinds of debt, states have established a variety of statutory or procedural measures for the authorization of debt issues. Figure 7 indicates the results of those efforts; respondents were asked to name the entity with primary responsibility for authorizing

FIGURE 7

**States Classified According to Types of Entities
With Principal Roles in Authorizing Specific State Bond Issues**

Type of Authorizing Entity	Type of Debt Issued		
	State General Obligation Debt (39 states)	State Revenue Debt (34 states)	Special Authority Revenue Debt (49 states)
Central Executive Branch Finance Office		AR, CO, NH, NJ, NC, OR, RI, WY	KY, NC, OR,
Executive Branch Commission, Authority or Board	MS	AZ, FL, MA, MI, MS, NM, TX, VA	DE, MS, NM
Joint Legislative/Executive Commission or Board	CT, SC	SC	LA, SC, TN
Legislative Majority	DE, GA, HI, IL, LA, MD, MA, MN, MO, MT, NH, NC,	AK, CA, CT, HI, IL, IA, KS, KY, MO, MT, NE, NV, RI, UT, VT, TN	AL, CA, GA, HI, ID, KS, ND, WV ND, WV, WI WI
Electorate (referendum)	AL, AK, AR, CA, FL, ME, MI, NV, NJ, NM, NY, OH, OK, OR, PA, TX, VA, WA, WV		
Individual Departments, Agencies or Authorities		OH	AK, AZ, AR, CO, CT, FL, IL, IN, IA, ME, MD, MA, MI, MN, MO, MT, NE, NH, NJ, NY, OH, OK, PA, RI, SD, TX, UT, VT, VA, WA, WI, WY

Source: The Council of State Governments National Survey, 1988.

specific debt issues of the various kinds discussed above.

In states whose constitutions designate such an entity (the legislature or the electorate), rather than specific debt limits (dollar amounts or flexible limits), that entity is identified in Figure 7. For example, 10 state constitutions require voters to approve GO bond issues via the referenda process. Figure 7 indicates that nine additional states have added statutory requirements for voter approval. Similarly, 12 state constitutions require that a legislative majority authorize GO bond issues. Figure 7 indicates that five additional states have added statutory requirements for formal legislative approval. In a number of states, such as New Hampshire, New York and West Virginia, the legislatures have also established limits on GO debt.

In states whose constitutions restrict state GO debt through specific limits (e.g., dollar limits on outstanding debt or flexible debt limits), statutes must designate entities that will authorize the sale of specific issues. For GO debt, this authorization often involves calculation of the state's current debt position relative to such limits. Such authorization may come from the legislature or from a variety of other sources, as indicated in Figure 7.

Finally, for state revenue debt and special authority debt — not typically addressed by constitutional limits — statutes may or may not erect some kind of authorization process. Legislative approval is required in 16 of the 34 states issuing state revenue debt. In 32 states, special authorities authorize their own debt issues. (In some states, such as California and New York, the complexity of authorization arrangements defies simple categorization; Figure 7 incorporates judgments of respondents with regard to the most appropriate classification of their states.)

Most respondents in these states noted that this debt is not considered a direct liability of state government, and therefore is not a matter of immediate state concern. In addition, the elected or appointed governing boards of these kinds of entities must approve bond issues. In a number of states, regular state officials are ex officio members of these boards.

Finding #6:

The issuance of state GO and revenue debt is typically subjected to oversight by a variety of elected and appointed officials of regular state government. Most debt-issuing state special authorities appear to be relatively free from oversight, other than that exercised by their boards of directors.

For the purposes of this survey, oversight was defined to include a broader range of responsibilities than are exercised in the authorization of specific debt issues. In this sense, oversight ranges from the periodic calculation of outstanding debt totals, to the on-going, direct review and approval of capital construction plans and operating budgets. The oversight of debt issuing activities varies with the type of debt issued, as well as the measures in place for approving, structuring and selling debt. Officials charged with oversight responsibilities may or may not be the same people who approve specific debt issues.

With regard to state GO debt, oversight is generally exercised as part of the management responsibilities of regular state government executives. Often, the entities that approve specific debt issues also monitor debt totals and collect other kinds of information, especially in the case of special boards or commissions. Examples of entities that oversee GO debt issuing activities include the Connecticut State Bond Commission, the Texas Bond Review Board and the Washington State Finance Commission. In states where legislative bodies play principal roles in approving debt issues, special legislative offices or commissions may collect and analyze information on state GO borrowing activities. Examples are the Maryland Legislative Department of Fiscal Services and the Joint Economic and Fiscal Commission of the Illinois legislature.

The issuance of nonguaranteed debt by regular state agencies and departments is also subject to the oversight activities of regular state government officials as part of their normal management responsibilities. In states such as Nevada, New Hampshire and Oregon, where such debt is issued by a central state office, that office normally collects debt-related information, calculates debt limits, etc. In North Carolina, most departments rely on the Treasurer's Office to structure and sell debt. The Treasurer and the legislature maintain information on these kinds of debt issuing activities and the Treasurer must approve capital plans.

In states such as Ohio, Colorado and Iowa, where departments structure and sell their own revenue bonds, the issuing entities generally maintain information on borrowing. In Colorado, for example, the Department of Education authorizes its own capital plan and bond issue, maintains all records on debt and calculates its own debt capacity.

The concept of oversight is most meaningful in connection with the activities of quasi-independent authorities, boards and other special purpose governments that operate outside of the regular, executive branch structure of state government. The principal means of overseeing the activities of these entities is through appointments to the boards of trustees (bodies that also authorize specific bond issues in 32 states, as noted above). Typically such appointments are made by the governor, or are ex officio in nature. In California, Maine, Massachusetts, Pennsylvania and Vermont, for example, the State Treasurer sits on the boards of all special purpose governments issuing debt. In Maine, Missouri, New York and many other states, the Governor appoints the trustees of each state's authority.

A second means of oversight involves formal requirements for regular reporting by these entities. For example, Arizona's Salt River Power District sets its own debt limits and structures its own bond issues, but is required to report amounts of its outstanding debt to the Department of Revenue. Authorities in Hawaii must report on a regular basis to the State Director of Finance, the legislature and the Governor regarding their bond market activity. Authorities in Rhode Island must report all bond issuing

activity on a regular basis to the State Public Finance Board.

A third means of oversight involves direct controls over their actions in the form of specific review and approval powers exercised by officials of regular state governments. For example, the State Treasurers in Delaware, Oregon and North Carolina must approve capital plans of issuing authorities in those states. The Kentucky Office of Investment and Debt Management reviews and approves all authority capital projects, and manages debt service payments. The Governors of New York and New Jersey may veto the board minutes (and thus any and all board minutes) of certain authorities in those states, thus affording them a powerful, but rarely used, form of oversight.

Most state authorities, commissions, districts, etc., appear to be relatively free from oversight. For example, the Arkansas Development Finance Authority maintains its own information on debt issues, and is not required to report information to state officials. Similarly, Colorado's authorities are not subject to formal reporting requirements, and are not supervised by any state office. The same is true of special purpose governments in Idaho, Connecticut, Delaware, Montana, Nebraska, Ohio and a number of other states.

Finding #7:

States can be said to tend toward either one of two extremes with regard to their organizational arrangements for planning, preparing, selling and repaying long-term, tax-exempt debt obligations.

The first extreme is a highly centralized, integrated management approach, represented by Kentucky, Michigan and Virginia, which maximizes state oversight and control. The second extreme is a highly decentralized approach, represented by Connecticut, Ohio and Massachusetts, which encourages more self-regulation on the part of state debt issuing entities.

Kentucky. Kentucky represents one of the most highly integrated approaches to debt management in the sample. The state no longer actively issues GO bonds. Instead, it issues lease revenue debt of various kinds, under carefully controlled conditions. State revenue bonds are issued by the Kentucky State Office of Investment and Debt Management (OIDM) on behalf of the State Property and Building Commission. OIDM also issues bonds on behalf of the several authorities authorized by the legislature to sell revenue debt. The directing board of each authority initially determines the need for such debt. OIDM evaluates the need for the project, carries out all activities of the issuance process and reports to the General Assembly regarding these debt issuing activities.

Virginia. The Treasury Board issues all general obligation debt as well as the debt of state higher education institutions. The Board also approves the terms and structure of revenue bonds issued by all state agencies receiving general fund appropriations. Revenue bonds issued by four state authorities are reviewed by the Board, and the Division of Debt Management of the Treasurer's Office performs staff services for those authorities. The State Treasurer is

a board member of all nine state authorities that issue tax exempt debt.

Michigan. All general obligation debt of the state is reviewed by the State Administrative Board, and is issued by the Cash and Debt Management Division of the Treasurer's Office. The State Administrative Board also reviews all revenue bond debt issued by state agencies. These agencies hire their own consultants to work on their financing and manage investment of proceeds.

For some Michigan state authorities, the procedures for review and issuance of revenue bonds are similar to those for state agencies. Some authorities report directly to other state agencies, such as the Commerce Department. Finally, some authorities act independently of all other state agencies or departments. The State Treasurer serves as board member for most authorities that issue bonds.

Connecticut. Connecticut illustrates a more decentralized approach to debt management policy. Like most states surveyed, Connecticut requires centralized review and approval of state GO and revenue bonds, but requires no centralized state review and approval of public authority debt financings — for which the state does not consider itself liable. One measure of control is provided, however, by using ex officio members on the boards of issuing authorities. The State Treasurer sits on the boards of most issuing authorities. Also, the Secretary of the Office of Policy and Management, an executive agency, sits on the boards of all state authorities.

Ohio. Ohio's GO debt is reviewed and issued by the Commissioners of Sinking Funds. These officials include the Governor, Attorney General, State Auditor and State Treasurer. However, no formal review exists either for state revenue bonds or for revenue bonds issued by state public authorities, although the State Treasurer sits on the board of several of these entities. The authorities coordinate all aspects of their revenue bond issues and hire outside consultants as necessary.

Massachusetts. Review of GO debt in Massachusetts is performed by the Finance Advisory Board (FAB). State agencies that issue revenue bonds not guaranteed by the state do not submit proposals to the FAB, but coordinate their own debt issues. Public authorities that issue non-guaranteed revenue bonds carry out financings using their own staff and outside consultants. One measure of control is provided by debt limits imposed on each authority by its enabling legislation.

EMERGING ISSUES OF CONCERN TO STATE OFFICIALS

In telephone responses to open-ended follow-up questions survey respondents were asked to identify one or two issues of growing importance in the formulation and implementation of debt management policy in their states. The following discussion covers a selection of typical responses.

Issue #1:

How can cost savings be promoted in the preparation, sale and repayment of public debt?

10

This issue grows with importance during periods of rising or uncertain interest rates, and as states face more restrictions on the kinds of debt they may issue in tax-exempt form. One example of a procedure used by some states for controlling debt issuance costs involves coordinating the size and timing of different kinds of issues originating within the state. If large state and local issues are sold simultaneously, issuers may be forced to pay interest penalties. New York State deals with this potential problem with its Securities Coordinating Committee, a body that schedules the issuance of state debt in a coordinated fashion.

Issue #2:

How can state credit standing be protected or improved at a time when credit standing seems increasingly vulnerable?

In the short term, credit protection helps guard against interest penalties associated with debt issues of questionable credit worthiness. In the long term, it helps guarantee the state continued access to the credit markets for appropriate public purposes. A complicating factor in the protection by states of their credit standings has been the dramatic shift in public borrowing from GO debt, over which states typically have direct control, to various kinds of non-guaranteed or revenue debt, over which states may not have direct control.

Technically, the debt issued by these entities may be only a contingent liability of the state, but the state's credit rating may nevertheless be threatened if the issuer defaults. In such cases, the investment community may perceive that the state is informally obligated to arrange or sponsor a "bailout." Such a perception was an important factor in New York's efforts to rescue the New York State Urban Development Corporation (UDC) after it defaulted on short-term debt in 1975, although the state's "moral obligation" support was pledged to UDC's long-term bonds rather than its short-term securities.

Survey responses indicated that over the last 10 years, a number of states have become concerned about the effects of special authority borrowing on state credit standings. Over that period, at least nine states undertook reviews and reforms of debt management policy for the purposes of enhancing protection of the state's credit standing. These states include New York, California, Illinois, Michigan, Kentucky, Wisconsin, Oregon, Maryland and Vermont. In each of these cases, state liability for nonguaranteed state revenue debt and the debt of special purpose governments came under careful study.

Issue #3:

To what extent can and should state capital plan-

ning and debt management include participation of local governments?

Another issue identified by some respondents affecting the formulation and implementation of debt management policy concerns the extent to which a state should involve itself in the debt issuing activities of governments operating within its boundaries, regardless of potential danger to the state's credit standing. In other words, policy makers in these states recognize a growing need to develop comprehensive, coordinated efforts for capital planning, budgeting and financing involving all government units within each state's boundaries. This need may be recognized as most critical in states facing a combination of resource scarcity, growing demands for government goods and services, and severe limits on debt issuance activities, in the form of constitutional restrictions, federal tax restrictions, or already large amounts of outstanding debt.

Issue #4:

What are the implications of the continuing search by states for new kinds of debt instruments?

Finally, the rapidly growing popularity of lease-backed financing is evidence of the continuing effort by state and local issuers to identify and make use of new kinds of debt instruments. Lease financing was originally used to circumvent restrictions on the issuance of GO bonds, and the need for voter approval of such borrowing. These continue to be major reasons for the use of this financing technique, but such debt has become widely used for a variety of purposes, raising additional questions concerning how such bond issues should be authorized, sold and monitored.

CONCLUSION

There have been few attempts to carry out broad studies of basic state debt management policies, using comparative state data, largely because of the complex and highly diverse nature of existing policies. But this lack of research has meant, among other things, that policy makers and their staffs have had little guidance as they attempt to adjust policies and practices to meet their states' changing capital financing needs, as well as the evolving legal and procedural requirements associated with the capital markets themselves.

This study offers a "baseline" assessment of state debt management policies. With such information, researchers and analysts should be better able to design future studies focusing on the impacts of existing policies, and provide state officials with information useful in improving state approaches to the planning, preparation, sale and repayment of tax-exempt public debt.

PART TWO

Debt Management Profiles of the 50 States

ALABAMA

GO Bonds: Alabama GO bonds are constitutionally limited to a specific dollar amount and require a public vote (a constitutional amendment) and approval by the legislature before they can be issued. These bond issues are rarely issued due to the involved process. If they are issued, the Treasurer's Office handles the bonding process, i.e. structuring and issuing the bonds.

State Revenue Bonds: Alabama does not issue any revenue bonds directly in its own name. All revenue bonds are sold by authorities.

Authority Revenue Bonds: Each authority must be created by the legislature and each issue must be approved by the legislature. The Governor "controls" each of the authorities by having at least one member of his cabinet on the board. Once the issues are approved, the authorities structure and sell each of their own bonds, with the aid of the executive bond counsel advisor. The Treasurer's office collects and records information for all authorities, except the Housing Authority, and acts as paying agent for the issues.

ALASKA

GO Bonds: All GO bonds are issued in the name of the State of Alaska by the State Bond Committee. This is composed of three cabinet members with staff assistance from the Treasury Department, Department of Revenue. The GO issues require voter and legislative approval. The Department of Revenue collects information on debt activity and maintains all records.

State Revenue Bonds: The same basic process applies to the sale of revenue bonds issued in the state's name. The legislature approves these issues.

Authority Revenue Bonds: State authorities have legal and managerial independence. Each of the authorities has an oversight board composed of officials appointed by the Governor. There is no central office that collects data for the authorities. Authorities approach the issuance of bonds in different ways. In general, however, the issuance of bonds is independent from oversight by any office of the state, excluding an annual debt report produced by the Department of Revenue, which includes authority bond activity.

ARIZONA

GO Bonds: Arizona does not actively issue GO debt.

State Revenue Bonds: The University system and the Department of Transportation issue revenue bonds, backed by fuel and sales taxes. The legislature sets debt limits for the Department of Transporta-

tion, but the approval of the debt is by the Highway Commission. The Board of Regents sets debt limits and approves issues for the University system. The Department of Revenue collects information on the outstanding debt of these agencies, along with the revenue debt of municipal issuers. Lease purchase agreements are not subject to the same criteria as the revenue debt. Lease purchases are carried out by the Department of Administration, are not viewed as debt outstanding by the state and are not backed by the full faith and credit of the state.

Authority Revenue Bonds: The Power Authority was created by the legislature to issue debt (i.e. the Hoover Dam Project). The authority sets its own outstanding debt limits and structures and issues its own bonds. It is not subject to review by any government entity, but is required to report debt outstanding to the Department of Revenue.

ARKANSAS

GO Bonds: Arkansas issues very little GO debt. This operation is carried out by the Treasurer's Office. All debt is authorized by voter referendum. The Treasurer's Office calculates and monitors debt limits and oversees the structuring, issuing and reporting of information regarding the debt.

State Revenue Bonds: The Treasurer's Office has the same responsibilities for revenue debt as with the GO debt. Very little revenue debt is issued in the name of the state. The Treasurer's Office calculates and monitors debt limits.

Authority Revenue Bonds: The Arkansas Development Finance Authority (ADFA) issues most of the debt in the state. Issues are sold for economic development, housing development and government projects of other types. The Treasurer's Office calculates and monitors debt limits, but after this step the authority is completely on its own. There is no outside authorization for specific issues and no outside approval of the capital plans of the authority. The ADFA coordinates the issuing process, arranges for bond counsel and credit ratings, etc., issues the debt and maintains records. The ADFA is not required to report any information to any state official. The ADFA maintains all records and information on the debt issue.

CALIFORNIA

GO Bonds: Voters approve GO debt issues. The management and oversight of debt issues falls to the Department of Treasury. The Office of Trust Services is trustee and paying agent for all general obligation bonds. The California Debt Advisory Commission serves as a center for information on public debt issuance. The Commission collects and analyzes infor-

mation on the issuance of debt by public agencies and provides technical assistance concerning the issue. This includes all local GO issues. The Treasurer serves as chairman of all related sub-committees.

State Revenue Bonds: The same issuance procedures apply to the sale of state revenue bonds. The legislature approves the issuance of state revenue bonds.

Authority Revenue Bonds: There are a series of special authorities within the state with oversight responsibilities for allocation of revenue or conduit revenue sales. These authorities only report the amount of debt and other related information to the Debt Advisory Commission. The legislature approves each bond program and specifies an administering agency to sell the bonds. The finance committee or financing authority approves the amount of the sale and works with the Trust Services Division of the Treasury to schedule and sell the bonds. No other office is directly responsible for oversight of these authorities. The Governor or Director of Finance, the State Comptroller and a member from the specific area serve on the authorities' boards.

COLORADO

GO Bonds: Colorado does not actively issue GO bonds.

State Revenue Bonds: The Department of Education has legal authority to issue revenue bonds in its own name. The Department of Education authorizes each bond and capital plan, coordinates the credit rating process, issues the bonds and maintains all records. The Department also calculates the debt capacity.

Authority Revenue Bonds: State authorities handle all aspects of the bonding process independently, including authorization of the bonds and capital plans. Each authority is controlled by a governing board, made up of officials appointed by the Governor. There is no formal reporting mechanism and no direct oversight by any state office.

CONNECTICUT

GO Bonds: GO debt is limited by the amount of tax receipts during the previous year. The issuance of GO bonds is coordinated by the Division of Debt Management in the Treasurer's Office. Oversight is performed by the State Bond Commission composed of the Governor, Treasurer, Attorney General, Comptroller, Commissioner of Public Works, Secretary of Office of Policy Management and four members of the state legislature. The Division of Debt Management structures the bond sale, prepares the official statement, reviews the documents and sells the bonds.

State Revenue Bonds: The only state agency that issues revenue bonds is the Department of Transportation, subject to approval by the Treasurer's Office. The issue is carried out by the Treasurer's Office and labeled a "special tax obligation bond," payable from motor fuel taxes, motor vehicle receipts and license permits and fees. All processes related to the structuring, financing and sale of the bond are

carried out by the Division of Debt Management in the Treasurer's Office. The state is directly responsible for the debt. The DOT is responsible to the Treasurers' Office and does not report to any special board for bond issuance.

Authority Revenue Bonds: Bond authorization is the responsibility of individual authorities, who also structure and sell their bonds. The state recognizes some contingent liability, but is not directly liable for debt. The authorities that issue bonds are Housing Finance Authority, Development Authority, Higher Education and Supplemental Loan Authority, Resource Recovery Authority and Southeastern Connecticut Water Authority. The issues are coordinated entirely by each authority and oversight results from the membership of either the Treasurer or Secretary of Office of Policy Management on each of the authority boards.

DELAWARE

GO Bonds: The legislature approves GO debt issues; executive branch issues, structure and sell the debt.

State Revenue Bonds: Delaware does not actively issue any revenue bonds, either through regular departments or state agencies.

Authority Revenue Bonds: The executive branch (bond issuing officers made up of the Governor, Treasurer, Secretary of State and Secretary of Finance) approves the capital plan of the issuing entity, the amount of the issue, type of bond structure and prospectus of the bond issue. It then signs over all other operations directly to the issuing authority. The authority coordinates the issuing process, arranges for bond counsel and credit ratings. Each authority issues its own debt. There is no mandatory reporting requirements on the part of the authority. The bonds of the authorities do not carry any legal backing or guarantee by the state.

FLORIDA

GO Bonds: Voter approval is required for GO bond issue. The Division of Bond Finance, governed by the Governor and other elected officials, is a centralized debt management staff authorized to sell all GO bonds of the state agencies and local governments. This division was established by the legislature and provides all fiscal, legal and marketing services for the state agencies and local governments. The State Board of Administration, another constitutionally required office within the executive branch, acts as trustee to the bond issues.

State Revenue Bonds: The same issuance procedures apply to revenue bonds for the state. The legislature approves these bonds.

Authority Revenue Bonds: The Division of Bond Finance is responsible for issuing the state's expressway authority bonds only. No other special authorities report to the Division of Bond Finance. The other state authorities structure and issue their own bonds.

GEORGIA

GO Bonds: GO debt is limited by the amount of revenue receipts in the previous year and must be approved by the legislature. The Governor must approve all capital plans. The process is carried out by the State Finance and Investment Commission.

State Revenue Bonds: Revenue bonds are not actively issued by Georgia. No state agency or department issues revenue bonds.

Authority Revenue Bonds: Authority debt backed by direct guarantees by the state must be approved by the legislature. The authorities are advised by the Financing and Investment Commission and the bonds are issued in the name of the authority by the Commission. Some authority bonds are not guaranteed and considered "stand-alone" bonds. This status is ultimately determined by the legislature.

HAWAII

GO bonds: GO debt is limited by the size of general fund revenues in the previous year and must be approved by the legislature. No voter approval is required. The bonds may be issued in an agency or department's name, but all bonds must be countersigned by the Director of Finance. The calculation of debt capacity is centralized in the Department of Finance. All processes related to the structuring, financing and sale of the GO bonds are centralized in the Department of Finance.

State Revenue Bonds: The same process applies to revenue bonds of the state. The only difference is that the outstanding debt is limited only by the agency's ability to pay off the debt. All bond activity is centralized within the Department of Finance.

Authority Revenue Bonds: State authorities structure their own bond sales. The Director of Finance arranges for the finance teams, including the bond counsel, trustee and paying agent. The authorities must get legislative approval for each issue and the bonds must be countersigned by the Director of Finance. The authorities must report on a scheduled basis to the Director of Finance, the legislature and the Governor on their activity in the bond markets. Again, the calculation of authority debt capacity is the responsibility of the Department of Finance.

IDAHO

GO Bonds: Idaho does not actively issue GO bonds.

State Revenue Bonds: State agencies and departments do not issue revenue bonds.

Authority Revenue Bonds: All bonds are issued by state authorities. The legislature approves each issue, but each authority sets debt limits, structures and issues its own bonds. There is no oversight or reporting requirements once the issue has been approved.

ILLINOIS

GO Bonds: All GO issues are authorized by the legislature. The legislature, along with the Governor, must also approve the associated capital plans. All

of the bond processes (including coordination of the rating process, arrangements for bond counsel and financial advisor), calculation of debt capacity and record keeping is done by the Bureau of the Budget.

State Revenue Bonds: State revenue bonds are reviewed and authorized by the Bond Commission and issued through the Bureau of the Budget, Executive Office. Other revenue debt, labeled "certificates of participation," issued by the State Department of Central Management Services, are considered revenue debt by the ratings agencies, but are considered by the state to be "state lease payments," not subject to taxing authority of the state. Neither the state nor its agencies directly issue moral obligation bonds.

Authority Revenue Bonds: Authority debt issuing activities are not reviewed by the Commission, as long as the debt carries no direct state obligation, and are secured by the revenues of the issuing authority. If an authority issues debt that requires backing by the state, the state legislature must authorize a special tax pledge to have direct liability for the debt. Such a case is the request for debt issues on behalf of the Chicago White Sox Stadium. Authorities often carry their own debt liability with no guarantees by the state. The authorities generally issue their own bonds.

INDIANA

GO Bonds: There is a constitutional prohibition against the state issuing any debt in its own name. No GO bonds are issued.

State Revenue Bonds: The constitutional prohibition applies to revenue debt also. No state agency has the power to issue debt of any type.

Authority Revenue Bonds: There are eight to 10 authorities that issue debt. These were created in the mid 1970's. An elected official serves on every board and the authorities are created by the legislature. The bonds carry no liability of the state and do not require legislative approval for issuance. Each authority structures and issues its own bonds. There are a few cases in which authorities are subject to a debt limit, such as the Bond Bank, but this is not the general rule.

IOWA

GO Bonds: Iowa does not actively issue GO bonds.

State Revenue Bonds: The Department of Education issues revenue bonds in its own name. The bonds are authorized by the legislature and the capital plans are also approved by the legislature. The Department of Education coordinates the credit rating process and all other bond activities. The Department of Education, along with the Treasurer's Office, collects information and maintains all debt information. Once the agency has received bond authorization, it calculates and monitors its own debt capacity.

Authority Revenue Bonds: State authorities coordinate and oversee all activity related to the issuance of bonds. Once the authorities have been established by the legislature, the authorities act independently

excluding limited oversight by the Treasurer's Office. The Treasurer's Office provides staff assistance for the issuance of the bonds and collects information on the bond activities. The authorities report to appointed boards, which approve all capital plans for the authorities.

KANSAS

GO Bonds: Kansas does not actively issue GO debt.

State Revenue Bonds: All revenue issues require the approval of the legislature. The actual structuring and issuance is carried out by the Development Finance Authority (DFA). This authority reports directly to the Governor and has a board of appointed members to oversee its activities. The DFA serves as a central office that maintains information concerning the bonds of the state.

Authority Revenue Bonds: All authority bonds fall under the oversight of the DFA. The authority carries out all activities related to the issue once legislative approval has been received. Again, the DFA has all information regarding the debt and the state bond activities.

KENTUCKY

GO Bonds: Kentucky does not actively issue GO bonds.

State Revenue Bonds: The State Property and Building Commission finances projects with revenue bonds, authorized by the state legislature. The Office of Investment and Debt Management (OIDM) issues these bonds and oversees the issues.

Authority Revenue Bonds: The state has several authorities authorized by the legislature to issue revenue bonds. These include the Higher Education Commission, the Housing Corporation and the Infrastructure Agency. The OIDM issues the bonds in the name of the authority. All activities concerning the bond are carried out by the OIDM. Each authority is headed by a board that initiates the debt issuing process by formally identifying the need for bond funds. The OIDM has the legislative authority to evaluate each revenue project and act as a liaison between the general assembly and the requesting agent. The OIDM reports monthly to the State Investment Commission concerning bond issues.

LOUISIANA

GO Bonds: All GO bonds are approved by the legislature and structured and issued by the Bond Commission in the name of the state.

State Revenue Bonds: No revenue bonds are issued directly in the name of the state.

Authority Revenue Bonds: State authorities allowed to issue revenue bonds coordinate their financings through their own staff and outside consultants, but the Bond Commission approves all state issues including the terms, conditions of the proposal and the price and interest rates.

MAINE

GO Bonds: The issuance of GO bonds for the state is centralized within the Treasury Department. After legislative approval and a vote by the public (required to exceed a constitutional limit on outstanding debt), the Treasury oversees the bond activity for the state. The Treasurer's Office structures, issues and monitors the bond issues for the state agencies.

State Revenue Bonds: The state of Maine does not directly issue revenue bonds.

Authority Revenue Bonds: State authorities are completely separate from oversight by the Treasury Department. The State Treasurer serves as ex-officio officer on all authority boards, but has no special control. The Governor appoints authority board members and the legislature sets outstanding debt limits for the authorities. The authorities are not required to report any other information and face no bond registration requirements.

MARYLAND

GO Bonds: GO bond issues must have associated capital plans approved by the legislature and the Governor. The legislature authorizes each GO bond issue and all functions related to GO debt issuance are carried out by the Treasurer's Office.

State Revenue Bonds: State agencies and departments do not directly issue revenue bonds.

Authority Revenue Bonds: The specific authority board authorizes the bond issue and approves the capital plan. The authority carries out all functions related to the debt sale and acts independently once its board has approved the issue. There is no central state office that oversees bond issuing activity or collects information concerning bond activity.

MASSACHUSETTS

GO Bonds: Most of the debt issued in the name of the state and its agencies is in the form of GO bonds. Currently, the state has about \$6 billion outstanding GO debt. The Administration and Finance department in the executive branch oversees these issues. Legally, all debt issues must be initiated through the Office of the Treasurer. The GO bonds do not require a vote of the people, but must be approved by the legislature.

State Revenue Bonds: The Secretary of the Administration and Finance Department sets a volume cap for these debt issues, which are sold by the agencies and departments themselves.

Authority Revenue Bonds: There are a large number of bonds issued by state authorities. The authorities are established by the legislature and the volume caps are set by the Secretary of Administration and Finance (executive branch). The state does not guarantee these bonds or have any moral obligation for them. There is currently about \$15 billion of this debt outstanding. The Treasurer serves as ex-officio on each of the authority governing boards. (There are several "fringe" authorities of the state such as the Massachusetts Transit Authority that issue revenue bonds. These authorities act as independent issuers

but are considered "creatures of the state." The state carries a liability for these bonds if the authority revenue streams do not cover debt service.)

MICHIGAN

GO Bonds: Both the electorate and the legislature must vote to issue GO bonds, which are sold through executive branch offices.

State Revenue Bonds: The Administrative Board reviews all revenue bonds issues proposed by state agencies. The Transportation Division is one of few state agencies that issues revenue bonds.

Authority Revenue Bonds: Most authorities have their own boards to which they are responsible. Some must be reviewed by the State Administrative Board, while others report directly to state agencies such as the Department of Commerce.

MINNESOTA

GO Bonds: The Commissioner of Finance of the Revenue and Finance Department oversees the issuance of all GO bonds of the state. The legislature must approve each issue. The Commissioner of Finance, appointed by the Governor, executes all activities related to bond issuance as directed by the Executive Office. This office only issues GO bonds.

State Revenue Bonds: The state of Minnesota does not directly issue any revenue bonds.

Authority Revenue Bonds: All revenue bonds are issued by "special bonding agencies." These authorities are not under the supervision of the Commission of Finance and act as separate entities, handling all aspects of their bond issues. The legislature establishes debt limits for these agencies, but has no control over how the issues will be structured and managed.

MISSISSIPPI

GO Bonds: The Bond Division handles all GO bond issues for the state. The legislature sets outstanding debt limits for the GO bonds, based on a state constitutional restriction of debt based on a recent history of revenue collection. The Bond Division maintains all records on the GO issues. Each agency request is reviewed on a case-by-case basis by the State Bond Commission, chaired by the Governor. Once the bonds are structured and issued, the State Bond Attorney, appointed by the Governor, must validate the sale.

State Revenue Bonds: The same procedures apply to the sale of state revenue bonds.

Authority Revenue Bonds: Each authority must go before the State Bond Commission for issue review and must report to the legislature annually after the issue is sold. Again, the State Bond Attorney must validate the issue before it can be sold. There are no formal reporting procedures for the authorities or bond counsel.

MISSOURI

GO Bonds: All GO bonds are issued by the Board of Fund Commissioners, made up of the Governor,

Attorney General, Treasurer, State Auditor and Commissioner of Administration. The state constitution places a dollar limit on all outstanding GO bonds, but the limit may be exceeded by referendum. The legislature also approves each issue. The Board of Fund Commissioners maintains all information and records concerning the GO bonds of the state.

State Revenue Bonds: State revenue bonds must be legislatively approved and are issued by the Governor, Lieutenant Governor and Attorney General. The legislature sets outstanding debt limits for the revenue bonds. These bonds are issued primarily for state building funds and correction facilities. The Division of Accounting collects information on the bond activity for an annual report; no other office maintains information on the bonds.

Authority Revenue Bonds: Members of the governing boards of the authorities are appointed by the Governor. These boards have authority to approve each issue with no debt limits. Each of the authorities structure, issue and carry out all phases of the bonding process, with oversight of their board. Again, the Division of Accounting collects yearly information about the bond activity of the authorities for its fiscal reports, but this is not a legal requirement. No other office has information about the authority bonds.

MONTANA

GO Bonds: All GO bonds are authorized by the legislature. The bonds are issued by the state agency, along with the Board of Examiners, which coordinates the rating process. The Department of Administration collects information on the state debt activity. The agency receiving authorization calculates and monitors the debt capacity and approves the capital plans once the legislature has established a dollar amount. There is no constitutional limit for the issuance of GO bonds.

State Revenue Bonds: The same process applies to revenue bonds issued in the name of the state.

Authority Revenue Bonds: State authorities act independently once the legislature has given them bonding authority. All processes related to the issuance of bonds are carried out by the authorities. The capital plans are approved by the governing board, made up of members appointed by the Governor. No central office of the state oversees the authorities or collects information on their activities.

NEBRASKA

GO Bonds: The state does not actively issue GO bonds.

State Revenue Bonds: Revenue bonds are issued for the Highway Department. The Highway Revenue Commission oversees the process, chaired by the Governor and Deputy of Roads. The Treasurer's Office serves as paying agent and trustee for the bonds. The legislature must approve each issue.

Authority Revenue Bonds: The only authority that issues bonds is the Nebraska Investment Finance Authority. These bonds are not backed by the state

and there is no reporting mechanism to the state. All aspects of the bond issue are handled directly by the authority.

NEVADA

GO Bonds: The constitution limits GO bonds according to the assessed valuation of property in the state subject to taxation. In practice, these issues require voter approval. The oversight of the bonding process is carried out by the Department of Administration Division, an executive office.

State Revenue Bonds: All revenue bonds require legislative approval, setting a limit for outstanding debt. The Department of Administration also carries out the bonding process, including structuring, issuance and record keeping.

Authority Revenue Bonds: The state does not currently have authorities issuing revenue bonds.

NEW HAMPSHIRE

GO Bonds: All GO bonds are approved by the legislature and issued by the Treasurer's Office. This office handles all aspects of the bond process, but each issue must be approved by the Governor.

State Revenue Bonds: The Treasurer's Office issues state revenue bonds, used primarily for the turnpike system. Again, each issue must be approved by the Governor.

Authority Revenue Bonds: Three entities have the power to issue debt. The Bond Bank, the Higher Education and Health Authority and the Housing Finance Authority issue bonds independently. The Bond Bank and Housing Finance Authority do not require formal approval for any of their issues. They structure and issue all bonds in their own name and they do not carry any liability of the state. The Higher Education and Health Authority requires approval of the Governor for each issue, but structures and sells its own bonds. The Housing Finance Authority has a legislative limit on the amount of its outstanding debt, but the other two authorities have no limits.

NEW JERSEY

GO Bonds: GO bonds are constitutionally limited relative to the size of annual appropriations, but the limit may be exceeded by referendum. The Treasurer's Office reviews all GO bonds and handles the sale of debt. The Office of Financial Management maintains records and information of all bond sales.

State Revenue Bonds: The Treasurer's Office reviews and approves revenue bonds issued by state agencies. The Office of Financial Management oversees the structuring of the bonds and the Treasurer's Office sells the debt. The state is now using certificates of participation more frequently, which do not require legislative approval or review. The Office of Financial Management maintains records and information of all bond sales.

Authority Revenue Bonds: State authorities structure and issue their own bonds. There is no legislative approval required and no debt limit established

by the legislature for these authorities. The bonds carry no formal state backing.

NEW YORK

GO Bonds: GO bonds are authorized by state voters. The legislature must review and approve capital plans on a case-by-case basis. The Office of the Comptroller in the Division of Investment and Cash Management handles all processes related to the issuance of GO bonds.

State Revenue Bonds: New York does not currently issue revenue bonds directly. Lease-purchase debt issued by state agencies is not considered by the state to be "revenue debt."

Authority Revenue Bonds: State authorities or "Public Benefit Corporations" operate on an independent basis with respect to issuing their bonds. All aspects of the bonding process are handled directly by the authorities. Some authority revenue bonds are formally guaranteed by the state. Some are lease-purchase service contracts. Initial authorization is set by the legislature, as to dollar amounts and project. Many authorities, but not all, are required to report to the Public Authority Control Board regarding issuing activity and rollover requests.

NEW MEXICO

GO Bonds: The Board of Finance reviews and issues all GO bonds. These are backed by full faith and credit of the state. GO authorization is by the electorate and review of capital plans by the executive branch and the legislature is required.

State Revenue Bonds: The Board of Finance also reviews, approves and issues revenue bonds secured by severance tax funding set by the legislature. These carry full backing by the state.

Authority Revenue Bonds: Housing, student loan, mortgage finance and education finance revenue bonds are not subject to "continuous review" by the Board. Borrowing requests, however, must be presented for Board review and approval. Once the bond issues are approved with regard to project, the authority issues its own bonds and oversees the process. These bonds do not carry the full faith and credit of the state.

NORTH CAROLINA

GO Bonds: All GO debt is subject to approval by the Treasurer's Office. The legislature sets ceilings for outstanding debt, within constitutional limits. The executive branch, Department of Treasury, authorizes the bond issue, coordinates the credit rating process, issues the bonds and maintains all records regarding the bond process. The capital plans are also approved by the executive branch.

State Revenue Bonds: Each issue must be approved by the Treasurer's Office. The Treasurer serves as financial advisor, helps with the official statement and collects information about the debt issues. Each state agency can issue its own debt (i.e. arrange for bond counsel and credit ratings), but most rely on the Treasurer for these services. The legislature deter-

mines the debt limits and monitors debt activity. The Treasurer approves each capital plan for the issuing entity.

Authority Revenue Bonds: The Treasurer's Office authorizes specific issues, serves as financial advisory to all of the authorities and issues the debt. The Treasurer approves the capital plan of the issuing entity in accordance with the legislative limits set for each authority.

NORTH DAKOTA

GO Bonds: The state does not actively issue GO bonds.

State Revenue Bonds: Revenue bond issues are approved by the legislature, then the agencies structure and issue their own bonds. There is a legislative limit on total outstanding debt, but no centralized oversight of the bonds once they are approved.

Authority Revenue Bonds: The State Building Authority structures and issues its own bonds, subject to approval by the legislature. The state has switched to using the Authority in the last six years in an effort to circumvent the state debt limits. The authority bonds do not count in the total debt limits set by the legislature. There is no centralized review of the bonds or collection of information on the bond activity.

OHIO

GO Bonds: GO bond issues are authorized by referendum. They are issued and reviewed by the Commissioners of Sinking Funds, including the Governor, Attorney General, State Auditor and State Treasurer.

State Revenue Bonds: There is no review of revenue bonds issued by state agencies. Each agency structures, issues and coordinates all aspects of its revenue bond issues. There is a debt limit set by the legislature, but the agency does not require approval of each issue by the legislature.

Authority Revenue Bonds: There is no formal review of bonds issued by state authorities. They act as separate entities, structuring and issuing their own bonds. An elected official on the board has the power to approve the issue, as long as it meets the debt limits set by the legislature.

OKLAHOMA

GO Bonds: All GO bonds require authorization by the electorate. The Treasurer's Office oversees the process, maintains all records and serves as paying agent and trustee.

State Revenue Bonds: Revenue bonds are not issued directly by state agencies or departments.

Authority Revenue Bonds: State authorities act independently with respect to bond activity. Each authority is overseen by its own directing board which approves all capital plans and debt issues. The authorities handle all aspects of the bonding process including structuring the issue, arranging for bond counsel and rating agencies and selling the bonds.

OREGON

GO Bonds: GO debt is limited by constitutional restrictions and must be approved by referendum. All GO bonds issued by the state are reviewed, approved and issued by the Treasury Department's Office of Debt Management (ODM).

State Revenue Bonds: The State Treasurer approves the capital plans and authorizes all state revenue bonds. Legal debt limits are set biannually by the state legislature. The ODM coordinates the issuing process, arranges for bond counsel, credit ratings, etc. and issues the bonds. It also collects and maintains a data base on all state bond issues and monitors all debt limits.

Authority Revenue Bonds: The only remaining authority, the Mass Transportation Authority, issues debt through the ODM. The Treasurer approves all capital plans and authorizes all revenue bond issues.

PENNSYLVANIA

GO Bonds: GO debt must be approved by the voters. Review and approval of GO debt is carried out by the Governor's Office, the Auditor General and the State Treasurer. The legislature establishes debt limits.

State Revenue Bonds: No revenue debt is issued by state agencies or departments.

Authority Revenue Bonds: There is no direct oversight of bond issuance by state authorities. Except for the Housing Authority, there is no state obligation for this debt. Each authority has its own board which approves and oversees issues. A measure of oversight is provided by the State Treasurer, who sits on the board of each issuing authority.

RHODE ISLAND

GO Bonds: Voters must approve all GO debt. All GO issues are handled directly by the Treasurer's Office, which structures and sells the debt, and maintains all records on GO debt.

State Revenue Bonds: Rhode Island only uses revenue bonds on occasion to refund GO bonds. The Treasurer's Office authorizes this debt and handles all aspects of its sale.

Authority Revenue Bonds: State authorities authorize and issue their own bonds. Some of the bonds carry the state's moral or legal obligation. The authority is not required to get legislative approve for their issues once the original borrowing authority has been established by the legislature. Bond issues and capital plans are approved by the board of each authority. Authorities must report all public finance activity (bonds, lease purchase agreements, etc.) to the Public Finance Management Board.

SOUTH CAROLINA

GO Bonds: GO bonds primarily go to service capital improvements for the state. The Treasurer's Office oversees the structuring of the bonds, sells the bonds and serves as paying agent. The legislature sets an annual debt service payment limit and the bonds must

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meet these restrictions. The Treasurer's Office must appear before the Central State Budget and Control Board for approval of each issue. The Board is made up of the Governor, two executive branch officials and two members of the legislature.

State Revenue Bonds: The same procedures apply for any revenue bonds issued directly by the state.

Authority Revenue Bonds: The Treasurer serves as trustee and paying agent for the bonds of the Housing Authority, although the authority structures its own issues. The Control Board must approve any issue of the Housing Authority. Issues of the other major authority, the JETA, must also be approved by the Control Board. Bonds of these two authorities carry no formal state backing. There is no mandatory reporting mechanism for information concerning bond activity.

SOUTH DAKOTA

GO Bonds: The state does not currently issue GO bonds.

State Revenue Bonds: The state does not currently issue state revenue bonds.

Authority Revenue Bonds: All state authorities structure and issue their own debt, with the exception of the Building Authority, which requires legislative approval of each issue. Members of authority governing boards, appointed by the Governor, oversee the authorities, but most of the decision are made by the respective executive directors. The Fiscal Administration maintain some records on the bond activity of authorities, but there is no legal reporting requirement. The debt of the authorities is not considered debt of the state. The state acknowledges no moral obligation or formal liability of any kind for these authority bonds.

TENNESSEE

GO Bonds: The legislature authorizes GO bond issues with no voter approval. The Bond Finance Office serves as staff for the GO bond issues, structuring the bonds, coordinating the bond process and arranging for bond counsel. The bonds are issued and approved by the State Funding Board (legislative branch). All information on the bonds are maintained by the Bond Finance Office (legislative branch).

State Revenue Bonds: No revenue bonds are issued directly by state agencies or departments.

Authority Revenue Bonds: All revenue debt is issued by the Local Development, School Board or Housing Authorities. These authorities cannot issue bonds without the State Funding Board's (legislative branch) approval. The legislature sets bond authorization for specific purposes and the authorities must adhere to these limits. The Bond Finance Office (legislative branch) serves as staff for the issuance of the bonds, coordinating all phases of the bonding process.

TEXAS

GO Bonds: All GO bonds must be approved by the voters. These bonds are issued by the Bond Finance Office with approval of the Bond Review Board com-

posed of the Governor, Lieutenant Governor, Speaker of the House, Comptroller and Treasurer.

State Revenue Bonds: State revenue bonds may be issued only with the Board's approval. State agencies must also obtain the Bond Review Board's approval prior to entering into lease purchase agreements over \$250,000 or five years. The Board reviews the structure, the use and provision, content of official statements, timing of the issues and costs associated with the issue.

Authority Revenue Bonds: Authorities approve, structure and sell their own issues if these bonds do not involve state liability.

UTAH

GO Bonds: All GO bonds are issued by the Treasury Department after approval by the legislature. No voter approval is necessary, but constitutional restrictions limit the amount of GO debt that may be outstanding. The Treasury Office maintains all records and information related to GO bonds.

State Revenue Bonds: The same procedures apply to revenue bonds issued directly by state agencies or departments.

Authority Revenue Bonds: State authorities have a large degree of independence. The outstanding debt is not limited by the state and the legislature does not approve the issues once the authorities have been legislatively established. Authority boards are usually chaired by the Treasurer. These boards approve the capital plans and bond issues for the authorities. The authorities handle all aspects related to the bond issue, including structuring the debt, selecting bond counsel, etc. No central office is responsible for maintaining records on the activities of authorities and there are no formal reporting requirements regarding bond issues.

VERMONT

GO Bonds: All GO bonds are handled by the Treasurer's Office. These issues require legislative approval only. The Treasurer's Office oversees all aspects of GO issues, including structuring, selection of bond counsel, record keeping and sale.

State Revenue Bonds: Revenue bonds are not currently being issued by state departments or agencies.

Authority Revenue Bonds: The Treasurer serves as an ex-officio member on each of the authority boards. No legislative approval of the capital plans or the issues is required. Each board approves the issue and sets the debt capacity of the authority. Once established by the legislature, all bond activity is independent from direct oversight by any state office. There is no reporting mechanism required for information on borrowing.

VIRGINIA

GO Bonds: Voter approval is required for each GO bond issue. The Office of Debt Management performs all duties related to the bond issue including structuring the sale, arranging for bond counsel and ratings, etc.

State Revenue Bonds: Revenue bonds sold by state agencies are reviewed by the Treasury Board. The Debt Management staff performs all duties related to the bond issue.

Authority Revenue Bonds: The Treasury Board approves the terms and structure of revenue bonds issued by authorities only if the authority receives general fund appropriations. The Division of Debt Management of the Treasurer's Office performs staff services for several of the state authorities whose bonds are reviewed by the Board. If the authority does not receive general revenue appropriations, there is no review process.

WASHINGTON

GO Bonds: The Finance Commission, a division of the Treasurer's Office, carries out all GO bonding activities for universities, state buildings, pollution control, etc. Voters approve individual issues with dollar limits set by the legislature. The Finance Commission is responsible for issuing the bonds. This office maintains all information on GO bond activity of the state. The Commission is headed by the Governor, Lieutenant Governor and Treasurer.

State Revenue Bonds: Revenue bonds are not currently issued by state departments or agencies.

Authority Revenue Bonds: State authorities issue their own bonds independently. There is no legislative approval required for these issues. The board of each authority makes all decisions regarding bond issues. The Governor, Lieutenant Governor and Treasurer serve on most of the boards. The Treasurer's Office collects information on the authorities' activities on a semiannual basis.

WEST VIRGINIA

GO Bonds: All GO bonds are approved by the electorate. The state legislature sets legal limits for debt capacity. The Municipal Bond Commission, made up of seven members who are appointed by the Governor, provides the technical assistance for all debt issues.

State Revenue Bonds: When a state agency requests bond funding, the Municipal Bond Commission provides technical assistance for the issues. Again, the

legislature sets the limits and provides each agency with the authority to issue bonds and approves the capital plans. The Commission also gathers information regarding all bond issues and maintains records on behalf of the state agencies.

Authority Revenue Bonds: The legislature sets debt capacity for any state authority that issues bonds. The legislature also approves the original capital plan of the issuing authority. All issuing activities, including bond structuring, bond counsel, credit relations, etc., are carried out by the authority. There is no on-going reporting mechanism for information about the activities of state authorities.

WISCONSIN

GO Bonds: The legislature must authorize the bond issues and approve all capital plans. The legislature sets outstanding debt limits for the GO bonds. The Department of Administration, Division of Capital Finance, serves as staff for each issue. The Capital Finance Office handles all aspects of the bond issue including structuring and issuing the bonds. This office also maintains all records regarding the state GO debt.

State Revenue Bonds: The same procedures apply to any revenue bonds issued by the state or its agencies.

Authority Revenue Bonds: Once the authorities receive their bonding authority from the legislature, all aspects of the bond issue are carried out by the authority independent of direct oversight by the state. The authority boards must submit a program report to the State Building Commission annually. Authorities report all bond activities to the legislature annually.

WYOMING

GO Bonds: The state does not actively issue GO bonds.

State Revenue Bonds: The only revenue bonds that are issued are private activity bonds. All phases of the bond issue are carried out by the Governor's Office.

Authority Revenue Bonds: Authorities structure and sell their own debt.

