SJR

5

SENATE COMMITTEE REPORT

FURTHER

DATE TURNED INTO OFFICE 2/13/90

4/26/89

Mr. President:

FINANCE Committee considered SSSJR 5

Proposing amendments to the Constitution of the State of Alaska amending provisions relating to the Alaska permanent fund; establishing temporary provisions relating to dedicated funds, the Alaska permanent fund; etc. and recommended

[✓] replace with ___ CS SS SJR 5 (Finance)) [] same title
[ ] or adopt ___ CS ___) [✓] new title
[] technical title change (HB only)

[ ] attached amendment(s) and

[ ] ___ letter of intent adopted

[ ] do pass

[ ] do not pass

[ ] no recommendation

[✓] individual recommendations

[ ] further referral to ___

FISCAL NOTE(S) [ ] zero [✓] fiscal impact 2.2 Gov/Div of Elects [ ] appropriation no FN
[✓] new [✓] updated [ ] previous
[ ] same as previous fiscal note(s) published ___

MEMBERS SIGNING DO PASS	OTHER RECOMMENDATIONS
[illegible signature]	Fred F. Zharoff do not Pass —
Paul Fischer	Jim Duncan Do Not Pass —
Rick Uehling (DO PASS)	

Chair: signature and recommendation

[ ] Committee Backup attached

STATE OF ALASKA
1990 LEGISLATIVE SESSION

BILL VERSION: CSSSSJR 5 (Finance)
PUBLISH DATE: 3/20/89

FISCAL NOTE

REQUEST:

Revision Date: 1/18/90
Title: Provisions relating to the Alaska Permanent Fund
Sponsor: Faiks
Requestor: Faiks

Agency Affected: Office of the Governor
BRU: Division of Elections
Components: II - Elections

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 91	FY 92	FY 93	FY 94	FY 95	FY 96
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL	2.2*	-0-	-0-	-0-	-0-	-0-
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	2.2*	-0-	-0-	-0-	-0-	-0-
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND	2.2*	-0-	-0-	-0-	-0-	-0-
FEDERAL FUNDS						
OTHER						
TOTAL	2.2*	-0-	-0-	-0-	-0-	-0-

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

* Costs included cover 2 to 3 pages in each Official Election Pamphlet, for printing and typesetting, and costs estimated to cover computer programming requirements for vote counting purposes.

Prepared by: Linda Edgeworth
Phone: 465-4611
Division: Division of Elections
Date:

Approved by Commissioner:
Date: 1·19·90
Agency: Division of Elections

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

CONTINUATION OF FISCAL NOTE ANALYSIS

For Bill/Resolution No. CSSSSJR 5

However, these costs are based on the assumption that all candidates and issues will fit on three ballot cards, which is the norm. It should be noted, however that should the inclusion of this issue require a 4th ballot to be printed, the cost increase would have to be calculated at 16 cents per ballot x approximately 320,000 voters. The total cost of printing the additional ballot card would be $51.2

Under these circumstances the fiscal note would be:

53.4

Original sponsor(s): SEN. FAIKS, Jones, Eliason, Fischer, Duncan

IN THE SENATE BY THE FINANCE COMMITTEE

CS FOR SPONSOR SUBSTITUTE FOR SENATE JOINT RESOLUTION NO. 5 (Finance)

IN THE LEGISLATURE OF THE STATE OF ALASKA

SIXTEENTH LEGISLATURE - SECOND SESSION

Proposing an amendment to the Constitution of the State of Alaska establishing temporary provisions relating to dedicated funds, the expenditure limit, and the budget reserve fund; and suspending the operation of provisions relating to dedicated funds and the appropriation limit.

BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. Article XV, Constitution of the State of Alaska, is amended by adding new sections to read:

SECTION 29. DEDICATED FUNDS. (a) The operation of Section 7 of Article IX is suspended from July 1, 1991, through June 30, 1996, and this section applies in lieu of Section 7 of Article IX.

(b) The proceeds of any State tax or license shall not be dedicated to any special purpose, except as provided in Section 15 of Article IX and Sections 30 and 31 of this article or when required by the federal government for State participation in federal programs. This provision shall not prohibit the continuance of any dedication for special purposes existing upon the date of ratification of Section 7 of Article IX by the people of Alaska.

SECTION 30. EXPENDITURE LIMIT. (a) The operation of Section 16 of Article IX is suspended from July 1, 1991, through June 30, 1996, and this section applies in lieu of Section 16 of Article IX.

(b) Except for appropriations to the permanent fund or for

Alaska permanent fund dividends, appropriations to the budget reserve fund, appropriations of revenue derived from a tax that has been approved by a vote of the taxpayers, appropriations of general obligation and revenue bond proceeds, appropriations required to pay the principal and interest on general obligation and revenue bonds issued by the State, appropriations to pay the principal and interest on general obligation bonds issued by a municipality for construction of elementary or secondary schools, appropriations to pay obligations of the State or a public authority or corporation of the State under lease-purchase agreements, appropriations of money received from a non-State source in trust for a specific purpose, appropriations of revenue of a public authority or corporation of the State that issues revenue bonds, and appropriations of revenue of a State program under which revenue bonds are issued, appropriations from the general fund made for

(1) fiscal year 1992 may not exceed $2,300,000,000;

(2) fiscal years 1993 - 1996 may not exceed an amount equal to one percent less than the amount appropriated during the prior fiscal year that was subject to the limit under this subsection.

(c) During a fiscal year the legislature may exceed the expenditure limit under (b) of this section if each bill that exceeds the limit is passed by affirmative vote of

(1) three-quarters of the membership of each house of the legislature; or

(2) two-thirds of the membership of each house of the legislature and the appropriation is to meet a disaster emergency declared by the governor as prescribed by law.

(d) Except as provided in (e) of this section, all money received by the State during a fiscal year that is subject to the expenditure limit under (b) of this section, that exceeds that limit, and that is not appropriated under (c) of this section shall be deposited in the budget reserve fund.

(e) Except for money deposited into the permanent fund under Section 15 of Article IX, all money received by the State as a result of the termination through settlement or otherwise, of litigation in State or federal court involving mineral lease rentals, royalties, royalty sale proceeds, and federal mineral revenue sharing payments and bonuses shall be deposited in the budget reserve fund.

SECTION 31. BUDGET RESERVE FUND. (a) This section applies from July 1, 1991, through June 30, 1996.

(b) In addition to deposits made to the budget reserve fund under Section 30(d) and (e) of this article, appropriations may be made to the fund at any time.

(c) Money in the budget reserve fund shall be invested so as to yield competitive market rates to the fund. Income from investment of the fund shall be retained in the fund.

(d) Except as provided in (e) of this section, money may be appropriated from the budget reserve fund only if the legislature determines that the money received by the State in a fiscal year and subject to the expenditure limit is less than the maximum amount that may be appropriated under Section 30(b) of this article. However, the amount appropriated from the budget reserve fund during a fiscal year may not exceed the lesser of

(1) the amount that, when added to money received by the State during that fiscal year and subject to the expenditure limit, equals the maximum amount that may be appropriated under Section 30(b) of this article; or

(2) twenty-five percent of the balance of the budget

reserve fund.

(e) An appropriation from the budget reserve fund may be made upon affirmative vote of two-thirds of the membership of each house of the legislature to meet a disaster emergency declared by the governor as prescribed by law. An appropriation from the budget reserve fund to the principal of the permanent fund may be made at any time.

SECTION 32. REPEAL. Sections 29 - 31 of Article XV are repealed July 1, 1996.

* Sec. 2. The amendment proposed by this resolution shall be placed before the voters of the state at the next general election in conformity with art. XIII, sec. 1, Constitution of the State of Alaska, and the election laws of the state.

2/13/90

Alaska State Legislature

Senate Judiciary Committee

February 13, 1990

MEMORANDUM

TO: Senate Finance Committee Members

FROM: Senator Jan Faiks

SUBJECT: Amendments to CS/SSSJR 5 (Fin)

At the committee's work session on expenditure limit legislation, two issues were discussed on which I want to report: fisheries tax enhancement receipts and lease-purchase obligation payments. The issue raised was if these two items were included or excluded under the expenditure limit.

FISHERIES ENHANCEMENT TAX

According to Legal Services, the salmon enhancement tax, projected to generate $7,551,500 in FY 91, would be included under the limit as currently drafted. An amendment (attached) to the proposed committee substitute would be necessary to exclude this tax from the limit. Memos from Legal Services addressing this issue are also attached.

LEASE PURCHASE DEBT

According to the Department of Revenue, bond rating entities consider lease obligations, such as that for the Seward prison and Palmer courthouse, to be debt obligations of the state. As the expenditure limit is currently drafted, a lease purchase financing obligation would be included under the limit. If the committee desires to exclude this obligation from the limit, an amendment doing so is attached. I have also attached other background information on the issue.

Amds #1 and #2
- OVER -

Post Office Box V • Juneau, Alaska 99811

6-0161Ib
Cook

Am #1
ADOPTED
SFC: 2/13/90
SF: Moved; no obj

A M E N D M E N T

OFFERED IN THE SENATE

BY SEN. FAIKS

TO: CSSSSJR 5 ( )

Page 2, line 2, after "fund,":

Insert "appropriations of revenue derived from a tax that has been approved by a vote of the taxpayers,"

2/8/90

6-0161Ia ✓
Cook

Am#2
ADOPTED
SFC: 2/13/90
SF: Moved, no obj

A M E N D M E N T

OFFERED IN THE SENATE

BY SEN. FAIKS

TO: CSSSSJR 5(   )

Page 2, after line 6:

Insert "appropriations to pay obligations of the State or a public authority or corporation of the State under lease-purchase agreements,"

2/8/90

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

POUCH Y · STATE CAPITOL
JUNEAU ALASKA 99811
907 465 3800

M E M O R A N D U M   February 8, 1990

SUBJECT: Salmon Enhancement Tax - application of appropriation limit (CSSSSJR 5( ))

TO: Senator Jan Faiks

FROM: Tamara Brandt Cook TBC
Director
Division of Legal Services

You have asked how the appropriation limit in draft CSSSSJR 5( ) would apply to salmon enhancement taxes collected under AS 43.76.010 - 43.76.030. In my opinion these taxes would be included within general funds and appropriations of these tax revenues would apply toward that limit. AS 43.76.025(c) makes it clear that the taxes are state revenues in the general funds, subject to appropriation.

> (c) The salmon enhancement tax collected under AS 43.-76.010 - 43.76.030 shall be deposited in the general fund. The legislature may make appropriations based on this revenue to the Department of Commerce and Economic Development for the purpose of providing financing for qualified regional associations. The legislature may base an appropriation for a qualified regional association operating within a region designated under AS 16.-10.375 on the value of the fisheries resources caught in that region rather than the value of the fisheries resources sold in that region if those values differ.

TBC:lmb
L9/109

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

POUCH Y STATE CAPITOL
JUNEAU, ALASKA 99811
907 465-3800

MEMORANDUM February 8, 1990

SUBJECT: Assessment on Sale of Salmon--Spending Limit (CSSSSJR5( ))

TO: Senator Jan Faiks

FROM: Tamara Brandt Cook TBC
Director
Division of Legal Services

You have asked how revenue generated under AS 16.10.540 would be treated under the draft CSSSSJR5( ) establishing a constitutional appropriation limit. AS 16.10.540 provides:

> Sec. 16.10.540. VOLUNTARY ASSESSMENT ON SALE OF SALMON.
>
> (a) An association of persons who hold entry permits under AS 16.43, which consists of at least 51 per cent of the persons holding entry permits and actively participating in a fishery to be benefited by a hatchery program, may levy and collect an assessment from among its members for the purpose of securing and repaying a loan made under AS 16.10.510.
>
> (b) Upon satisfactory demonstration to the commissioner that an assessment levied under this section may reasonably be relied upon to secure and repay a loan to be made under AS 16.10.510, the commissioner may make the loan.
>
> (c) [Repealed, sec. 33 ch 14 SLA 1987.]

The money raised through this voluntary assessment comes from purely private sources and is pledged to the state to secure a loan, but the money is not state revenue subject to appropriation by the legislature. The individuals involved either raise the money through assessments and make payments on the loan or default on the loan. In neither case may the state appropriate money from these individuals. Since the appropriation limit applies only to appropriations, it is my conclusion that it has no application with respect to any revenue raised through assessments under AS 16.10.540.

TBC:pl
WKP2/013

Faiks
2/2/90

Alaska State Legislature

JUDICIARY
CHAIRMAN
907-465-4523

JAN FAIKS
POST OFFICE BOX V
JUNEAU, ALASKA 99811

THE SEAL OF THE STATE OF ALASKA

Senate

February 2 , 1990

MEMORANDUM

TO: Senate Finance Committee Members

FROM: Senator Jan Faiks

SUBJECT: Changes to Proposed Finance CS to SS SJR 5

The changes reflected in the February 1, 1990 proposed Finance CS for SS SJR 5 are as follows:

Page 1, line 29 and Page 2, lines 1 - 10:

- Clarifies the appropriations specifically excluded from the Expenditure Limit as:

Appropriations to the permanent fund
Appropriations to pay permanent fund dividends
Appropriations to the budget reserve fund
Appropriations of general obligation and revenue bond proceeds;
Appropriations required to pay principal and interest on general obligation and revenue bonds issued by the state;
Appropriations to pay principal and interest on general obligation bonds issued by a municipality for school construction;
Appropriations of money from a non-State source in trust for a specific purpose;

ie. federal funds

Appropriation of revenue of a public authority or corporation of the state that issues revenue bonds;

ie. AHFC, AIDEA, Municipal Bond Bank, Alaska Energy Authority, revenue received from Alaska Energy Authority four dam pool payments

Appropriation of revenue of a State program under which revenue bonds are issued.

ie. Fairbanks and Anchorage airports

Am #1

Page 2, line 11:

- Appropriations subject to the limit are those from the "general fund" (previously "from the treasury");

Page 2, line 15:

- In calculating the Limit for FY 93 - 96, adds language "that was subject to the limit under this subsection" to clarify that if the Legislature votes to exceed the Limit one year, in calculating the Limit for the next year you use the prior year's Limit as the base from which you calculate a 1% decrease, not the prior year's Limit plus the increased spending as the base;

Page 2, line 22:

- Changes "natural disaster" to "disaster emergency"

Page 3, line 29:

- Changes "natural disaster" to "disaster emergency"

Spending Limit and Budget Reserve Fund - Options

As Currently Drafted	To Tighten Limit	To Loosen Limit
• Appropriations for FY 92 - 96 can not exceed $2.3 billion	• Reduce base year amount so less than 2.3 billion • Require by FY 96 that state spending be gradually reduced to a specified level	• Increase base year amount above $2.3 billion • Allow increases each fiscal year for inflation • Allow increases for population growth • Allow increases based on the change in personal income averaged over the last 3 years
• Appropriations excluded under the Limit are: To the Permanent Fund For dividends To the Budget Reserve Fund To meet a natural disaster Revenue bond proceeds Revenues from non-state sources	• Eliminate from the list any of the non-general fund appropriations so count as spending under the Limit: To PF To meet a natural disaster To the Budget Reserve Fund	• Add to the list of exclusions: G.O. Debt (95.6 in FY 91) or all debt (school debt, lease payments and general obligation: 215.5 in FY 91) • Supplementals will not count under the limit as to how much can be spent that fiscal year
• A 2/3 vote of each House is required to exceed the Limit	• Require a 3/4 vote • Eliminate this option	• Require a majority vote
• Limit can also be excced by voter approval	• Eliminate this option	
• Revenues in excess of the Limit: 50% are deposited in the PF 50% are deposited in the Budget Reserve Fund	• All deposited in the Permanent Fund	• All deposited in Budget Reserve Fund

Senator Jan Faiks

SFC 2/1/90

Spending Limit and Budget Reserve Fund - Options

As Currently Drafted	To Tighten Limit	To Loosen Limit
• All windfalls and settlements go into the Budget Reserve Fund	• All goes into Permanent Fund • Split 50/50 between PF and Budget Reserve	• Have a mechanism to spend some of it
BUDGET RESERVE FUND		
• If revenues are less than the amount which can be spent under the Limit: By a 2/3 vote of each House Legislature can appropriate from the BRF:	• Require a 3/4 vote	• Require a majority vote
an amount up to the Limit or 25% of the BRF balance, whichever is less	• Reduce percent balance of fund which can appropriate	• No percentage of balance limit so can appropriate an amount up to the Limit
• Money from the BRF can be appropriated to meet a state disaster	• Eliminate provision	
REPEAL		
• All the provisions sunset on July 1, 1996	• Have no sunset provision	• Have sunset earlier than 1996

Senator Jan Faiks

2/2/90
OMB

MEMORANDUM

State of Alaska
Office of the Governor
Division of Policy

TO: Senate Finance Committee

DATE: February 2, 1990

FROM: Brad Pierce
Chief Analyst

PHONE: 465-3568

SUBJECT: Fiscal Impacts of SJR 5

The attached Table 1 is an interpretation of the provisions embodied in SJR 5 and their effects on real government spending. Table 2 provides detail on historical and projected growth in formula programs and other categories of state spending. Table 3 shows the difference in projected budget growth with and without SJR 5 as written ($2.3 billion FY 92 base and a 1% annual decrease in the limit through FY 96). Table 4 shows the same information starting from a $2.4 billion base in FY 92 with a 2% annual reduction in the limit through FY 96.

Table 1

Projected Fiscal Impact of SJR 5

FY 1992 - FY 1996
(Millions of Nominal Dollars)

Revenues	1992	1993	1994	1995	1996
Fall Forecast Unrestricted General Fund Revenue	2,416.1	2,435.2	2,460.7	2,375.8	2,209.0
Expenditures	(2,300.0)	(2,277.0)	(2,254.2)	(2,231.7)	(2,209.4)
Reserve Balance	116.1	283.6	512.8	697.9	753.3
Real Spending (FY 91 dollars)	(2,195.7)	(2,075.2)	(1,961.2)	(1,853.6)	(1,755.1)
Percent Change in Real Spending From Previous Year	(11.3%)	(5.5%)	(5.5%)	(5.5%)	(5.3%)
Cumulative Four Year Change in Real Spending From Gov's Proposed FY 91 Budget	(29.1%)				

Notes: Reserves are deposited into the Reserve Fund at the end of each fiscal year and the balance earns 8% interest.
Inflation assumptions are based on the DOR Fall Revenue Forecast mid-case scenario.
FY 91 appropriations subject to the limit = $2,476.7.

Office of the Governor, Division of Policy.
2/2/90

Table 2

Five Year Fiscal Plan Detail
FY 91 - 95

(Millions of Nominal Dollars)

Budget ($Millions)	FY 88	Actual FY 89	Authorized FY 90	Proposed FY 91	Projected FY 92	Projected FY 93	Projected FY 94	Projected FY 95
Operating Subtotal	1,911.3	1,991.5	2,036.7	2,183.1	2,265.8	2,322.1	2,388.2	2,461.3
Education	454.3	470.8	490.8	558.8	586.0	606.1	629.5	659.9
School Debt Retirement	109.5	109.5	107.8	107.8	131.5	131.5	131.5	123.8
Longevity Bonus	50.6	53.3	56.5	59.4	62.6	65.8	69.0	72.4
H&SS Transfer Payments	103.0	115.0	133.2	166.5	198.1	229.8	267.6	312.7
Power Cost Equalization	15.0	16.8	19.4	18.4	20.8	21.4	22.4	23.5
Municipal Asst. & Revenue Sharing	96.9	96.9	91.0	91.1	91.0	91.0	91.0	91.0
Other Senior Tax Relief, Shared Taxes	20.5	23.6	32.1	31.7	26.4	27.1	27.8	28.6
University	137.6	154.2	159.4	163.2	163.2	163.2	163.2	163.2
Courts	37.9	39.0	39.5	40.3	40.3	40.3	40.3	40.3
Legislature	26.7	29.5	30.8	31.2	31.2	31.2	31.2	31.2
Operating Agencies	856.3	882.9	676.2	914.7	914.7	914.7	914.7	914.7
General Obligation and Other Debt	147.9	135.5	132.5	95.5	68.2	59.7	33.9	23.1
Capital Projects	173.4	127.1	132.8	100.0	100.0	100.0	100.0	100.0
Loans	22.6	17.5	10.0	13.7	17.0	17.0	17.0	17.0
Special Appropriations - Oil Fund			32.0	27.0				
Total Unrestricted General Funds	$2,255.2	$2,271.6	$2,344.0	$2,419.3	$2,451.0	$2,498.8	$2,539.1	$2,601.4

Notes: Under the Operating Budget subtotal, the Education entry includes formula distributions only. The Other category includes Fisheries Enhancement Tax distributions ($10.5 million in Fy 90), Shared Taxes ($18.6 million) and Senior Tax Relief ($3 million).
FY 90 budget totals include only authorized expenditures, they do not include supplementals.

Sources: Division of Budget Review and various state agencies.

Office of the Governor, Division of Policy
2/2/90

Scenario 1: $2.3b Limit, 1% Annual Decrease

Table 3

Projected Budget Growth vs. SJR 5 Limit

(In Millions of Nominal Dollars)

Fiscal Year	1990	1991	1992	1993	1994	1995	1996
Projected Budget							
Unrestricted General Funds	2,344.0	2,419.3	2,438.8	2,486.6	2,526.9	2,589.2	2,639.2
Other General Funds	152.9	152.9	152.9	152.9	152.9	152.9	152.9
Minus General Obligation Debt	(120.3)	(95.5)	(68.2)	(59.7)	(33.9)	(23.1)	(21.5)
Total Subject to Limit	2,376.6	2,476.7	2,523.5	2,579.8	2,645.9	2,719.0	2,770.6
SJR 5 Limit			2,300.0	2,277.0	2,254.2	2,231.7	2,209.4
Difference Between Projected and SJR 5 Limited Budget			223.5	302.8	391.7	487.3	561.2
Annual Decrease in Spending Under SJR 5 Limit			223.5	23.0	22.8	22.5	22.3

Office of the Governor, Division of Policy.
2/1/90

Scenario 2: $2.4b Limit, 2% Annual Decrease

Table 4

Projected Budget Growth vs. SJR 5 Limit

(In Millions of Nominal Dollars)

Fiscal Year	1990	1991	1992	1993	1994	1995	1996
Projected Budget							
Unrestricted General Funds	2,344.0	2,419.3	2,438.8	2,486.6	2,526.9	2,589.2	2,639.2
Other General Funds	152.9	152.9	152.9	152.9	152.9	152.9	152.9
Minus General Obligation Debt	(120.3)	(95.5)	(68.2)	(59.7)	(33.9)	(23.1)	(21.5)
Total Subject to Limit	2,376.6	2,476.7	2,523.5	2,579.8	2,645.9	2,719.0	2,770.6
SJR 5 Limit			2,400.0	2,352.0	2,305.0	2,258.9	2,213.7
Difference Between Projected and SJR 5 Limited Budgets			123.5	227.8	340.9	460.1	556.9
Annual Decrease in Spending Under SJR 5 Limit			123.5	48.0	47.0	46.1	45.2

Office of the Governor, Division of Policy.
2/1/90

SFC 2/1/90

Alaska State Legislature

JUDICIARY
CHAIRMAN
907-465-4523

JAN FAIKS
POST OFFICE BOX V
JUNEAU, ALASKA 99811

Senate

January 31, 1990

MEMORANDUM

TO: Senator Johne Binkley, Co-Chairman
Senator Rick Uehling, Co-Chairman
Senate Finance Committee

FROM: Senator Jan Faiks

SUBJECT: Proposed Finance Committee Substitute for SSSJR 5 - Expenditure Limit and Budget Reserve Fund

Attached is a proposed Finance Committee Substitute for Senate Joint Resolution 5.

Major changes in the bill are:

- Elimination of sections addressing distribution of Permanent Fund earnings;
- Creation of an Expenditure Limit which sets a FY 92 base year of $2.3 billion with a 1% decrease from the prior year's limit for FY 93 through 96;
- All revenues above the Expenditure Limit, including windfalls and settlements, shall be deposited into the Budget Reserve Fund.

Attached is a sectional analysis of the bill as well as a chart illustrating how the Expenditure Limit would work in relationship with projected revenues. I welcome any questions you and the committee may have.

Thank you.

Sectional Analysis
Proposed Finance CS for SSSJR 5

Expenditure Limit and Budget Reserve Fund

Section 1. Adds the following new sections to Article XV of the Constitution (Transitional Measures):

SECTION 29. DEDICATED FUNDS.

(a) Suspends current constitutional section dealing with Dedicated Funds from July 1, 1991 through June 30, 1996;

(b) Permits dedication of funds under the Expenditure Limit and Budget Reserve Fund;

SECTION 30. EXPENDITURE LIMIT.

(a) Suspends current constitutional Appropriation Limit from July 1, 1991 through June 30, 1996;

(b) Excluded from the Limit are:
Appropriations to the permanent fund
Appropriations to pay permanent fund dividends
Appropriations to the budget reserve fund
Appropriations to pay principal and interest on G.O. bonds by the state or municipality for construction of schools
Appropriations of revenue bond proceeds
Appropriation of money from a non-state source

Appropriations for FY 92 may not exceed $2.3 billion;

Appropriations for fiscal years 93 through 96 must be 1% less than the amount appropriated the prior year;

(c) The Limit may be exceeded:
Upon a 3/4 vote of each house of the legislature;
Upon a 2/3 vote to meet a natural disaster declared by the Governor;

(d) All revenues above the limit shall be deposited in the budget reserve fund;

(e) Money received from a settlement or the result of litigation concerning minerals and royalties shall be deposited in the budget reserve fund.

SECTION 31. BUDGET RESERVE FUND.

(a) Applies from July 1, 1991 through June 30, 1996;

(b) In addition to revenues in excess of the Expenditure Limit and money resulting from settlements and windfalls, other appropriations may be made to the budget reserve fund;

(c) Money in the fund shall be invested and its earnings retained in the fund;

(d) If revenues are less than the amount which can be appropriated during a fiscal year, the Legislature may appropriate money from the fund up to the amount permitted under the Limit or 25% of the fund's balance, whichever is less;

(e) An appropriation from the fund may be made:
Upon 2/3 vote of each house for a natural disaster declared by the Governor;
To the principal of the permanent fund.

SECTION 32. REPEAL.

The above sections sunset on July 1, 1996.

<u>Section 2</u>.
The amendment shall be placed before voters at the next general election.

How Expenditure Limit Would Work

FY	Revenues Fall 89	Expenditure Limit	To BRF Each Year	Cummulative BRF Balance
92	2,416.1	2,300.0	116.1	116.1
93	2,435.2	2,277.0	158.2	274.3
94	2,460.7	2,254.2	206.4	480.7
95	2,375.8	2,231.7	144.1	624.8
96	2,209.0	2,209.4	-.4	624.4

Senator Jan Faiks - February 1, 990

EXPENDITURE LIMIT

The Limit:

- In FY 92, appropriations can't exceed 2.3 billion
- For FY 93 through 96, appropriations must be 1% less than the amount appropriated the prior year, which means:

FY 93	2277.0
FY 94	2254.2
FY 95	2231.7
FY 96	2209.4

Appropriations excluded under the Limit:

- to permanent fund
- to pay permanent fund dividends
- to budget reserve fund
- to pay G.O. debt
- to pay municipal debt for school construction
- of revenue bond proceeds
- of money from a non-state source

Limit Can Be Exceeded By:

- 3/4 vote of each house
- 2/3 vote to meet natural disaster declared by Governor

Money into Budget Reserve Fund

- All revenues exceeding Limit
- All windfalls and settlements

BUDGET RESERVE FUND

If revenues are less:

Legislature can appropriate from the fund:

- an amount up to the limit; or
- 25% of the fund's balance, whichever is less

Appropriations from the fund may be made:

- 2/3 vote for natural disaster
- To the principal of the permanent fund

REPEAL

Sunsets on July 1, 1996.

Senator Jan Faiks - February 1, 1990

SFC 2/1/90

Unrestricted General Funds - Fall 1989 Forecast

		Low Case			*Mid Case*			*High Case*	
	Nominal $	Real 1989 $	Inflation Rate	Nominal $	Real 1989 $	Inflation Rate	Nominal $	Real 1989 $	Inflation Rate
FY 90	2005.49	1932.56	3.77	2295.53	2205.33	4.09	2644.96	2527.43	4.65
FY 91	1743.35	1619.04	3.76	2255.57	2074.82	4.44	2765.67	2507.62	5.39
FY 92	1860.07	1662.85	3.88	2416.08	2121.69	4.75	2993.53	2570.96	5.57
FY 93	1813.15	1559.45	3.94	2435.18	2041.47	4.75	3243.04	2635.29	5.69
FY 94	1813.29	1500.45	3.94	2460.67	1969.30	4.75	3654.97	2810.13	5.69
FY 95	1755.96	1397.93	3.94	2375.81	1815.16	4.75	4094.25	2978.40	5.69
FY 96	1586.66	1214.57	4.0	2208.96	1614.08	4.56	4310.73	2967.05	5.69
FY 97	1449.40	1066.82	4.0	2031.38	1419.59	4.56	4421.24	2879.28	5.69
FY 98	1332.25	942.88	4.0	1896.64	1267.63	4.56	4521.87	2786.28	5.69
FY 99	1202.74	818.47	4.0	1752.78	1120.38	4.56	4422.43	2578.30	5.69
FY 00	1081.21	707.47	4.0	1597.27	976.45	4.56	4218.40	2326.94	5.69

DOR/OMB
SFC 2/1/90

Faiks 2/1/90

6-0161I
Cook
1/31/90

Original sponsor(s): SEN. FAIKS, Jones, Eliason, Fischer, Duncan

IN THE SENATE

CS FOR SPONSOR SUBSTITUTE FOR SENATE JOINT RESOLUTION NO. 5 (   )

IN THE LEGISLATURE OF THE STATE OF ALASKA

SIXTEENTH LEGISLATURE - SECOND SESSION

Proposing an amendment to the Constitution of the State of Alaska establishing temporary provisions relating to dedicated funds, the expenditure limit, and the budget reserve fund; and suspending the operation of provisions relating to dedicated funds and the appropriation limit.

BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. Article XV, Constitution of the State of Alaska, is amended by adding new sections to read:

SECTION 29. DEDICATED FUNDS. (a) The operation of Section 7 of Article IX is suspended from July 1, 1991, through June 30, 1996, and this section applies in lieu of Section 7 of Article IX.

(b) The proceeds of any State tax or license shall not be dedicated to any special purpose, except as provided in Section 15 of Article IX and Sections 30 and 31 of this article or when required by the federal government for State participation in federal programs. This provision shall not prohibit the continuance of any dedication for special purposes existing upon the date of ratification of Section 7 of Article IX by the people of Alaska.

SECTION 30. EXPENDITURE LIMIT. (a) The operation of Section 16 of Article IX is suspended from July 1, 1991, through June 30, 1996, and this section applies in lieu of Section 16 of Article IX.

(b) Except for appropriations to the permanent fund or for

Alaska permanent fund dividends, appropriations to the budget reserve fund, appropriations of revenue bond proceeds, appropriations required to pay the principal and interest on general obligation bonds issued by the State or a municipality for construction of elementary and secondary schools, and appropriations of money received from a non-State source in trust for a specific purpose, including revenues of a public enterprise or public corporation of the State that issues revenue bonds, appropriations from the treasury made for

(1) fiscal year 1992 may not exceed $2,300,000,000;

(2) fiscal years 1993 - 1996 may not exceed an amount equal to one percent less than the amount appropriated during the prior fiscal year.

(c) During a fiscal year the legislature may exceed the expenditure limit under (b) of this section if each bill that exceeds the limit is passed by affirmative vote of

(1) three-quarters of the membership of each house of the legislature; or

(2) two-thirds of the membership of each house of the legislature and the appropriation is to meet a State natural disaster declared by the governor as prescribed by law.

(d) Except as provided in (e) of this section, all money received by the State during a fiscal year that is subject to the expenditure limit under (b) of this section, that exceeds that limit, and that is not appropriated under (c) of this section shall be deposited in the budget reserve fund.

(e) Except for money deposited into the permanent fund under Section 15 of Article IX, all money received by the State as a result of the termination through settlement or otherwise, of litigation in State or federal court involving mineral lease rentals, royalties, royalty sale proceeds, and federal mineral revenue sharing payments and bonuses shall be deposited in the budget reserve fund.

SECTION 31. BUDGET RESERVE FUND. (a) This section applies from July 1, 1991, through June 30, 1996.

(b) In addition to deposits made to the budget reserve fund under Section 30(d) and (e) of this article, appropriations may be made to the fund at any time.

(c) Money in the budget reserve fund shall be invested so as to yield competitive market rates to the fund. Income from investment of the fund shall be retained in the fund.

(d) Except as provided in (e) of this section, money may be appropriated from the budget reserve fund only if the legislature determines that the money received by the State in a fiscal year and subject to the expenditure limit is less than the maximum amount that may be appropriated under Section 30(b) of this article. However, the amount appropriated from the budget reserve fund during a fiscal year may not exceed the lesser of

(1) the amount that, when added to money received by the State during that fiscal year and subject to the expenditure limit, equals the maximum amount that may be appropriated under Section 30(b) of this article; or

(2) twenty-five percent of the balance of the budget reserve fund.

(e) An appropriation from the budget reserve fund may be made upon affirmative vote of two-thirds of the membership of each house of the legislature to meet a State disaster declared by the governor as prescribed by law. An appropriation from the budget reserve fund to the principal of the permanent fund may be made at any time.

SECTION 32. REPEAL. Sections 29 - 31 of Article XV are repealed

July 1, 1996.

* Sec. 2. The amendment proposed by this resolution shall be placed before the voters of the state at the next general election in conformity with art. XIII, sec. 1, Constitution of the State of Alaska, and the election laws of the state.

THE FOLLOWING DOCUMENT HAS NOT BEEN FILMED BUT IS AVAILABLE IN THE ORIGINAL FILE

ALASKA PUBLIC DEBT
1988

State of Alaska
Department of Revenue
May 1989

D. State Agencies

1. University of Alaska

In addition to the State issuing general obligation bonds to finance University-related projects, the University issues notes and bonds for specific University purposes, some of which are secured by project revenues. The facilities which have been financed include the Anchorage and Fairbanks student centers, Fairbanks dormitories, and the Anchorage and Fairbanks utility systems. Total investment in plant was $547.0 million at June 30, 1988.

The Fairbanks campus housing bonds are secured by housing system revenues. The University of Alaska Heating Corporation bonds are secured by lease payments made by the University from general fund appropriations.

Following is the amount of university debt outstanding as of December 31, 1988:

University of Alaska Notes	$ 3,633,012
University of Alaska Heating Corporation Bonds	10,270,000
Fairbanks Campus Housing Bonds	6,297,836
TOTAL	$20,200,848

Legislation enacted in 1987, Chapter 54, SLA 1987, authorizes the issuance of up to $2,400,000 in revenue bonds to refinance an existing mortgage note on housing of the University at Fairbanks known as Yak Estates.

University debt is not a general obligation of the State. However, because the debt may be payable from State appropriations to the University for general operating purposes, the debt is considered to be State-supported debt. State appropriations were approximately 77 percent of unrestricted University revenues in fiscal year 1988.

Moody's Investors Service has assigned a credit rating of Baa1 to the University revenue bonds. This rating is lower than the State's due to the lesser security of housing system rents and the discretionary nature of State appropriations that are used to retire the debt.

2. Lease-Purchase Financing

a. General

Lease-purchase financing involves the issuance, by a lessor, of debt which is secured by the lease payments from the lessee and possibly by the leased facilities.

A lease-purchase financing obligation may take the form of either revenue bonds or certificates of participation. In cases where the State is the lessee, the fact that the lease payments are subject to annual appropriations precludes the obligations from being considered State debt under the constitution and thus requiring voter approval. However, because the debt obligation is paid from the State's General Fund, these obligations are counted by the rating agencies in measuring the State's debt burden.

Lease-purchase obligations provide for the acquisition of the property by the lessee by the end of the lease. The term of the lease, the lease payments, or purchase price are such that the lessee (State) is considered the owner of the property for federal tax purposes from the outset of the lease. As a result, a portion of the lease payments is treated as tax-exempt interest income under the federal income tax.

Two important controls on lease-purchase financing were enacted into law in 1986. Chapter 103, SLA 1986, effective September 4, 1986, requires approval by law of ASHA public building (State lease) projects. Chapter 106, SLA 1986, effective January 1, 1988, requires approval by law of any executive branch or University of Alaska lease-financing agreements with annual rent exceeding $1 million.

In consort with these legislated controls, a Memorandum of Understanding among ASHA, the executive and judicial branches, the University of Alaska, and the State Bond Committee was executed on October 28, 1987 that provides for debt management guidance from the State Bond Committee in lease-purchase financings conducted by ASHA. The Memorandum generally defines the roles of the various parties in executing lease-financing projects.

All State lease revenue bonds, with the exception of the City of Palmer Courthouse Lease Revenue Bonds, Series 1987, have been issued by ASHA. The ASHA bonds are discussed in section I.D.11. The Palmer bonds are rated A by Moody's, reflecting the State's credit standing and the risk of non-appropriation of rent. The Palmer bonds outstanding as of December 31, 1988 were $3,510,000.

b. Certificates of Participation

Certificates of participation in rent (CP's) are similar to lease revenue bonds. The certificates represent fractional interests or shares in lease payments from lessees, in this case the State, and are sold to finance construction of the leased facilities. The issuer can be a private developer, public agency, or other party acting as lessor. It can be the State itself, utilizing a trustee to hold title to the property and serve as lessor.

Standard & Poor's Corporation
25 Broadway, New York, New York 10004

December 29, 1983

RECEIVED
JAN 03 1984
ALASKA DEPARTMENT OF REVENUE
TREASURY DIVISION
JUNEAU

Mr. Milt Barker
Deputy Commissioner
Department of Revenue
11th Floor State Office Bldg.
Pouch, SB
Juneau, Alaska 99811

Dear Mr. Barker:

I would like to respond to your letter of December 13, regarding our views on lease obligations.

Lease Payments are viewed in essentially the same light as debt service on general obligation bonds, regardless of whether the obligation is cancellable due to non-appropriation. In fact, debt obligations secured by lease payments are included in our computations for overall debt burden.

Many states do not consider lease rental debt under debt limitation laws, primarily because legal interpretations view the obligations to pay rent as an annual budget item, and not a long term debt with a continuing appropriation. The fact remains, however, that the debt is still outstanding, and payable for as long as the property is being used by the lessee. While many leases permit non-payment of rent and cancellation of lease obligations, Standard & Poor's would be very concerned about an issuer's general obligation rating, in those cases where leases were cancelled as a ploy to avoid paying debt obligations.

I've enclosed some information regarding our approach to rating lease-rental debt obligations. If you have any further questions, feel free to contact Vladimir Stadnyk or myself at (212) 201-1767.

Very Truly Yours,

Richard P. Larkin

Richard P. Larkin
Managing Vice President
Municipal Finance Department

cc: V. Stadnyk
T. Arthur

Moody's Municipal Issues

Moody's Investors Service | Volume 6 Number 1 | March 1989

Moody's Views on Lease Rental Debt

The use of lease rental debt has increased dramatically in recent years. As a consequence, Moody's has been asked to rate a growing number of lease obligations. In 1980, Moody's rated $458 million of new lease debt; by 1986, the amount of rated new lease debt was over $7 billion. Although the annual volume of rated lease debt dropped in 1987 to $4.8 billion, this decline was not due to a decrease in the popularity of lease debt (in fact, the number of issues rated in 1987 was higher than in 1986). Rather, the extremely high volume of lease debt rated in 1986 reflects the efforts by many municipal borrowers to issue lease as well as other forms of debt prior to the passage of the Tax Reform Act of 1986. In 1988, the annual volume of rated lease debt was again on the rise.

Moody's currently maintains over 1,300 ratings on lease obligations sold by issuers in 41 states. These figures include ratings on certificates of participation. Certificates of participation, when secured by underlying leases, give certificateholders an interest in the stream of revenue from lease payments.

Annual Volume of Rated Lease Debt ($ in millions) [1]

	Amount of Debt	Number of Ratings
1980	$ 458	55
1981	753	40
1982	644	41
1983	1,200	75
1984	2,214	80
1985	3,816	137
1986	7,009	196
1987	4,839	222
1988	5,265	250

[1] Includes certificates of participation. Excludes insured and credit-supported lease debt.

The popularity of lease rental debt primarily stems from the borrower's ability, through the use of lease and lease-like arrangements, to circumvent limitations on general obligation or revenue bond debt issuance. In most states, leases are not legally defined as debt. There are exceptions, however. For example, in a decision that went against the national trend, the New Mexico Supreme Court recently ruled that tax-exempt lease purchase agreements are debt, requiring voter approval.

Regardless of whether lease obligations are legally considered to be debt in any particular state, Moody's views all lease obligations issued for capital purposes as debt. More importantly, Moody's expects issuers of lease obligations to honor their lease commitments. From Moody's point of view, the credit quality of a municipal borrower's debt will depend on its ability and willingness to meet all of its obligations, including those involving leases. Therefore, even if lease obligations are not legally defined as debt for a particular municipality, Moody's will include leases in its calculation of such debt ratios as debt burden (debt as a percent of the full valuation of taxable property) and debt per capita.

Moody's approach to analyzing the actual lease obligation itself depends on both the security for the lease and the lessee's general credit characteristics as well as other factors. In certain states, municipal borrowers can pay lease debt through an unlimited tax levy. In these cases, the credit quality of lease debt is usually viewed as identical to that of the municipality's own general obligation bonds. More typically, the security for a lease obligation is weaker than that for a general obligation bond; in most instances, leases are payable from General Fund appropriations. Because of this weaker security, lease debt is usually assigned a rating lower than that of the same municipality's general obligation bonds.

This edition of ***Municipal Issues*** is devoted to a discussion of leases. The primary focus of these articles is on the typical lease, one secured by a General Fund appropriation. The discussion begins with a description of the rating process for lease rental debt, including the analytic factors that are examined in evaluating leases. This is followed by an examination of the key points that Moody's considers in evaluating individual lease structures and financing plans.

Lease debt should be analyzed in the context of the laws and practices within a particular state; to illustrate Moody's approach we compare local lease debt in three states - California, Kentucky, and New Jersey. The discussion concludes with an historical overview of the use of lease debt by state governments. ❑

Managing Editor

The Rating Process for Lease Debt

by Robert Tucker

As is the case with other types of debt, Moody's rating process for lease rental obligations begins with a request for a rating from the issuer, or its advisor or underwriter.

The minimum information required includes: the preliminary official statement or offering prospectus; legal documents, including lease, trust indenture, and bond counsel opinion; three years of lessee financial statements; details on all other lease obligations including annual lease requirements and projects financed; future borrowing plans; and the budget. Additionally, Moody's must receive detailed information on the proposed financing including project description, information on construction or acquisition status, schedule of construction or acquisition, and useful life of any equipment to be financed. Additional information is often obtained through meetings, telephone contact, and on-site visits. A detailed list of informational requirements appears on page 3.

Moody's Analysis

Most lease obligations rated by Moody's are either lease rental

continued on page 2

The Rating Process for Lease Debt

continued from page 1

bonds or certificates of participation. Certificates of participation, when secured by underlying leases, give certificateholders an interest in the stream of revenue from lease payments. Though differences do exist between the more traditional lease rental bond and the increasingly popular certificate of participation, the basic security elements are not inherently influenced by the instrument itself. Moody's analysis remains the same for both. The analysis focuses on the project purpose, the nature or type of lease, and the issuer's ability and willingness to make lease payments as scheduled. Also key to Moody's evaluation of lease obligations is a detailed analysis of lease documents and an assessment of the reasonableness of the financing plan. These are discussed in the accompanying article entitled "Evaluating the Lease Structure and Financing Plan."

Project Purpose
The purpose of the project, i.e. what is being financed, and the essentiality thereof, is one of the most important determinants of whether lease appropriations are likely to continue under all circumstances. Thus, project essentiality, in a sense, provides the practical collateral or motivation to pay. Courthouse facilities, jails, and governmental offices are viewed as providing true essential services, and a lessee's willingness to appropriate for these can be expected during a period of fiscal stress.

While equipment leases often involve very necessary items such as police, fire, or rescue equipment, other vulnerabilities exist. The possibility of a piece of equipment not fulfilling its original objective, not functioning, becoming obsolete, or being replaced, is of concern, particularly when the lessee has the legal ability to terminate the obligation, or where the lease payment is contingent on full use of the equipment. These vulnerabilities are seen as reducing credit strength and usually result in lower ratings on equipment leases.

Nature of Lease
The nature or type of lease is fundamental in the determination of the security provided. As typical with most debt instruments, lease obligations are governed by state constitutional or statutory provisions, which vary widely from state to state. Each transaction, therefore, must be evaluated within this context.

Leases are primarily structured in one of three ways: long-term leases, annually renewable leases, or special fund (enterprise type) leases. Between and within each of these categories, subtle variations can exist both within a state and from state to state. Additionally, lease payments may be backed by various revenue sources including general obligation unlimited or limited property tax pledges, annual general fund appropriations, special tax pledges, or revenues from an enterprise system. These variations can cause considerable differences in the degree and type of security provided under the lease and thus affect the final rating.

Long-term leases are typically considered binding for the full-term of the lease (which should parallel the financing structure), and failure to appropriate a lease payment constitutes an event of default, giving the bondholder some legal recourse. An exception to this general rule exists in states where payment is based on beneficial use and occupancy; there, substantial interference with the lessee's use and occupancy of the project can reduce or eliminate the lessee's obligation to make lease payments during such interference.

If lease payments are not required to be made until construction of the project is completed, Moody's assigns a conditional rating (**Con.**) to the lease obligation. The conditional rating reflects the fact that while construction or acquisition assumptions appear reasonable, there is still some construction related risk which is not fully assessable during this period. The alpha component of the rating (**Aa, A, Baa,etc.**) that accompanies the conditional designation indicates Moody's long-term credit assessment once the project is completed and the conditional status eliminated. While a lessee may have the legal ability to terminate a lease or withhold lease payments because of construction problems, Moody's expects the lessee to resolve the problems and continue to make timely lease payments. To date, all have. However, various forms of insurance serve to mitigate abatement and construction concerns.

Annually renewable leases give the lessee the ability to unilaterally terminate the lease, at least annually, by not appropriating funds for the subsequent lease payment. No event of default under the lease or remedies against the lessee would typically be available to the bondholders. In this case, the bondholders remedy would be repossession and re-lease or sale of the asset financed. Project essentiality, issuer strength, non-substitution clauses, and a good historical track record of the lessee making lease payments for the life of a financing help somewhat to temper non-appropriation concerns; however, these leases are still typically viewed as providing a weaker security than a long-term lease structure. It should be noted that to date we have never seen any locality exercise its non-appropriation rights on a financing sold in the public markets.

Special fund leases are revenue obligations payable from a designated special fund. These obligations are typically structured like revenue bonds with the obligation to make lease payment being unrelated to project availability.

As a result of the different types of leases, two indentical projects could be viewed as providing a very divergent degree of bondholder security based on the structure used, and therefore have different credit ratings.

Ability and Willingness to Make Lease Payments
Although mentioned last, the ability and willingness of the lessee to make lease payments are key credit factors. In most cases, a lease payment represents a current operating expense and required lease payments compete with all other operating demands. To the extent a state or local government has any revenue or expenditure limitations, this competition for a limited pool of resources could intensify and have a significant negative bearing on the rating decision. Conversely, in states where a lessee can utilize or pledge its unlimited property tax to meet lease payments, credit security is obviously enhanced.

With the proliferation of lease financing debt, lease burden has become an important and widely used analytical statistic. It is a measurement that is simply a ratio of the cost of all annual lease type obligations to current pledged revenues. Generally, lease burden is considered moderate if it is below 6%. It is important to note that, as with other selected debt indicators, lease burden should be considered as a broad guideline only. Performance relative to the guideline is not an absolute indicator of credit quality, and a bond rating cannot be inferred within this narrow context. Additionally, some lessees provide that supplemental, but not legally pledged, funds will be used to service a specific lease. While the availability of these funds can significantly reduce the burden on the pledged revenue source, Moody's typically exercises caution in assessing the reliability of this source and the ability of the lessee to redirect these funds for other uses. Examples of supplemental sources include hotel transient

continued on page 4

Evaluating the Lease Structure and Financing Plan

by Robert Tucker

In addition to assessing the nature or type of lease, Moody's evaluates other aspects of a lease structure as well as the entire financing plan. This article will discuss some of the key points Moody's addresses when analyzing the legal and financing structures of lease obligations. Because lease structures vary, some points will not apply to specific types of leases or to certain states. For example, in those states where the lessee's legal obligation to make lease payments is based on project use and occupancy, lease documents should contain provisions that protect bondholders against potential abatement of lease payments in the event that the project is not completed or not usable. On the other hand, if the lessee is required to make lease payments regardless of the construction or operating status of the project, the lease documents do not need to address potential rental abatement problems.

Information Needed for Rating Lease Rental Bonds

Primary Documents:

Official statement or prospectus	Tax and levy limitations
Notice of sale (if public sale)	Debt or interest rate limits
Annual reports or audits for the last three years	Statement of direct debt and debt of overlapping debt issuers, including allocable share
Most recent budget for operations	Principal and interest payments of outstanding debt, each by year; bonds segregated by security
Capital budget or planning document	Future borrowing plans
Copy of local charter or document which describes governmental structure	Number of building permits over the last five years, plus the dollar amount
For school districts: ten-year enrollment trend and projection; school plant description, including facilities and capacity	Number of governmental employees: whether unionized and contract status
Legal opinion	Statement regarding status of employee pension funds; latest actuarial study, if available
Relevant legal documents including trust, lease, agency, site, and assignment agreements	Local and area unemployment rate
Support Documents: (for information not contained in any of the above documents):	List of ten major employers, number of employees and type of business
Assessed valuation for the last five years	Area of the issuer (in square miles) and percentage of land that is developed
Equalization ratios for the last five years	Investment policy; formal document or brief description of practices
List of ten largest taxpayers, their assessed valuation, and type of business	Enterprise system description, if relevant and description of enterprise, including system capacity and trend of usage, particularly customers and consumption (output) by year for past five years, percent of service purchased by each major user; description of rate setting process; record of revisions for past five years
Current population and latest census estimates	
Tax rates and levies for the last five years, current and total collections, tax rates of overlapping jurisdictions	
Tax assessment and collection procedures, including due dates and penalty rates	

Appropriate Debt Issue Sizing
In general, the proceeds of lease rental bonds or certificates should fully fund the project being financed. Financing a project in stages introduces uncertainties regarding the issuer's continued ability to obtain market access and any needed authorizations for completion bond issues. This is especially important if lease payments are tied to use and occupancy of the project; failure to complete the project would allow the lessee to be able to withhold lease rental payments.

In determining the amount of proceeds needed to complete a project, the size of construction or acquisition funds should be based on bids received or a consultant's or architect's estimate and include an appropriate contingency allowance to deal with possible cost overruns. Funded capitalized interest (where necessary), a bond reserve and all other costs necessary to accomplish the financing should also be included. Any equity contribution provided by the lessee should be fully restricted to the project no later than the bond closing. This type of equity contribution further reflects the lessee's commitment to the project.

Adequate Capitalized Interest
If lease payments are dependent on beneficial use and occupancy, or revenues derived from the project are necessary to make lease payments, interest should be capitalized sufficiently past the scheduled project acceptance date. This should help ensure that there is no gap in the payment stream due to construction delays. While the exact duration will depend on the specifics of each project (such as construction complexity or environmental issues), and thus cause some projects to require an increased amount of capitalized interest, the typical period beyond the expected construction/acquisition completion date needing to be capitalized ranges from three to six months for equipment acquisitions and six months to one year for construction projects.

Satisfactory Bond Reserve Fund
The Bond Reserve Fund provides bondholder protection in the event of construction delays, lease payment abatement risk, budgetary delays in the appropriation process, and insurance receipt delays; it also provides a temporary source of liquidity. Ideally, the reserve should generally equal maximum annual debt service. However, because federal tax legislation has generally restricted the funding of a reserve for tax-exempt issues to no more than 10% of the initial offering, maximum annual debt service may not be obtainable. In those instances where a lessee does not fund the difference from its own resources or through an acceptable surety bond or credit agreement, credit position may be affected.

Appropriate Financing Term
Because general obligation bonds are generally not supported directly by revenues derived from the projects they finance, there is often no direct correlation between the amount or length of borrowing and the value or useful life of the project; however, in lease financings, a more direct relationship should exist.

continued on page 4

Evaluating the Lease Structure and Financing Plan

continued from page 3

The repayment schedule to the bondholders should not be longer than the term of the lease which in turn should not be longer than the useful life of the project. This stems from the fact that willingness to appropriate may be reduced if the project becomes obsolete.

Appropriate Structuring of Lease Payments
Lease payments should be tied to the value of the project; this can be accomplished by basing lease payments, whenever possible, on the project's fair rental value. Additionally, all lease payments should be an absolute return for the bondholders and not subject to any offset, counterclaim, or recoupment. This prevents the lease payment from being less than the amount required to pay bondholders.

Adequate Insurance Coverage
Adequate insurance for both the construction and the operating phases of a project is particularly important because of the nature of lease structures. Insurance proceeds can be used to repair or replace a damaged or disfunctional project and to provide funds for debt service payments during a period of rental abatement. Construction risk, including delays and damage, can be substantially reduced through the use of performance bonds and builders' risk insurance. During project operation, risk associated with damage and destruction can be substantially reduced through the maintenance of all risk insurance (equal to the full replacement value of the project or the aggregate principal amount of outstanding bonds) and rental interruption insurance (adequate to cover the period of repair or replacement). Additionally, title insurance to protect against any defects in title to the property and public liability insurance to protect the lessee from general claims occasioned by the use and operation of the project should be provided.

As a result of increasing insurance cost, many issuers have turned to self-insurance as a means to provide coverage. While this may be a viable method, such an approach must afford protection comparable to available commercial policies and should be annually evaluated by someone with actuarial experience to show its soundness.

Provisions for Replacement, Maintenance, and Repair
The lessee's obligation to replace, maintain, and repair the project during the term of the lease enhances bondholder protection by ensuring the asset value of the project. The asset value is important in maintaining fair rental value.

Inclusion of Non-Substitution Clause
Non-substitution provisions provide that, for a certain duration of time following non-appropriation on a specific lease, the lessee will not acquire or use a like piece of property to perform the same function as the property previously leased. This provision makes it more difficult for the lessee to terminate the lease, and can enhance bondholder protection in an annually renewable lease structure. While some bond counsel question the enforceability of such language, since it may violate public policy by preventing a public entity from performing its basic functions, such language clearly reflects the intent of the lessee to honor its commitments.

Default and Remedies
Failure of the lessee to abide by the terms of the lease, including annual budget appropriations with long-term leases, should result in an event of default under the lease. Remedies typically include judicial proceedings (whether for specific performance or other legal or equitable rights), termination of the lease and sale or releasing of the asset (here, the asset must be marketable to provide any security), and maintenance of the lease in full force and effect with the lessee remaining liable for unpaid lease payments (this applies to long-term leases). While remedies vary widely depending on the lease structure, bondholder security is enhanced by increased remedies available.

Investments
Prudent investments are obviously the most acceptable such as direct or guaranteed U.S. obligations or other instruments which Moody's rates **A** or better on a long-term basis or in the highest rating category on a short-term basis. Also, the duration or life of the investments should be tied to the expected use of the funds. Because of constant changes in the investment environment Moody's analysts remain open to discuss other investment options.

Summary
This article has described the major issues that Moody's considers in evaluating the lease structure and financial plan for a lease financing. Depending on the particular debt issuance in question, all or only some of the points addressed would be applicable. Moody's analysts remain available to discuss the factors that would pertain to a specific lease rental financing. ❑

The Rating Process for Lease Debt

continued from page 2

occupancy tax, tax allocation revenues from redevelopment agencies, and rental payments made by other internal departments of the lessee for use of the project.

It is also worth noting that while each lease financing may be separately secured, Moody's analysis always involves a comprehensive approach. A lessee's entire debt position is reviewed since problems in meeting payment obligations on one lease have credit implications for all leases. Additionally, problems with one class of debt, such as lease financing, often have credit implications for another class, such as general obligation debt. Consequently, an issuer with a general obligation rating cannot expect that general obligation rating to remain unaffected by an undue reliance on lease financings.

Summary
Project purpose, the nature of the lease, and the lessee's ability to make lease payments are all essential credit factors evaluated in determining the security provided bondholders.

Moody's analytical approach is to view all lease transactions as long-term obligations of the lessee. Lessees are expected to honor fully commitments through retirement of the debt, and to resolve any problems during construction or operation phases of the project.

To date, issuers rated by Moody's have shown a high degree of commitment to outstanding leases, with the resulting rate of non-appropriation or default being extremely low. This track record reflects the importance issuers place on lease financing and their ability to access the capital markets. In most states, issuers have shown restraint in proceeding with lease financings. Moody's views this positively, but also considers voter approval of debt as an element of stability to future repayment of that debt.

While Moody's has been rating lease issues for some time, our policy on ratings continues to evolve along with the development of this portion of the municipal market. The continued use and growth of lease financing, however, appears certain. ❑

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assachusetts and agencies

lings are lowered on Massachusetts' $4.8 billion of general ligation bonds and $1.4 billion of various agency issues to 'A' m 'AA–'. Also, ratings are lowered on $757 million of G.O. tes and $710 million of various agency notes to 'SP-1' from '-1+' *(see table)*. The issues are removed from CreditWatch ere they were placed June 26. The downgrades reflect the array in commonwealth debt management and continuing fis- stress. The commonwealth's economy remains strong while ot and fiscal management display serious weaknesses. The wngrade also reflects S&P's continuing concern about Mas- :husetts' willingness to adhere to sound fiscal practices and ely financial decision making. Massachusetts recently failed make a timely lease rental payment resulting in a default on tificates of participation issued on the commonwealth's be- . Although the default was not on commonwealth G.O. debt, expects lease rental payments to be made in full and on and be treated as debt-like instruments. Lack of timely ment and resulting default brings into further question man- ment oversight of Massachusetts' finances, as well as the nmonwealth's sensitivity toward its debt obligations. Rental ments were late due to administrative oversight in a period n the commonwealth was trying to tightly control its dis- ements at the low point of its annual cash flow. Certificate articipation payments, issued in 1987 and rated 'AAA' due BIA insurance, were made in full by Massachusetts on July 10 days late. The bond insurance was not called upon, e there were no claims for payment filed by either the pay- gent or certificateholders. On July 13, Governor Michael Dukakis announced a package of vetoes which he says will bring the budget back into balance. S&P continues to evaluate the package and is assessing its viability. The legislature intends to consider a variety of measures to respond to the governor's package. With a number of issues still unresolved, such as the amount of local aid and the tax package, S&P again ob-

Massachusetts long- and short-term agency issues

	Amount (mil. $)
Long-term issues lowered to 'A'	
Massachusetts Bay Transportation Auth.	928.0
Massachusetts Conv. Ctr. Auth.	167.5
Massachusetts Govt. Land Bank ser. 1987	32.3
Mass. State College Bldg. Auth. ser. 1986A and 1987A	94.5
Pioneer Valley Transit Authority	1.5
Southeastern Mass. Univ. Bldg. Auth. ser. A	37.1
Univ. of Lowell Bldg. Auth.	24.1
Univ. of Mass. Bldg. Auth. ser. 1984A, 1986A, and 1988A	88.0
Woods Hole, Martha's Vineyard, & Nantucket Steamship	22.2
Agency short-term debt lowered to 'SP-1'	
Massachusetts Bay Transportation Authority ser. 1988 and 1989	260.0
Massachusetts Water Resources Authority ser. 1988B and 1989A	450.0

serves a lack of timely financial decision making. The commonwealth expects to enter the short-term market early this week with a $450 million commercial paper program for cash flow purposes.

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Payment snafu linked to Mass. downgrading

Massachusetts' failure to make a $400,000 payment on a lease for telecommunications and computer equipment is partly to blame for its third credit downgrading in two months.

"The check was never cut, and that was the straw that broke the camel's back," said Richard P. Larkin, managing director of municipal finance at Standard & Poor's Corp., New York.

Massachusetts delayed a July 1 payment on the equipment until July 13. S&P, in turn, downgraded the state July 14 to A from AA– citing the late payment as a symptom of disarray in the state's debt management. State leaders have been haggling over $491 million in needed budget cuts for the 1990 fiscal year.

Massachusetts may be the first state to suffer from a downgrading that was triggered, in part, by a late lease payment. Mr. Larkin and other S&P analysts said they were unaware of other downgradings related to lease debt. S&P found the state's late payment noteworthy even though the paying agent for the certificates and the bondholders had yet to complain.

The certificates were insured by the Municipal Bond Investors Assurance Corp., White Plains, N.Y. Although the insurance guaranteed payment of the debt, in this case it failed to help the state's case before the rating service. The agency viewed the state's response that its payment was late due to a computer error as unacceptable.

"Although the default was not on commonwealth G.O. debt, S&P expects lease payments to be made and treated as debtlike instruments," the July 17 issue of S&P's CreditWeek said. "We've been sending that message for a long time," said Mr. Larkin.

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