

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILE 8672

1313 SCOMM 50: HOUSE SPECIAL COMMITTEE ON STATE LOANS 1985-86

As a consequence of the 1980 legislation, the AHFC had been raising capital by issuing the more expensive taxable bonds because the Alaska Constitution prohibited the issuance of State G.O. bonds for other than State capital improvements.

It is important to note that the State's general obligation pledge was not needed in order to make the bonds attractive to investors, or to improve their security structure. The "double-barrell" bonds are being issued solely to circumvent the federal restrictions on the issuance of tax-exempt mortgage revenue bonds mentioned above. In recognition of the independent creditworthiness of the Veterans bonds, the bonds are rated higher than the State itself. Whereas the State's rating on its general obligation bonds is Aa/AA-, the AHFC veteran's housing bonds are rated Aa/AA. Although the difference between a Standard & Poor's rating of AA and AA- is a fine distinction, it is a sign that the veterans bonds are not being rated on the strength of the State's general obligation pledge, but on their own merit.

Because of the strong support behind the bonds, independent of the State's general obligation pledge, this debt is not considered to be direct tax-supported debt as is other general obligation debt. However, if problems in the administration of the veterans program were to arise, the bonds would be treated as general obligation debt. These bonds are still indirect obligations of the State, just as are AHFC moral obligation-backed bonds. Since the November 1982 election which authorized their issuance, there have been two issues of AHFC State Guaranteed Bonds, totaling \$175 million. Because the bonds are general obligations of the State, their issuance must be approved by the State Bond Committee.

Moral Obligation Bonds of State Public Corporations

Moral obligation (M.O.) bonds, as issued by Alaska's public corporations, are secured primarily by revenues generated by the purpose for which the bonds are issued and are not direct tax-supported obligations of the State. Neither State tax revenues nor State appropriations are pledged to retire the revenue bonds. However, such debt is an indirect, contingent obligation of the State because in the event that revenues of the corporation which issues the debt are insufficient to meet debt service commitments, the State has a "moral obligation" to appropriate the required funds.

The State has declared its moral obligation backing of State corporate debt in the original enabling legislation of the public entity. For example, the State's M.O. pledge behind bonds issued by the Alaska Industrial Development Authority reads as follows: (Alaska Statutes Sec. 44.88.105)

- (d) The chairman of the authority shall annually, no later than January 2, certify in writing to the governor and the legislature the amount, if any, required to restore a capital reserve fund to the capital reserve fund requirement. The legislature may appropriate to the authority the amount

certified by the chairman of the authority. ...Nothing in this section creates a debt or liability of the state.

The capital reserve fund mentioned in the statute is generally equal in size to the minimum amount of debt service required in any year. It is common for issuers of revenue bonds to include a capital reserve or debt service reserve fund in the structure of the bond offering for it lends additional security to the bondholders and helps ensure the highest possible credit rating for the bonds. Alaska's moral obligation provision means that if the debt service reserve fund should fall below its required level, the State legislature may, but is not legally required to, appropriate the funds sufficient to restore the capital reserve fund to its required level. The most likely reason that such a reserve fund would fall short of the required level is if agency revenues were insufficient to meet a given debt service payment and the reserve fund had to be used to make the payment.

Similar clauses were included in the enabling legislation of each of the other State corporations. Consequently, the State's M.O. stands behind the debt issued by the Alaska Municipal Bond Bank, the Alaska Power Authority, the Alaska Medical Facility Authority, and certain bonds issued by the Alaska Housing Finance Corporation.

Alaska Municipal Bond Bank - The Alaska Municipal Bond Bank is a public corporation administratively located within the Department of Revenue but with a separate and independent legal existence. It was established in 1975 in order to loan funds for capital construction to cities and boroughs in the State. The Bank raises the money it loans to the municipalities through the issuance of tax-exempt bonds. The Municipal Bond Bank bonds are general obligations of the Bank alone, and are not obligations of the State of Alaska. The State has pledged its moral obligation to the maintenance of the debt service reserve fund, however.

The Bank loans funds to local governmental units through the purchase of general obligation and revenue bonds of the localities. Instead of directly selling a bond issue in the national bond market, a city may sell its bonds to the Municipal Bond Bank. The Bank collects several such bond issues and consolidates them into a single bond issue which it sells on the national market. The interest rate bid on the Bank's bonds becomes the rate the localities must pay to the bank. The Bank is, therefore, a middleman — facilitating the debt issuance of smaller units of government.

The advantages to Alaska's localities are several. First, interest rates tend to be more competitive (i.e., lower) because of the additional security local bonds enjoy through the structure of the Bond Bank. Also, by pooling the bond issuances of localities the Bank's bond issue is larger than the individual offerings would be and the lower administrative costs can be shared by the localities which comprise the Bank's issue. The Bank's bonds are rated A by Moodys Investors Service. This is a higher rating than many of Alaska's smaller, lesser known, municipalities could achieve on their own. Purchasers of the

Table 3.11

Alaska Municipal Bond Bank
General Obligation Debt Outstanding by Locality

<u>Governmental Unit</u>	<u>Moody's Credit Rating</u>	<u>Obligation to the Bank As of 4/1/83</u>	<u>Percent of Total</u>
City and Borough of Juneau	Baal	\$40,625,000	37.6%
Matanuska-Susitna Borough	A	22,025,000	20.4
Kodiak Island Borough	Baal	11,810,000	10.9
City and Borough of Sitka	NR	8,920,000	8.3
City of Ketchikan	Baal	4,870,000	4.5
Bristol Bay Borough	NR	3,785,000	3.5
City of Unalaska	NR	3,060,000	2.8
City of Homer	Baa	2,190,000	2.0
City of Soldotna	NR	2,115,000	1.9
City of Palmer	NR	1,835,000	1.7
City of Fairbanks	A	1,610,000	1.5
City of Kodiak	Baa	1,425,000	1.3
City of Wrangell	NR	1,405,000	1.3
City of Seward	NR	990,000	0.9
City of Bethel	NR	625,000	0.6
City of Kenai	NR	390,000	0.4
City of Nome	NR	165,000	0.2
TOTAL		\$107,845,000.	100.0%

SOURCE: Alaska Municipal Bond Bank, Official Statement, March, 1983.

Bank's bonds have additional security that would not be available from purchasing, for example, the City of Ketchikan's bonds directly (the City of Ketchikan is rated Baa). The increase in bond rating translates into lower interest costs. Finally, the Bond Bank, carrying the Alaska State name, is better known than many of Alaska's smaller units of government. This enhances the marketability of the bonds to investors in the "lower 48".

A listing of the debt outstanding to the Bond Bank by each municipality that has issued bonds through the Bank is provided in Table 3.11. With the exception of Matanuska-Susitna Borough and the City of Fairbanks, the municipalities that have used the Bank are rated Baal or lower (or are unrated). The A rating of the Bank's bonds, therefore, has resulted in significant savings in interest costs especially to these communities.

The security behind the bonds issued by the bank, which is multi-layered, is as follows:

1. First, the pledge and assignment of the individual general obligation municipal bonds which the Bond Bank's bond proceeds will be used to purchase.

2. Second, a debt service reserve fund must be maintained at a level equal to 15% of the principal amount of the Bank's bonds outstanding. The reserve account is funded through two sources. State appropriations to the Bank make up 10% of the principal amount. The remaining 5% is borrowed along with each bond issuance.

3. Third, the Bank has a first claim on State aid payments to localities (including school aid payments, the local share of various taxes collected by the State, and State aid to local governments) if the local government defaults on its obligation.

4. Finally, the State has pledged its moral obligation to maintain the debt service reserve fund at its proper level.

Upon creation of the Bond Bank by the State in 1975, it was authorized to have a maximum of \$150 million in debt outstanding. The State appropriated to the Bank an amount equal to 10% of the maximum authorization (\$15 million) partially to fund the debt service reserve account. As of the Bank's most recent issuance (March 1983) \$ 123,540,000 in general obligation bonds had been issued. In addition to general obligation bonds, the Bank has issued a limited amount of revenue-supported debt and federally guaranteed bonds under the Coastal Energy Improvement Program (CEIP). Out of a total amount of \$160,097,300 issued since 1976, the following debt remains outstanding:

Table 3.12
Alaska Municipal Bond Bank Issues
1976 - 1983

GENERAL OBLIGATION BONDS		Amount Issued By Bank ^{1/}	Amount Outstanding as of 4/1/83	Interest Range
Date	Purchased From			
June 1976	Kodiak, Seward	\$3,150,000	2,720,000	N/A
Sept. 1976	Mat-Su	7,245,000	6,345,000	6-8%
Sept. 1976	Homer	430,000	220,000	5-8%
Feb. 1977	Nome, Soldotna	680,000	365,000	4.85-7%
May 1977	Ketchikan, Juneau	4,920,000	4,205,000	5.2-6.5%
Nov. 1977	Bethel	795,000	625,000	5-8%
July 1978	Ketchikan	5,515,000	4,815,000	5.5-7.5%
Oct. 1978	Sitka	3,520,000	3,130,000	5.5-7.5%
Oct. 1978	Juneau	2,100,000	2,100,000	5.5-7.5%
Jan. 1979	Wrangell	1,575,000	1,480,000	5.9-7.5%
May 1979	Fairbanks, Soldotna, Mat-Su	5,335,000	4,925,000	6-8%
Oct. 1979	Palmer, Sitka	3,150,000	2,630,000	6.2-8%
April 1980 ^{2/}	Bristol Bay, Sitka	10,080,000	9,565,000	9.95-11%
Aug. 1980	Kodiak, Homer, Kenai, Unalaska, Fairbanks	16,170,000	15,800,000	7.3-9%
Oct. 1981	Juneau	2,100,000	1,960,000	12-13%
Feb. 1982	Juneau	10,815,000	10,230,000	11.25-14%
Feb. 1982	Mat-Su	15,615,000	15,410,000	13-16%
March 1982	Homer	420,000	400,000	11.5-12%
April 1983	Juneau	24,795,000	24,795,000	8.5-10.75%
April 1983	Unalaska	2,190,000	2,190,000	8-10%
TOTAL G.O.		\$123,540,000	\$113,680,000	
REVENUE BONDS				
July 1980	Ketchikan Airport	\$ 410,000	\$ 410,000	6.2-8.5%
April 1982	Fairbanks Utility	4,440,000	4,440,000	10.25-11.4%
TOTAL REVENUE		\$ 4,850,000	\$4,850,000	
Coastal Energy Improvement Program Bonds ^{3/}		\$31,707,300	\$31,467,300	
TOTAL BOND BANK		\$160,097,300	\$149,997,300	

SOURCE: Alaska Municipal Bond Bank, Official Statement, March, 1983.

- ^{1/} Amount issued by the Bank is approximately equal to the amount of bonds purchased by the Bank plus 5 percent for the debt service reserve fund contribution.
- ^{2/} Bonds issued under 1980 Resolution.
- ^{3/} Federally guaranteed.

Total Municipal Bond Bank Bonds Outstanding

General Obligation Bonds	\$113,680,000
Revenue-Supported Bonds	4,850,000
CEIP Bonds	31,467,300
TOTAL	\$149,997,300

An itemization of these amounts is provided in Table 3.12. Of the \$149.9 million currently outstanding, only the general obligation and revenue bonds are indirect obligations of the State, carrying its moral obligation. The CEIP bonds are secured by the federal government and do not have a claim on the the reserve fund established for the general obligation bond series. At the end of fiscal year 1983 the Bond Bank had exhausted all but \$2,700 of its original authorization of \$150 million. During the 1983 legislative session, however, the State Legislature appropriated an additional \$20 million to the Bond Bank, increasing its borrowing capacity by \$200 million.

Alaska Medical Facility Authority - The Alaska Medical Facility Authority is a public authority administratively located in the Department of Revenue with a separate and independent legal existence. The Authority was created by the legislature in 1978 to finance construction and improvements to medical facilities in the State. As of April 1983, the Authority had sold one bond issue in October 1979, of \$12 million to finance improvements to a Fairbanks hospital. The bonds, rated Baal are secured by hospital lease payments and are not a direct obligation of the State; however, the State has pledged its moral obligation to the maintenance of the debt service reserve fund. The outstanding debt of the Authority at the end of fiscal year 1982 was \$11,410,000.

Alaska Housing Finance Corporation - The Alaska Housing Finance Corporation (AHFC) is a public corporation administratively located within the Department of Revenue but has a separate and independent legal existence. AHFC was chartered in 1971 to provide financing for low- and moderate-income housing and housing located in remote, underdeveloped, or blighted areas of the State. Since 1980, when the AHFC's powers were expanded by removing mortgagor income restrictions, the Corporation has emerged as the largest supplier of mortgage funds in the State, in addition to being the largest issuer of debt (taxable and tax-exempt). Table 3.13 indicates the amounts of AHFC borrowing since 1972, and that 76 percent of this borrowing has occurred since 1980.

The bonds issued by the AHFC are secured by the mortgages purchased with bond proceeds, including federal and private mortgage insurance, state appropriations, a reserve fund, and in certain instances, the State's moral obligation pledge. In addition, the AHFC has issued certain veterans housing bonds which carry the full faith and credit pledge of the State (discussed above).

Table 3.13

Alaska Housing Finance Corporation
Debt Issued by Year
All Programs 1972-1983
(000s)

1972	\$ 13,500
1973	49,000
1975	52,000
1976	45,000
1977	123,000
1978	146,225
1979	170,600
1980	503,800
1981	650,000
1982	652,000
1983 (to 5/30/83)	<u>175,000</u>
Total	\$2,580,125

Source: Alaska Housing Finance Corporation, Selected Corporation and Program Information, December 1982, revised with 1983 data.

The AHFC operates many other loan programs aside from the State guaranteed Veterans Housing bonds. The amounts issued under each program and the amounts outstanding are presented in Table 3.14. The largest program is the Insured Mortgage Program which issued approximately \$984 million from 1975 to 1980. Borrowing was curtailed in 1980 due to federal restrictions on tax-exempt housing mortgage revenue bond issuance. The bonds are secured by the mortgages and a 10% capital reserve fund which the State has pledged its moral obligation to replenish if mortgage income is insufficient to meet debt service. Approximately \$953 million is presently outstanding.

The second largest program is the State Assisted Mortgage Program, with \$875 million issued and currently outstanding. Bonds issued under this program are taxable, because of federal restrictions enacted in 1980 on the use and amount of state tax-exempt housing bonds that may be issued. This program is not subject to the State's moral obligation. The only other program carrying the State's moral obligation is the one issue of \$15 million home improvement loan bonds.

As Table 3.14 indicates, AHFC has \$2.4 billion in taxable and tax-exempt debt outstanding. Of this amount, slightly less than \$970 million (38 percent) is backed by the State's moral obligation. The moral obligation bonds, plus the State fully guaranteed bonds issued to date of \$175 million, are included as indirect debt of the State. Indirect AHFC debt therefore amounts to \$1.14 billion or 45 percent of total AHFC debt outstanding as indicated below.

<u>AHFC Debt Outstanding</u>		
	<u>Amount</u>	<u>Percent</u>
<u>State Back-Up</u>	<u>(millions)</u>	
General Obligation	\$ 175.00	7
Moral Obligation	967.60	38
No Liability	1,390.90	55
TOTAL	\$2,533.50	100

Alaska Industrial Development Authority - The Alaska Industrial Development Authority (AIDA) is a public corporation administratively located in the Department of Commerce and Economic Development but with a separate and independent legal existence. AIDA was created in 1980 as the successor to the Alaska State Development Authority. AIDA promotes economic development within the State by providing lowinterest loans to industrial and commercial projects. None of the tax-exempt bonds issued to finance the loan programs are direct obligations of the State; however, the State's moral obligation stands behind the debt service reserve fund which secures certain bonds issued by AIDA.

AIDA has three major loan programs. The Economic Development "Umbrella" Bond Program issues tax-exempt industrial development bonds to finance projects of \$1 million or less. Because of their small size, the projects financed under this program are grouped together when AIDA issues bonds, hence the title "umbrella". AIDA does not directly loan bond proceeds. Proceeds of the Authority's bond sales are used to purchase eligible loans from financial

Table 3.14

Alaska Housing Finance Corporation

Amounts Issued and Outstanding by Program
(000s)

	Program Rating	Amount Issued	Amount Outstanding as of 5/30/83
Housing Mortgage Program Bonds	Aa/AA	\$ 109,500	\$ 96,245
Insured Mortgage Program Bonds*	A	983,625	952,625
Home Mortgage Bonds	Aa/AA-	385,000	385,000
State Assisted Mortgage Bonds**	Aa/AA	875,000	875,000
Second Mortgage Bonds	AA	27,000	27,000
Home Improvement Loan Bonds*	A/A-	15,000	15,000
Insured Rural Mortgage Bonds	NR	10,000	10,000
State Guaranteed Bonds***	Aa/AA	175,000	175,000
		\$2,580,125	\$2,533,615

Source: Alaska Housing Finance Corporation, Selected Corporation and Program Information, December 1982.

* Backed by State Moral Obligation

** Taxable Bonds

*** Backed by State General Obligation

institutions in the State. Security for AIDA's bonds comes from the financed projects, a capital reserve fund established by the State for the Authority, and the full faith and credit of the Authority. This program's debt is considered to be an indirect obligation of the State.

The second program, the Consolidated "Umbrella" Bond Program, is similar to the Economic Development "Umbrella" Bond program except the projects financed are of amounts larger than \$1 million. The bonds are secured by the Authority's general obligation and the moral obligation of the State. As of December 1982, \$101,325,000 of umbrella bonds from both the economic development and consolidated loan programs were outstanding.

The following amounts of umbrella bonds have been issued:

1981	\$17,640,000
1982	60,480,000
1983	23,205,000

In its third and largest loan program, the Revenue Bond Program, AIDA acts as a conduit in the sale and issuance of certain industrial development bonds on behalf of private borrowers who secure the bonds entirely. AIDA does not participate financially in the projects nor is the Authority's full faith and credit pledged as security for the bonds. Bonds issued under this program are not considered to be obligations of the Authority or the State. Furthermore, the State's M.O. does not stand behind bonds issued through the revenue bond program. At the end of December 1982, \$310,690,185 was outstanding under this program.

Alaska Power Authority - The Alaska Power Authority (APA) is a public corporation of the State situated for administrative purposes in the the Department of Commerce and Economic Development but with separate and independent legal existence. The APA was created to finance, construct, and operate power production and transmission facilities. The Authority is subject to the Executive Budget Act (Alaska Statutes 37.07) and must receive legislative authorization for the financing of any project which involves the appropriation of state funds or that exceeds 1.5 million megawatts of installed electrical generating capacity.

To date, the APA has issued only short-term bond anticipation notes with maturities of three years or less. Presently, \$200 million is outstanding with the first maturity of \$35 million in May 1984. Of the remaining shortterm notes, \$50 million matures in October 1984 and \$115 million in May 1985. The notes are rated MIG-1 by Standard & Poor's. MIG-1 is the rating assigned to the highest quality borrower enjoying strong credit protection with adequate cash flows for servicing the debt. The APA short-term notes are so-rated because of a letter of credit backing from various AAA-rated banking institutions. For an annual fee, certain banks will provide issuers with a letter of credit that acts as an external credit support, much like municipal bond insurance. Because the short-term notes are "variable rate" notes -- meaning the interest rate paid to

noteholders is not fixed but changes monthly according to a predetermined index -- a letter of credit was necessary in order to market the bonds. This is true of virtually all variable or floating rate notes.

Other Obligations of Public Corporations

International Airport Revenue Bonds - These bonds have been issued to finance improvements to the State's two international airports and are secured by a first lien on gross revenues derived from airport operations; however, they are also "special" obligations of the State. If airport revenues were ever insufficient to meet debt service requirements, it is likely that the State would be called upon to make up the difference.

The bonds are issued by the State Bond Committee with the approval of the Commissioner of Transportation and Public Facilities. The Commissioner is required by each bond resolution to fix and collect fees, charges and rentals for the use of facilities of the International Airports sufficient each year to provide net revenues at least equal to 130 percent of debt service requirements during that year. Table 3.15 indicates that over that past seven fiscal years, net revenues have far exceeded the amount required to pay debt service.

The State is authorized by statute (A.S. 37.15.410) to issue a maximum of \$43.325 million in international airport revenue bonds. Of this amount, \$34.825 million (80 percent) had been issued as of April 30, 1983. The February 1975 issue (the most recent) was defeased (retired early) in July of 1975 because the bond proceeds were no longer required upon cancellation of the Anchorage Terminal Expansion Project. Therefore, these bonds are no longer considered to be outstanding. The net amount of International airports revenue bonds outstanding as of June 30, 1982 was \$18,285,000.

Municipal Debt

In addition to Municipal Bond Bank debt issuance on behalf of Alaskan municipalities, local governments in the State issue debt independently in the tax-exempt bond market. At the end of fiscal year 1982, approximately \$1.3 billion in general obligation debt and \$347.4 million revenuesupported debt was outstanding at the local government level. The debt of Alaska's localities, therefore, comprises approximately 43 percent of the total amount of public debt outstanding in the State. The debt position of local governments in the State is described at length in Section Five of this Report.

Other Long-Term Obligations

Public Pension System Liabilities - The State administers two major retirement systems: the Public Employees Retirement System (for State employees and employees of political subdivisions who elect to join the system), and the Teachers Retirement System (for teachers and school

Table 3.15

International Airports Revenue Bonds
Coverage Ratios
1975 - 1982

<u>Fiscal Year</u>	<u>Net Revenues (millions)</u>	<u>Debt Service (millions)</u>	<u>Coverage of Net Revenues Over Debt Service^{1/}</u>
1975	\$ 5.6	\$ 2.1	266%
1976	5.6	1.9	294
1977	7.4	1.9	389
1978	10.0	1.9	526
1979	12.6	1.9	663
1980	13.6	1.9	775
1981	15.9	1.9	836
1982	14.6	1.9	768

SOURCE: Department of Administration, Bonded Debt and Debt Service, Fiscal Years ended 1982.

^{1/} required coverage 130%.

administrators). The difference between the present value of accrued benefits for employees who are covered by the pension system and the value of the particular pension system's assets is the amount of the State's unfunded liability. The unfunded pension liability is not generally treated by the rating agencies or investors as "debt" unless it is judged to constitute a significant burden on the State; however, it is an long-term obligation of the State.

According to William M. Mercer, Inc., the unfunded current liability for each of the State's public pension systems at the end of fiscal year 1982 was as follows:

Public Employees Retirement System
(dollars in millions)

Present Value of Accrued Benefits	\$775,115
Value of Assets	613,653
Unfunded Liability for Accrued Benefits	161,462
Unfunded Liability as Percent of Benefits	20.8%

Teachers Retirement System

Present Value of Accrued Benefits	\$587,016
Value of Assets	451,650
Unfunded Liability for Accrued Benefits	135,366
Unfunded Liability as Percent of Benefits	23.1%

Both of these systems are considered to be "fully funded" since the ratio of assets to accrued benefits, (i.e., the unfunded pension liabilities) is 77 to 80 percent for both of the retirement systems. Unfunded pension liabilities are generally not considered to be a contingent liability until this ratio drops below 60 percent. The State's pension liability, therefore, does not need to be included in calculation of the indirect debt of the State.

Local School Construction Debt - A portion of the State's education assistance program to independent school districts consists of the partial reimbursement for cash expenditures on school construction and debt service on bonds issued to finance school construction. As described in Section Five, approximately \$641 million in school construction debt was outstanding at the local level at the end of fiscal year 1982. The State's legal commitment to repay this debt is restricted to the annual appropriation allocated to this purpose by the legislature; however, because the bonds were issued with the expectation of some level of State assistance, a de facto moral obligation to provide assistance with debt service on school construction debt exists at the State level.

Table 3.16

State of Alaska Classification of Outstanding Debt
(amounts in millions)

	Amount Outstanding June 30, 1982	Amount Retired	Amount Issued	Amount Outstanding May 30, 1983	Percent of State-Level Debt
<u>Direct Debt</u>					
General Obligation Debt	\$842.2	\$81.2	\$185.0	\$946.2	23.5%
Alaska State Housing Auth. Lease-Revenue Bonds	67.1	3.7	-0-	63.4	1.6
University of Alaska	20.3	1.1	-0-	19.2	0.5
NET TAX-SUPPORTED DEBT	\$929.8	\$86.0	\$185.0	\$1,028.8	25.6%
<u>Indirect Debt (moral obligation)</u>					
Alaska Housing Finance Corp. State Guaranteed Veterans Housing Insured Mortgage Bonds	-0-	-0-	\$175.0	\$175.0	4.3%
Home Improvement Loan Bonds	\$963.3	\$ 10.6	-0-	952.7	23.6
Alaska Industrial Devel. Authority	15.0	-0-	-0-	15.0	0.4
Alaska Power Authority	77.9	3.3	23.4	98.0	2.4
Alaska Municipal Bond Bank	200.0	-0-	-0-	200.0	5.0
Alaska State Devel. Corporation	95.8	2.9	27.0	119.9	3.0
Low Income Housing Bonds	11.4	0.3	-0-	11.1	0.3
	-0-	-0-	2.4	2.4	0.0
<u>Indirect Debt (special obligation)</u>					
International Airport Authority	18.3	0.8	-0-	17.5	0.5%
TOTAL INDIRECT DEBT	\$1,381.8	\$ 17.9	\$227.8	\$1,591.6	39.5%
TOTAL DIRECT AND INDIRECT STATE DEBT	\$2,311.6	\$103.9	\$412.8	\$2,620.4	65.1%
<u>Other State-Level Debt</u>					
Alaska Housing Finance Corp. State Assisted Mortgage Bonds	\$675.0	-0-	\$200.0	\$875.0	21.7%
Housing Mortgage Program Bonds	96.2	\$ 2.2	-0-	94.0	2.3
Home Mortgage Bonds	200.0	-0-	185.0	385.0	9.6
Second Mortgage Bonds	27.0	-0-	-0-	27.0	0.6
Fairbanks Residential Mortgage	28.3	-0-	-0-	28.3	0.7
TOTAL OTHER STATE-LEVEL DEBT	\$1,026.5	\$ 2.2	\$385.0	\$1,409.3	34.9%
TOTAL STATE-LEVEL DEBT	\$3,338.1	\$106.1	\$797.8	\$4,029.7	100.0%

Conclusion

From a territory that had slightly less than \$3 million in debt outstanding when it received statehood to today, with nearly \$6 billion outstanding from a variety of public issuers, long-term debt has played an important role in Alaska's development. The borrowing programs profiled above have served the public by financing service provision, education, housing and industrial development. However, because of the large amounts of debt that have been issued from within the State, the interrelationship of the different types of debt, issuers, and the State is an important concept that must be incorporated into State's financial management.

Classification of outstanding State-level debt using the criteria presented in this section will improve the ability of State officials to manage outstanding debt and plan future debt issuance. Table 3.16 presents such a classification of Alaska's debt position as it nears the end of fiscal year 1983. The two most important points that this exercise illuminates are: 1) general obligation debt is not the only State-level debt supported by tax revenues; and 2) indirect (moral and special obligation) State debt comprises a significant share of total State-level debt. According to Table 3.16, over 65 percent (\$2.6 billion) of State-level debt is either direct tax-supported or indirect moral or special obligation debt while only 23 percent (\$946 million) is general obligation debt. Therefore, the use of general obligation debt as the sole measure of State indebtedness understates Alaska's contingent debt position.

It is recommended that the State Bond Committee make use of the concepts of direct tax-supported debt and indirect moral and special obligation debt when assessing the State's current debt position. Such a categorization is more accurate for analytical purposes and more proper for improving debt management than G.O. debt alone. The information from this exercise should also be included in the State's official statements for future debt offerings presented in a format similar to Table 3.16.

CHAPTER IV

MARKET PERFORMANCE AND RECEPTION OF STATE GENERAL OBLIGATION BONDS AND THE ALASKA HOUSING FINANCE CORPORATION

Investors in tax-exempts continually segment the myriad of different issues and issuers into classes of approximately similar standing. Distinctions between general obligation and revenue bonds serve as one example. Institutional investors often refine the market segments to separate housing revenue bonds from public power bonds and many institutions will have portfolio-balancing policies or rules to enforce the perceived benefits from portfolio diversification, on both a type-of-bond and geographic basis. Another method of categorization is the credit quality of an issuer. Exhibit 4.1 lists state credits by their June 1982 Moody's rating. One important and well-defined market segment is the high-grade state general obligation (GO) credit, which can be broadly-defined to include triple-A (Aaa) and well-regarded double-A (Aa) rated states. Alaska, with its June 1980 upgrading by Moody's Investors Service, can now be regarded as a member of this peer group. For comparative purposes the subsequent analysis will compare Alaska State GO market performance with four defined segments of the high-grade state market:

- States that have consistently maintained a Moody's Aaa rating over the 1978-82 period;
- States that have consistently maintained a Moody's Aa rating;
- States that have been downgraded to Aa over the period;
and
- States that have been upgraded to Aa or Aa1 over the 1978-82 period.

The states comprising each group are listed in Exhibit 4.2.

Table 4.1 compares the volume of Alaska GO State new issues with these sample groups. New Alaska debt issuance has risen consistently over the 1977-82 period, except in the difficult period of high interest rates, (calendar year 1981), when Alaska issued no bonds. During the 1977-82 period, State debt commanded a four-fold increase in its market share among all high-grade states. In 1977, Alaska's \$80 million in new financings accounted for only 2.1% of the \$3.7 billion in Aaa or Aa-rated state new issues; by 1982, Alaska's \$385 million accounted for 8.2% of this market segment.

Exhibit 4.1

Moody's State Credit Ratings
(as of June 1982)

<u>Aaa</u>	<u>Aa</u>	<u>A</u>
Georgia	Alabama	Massachusetts ²
Illinois	Alaska	Michigan
Maryland	California	New York
Missouri	Connecticut	Pennsylvania
New Jersey	Deleware	Washington
North Carolina	Florida	West Virginia ²
Oklahoma	Hawaii	
South Carolina	Kentucky	
Tennessee	Louisiana	
Texas	Maine ¹	
Utah	Minnesota	
Virginia	Mississippi	
	Montana ¹	
	Nevada	
	New Mexico ¹	
	Ohio	
	Oregon	
	Rhode Island	
	Vermont	
	Wisconsin	

- ¹ Rated Aa1
² Rated A1

Exhibit 4.2
Selected Sample States

States Consistently
Maintaining Aaa Ratings

Georgia
Illinois
Maryland
Missouri
New Jersey
North Carolina
Oklahoma
South Carolina
Tennessee
Texas
Utah
Virginia

States Consistently
Maintaining Aa Ratings

Alabama
Connecticut
Florida
Idaho
Kentucky
Louisiana
Mississippi
Nevada
Ohio
Rhode Island
Vermont

States Downgraded
to Aa Ratings

California
Minnesota
Wisconsin

States Upgraded
to Aa Ratings

Delaware
Maine (to Aal)
Montana (to Aal)
New Mexico (to Aal)

Two other points are worth noting from the data in Table 4.1. The volume of new debt commitments from states that were rated Aaa at the outset of this period but subsequently downgraded to Aa (California, Wisconsin and Minnesota) stands out as one example. For these states, average new issue volume per state was more than twice the average for states that maintained a triple-A rating over the period, and this markedly higher volume (especially in the 1977-80 period) serves as one precursor of the negative rating change.

By marked contrast, states that were upgraded over this same period (including Alaska, until the large increase in 1982) stand out for the very modest volume of new obligations. Average borrowings from these states were only 20-30 percent of the new commitments issued by other Aa-rated states.

The lessons embodied in these data are clear: regardless of the level of other resources that are important in determining debt capacity, the pace at which new claims on State resources are added through the debt issuance process can have a measurable impact on perceived credit quality.

Market Performance of GO Bond Issues

One measure of market demand for Alaska GO debt is the number of competitive bids received from underwriters — investment bankers and commercial banks. Underwriters serve as important intermediaries in governmental finance, purchasing bond issues from borrowers and then distributing bonds to investors. Underwriters bear risks in this distribution effort because the purchase price to the issuer is fixed at the time of sale but investor demands may change during the distribution period. In a manner similar to other goods and services, the stronger the demand for the product (e.g. the bond issue), the less uncertainty faced by underwriters and the greater the number of potential underwriters. Exhibit 4.3 lists the managing underwriters for recent State bond sales and highlights the broad appeal of Alaska bonds to underwriters. This data also suggests indirectly that Alaska debt must be designed to appeal to the national market: the absence of underwriters domiciled in Alaska attests to a relatively weak "domestic" market.

Table 4.2 presents statistics on the average number of bids received on selected State GO bonds. Of particular interest, Alaska bonds have received fewer bids since 1980 than in prior years, even though the upgrading of Alaska debt in 1980 could be expected to broaden the appeal of State bonds to investors.

Two factors have contributed to the decline in bid activity. First, as reference to the other state statistics points out, there has been a general trend towards fewer bids since 1980. Exhibit 4.3 points up a corollary — namely, that the number of firms combining to form a syndicate has been increasing. These events — fewer bids and larger syndicates — are responses dictated by the risks of underwriting in markets with high and volatile interest rates.

Table 4.1

New Issues of State General Obligation Bonds

(dollar volume in millions)

	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
Alaska	\$80.6	\$85.0	\$60.0	\$125.0	--	\$385.0
States Consistently Rated Triple A:						
Total	1688.9	964.8	485.8	1091.6	1361.8	2162.5
Average	105.7	137.8	81.0	136.5	194.5	216.3
States Downgraded To Double A:						
Total	872.0	980.7	856.6	715.0	363.0	705.0
Average	290.7	490.4	285.5	238.3	121.0	235.0
States Upgraded To Double A:						
Total	112.4	86.9	5.0	125.0	36.6	106.2
Average	37.4	21.7	5.0	31.3	36.6	53.1
States Consistently Rated Double A:						
Total	1056.8	853.5	758.0	824.7	333.8	1358.1
Average	105.7	121.9	108.3	103.1	55.6	169.8
Alaska as Percent of:						
All Aa, Aaa States	2.1%	2.9%	2.8%	4.3%	--	8.2%
All Aa States	3.8	4.2	3.6	7.0	--	15.1
All Consistent Aa States	7.6	9.9	7.9	15.2	--	28.3

Exhibit 4.3

Managing Underwriters On State Of Alaska

GO Bond Sales

March 1978

Northern Trust Company (ILL)
First Boston Corporation (NY)
Seattle First National Bank (WASH)
Harris Trust (ILL)
European American Bank (NY)
Foster & Marshall (WASH)

April 1979

Merrill Lynch (NY)
Continental Illinois Bank (ILL)
Harris Trust Bank (ILL)
Lehman Brothers (NY)
First Boston Corp (NY)
Bankers Trust Co., (NY)
Bank of America (CAL)

March 1982

Bankers Trust (NY)
Chemical Bank (NY)
Bank of America (CAL)
Kidder Peabody (NY)
Dean Witter (NY)
Morgan Guaranty (NY)
Blyth Eastman (NY)
Shearson American Express (NY)
Weiden (NY)
Prudential-Bache (NY)
Goldman Sachs (NY)
Bear Stearns (NY)
Lehman Brothers (NY)
L.F. Rothschild (NY)
Salomon Brothers (NY)
Donaldson Lufkin Jenrette (NY)
Lazard Freres (NY)
Drexel Burnham (NY)

December 1978

Bank of America (CAL)
Continental Illinois Bank (ILL)
Bache (NY)
Goldman Sachs (NY)
Bear Stearns (NY)
Bankers Trust Co. (NY)
Chemical Bank (NY)
Lehman Brothers (NY)

June 1980

Morgan Guaranty Trust (NY)
Blyth Eastman Paine Webber (NY)
Salomon Brothers (NY)
Stephens, Inc. (NY)

October 1982

Morgan Guaranty (NY)
Bankers Trust (NY)
Bank of America (CAL)
Bear Stearns (NY)
Salomon Brothers (NY)
Merrill Lynch (NY)
First National Bank
of Boston (MASS)
Lazard Freres (NY)

Table 4.2

Average Number Of Bids On
New Issues Of State General Obligation Bonds

	<u>1977</u>	<u>1978</u>	<u>Average Number of Bids</u>		<u>1981</u>	<u>1982</u>
			<u>1979</u>	<u>1980</u>		
Alaska	4.0	4.5	6.0	3.0	--	2.0
States Consistently Rated Aa	5.4	5.9	5.1	4.8	4.1	5.3
States Upgraded To Aa	11.5	8.5	14.0	10.2	6.0	5.3
States Downgraded To Aa	3.0	3.0	3.3	3.0	3.3	3.1
States Consistently Rated Aaa	4.8	4.2	4.4	3.7	3.7	3.5

A second factor at work is the vastly increased size of new Alaska debt issues. Larger issues add to the distribution risks faced by underwriters and the typical response is, again, the formation of fewer but larger bidding syndicates. A parallel observation supporting this is the consistently lower number of bids received on the large volume of issues from states subsequently downgraded to double-A.

Table 4.3 provides a direct measure of the relationship between issue size and number of bids received for all state GO bonds issued in 1982. Bond issues less than \$20 million received, on average, 8.7 bids, while issues between \$50 and \$100 million received 3.5 bids and bonds of \$100 million or more received only 2.8 bids on average.

These comparisons suggest that Alaska's recent increases in bond issue size have been unfortunately timed to place underwriters with the "double jeopardy" of marketing significantly larger issues in an increasingly hostile and volatile market.

Underwriting Spreads

Underwriters specialize in bearing the risks of distributing securities at fixed prices and they are compensated for these risk-bearing services through the gross underwriting spread. The underwriting spread is the difference between the price paid to the issuer for the bonds and the prices at which they are reoffered (and hopefully sold) to investors. The amount of the spread is determined partially by the anticipated degree of effort required to sell the bonds. Generally the more difficult it is to sell or issue, the spread will be higher. Table 4.4 provides statistics on these underwriting spreads for sample state GO bonds since 1977.

These data indicate that the costs of underwriting Alaska GO bonds have risen dramatically since 1977, from \$6.71 per \$1000 par value in 1977 to \$10.30 per \$1000 par value in 1982. The rising costs of underwriting are not unique to Alaska. Table 4.4 points out that the costs of underwriting other state bonds has risen as well. States maintaining Aa-ratings over the period have witnessed underwriting spread increases from \$8.32 per \$1000 in 1977 to \$12.73 per \$1000 in 1982, a 53 percent increase. Again, the rising risks of entering the volatile credit markets of the past three years account for the increased returns demanded by underwriters for bearing these risks.

Of particular importance, however, is the noticeably lower cost of underwriting for Alaska bonds relative to other states that maintained double-A bond ratings over this period. In 1980, the difference amounted to \$5.79 per \$1000 par value. As an indication of the magnitude of this lower underwriting spread, this savings translates into \$723,750 in lower underwriting charges on the \$125 million in Alaska bonds issued in 1980. In 1982, the lower spread of \$2.43 per \$1000 translates into savings of \$935,000 on the \$385 million in new Alaska bonds.

Table 4.3

Number of Bids and Issue Size
National Bond Market
State GO Bond Issues

1982

Number Of Bids	Issue Size (\$ millions)			
	Less Than \$20	\$20-49	\$50-99	\$100 And Over
1			1	
2			1	10
3		2	3	6
4		3	3	5
5	1	1	3	
6	1			
7	2			
8	3			
9				
10				
11	1			
12	3			
Total Number Of Issues	11	6	11	21
Average Number Of Bids Per Issue	8.7	3.8	3.5	2.8

Table 4.5 points to the principal factor explaining the significantly lower underwriting spreads on Alaska GO bonds. Alaska has consistently issued new debt with relatively short average maturities. In 1982, for example, the average maturity on Alaska bonds was 5.5 years, compared with 8.7 years for states recently upgraded and with more than 11 years for all sample states.

The shorter average maturity reduces interest costs at the time of sale since the tax-exempt yield curve is upward sloping. Interest rates for bonds maturing in, say, 3 years are less than rates for bonds maturing in 10 years. Short maturities also translate into reduced underwriting risks as well. Price changes, which affect underwriter revenues, are less on short-dated securities and demand by banks is concentrated among securities with 10 years or less to maturity.

Interest Rates on Alaska State Bonds

Comparing interest rates on new bond issues is difficult because each new issue differs in several important ways. Most bond issues are sold as serial bonds, with varying amounts of principal maturing each year over the life of the issue. And, as just noted, Alaska bond issues carry significantly shorter maturities than most other comparable state bonds. Moreover, borrowing costs on any given maturity on any given bond issue can be closely associated with the then current market conditions.

Most generally, three broad and interrelated determinants combine to explain the interest rate on a specific bond issue:

1. Issuer characteristics: Credit quality and the risk of default; name recognition, and
2. Issue characteristics: the issue's average maturity, its size, its type, and the method of sale; and
3. Market characteristics: the overall level and trend of interest rates and aggregate investor demand for tax-exempt securities.

Therefore, evaluating the relative market performance of Alaska State GO debt requires a careful matching of these characteristics with other comparable bond issues.

As a first stage of comparison, Table 4.6 compares interest rates on Alaska bonds with other double-A rated state bonds sold within two weeks of the Alaska sale. The combined requirements of double-A rating and an approximately coincident sale date permit comparisons with 5 of the 6 Alaska bond sales since 1978. Based on the net interest cost (NIC)¹ of the entire bond issue, Alaska has consistently carried lower borrowing costs than other comparable states, but these differences are based largely on the far shorter average maturities on Alaska bonds.

Table 4.4
Average Underwriting Spreads On
New Issues of State General Obligation Bonds
1977 - 82

	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
Average Underwriting Spread:						
Alaska	\$6.71	\$7.71	N.A.	\$8.00	--	\$10.30
Consistently Rated Aa States	8.32	7.53	7.60	13.79	16.42	12.73
Upgraded States	6.93	5.48	5.45	10.31	14.38	N.A.
Downgraded States	6.63	7.02	7.29	12.90	12.28	10.88
Aaa Rated States	6.92	6.84	6.53	11.09	13.27	8.88
Difference in Spreads Alaska vs:						
Consistently Rated Aa States	-\$1.61	\$.18	--	-\$5.79	--	-\$2.43
Upgraded States	-.22	2.23	--	-2.31	--	--
Downgraded States	+.08	.69	--	-4.90	--	-.58
Aaa Rated States	-.21	.87	--	-3.09	--	1.42

Table 4.5
Average Maturities on New Issues
Of State General Obligation Bonds

	Average Maturity (years)					
	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
Alaska	8.0	5.5	6.0	6.0	--	5.5
States Consistently Rated Aa	14.6	12.1	14.4	12.2	12.3	11.2
States Upgraded To Aa	5.0	7.5	4.0	10.2	9.3	8.7
States Downgraded To Aa	12.9	11.8	12.0	12.9	10.4	11.6
States Consistently Rated Aaa	11.9	11.9	12.4	12.9	11.2	11.1

More revealing is the comparison of reoffering yields to investors on selected bond maturities. These reoffering yields are measures of the returns required by investors to purchase specific bonds, therefore this measure avoids the problems associated with different average bond issue maturities and comparisons using NIC.

Table 4.6 points out that prior to the June 1980 upgrading of Alaska's bond rating, Alaska GO bonds carried yields above states with double-A bond ratings. Although the June 1980 issue carried an Aa rating, yields on Alaska debt remained well above yields on Louisiana State bonds.

By October 1982, however, new Alaska issues were carrying demonstrably lower yields than comparable maturities on California and Connecticut bond issues. Although these data are somewhat sparse, the matched comparisons suggest that the marketplace, in consent with the opinion of Moody's analysts, has upgraded the performance of Alaska GO debt in the past 5 years. The technical appendix to this section reports the results of a statistical analysis that has been developed as an alternative approach to the evaluation of relative state bond interest costs. This procedure — multiple regression analysis — permits valid comparisons of relative costs on bonds sold with differing characteristics over distinct time periods. This statistical analysis has been applied to a sample of 254 state bonds to develop predictive measures of interest cost on Alaska bonds. By comparing the actual NIC on Alaska bonds with the predicted costs, this analysis can provide a measure of relative market standing.

The results, summarized in Table 4.7, suggest that the NIC on Alaska debt is lower than would be predicted for the average double-A rated state bond sold over this period. The statistical approach indicates that since June 1980, Alaska bond issues have carried NICs that are on average, 51 basis points lower than would be predicted. Prior to 1980, this difference averaged only 20.5 basis points. Expressed in different terms, the 51 basis points in lower NIC translates into \$14.3 million in interest savings over the approximate 5 1/2 year average life of the \$510 million in new Alaska bonds issued since 1980.

Secondary Market Yields

The prior analysis of relative borrowing costs has focused on new issue interest rates. Borrowing costs at the time of sale are generally of most concern to governments since these rates directly affect future budgets. But, investors have a broader perspective and they are continually revising their portfolio holdings through transactions in the secondary market. Underwriters, broker/dealers and investors follow closely the relationships among securities in daily secondary market trading to detect important clues to supply and demand conditions for individual securities as well as broad market trends. These constantly shifting secondary market yield relationships often provide early indicators of market sentiment prior to the offering of a new bond issue.

Table 4.6

Comparison Of State Of Alaska General Obligation Bonds
To Other State General Obligation Bonds

Date Of Issue	Issuer	Issue Size (\$millions)	Average Maturity (years)	NIC	5-Year Reoffer Yield	10-Year Reoffer Yield	Difference in Yields Alaska-Other States (basis points)	
							5-Year	10-Year
3-28-78	Alaska	45.0	6	4.866%	4.50%	5.00%	--	--
3-21-78	Alabama	15.0	10	4.784%	4.25%	4.60%	+25	+40
3-28-78	Florida	18.3	20	5.400%	4.40%	4.80%	+10	+20
12-12-78	Alaska	40.0	5	5.525%	5.35%	5.50%	--	--
12-14-78	Rhode Island	21.3	8	5.717%	5.30%	5.40%	+5	+10
6-24-80	Alaska	125.0	6	5.767%	5.35%	6.00%	--	--
6-10-80	Louisiana	154.5	13	6.375%	5.10%	5.60%	+25	+40
6-10-80	Hawaii	75.0	12	6.594%	5.40%	6.10%	-5	-10
3-10-82	Alaska	200.0	5	9.985%	9.50%	NA	--	--
3-9-82	California	140.0	8	10.309%	9.25%	10.25%	+25	--
3-3-82	Maine	19.4	8	10.275%	9.20%	10.25%	+30	--
10-20-82	Alaska	185.0	6	7.728%	7.00%	8.20%	--	--
10-26-82	California	180.0	9	8.778%	7.30%	8.60%	-30	-40
10-5-82	Connecticut	100.0	11	9.165%	7.75%	8.80%	-75	-60

Table 4.7
Actual and Predicted
Net Interest Costs On
Alaska State GO Bond Sales

<u>Sale Date</u>	<u>Actual NIC</u>	<u>Predicted NIC</u>	<u>Difference (in basis points)</u>
2-17-76	5.867%	6.292%	-42.5
6-29-76	5.804	6.241	-43.7
9-27-77	4.510	4.944	-43.4
3-28-78	4.866	5.002	-13.6
12-12-78	5.525	5.420	10.5
4-10-79	5.592	5.493	9.9
6-24-80	5.767	6.347	-58.0
3-10-82	9.985	10.621	-63.6
10-20-82	7.728	8.042	-31.4

Note : See technical appendix to this section for an explanation of the technique used to predict NIC.

To provide a secondary market perspective on Alaska State debt, selected national traders were polled on May 5, 1983 to get the secondary market yields on a 10-year bond for selected states. The results of this poll are tabulated in Table 4.8.

These data show a fairly narrow band of yield differentials ranging from 7.60% on 10-year maturities for Maine and Minnesota bonds to 7.90% on 10-year Nevada bonds. Alaska falls exactly midway in this range with an estimated yield of 7.75 percent. These comparisons suggest that, at present, Alaska has a well-defined status as a high-grade state credit, solidly entrenched among the broad range of states carrying similar bond ratings.

Investor Perceptions of State General Obligation Bonds

Interest rates and underwriting spreads established in the marketplace represent an amalgam of the investment choices of many different individuals and institutions. The market reception and performance of Alaska's bonds can, therefore, be viewed as a summary expression of investor perceptions of the relative value of the State's creditworthiness. As part of this study, further and more detailed expressions of investor sentiment were elicited from key participants in the municipal bond market.

As its market performance indicates, Alaska is viewed by most investors as a high-grade AA credit. However, many investors expressed concerns over the future security of state revenues that some believe are too dependent on oil and, therefore, overly exposed to fluctuations in world oil prices. Indeed, one professional market observer quipped, "Alaska is a giant industrial development bond, tied to the fortunes of the oil companies". This sentiment is mirrored in the credit analyses of Alaska general obligation debt by two major participants in the municipal bond market excerpted below:

Continental Illinois National Bank:

Alaska currently enjoys a very strong financial position and has an impressive natural resource base; however, its economy depends heavily upon oil and gas production and defense expenditures. In addition, Alaska's debt load is high, and income growth in the State has slowed considerably. Alaska ranks near the bottom of "Aa" rated states.

E.F. Hutton:

The mineral-rich State of Alaska may have to adjust to the current period of softening oil prices, during which its revenue stream may grow more slowly than has been the case during recent years. Although the balance of the Permanent Fund may approach \$4 billion by the end of fiscal year 1982, the uses of the Fund are restricted by State legislation. We are maintaining our Mid-A rating, but revising the trend from improving to stable in view of the reduced surplus margins in the general fund.

Table 4.8

Estimate of Secondary Market Yields On 10-Year Maturities

Of Selected State GO Bonds

May 5, 1983

<u>State</u>	<u>Yield</u>
Maine	7.60%
Minnesota	7.60
California	7.70
Connecticut	7.70
Florida	7.70
Louisiana	7.70
Ohio	7.70
Alaska	7.75
Alabama	7.75
Mississippi	7.75
New Mexico	7.75
Wisconsin	7.75
Hawaii	7.80
Vermont	7.80
Nevada	7.90

Alaska is seen by some market participants and credit analysts as a classic "boom or bust" economy. Such beliefs did not prevent them from purchasing Alaska bonds at the height of its "boom" in the late 1970s, but the sensitivity of Alaska to a "bust" as demonstrated by the effects of 1982-83 oil price revisions on Alaska revenues is likely to make these investors more cautious in the future. Such concerns will increase investor scrutiny of the State's oil revenue projections and the demands for those revenues in addition to paying debt service. In line with the "boom and bust" attitude, one investor put forth that Alaska may have certain appeal to the speculative investor, and could capitalize on that appeal by selling "equity shares" in the State with both an "up and a downside" potential rather than fixed-income bonds.

The mention of the State's Permanent Fund in the E.F. Hutton credit report deserves comment. The Alaska Permanent Fund was established by a constitutional amendment effective February 21, 1977. The amendment stated that contributions to the fund must consist of at least 25 percent of mineral lease rentals, royalties, royalty sale proceeds, Federal mineral revenue sharing payments, and bonuses received by the State. Enacted legislation (Ch. 18 SLA 1980) has modified this contribution rate to the Permanent Fund from 25 percent to 50 percent on new discoveries.

Because of its massive size, The Permanent Fund is viewed by certain investors as a potential source of repayment for Alaska debt, regardless of the fact that it is constitutionally unavailable for that purpose. The Permanent Fund has other indirect benefits on credit perceptions; establishment of the permanent fund is recognized as a sign of prudent financial management, which is looked upon favorably by investors. This contrasts with the abolishment of the State's individual income tax in 1980 that is considered by some to be a sign of fiscal irresponsibility. Alaska particularly must go out of its way to demonstrate competent responsible fiscal management because of its uniqueness. Such actions as following through on its appropriation commitment to the Permanent Fund and conservatively controlling legislation which erodes the principal or redirects the earnings of the Permanent Fund are necessary to reassure investors that the State is acting responsibly.

Market Performance Of The AHFC

The significance of the borrowing programs of the Alaska Housing Finance Corporation (AHFC) has been discussed in Section Four. AHFC tax-exempt bond sales have accounted for more than 30 percent of all Alaska debt issues since 1978 and constitute more than 60 percent of all state-level debt currently outstanding. In addition, many bonds are backed by the state's credit indirectly through the pledge of the State's moral obligation.

Table 4.9
Comparison of Tax-Exempt Alaska Housing Finance Issues
To Other States' Housing Issues
1978 - 1982

Date Of Issue	Issuer	Issue Size (\$million)	NIC	Spread	RY10	RY15	Difference In Yields	
							RY10	RY15
2-21-78	Alaska Housing Finance Corp	\$47.225	6.365%	\$18.50	5.40%	5.75%	--	--
2-9-78	New Jersey Mortgage Finance	11.105	5.446	18.00	5.00	5.50	+40	+45
6-29-78	Alaska Housing Finance Corp	55.000	7.465	25.00	6.30	6.80	--	--
6-27-78	California Housing Finance	50.000	6.519	NA	5.90	6.35	+40	+45
6-29-78	New Mexico Mortgage Finance	61.200	NA	NA	6.15	6.55	+15	+25
7-9-78	Colorado Housing Finance	90.000	7.000	18.98	6.20	6.70	+10	+10
11-21-78	Alaska Housing Finance Corp	44.000	7.062	19.00	6.10	6.50	--	--
11-10-78	Massachusetts Housing Finance	53.125	7.384	23.81	6.20	6.70	-10	-20
11-30-78	Rhode Island Mortgage Finance	61.610	7.400	18.80	6.30	6.75	-20	-25
2-23-79	Alaska Housing Finance Corp	60.000	7.247	18.71	6.25	6.70	--	--
2-23-79	Michigan State Housing Develop	41.000	7.321	NA	6.25	6.65	0	+5
2-21-79	Delaware State Housing Auth.	23.795	6.990	NA	6.20	6.50	+5	+20
6-18-79	Alaska Housing Finance Corp	\$105.000	7.080%	\$18.50	6.10%	6.60%	--	--
6-18-79	New Mexico Mortgage Finance	175.000	6.900	NA	6.10	6.60	0	0
6-29-79	Wisconsin Housing Finance	20.120	6.322	NA	6.00	6.40	+10	+20
12-18-79	Alaska Housing Finance	39.400	8.748	24.10	7.60	8.20	--	--
12-19-79	Michigan State Housing Devel	50.000	8.050	16.00	7.50	8.20	+10	0
12-20-79	New Hampshire Housing Fin	15.885	8.470	21.94	7.15	7.90	+45	+30
6-30-80	Alaska Housing Finance Corp	230.000	9.248	24.64	7.50	8.40	--	--
7-10-80	Pennsylvania Housing Finance	51.600	9.256	21.55	7.25	8.30	+25	+10
11-14-80	Alaska Housing Finance Corp	230.000	11.070	25.38	9.50	10.50	--	--
10-24-80	Texas Housing Agency	150.000	9.950	22.91	8.00	9.25	+150	+125
11-11-81	Alaska Housing Finance Corp	100.000	12.500	22.52	11.75	NA	--	--
11-6-81	Hawaii Housing Authority	20.000	12.810	27.56	11.75	NA	0	--
11-16-81	Michigan State Housing Dev.	40.000	13.030	26.65	11.80	12.75	-5	--
11-12-81	North Carolina Housing Fin.	30.000	12.802	19.50	10.75	NA	+100	--
11-19-81	Connecticut Housing Finance	200.000	12.890	20.57	11.75	NA	0	--
11-18-81	Minnesota Housing Finance	52.625	12.755	24.95	12.00	NA	-25	--
12-17-81	Alaska Housing Finance Corp	\$100.000	11.540%	\$21.74	NA	13.375%	--	--
12-4-81	Virginia Housing Devel Auth	100.000	13.280	23.31	12.00	NA	--	--
12-18-81	Alabama Housing Finance	100.000	13.471	25.00	12.50	NA	--	--
12-18-81	Louisiana Housing Finance	150.000	11.810	24.80	12.00	13.00	--	+37.5
3-4-82	Alaska Housing Finance Corp	15.000	13.420	28.26	NA	NA	--	--
3-3-82	Minnesota Housing Finance	40.920	13.560	25.00	12.25	NA	--	--
3-5-82	West Virginia Housing Devel	25.000	13.222	27.00	13.00	NA	--	--
9-9-82	Alaska Housing Finance Corp	85.000	10.950	22.25	10.75	NA	--	--
9-1-82	Massachusetts Housing Fin.	17.364	11.724	26.54	10.25	NA	+50	--
9-1-82	Pennsylvania Housing Fin.	28.730	10.972	23.03	10.50	NA	+25	--
9-10-82	Connecticut Housing Finance	150.000	11.061	19.25	10.20	NA	+55	--
9-10-82	California Housing Finance	75.090	NA	20.61	10.00	NA	+75	--
11-24-82	Alaska Housing Finance Corp	93.24	NA	23.21	9.75	NA	--	--
11-12-82	Alabama Housing Finance	100.000	10.170	25.77	9.25	NA	+50	--
11-30-82	Connecticut Housing Finance	50.000	9.735	13.50	9.00	10.20	+75	--
11-24-82	Minnesota Housing Finance	45.000	10.850	25.00	9.60	NA	+15	--

This section provides a brief review of the market performance of AHFC bond issues at the time of sale. Following the approach utilized in analyzing State GO bond sales, the analysis is based on matched comparisons of AHFC bond terms with bonds of comparably rated state housing agencies sold during a similar period. Table 4.9 presents the results of this analysis for those issues of AHFC for which comparisons were possible.

Housing bond issues are structured with long average maturities designed to match expected repayments of mortgage principal. The comparisons of reoffer yields, therefore, focus on 10-year and 15-year maturities. The comparisons on 10- and 15-year maturities indicate that, on average, AHFC bonds have carried yields that are 28.3 and 21.8 basis points higher than other state HFA bonds sold under approximately similar conditions.

AHFC bonds are sold through negotiation as are most mortgage revenue bonds. Table 4.10 summarizes yearly average underwriting spreads for the AHFC issues and other state housing agency issues included in Table 4.9. Based on these comparisons, average costs of underwriting appear to have been higher on AHFC issues in all years but 1981 with an apparent widening of this gap in 1982.

As noted in Section Four, AHFC issues taxable bonds in addition to the tax-exempt issues discussed above. The taxable bond market is different from the municipal market because competition comes not from other governmental borrowers, but, primarily from private corporations. Similarly, the investors and therefore the underwriting process for taxable bonds is different from that of municipals. Table 4.11 presents details on \$775 million of the \$875 million in taxable bonds issued since 1980. The Table does not compare AHFC taxable bonds with other taxable bonds; rather, it compares past AHFC taxable issues with U.S. Treasury Bonds sold during the same week with similar maturities.

Since 1981, the spread has narrowed dramatically from over 300 basis points (3 percent) to 87 basis points (0.87 percent) in 1983. Treasury bonds represent the benchmark security against which all taxable yields are measured because they are the most secure form of fixed-income investment. The narrowing of the difference between AHFC and Treasury yields indicates broad market acceptance and greater investor familiarity with the AHFC name.

Most all of the taxable and tax-exempt AHFC bond issues have been sold through a negotiated sale process of the type described in Section Six. The exception are the 1983 issues of State Guaranteed Veterans Housing Bonds which must be sold at a competitive sale because the State requirements that general obligation bonds be sold competitively. Taxable AHFC issues must be sold in a negotiated sale because of market norms; however, future tax-exempt AHFC issues may profit from a competitive sale if the trend towards improved market acceptance of Taxable AHFC bonds holds true for its tax-exempt offerings.

Table 4.1C
Average Underwriting Spreads
State Housing Finance Agencies
1978-82

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
Alaska Housing Finance Agency	\$20.83	\$20.44	\$25.01	\$22.13	\$24.57
Other State Housing Agencies	19.89	18.97	22.23	24.04	21.24
Difference: Alaska Less Other SHAs	\$.94	\$1.47	\$2.78	-\$1.91	\$3.33

Table 4.11

ALASKA HOUSING FINANCE CORPORATION

Taxable SAM Bonds (1)
Summary of Principal Terms

Issue	Offering Date	Ratings S&P/Moody's/Fitch	Principal Amount	Maturity	Dollar Price	Coupon	Yield	Spread (2)	Benchmark Treasury
Series B	9/30/81	AA/N.R./N.R.	\$ 75,000,000	12/1/91	98.393	17.500	17.850	203.0	14 7/8s due '91 (15.82%)
Series C	9/30/81	AA/N.R./N.R.	\$ 75,000,000	12/1/01	98.703	18.500	18.750	316.0	13 3/8s due '81 (15.59%)
Series D	10/27/81	AA/N.R./AA	\$ 90,000,000	12/1/91	98.815	17.750	18.000	243.0	14 7/8s due '91 (15.547%)
Series E	10/27/81	AA/N.R./AA	\$ 60,000,000	12/1/01	97.000	18.375	18.950	245.0	15 3/4s due '01 (15.504%)
Series F	5/26/82	AA/N.R./AA	\$225,000,000	6/1/92	99.250	15.250	15.400	179.0	13 3/4s due '92 (13.61%)
Series G	8/3/82	AA/Aa/AA	\$100,000,000	6/1/92	99.250	15.000	15.162	169.6	13 3/4s due '92 (13.466%)
Series H	11/17/82	AA/Aa/AA	\$ 50,000,000	12/1/92	98.400	11.750	12.030	147.8	10 1/2s due '92 (10.55%)
Series I	1/19/83	AA/Aa/AA	\$ 50,000,000	6/1/93	99.750	11.500	11.536	113.6	10 1/2s due '92 (10.412%)
Series J	3/9/83	AA/Aa/N.R.	\$ 50,000,000	6/1/93	100.000	11.375	11.375	87.3	10 7/8s due '93 (10.502%)

(1) Does not include \$27,000,000 Private Placement.

(2) Difference between coupon and treasury bonds.

Source : Salomon Brothers

Technical Appendix
A Statistical Analysis of Interest Costs
On State General Obligation Bonds

The purpose of this study is to determine how investors perceive State of Alaska issues relative to other states' general obligation bonds. The method of analysis is to first determine what factors are significant in explaining the variations in Net Interest Costs (NICs) for a sample of 254 state general obligation bonds sold between 1970 and 1982. These estimates will be obtained by using the statistical technique of ordinary least squares regression. The estimates of how each factor affects NIC will then be used to predict the interest costs on State of Alaska general obligation bonds. If investors perceive State of Alaska issues as comparable to other states' issues, then the actual and predicted interest costs will be the same. On the other hand, if investors consider State of Alaska issues to be more desirable, then the actual NICs will be less than the predicted NICs.

The sample of bonds used to estimate the influence of the explanatory variable on NIC consists of 254 general obligation bonds sold by states other than Alaska between 1970 and 1982. The sample is restricted to those issues having an average maturity of 10 years or less; this selection criterion was used because of the relatively short average maturity of State of Alaska issues.

Table 4.12 presents summary statistics for the sample. Borrowing costs, as measured by NIC, range from 2.979% to 11.794% and averaged 5.894%. The mean average maturity was 8.2 years with a range from 2 to 10 years. The average issue size was \$50.018 million with a range from \$370,000 to \$450 million. Over 80% of the bonds were rated Aaa or Aa and virtually all were sold by competitive bid.

The distribution of bonds by Moody's rating and issue size is presented in Table 4.13. There appears to be some relationship between size and rating. Over one-half of the issues above \$50 million were rated Aaa while only 7 percent of the issues under \$10 million were rated Aaa.

The following explanatory variables have been included in the regression equation:

1. Issue Size (\$ thousands) in logarithm. Size is specified in logarithmic form to reflect the diminishing impact that increases in size have on NIC.
2. Average Maturity (years).
3. Negotiated Dummy Variable (equal to 1 if the issue was sold through negotiation). This variable measures the difference in NIC, if any, due to method of sale. The variable coefficient reflects the differences in NIC on negotiated issues relative to competitive issues.
4. Bond Buyer Index of 11 bonds. This index is a measure of average 20-year reoffer yields for the week of each issue. The index variable is designed to control for the effects of variations over time in the overall levels of interest rates.
5. Moody's Bond Rating in Dummy Variable Form:
 - Aa = 1 if the issue is rated Aa, 0 otherwise;
 - A-1 = 1 if the issue is rated A-1, 0 otherwise;
 - A = 1 if the issue is rated A, 0 otherwise.

Table 4.12
Summary Statistics For 254 State
General Obligation Bonds

	<u>Mean</u>	<u>Minimum</u>	<u>Maximum</u>	<u>Standard Deviation</u>
Net Interest Cost (%)	5.894	2.979	11.794	1.937
Average Maturity (years)	8.193	2.000	10.000	2.201
Size (\$ millions)	50.018	0.370	450.000	50.015
Negotiated	0.1%			
Competitive	99.9%			
Moody's Rating (%)				
Aaa	39.4%			
Aa	45.7%			
A-1	7.9%			
A	7.0%			

These variables are specified to capture the effects of differences in Moody's ratings on NIC. Moody's ratings are used as surrogate measures of credit risk. The omitted class is bonds rated Aaa. Therefore, the coefficients on these variables represent the average differences in borrowing costs for bonds of a given rating relative to Aaa rated bonds.

The regression results are presented in Table 4.14. The explanatory variable coefficients have the expected sign and most are statistically different from zero. A t-value greater than two indicates that a coefficient is statistically significant at the 5% level. The regression equation explains approximately 95% of the inter-issue variation in NIC.

The coefficients indicate that extending the maturity of issues by 1 year increases borrowing costs by 11.3 basis points. The rating variable coefficients reflect the difference in NIC between Aaa rated bonds and the indicated rating. For the sample of state GO bonds, Aa rated bonds had NICs that were 32.1 basis points higher, on average, than Aaa rated bonds. The differential was 70.7 basis points and 114.6 basis points for A-1 and A rated bonds, respectively.

The Bond Buyer Index coefficient indicates that for a 100 basis point increase in the index, NIC increases, on average, 85.5 basis points. The issue size variable coefficient indicates that larger issues have higher borrowing costs, but the effect on NIC diminishes as issue size is increased. For instance, increasing size from \$5 to \$10 million increases NIC by 4.8 basis points, while the impact on NIC is only 0.4 basis points for an increase from \$95 to \$100 million. The method of sale variable coefficient was not statistically significant.

These estimates of the influence each factor has on NIC can be used to predict the borrowing cost on State of Alaska issues. This calculation is illustrated below for the State GO issue sold February 17, 1976:

Variable	Coefficient	Issue Feature	Product
Average Maturity	0.1128	10	1.1280
Issue Size	0.0695	10.597*	.7365
Aa	0.3208	0	0
A-1	0.7066	1	.7066
A	1.1459	0	0
Bond Buyer 11	0.8552	6.43	5.4989
Negotiated	-0.1161	0	0
Constant Term	-1.7778	1	-1.7778
Predicted NIC			<u>6.2922</u>

* Natural logarithm of \$40,000 is 10.597

Table 4.15 shows predicted NIC values for all State of Alaska general obligation issues that were rated A-1 or better and had an average maturity of 10 years or less. Exhibit 4 also shows the actual NIC for each issue and the difference between the actual and predicted NIC; this difference is referred to as the residual.

A positive residual indicates that the actual borrowing cost paid by the State of Alaska was greater than comparable issues sold by other states. A negative residual indicates that the State of Alaska paid less than comparable issues. The data in Table 4.15 indicate that

Table 4.13
Distribution of Bonds by Moody's Rating
and Issue Size

<u>Issue Size</u> <u>(\$ million)</u>	<u>Aaa</u>	<u>Aa</u>	<u>A-1</u>	<u>A</u>	<u>Total</u>
2.5 or less	2	15	3	1	21
2.5 - 5.0	1	12	5	2	20
5.0 - 10.0	4	14	1	2	21
10.0 - 25.0	9	30	0	4	43
25.0 - 50.0	25	18	6	2	51
50.0 - 100.0	43	19	2	6	70
More than 100.0	16	8	3	1	28
TOTAL	100	116	20	18	254

Table 4.14
Summary of Regression Results
for 254 State GO Bonds

NIC Dependent Variable

<u>Explanatory Variable</u>	<u>Regression Coefficient</u>	<u>t-value</u>
Average Maturity	0.1128	7.62
Issue Size (ln)	0.0695	2.63
Moody's Rating		
Aa	0.3208	4.72
A-1	0.7066	6.15
A	1.1459	9.62
Bond Buyer 11 Index	0.8552	60.57
Negotiated	-0.1161	0.25
Constant Term	-1.7778	
R^2	.945	
SEE	.455	

Alaska has consistently experienced lower borrowing costs than other states with the same rating. Between 1976 and 1979, when State of Alaska general obligation bonds were rated A-1, the average interest cost advantage averaged 20 basis points and exceeded 40 basis points on several occasions.

The borrowing cost advantage enjoyed by the State of Alaska increased somewhat after 1980 when the State's GO bonds were upgraded to Aa by Moodys. After controlling the effects of issue size, average maturity, method of sale, and the general level of interest rates, the State of Alaska paid average interest costs that were 31 to 646 basis points lower than the costs on other Aa rated state GOs.

In summary, the results of the regression analysis indicate that investors perceive State of Alaska issues more favorably than general obligation bonds sold by other states. This result holds even after differences in issue and issuer characteristics and market conditions are held constant.

Table 4.15
Comparison of Predicted Borrowing Costs with Actual
Borrowing Costs for State of Alaska Issues

<u>Date of Sale</u>	<u>Actual NIC</u>	<u>Predicted NIC</u>	<u>Residuals</u>
2-17-76	5.867	6.292	-.425
6-29-76	5.804	6.241	-.437
9-27-77	4.510	4.944	-.434
3-28-78	4.866	5.002	-.136
12-12-78	5.525	5.420	.105
4-10-79	5.592	5.493	.099
6-24-80	5.767	6.347	-.580
3-10-82	9.985	10.621	-.636
10-20-82	7.728 .	8.042	-.314

CHAPTER V

ANALYSIS OF THE MARKET PERFORMANCE AND MANAGEMENT OF LOCAL GOVERNMENT DEBT

Profile of Local Borrowing

Local governmental units in Alaska have been active issuers of debt. Alaskan localities had approximately \$1.3 billion in general obligation debt outstanding at the end of June 1982, for a Statewide average of \$4,648 per capita. This level contrasts with the State's own general obligation indebtedness at the end of fiscal year 1982 of \$842 million. In addition to general obligation debt that is supported by local taxes, cities and boroughs also issue debt that is supported by the revenues generated by the project financed through the issuance of debt. At the end of June 1981 (the latest fiscal year for which data are available), approximately \$347.4 million in revenue bonds was outstanding (see Table 5.1). The general obligation and revenue bonds of local governments comprise approximately 43 percent of the total amount of public debt outstanding in the State.

Revenue-supported debt is not appropriate to finance all local governmental capital investment. The construction of schools, roads, and most public buildings generally must be financed through general obligation bonds if debt is raised to finance these capital improvements. Water and sewer systems, waste treatment facilities, municipal utilities and other services for which a user charge can be levied may be financed through the use of revenue bonds. If operation of the project is expected to generate sufficient revenues to provide adequate "coverage" of debt service (excess of net revenues over debt service usually by 1.25 times), revenue bonds are a possibility for the financing instrument.

Revenue bonds account for approximately 25 percent of all local debt outstanding in Alaska, compared with the national average of 54 percent. This comparison indicates that Alaska's municipalities rely on general obligation borrowing at twice the national rate. This is to be expected because of the lack of a concentration of population and resources and the resulting greater efficiency of taxation as a revenue source. The amounts of general obligation and revenue-supported debt outstanding in each city and borough in the State are presented in Table 5.2. The majority of communities that have issued debt have a mix of revenue and general obligation bonds outstanding. The most notable exceptions are the North Slope Borough, Kenai Peninsula Borough, and Matanuska-Susitna Borough, none of which have revenue bonds outstanding. Not surprisingly, these three communities also have ratios of general obligation debt to assessed property value among the highest in the State (see Table 5.3). Table 5.3 also presents the debt per capita ratios for local governments in the State, and the national medians as computed by Moody's Investors Service. Because of the relatively sparse population in the State, these ratios are above the national median in the majority of Alaskan localities.

Table 5.1
Estimated Alaska Municipal Debt
(Millions)

<u>Fiscal Year</u>	<u>Amount of Revenue and G.O. Debt Issued</u>	<u>Amount Outstanding</u>		<u>Revenue Debt Outstanding as % of Total</u>
		<u>G.O.</u>	<u>Rev.</u>	
1971	78.7	\$ 30.9	\$ 56.3	19.6%
1972	88.9	279.2	81.0	22.5
1973	46.8	319.9	70.3	18.0
1974	85.3	345.1	77.6	16.4
1975	120.2	415.8	94.8	18.6
1976	70.1	452.5	99.4	18.0
1977	220.8	514.1	215.7	29.6
1978	178.2	449.5	277.7	38.2
1979	320.9	731.6	286.3	28.1
1980	250.0	809.4	316.0	28.1
1981	277.7	1,030.2	347.4	25.2
1982	515.0	1,316.2	N/A	N/A

Source: U.S. Department of Commerce, Bureau of the Census, Governmental Finances, various years, and Moody's Investors Service, Inc. Municipal Bond Record, 1983.

Table 5.2
State of Alaska
Local Government Debt

City/Borough	General Obligation Debt Outstanding 7-1-82 ¹	Revenue- Supported Debt Outstanding ² 12-31-81	Moody's Rating ³
North Slope	\$587,400,000	-0-	A
Anchorage	261,010,000	\$236,660,000	A1/Baa
Kenai Peninsula	98,999,603	-0-	A
Valdez	84,460,000	9,200,000	A
Fairbanks North Star	83,158,350	35,000,000	A/Aa
Matanuska-Susitna	65,218,090	-0-	A
Juneau	27,904,000	146,000	Baal
Kodiak Island	20,042,372	-0-	Baal
Sitka	17,486,200	5,168,000	Baal
Ketchikan Gateway	14,495,000	-0-	Baal
Fairbanks	11,915,000	36,400,000	A
Ketchikan City	8,110,000	12,567,000	Baal/Baa
Bristol Bay	3,895,000	-0-	NR
Kenai	3,695,000	280,000	NR
Palmer City	3,629,401	-0-	NR
Unalaska	3,500,000	456,000	NR
Kodiak City	3,250,000	4,295,000	Baa
Petersburg	2,995,000	2,526,000	Baal
Homer City	2,877,000	1,096,000	Baa
Nenana	2,725,000	-0-	NR
Wrangell	2,578,000	612,000	NR
Skagway	1,826,325	-0-	NR
Cordova	1,673,200	1,611,000	NR
Haines	923,310	-0-	NR
Haines City	805,000	-0-	NR
Bethel	585,000	-0-	NR
Nome	507,872	960,000	NR
Seldovia	430,000	55,000	NR
Dillingham	73,000	231,000	NR
Craig	37,498	93,000	NR
Totals	\$1,316,294,221	\$347,356,000	

NOTES: 1. From Department of Community and Regional Affairs, Alaska Taxable 1982.

2. From Moody's Investors Service, Moody's Municipal and Government Manual 1983, and Department of Community and Regional Affairs.

3. When two ratings are given, the first applies to general obligation debt, and the second to the majority of revenue bonds.

NR = Not Rated.

Table 5.3
Municipal Debt Ratios

<u>City/Borough(population)</u>	<u>G.O. Debt Per Capita</u>	<u>Debt as % of Assessed Value</u>
North Slope *	\$77,781	7.10%
Anchorage *****	1,278	2.46
Kenai Peninsula ***	3,064	4.45
Valdez *	22,864	4.97
Fairbanks North Star ****	1,146	2.78
Matanuska-Susitna ***	2,508	5.42
Juneau **	1,267	2.69
Kodiak Island **	1,576	4.58
Sitka *	2,127	4.15
Ketchikan Gateway **	1,166	2.17
Fairbanks ***	463	1.12
Ketchikan City *	1,043	2.58
Bristol Bay *	3,064	4.45
Kenai *	706	1.80
Palmer City	1,438	3.93
Unalaska *	1,821	4.76
Kodiak City *	553	1.00
Petersburg *	985	2.32
Homer City *	993	1.85
Nenana *	5,046	30.39
Wrangell *	1,085	2.94
Skagway *	2,312	3.21
Cordova *	747	1.44
Haines *	499	1.30
Haines City *	746	0.23
Bethel *	159	0.41
Nome *	148	0.32
Seldovia *	590	2.26
Dillingham *	40	0.11
Craig *	62	0.17
Statewide Average	\$ 4,648	3.75%

Moody's Local Debt Medians
Population

*****	200-300,000	361	2.1%
****	50-100,000	391	1.8
***	25-50,000	289	1.9
**	10-25,000	422	2.7
*	Under 10,000	600	3.2

Source: Department of Community and Regional Affairs,
Alaska Taxable, Fiscal year 1982.

A major use for local general obligation debt has been to finance school construction. As of April 1, 1983, school districts in the State had approximately \$644 million in school construction debt outstanding (see Table 5.4). Under existing programs this debt will be retired, in part, through State aid. Thus, school construction debt comprises approximately 49 percent of all local general obligation debt. Because there are no State restrictions on how school debt must be issued, localities may issue bonds on their own or may make use of the Municipal Bond Bank. Table 5.4 indicates that approximately \$76 million or 12 percent of outstanding school debt has been issued through the Bond Bank.

The State of Alaska's education assistance program to local governments, in part, reimburses boroughs and cities for cash expenditures on school construction and debt service on bonds issued to finance school construction. Under a program created by the State legislature in 1970, and contained in provisions of Alaska Statutes 43.18.100, the State allocates the following amounts to municipalities which are also school districts, subject to annual appropriation by the legislature:

100 percent of payments made in the fiscal year two years prior for debt service on bonds issued prior to July 1, 1977 for school construction;

90 percent of payments made in the fiscal year two years prior for debt service on bonds issued after June 30, 1977 and cash payments for school construction; and

90 percent of payments made in the current fiscal year for debt service on bonds issued after December 31, 1981.

Legislation enacted in 1982 (HB279) raised the State share of construction expenditures from its earlier level of 80 percent to the 90 percent figure. This legislation also eliminated the two-year lag between local payment of school construction costs and receipt of State aid on bonds issued after December 31, 1981.

To qualify for State reimbursement of debt service expenditures, school construction projects must be approved by the State's Department of Education prior to construction. The local school district must submit the school design, schematics, and contract documents for approval. Approval is given once the two parties agree on design, school enrollment, and distribution of space in the school to various required uses. Neither the cost of the project, nor the intended means of financing, are significant factors considered during the approval process.

Once approval is received, the locality may begin construction; using any mix of current revenues or borrowed funds to finance the project. There are no State restrictions on the sources of financing, in spite of the fact that nearly

Table 5.4
State of Alaska
School Debt Outstanding
(as of April 1, 1983)

<u>School District</u>	<u>Amount</u>	<u>Moody's Rating</u>
A) Public Offerings ¹		
North Slope Borough	\$197,235,000	A
Greater Anchorage Area Borough	138,665,000	A1
Fairbanks North Star Borough	101,475,000	A
Kenai Peninsula Borough	56,938,000	A
Matanuska-Susitna Borough	37,995,000	A
Valdez	27,685,000	A
City and Borough of Juneau	3,325,000	Baal
Petersburg	2,995,000	Baal
Greater Sitka Borough	1,560,000	Baal
Kodiak Island Borough	375,000	Baal
Ketchikan Gateway Borough	<u>345,000</u>	Baal
	\$568,593,000	
B) School Bonds Issued Through Bond Bank ²		
City and Borough of Juneau	\$ 35,205,000	Baal
Matanuska-Susitna Borough	22,610,000	A
Kodiak Island Borough	11,810,000	Baal
Bristol Bay Borough	3,785,000	Unrated
City of Wrangell	1,405,000	Unrated
City of Unalaska	<u>975,000</u>	Unrated
	\$ 75,790,000	
Total School Debt Outstanding \$644,383,000		

NOTES: 1) Data through fiscal year 1981 from Moody's Municipal and Government Manual 1983, Moody's Investors Service. Fiscal Year 1981 to date from Public Securities Association data base.

2) Data from Mary J. Hughes, Foster & Marshall/American Express, Inc., Seattle, WA.

90 percent of the cost will be borne by the State. To be reimbursed for debt service and current construction expenditures, the school district must file an annual report with the State Commissioner of Education, certifying the amounts which are eligible for reimbursement in the current year.

Although the statute provides that the State will reimburse school districts for 90 to 100 percent of construction costs, the actual funding for the program is dependent on annual legislative appropriations to the school construction account. Historically, appropriations have not been sufficient to fund the level of payments authorized by statute fully. When amounts in the account are insufficient, the available funds are allocated pro rata among the eligible school districts. Over the fiscal years 1981 to 1984 the program has been or will be funded at the following percent of entitlement due:

<u>Fiscal Year</u>	<u>Amount of Payments</u>	<u>Percent of Entitlement</u>
1981	\$38,380,174	100%
1982	38,262,156	100
1983	36,203,300	79
1984	85,373,459	63

The declining percentage of entitlement paid to school districts since 1982 indicates that the legislature is unwilling to appropriate full funding to this program. Unwillingness to fund this program at statutorily authorized levels could cause concern among investors and credit analysts over the State's willingness to fund other indirect or moral obligations. Eventually this might lead to an erosion of State and local credit quality.

Other concerns that have been raised over the reimbursement program were addressed by emergency regulations promulgated by the State board of Education early in 1983. As a result of the Board's actions, localities must issue debt with a maximum maturity not less than 10 years, cannot refinance outstanding debt if the necessary annual debt service on the refinancing bonds would be greater than on existing bonds, and cannot incur school debt through loans from the general fund. These regulations were necessary to prevent school districts from shortening the maturities on their debt, thereby freeing up local debt capacity, but increasing the burden for State reimbursement.

Local Government Bond Sales and Market Performance

Alaska's local government bond issues are viewed by market participants as attracting an investor of different characteristics from those investing in the State's general obligation bonds. For the most part, interviews with bond analysts have suggested that the market outlet for Alaska's local government debt is the retail market, comprised largely of mutual funds, unit investment trusts, and individual investors. Investors in the State's obligations, on the other hand, include primarily institutional investors such as commercial banks, insurance companies, and other corporations. In part, this market segmentation

Table 5.5
Comparison of State of Alaska and
Local Issues General Obligation Bonds

<u>Issuer</u>	<u>Date Of Sale</u>	<u>Bids</u>	<u>Size (000)</u>	<u>NTC</u>	<u>Spread</u>	<u>Average Maturity</u>	<u>RY 5</u>	<u>RY 10</u>	<u>Moody's Rating</u>
State of Alaska	3-4-70	7	\$11,501	5.4902	\$ 9.90	6	5.10	5.50	Baa-1
Greater Anchorage Borough	3-16-70	3	7,000	6.965	19.00	18	5.60	6.10	Baa
State of Alaska	6-9-71	5	23,830	6.036	13.46	18	4.40	5.25	Baa-1
Greater Anchorage Borough	6-21-71	2	2,550	5.986	16.20	6	5.25	6.20	Baa
State of Alaska	2-8-72	5	23,445	5.239	9.00	15	3.75	4.60	Baa-1
Anchorage	2-22-72	6	4,870	5.460	14.38	10	4.00	5.10	Baa
State of Alaska	5-17-72	6	30,000	5.155	10.41	15	4.00	4.60	Baa-1
Juneau	5-23-72	5	2,500	5.915	15.71	13	4.70	5.40	Baa
State of Alaska	5-15-73	6	27,000	5.106	8.00	15	—	4.60	Baa-1
Mantanuska Borough	5-23-73	8	1,500	5.142	11.24	7	4.75	5.10	Baa
State of Alaska	8-14-73	6	31,000	5.805	16.00	17	5.25	5.40	Baa-1
Juneau	8-14-73	5	2,780	6.218	17.00	13	5.70	5.80	Baa
State of Alaska	1-28-75	4	40,300	5.989	12.75	15	4.55	5.20	A-1
Anchorage	1-28-75	7	5,570	6.127	22.50	11	4.95	5.60	A
State of Alaska	2-17-76	4	40,000	5.867	8.32	10	4.80	5.70	A-1
North Slope Borough	2-10-76	2	8,000	6.916	23.25	7	5.75	6.75	A
State of Alaska	12-12-78	5	40,000	5.525	6.75	5	5.35	5.50	A-1
Anchorage	12-12-78	5	17,625	6.316	15.00	12	5.50	5.75	A
State of Alaska	3-10-82	2	200,000	9.985	10.00	6	9.50	—	AA
Anchorage	3-2-82	4	8,500	12.428	22.00	11	10.00	11.50	A

is based on structural differences between local bonds and the State's obligations; local bonds are issued in lesser amounts, longer in average maturity, and lower in credit rating. These differences, and the attendant market distinctions, are captured in Table 5.5, which presents paired comparisons of State and local issues sold at approximately similar dates since 1970.

Table 5.6 presents summary statistics on the methods of sale, the average number of bids received on competitive issues, and the average underwriting spreads on local issues. By comparison with Table 5.5, and the statistics in Section Four on State general obligation issues, these data indicate that local bonds which are sold competitively attract more bids on average than State issues. This is to be expected since the local issues are smaller in size. In addition, many local issues are sold through negotiation, making the competitive issues more attractive and aggressively sought. The most significant comparison of local and State bond issuance, however, is the markedly higher underwriting cost on local issues. In 1982, the average gross underwriting spread on all local bonds was in excess of \$21 per \$1,000 par value, more than double the underwriting spread on State general obligation issues.

Table 5.7 presents a detailed market analysis of reoffering yields on selected local government bonds sold since 1978. As described in Section Four, reoffering yield is a measure of the return that investors require in order to purchase the bonds. While the reoffering yields are not the coupon interest rate on the bonds, high reoffering yields generally mean that the interest paid by the issuer (coupon rate) on the bonds are also high. Therefore, comparisons of reoffering yields give a reasonable indication of interest cost and market reception of a government's bonds.

Comparing local government issues with issues from other states is impractical and subject to more than the usual ambiguities mentioned in Section Four. The vast number of local issues from other states, and the vastly different local market conditions hinder the selection of matched pairs. As an alternative, the analysis in Table 5.7 compares reoffering yields on Alaska local issues with the monthly average reoffering yield of all bonds with similar ratings and security features. (e.g., general obligation bonds are not matched with revenue bonds).

The results of these comparisons indicate that local government bonds from Alaska carry yields at all maturities significantly above the average for the overall market. On 5-year maturities, the average yield differential is 39 basis points; 35 basis points on 10-year maturities; and 34 basis points on 15-year maturities. These higher interest rates translate to an additional cost to Alaskan municipalities of approximately \$135,000 over the life of a 15-year, \$5 million bond, than would be paid by the average similarly rated locality in the "lower 48".

Perhaps in recognition of the relatively poor market reception accorded local bond issues, a growing number of issuers and their underwriters have opted to purchase municipal bond insurance from private bond insurers. To qualify for insurance, an issuer must be investment-grade rated, apart from credit

Table 5.6
Selected Summary Statistics On
Local Government Bond Sales In Alaska

	<u>1982</u>	<u>1981</u>	<u>1980</u>	<u>1979</u>	<u>1978</u>
Local Government General Obligation Bonds:					
Number of Issues:					
Negotiated	3	3	3	1	--
Competitive	10	0	2	3	7
Average Number of Bids (Competitive)	3.6	--	4.5	4.6	4.3
Average Underwriter Spread:					
Negotiated	\$23.35	\$26.64	\$14.50	\$16.00	--
Competitive	\$22.11	--	NA	\$15.50	\$11.83
Local Government Revenue Bonds:					
Number:					
Negotiated Issues	3	1	1	3	1
Competitive Issues	3	3	--	2	3
Average Number OF Bids (Competitive)	3.0	3.6	--	4.5	2.7
Average Underwriter Spread:					
Negotiated	\$24.27	\$14.83	\$15.00	\$14.18	\$14.90
Competitive	\$16.00	\$19.53	--	\$22.88	\$11.52

Table 5.7

Analysis of Reoffer Yields on Alaska
Local Government Issues
1978 - 1982

Date of Issue	Issuer	Rating	Type of Issue	RT5/Average*	Difference	RT10/Average*	Difference	RT15/Average*	Difference
1-17-78	Kenai Peninsula Borough	A/A	GO	4.80/4.48	+ .32	5.30/4.95	+ .35	5.70/5.34	+ .36
1-24-78	Anchorage	NR/BBB	Revenue	5.20/4.68	+ .52	5.65/5.27	+ .38	5.90/5.72	+ .18
4-4-78	Matanuska-Susitna	A/NR	GO	4.85/4.58	+ .27	5.35/4.99	+ .36	5.75/5.33	+ .42
4-18-78	Anchorage	Baa-1/BBB+	Revenue	5.00/5.13	-.13	5.50/5.70	-.20	5.90/6.01	-.11
6-5-78	Fairbanks	A/BBB+	Revenue	5.50/5.26	+ .24	6.00/5.82	+ .18	6.40/6.17	+ .23
8-1-78	Anchorage	A/A	GO	5.30/5.05	+ .25	5.60/5.33	+ .27	6.10/5.69	+ .41
9-19-78	Anchorage	Baa-1/BBB+	Revenue	5.30/5.40	-.10	5.75/5.91	-.16	6.10/6.35	-.25
12-12-78	Anchorage	A/A	GO	5.50/5.49	-.01	5.75/5.70	+ .05	6.20/6.06	+ .14
1-9-79	Matanuska-Susitna	A/BBB+	GO	5.85/5.49	+ .36	6.10/5.65	+ .45	6.45/5.93	+ .52
4-20-79	North Slope Borough	A/A	GO	6.25/5.38	+ .87	7.20/5.58	+1.62	---	---
5-16-79	Valdez	A/A	GO	5.75/5.39	+ .36	6.00/5.55	+ .45	6.40/5.69	+ .71
5-8-79	Anchorage	A/A	GO	5.50/5.39	+ .11	5.90/5.55	+ .35	6.25/5.69	+ .56
6-14-79	Sitka	Baa/BBB	Revenue	6.20/5.51	+ .69	6.50/5.75	+ .75	7.00/6.02	+ .98
7-31-79	Anchorage	Baa-1/A	Revenue	5.70/5.43	+ .27	6.00/5.63	+ .37	6.25/5.94	+ .31
4-9-80	North Slope Borough	A-1/A	GO	10.00/7.45	+2.55	10.20/7.78	+2.42	---	---
5-13-80	Anchorage	Baa-1/A	Revenue	6.80/7.31	+1.49	7.25/8.04	-.79	7.70/8.20	-.50
6-26-80	Anchorage	A-1/A	GO	5.80/5.65	+ .15	6.55/6.29	+ .26	7.40/7.02	+ .38
9-19-80	North Slope Borough	A/A	GO	7.70/6.81	+ .89	8.90/7.01	+1.89	---	---
6-2-81	Anchorage	A-1/A	GO	8.80/8.73	+ .07	8.80/9.55	-.75	9.60/10.15	-.55
11-17-81	Anchorage	Baa-1/A	Revenue	10.00/10.21	-.21	11.25/11.56	-.29	---	---
1-26-82	Fairbanks	A/A+	GO	11.00/10.11	+ .89	---	---	---	---
2-2-82	North Slope Borough	A/A	GO	11.25/10.00	+1.25	13.00/11.17	+1.83	13.75/12.86	+ .89
4-6-82	Anchorage	A-1/A	GO	10.25/9.81	+ .44	11.80/11.10	+ .70	13.00/12.02	+ .98
4-30-82	Fairbanks	Aa/AA	Revenue	9.75/9.59	+ .16	11.50/11.28	+ .22	---	---
6-1-82	North Slope Borough	A/A	GO	10.75/9.99	+ .76	12.00/11.24	+ .76	---	---
10-12-82	Anchorage	Baa-1/A	Revenue	7.75/8.32	-.57	8.70/9.72	-1.02	---	---
10-15-82	Ketchikan	Baa/BBB+	Revenue	9.25/8.32	+ .93	10.20/9.72	+ .48	10.90/10.18	+ .72
11-16-82	Anchorage	A/A	Revenue	8.50/8.25	+ .25	9.70/9.50	+ .20	---	---
12-2-82	Anchorage	A-1/A	GO	8.00/7.72	+ .28	9.25/9.00	+ .25	---	---
12-14-82	North Slope Borough	A/A	GO	8.00/7.72	+ .28	9.25/9.00	+ .25	---	---
Average Yield Differential				0.39%		0.35%		0.34%	

* The Average Reoffer Yields are the average reoffer yields on all like-rated GO or revenue bonds sold during the month of the Alaska issue as reported by the Public Securities Association.

enhancements or external supports (such as a bank letter of credit). Prior to marketing the bonds, an issuer secures an insurance policy commitment from either the American Municipal Bond Assurance Corporation (AMBAC) or Municipal Bond Insurance Association (MBIA), the two leading municipal bond insurers. Bond insurance guarantees investors timely payment of principal and interest on the bonds, and results in a AAA rating on the bonds by Standard & Poor's Corporation. Moody's Investors Service does not recognize the insurance feature in its rating. The issuer pays a one-time premium for the insurance policy, based upon the appraised credit risk and the aggregate liability for principal and interest that is covered by the policy. As a rule of thumb, an issuer can expect to pay between 0.5 and 1.5 percent of aggregate principal and interest due on the bonds for insurance. In return, of course, it is hoped that interest savings on the higher rated bonds will be greater than the insurance premium.

Table 5.8 presents an analysis of reoffering yields on insured local bonds since 1978, comparing these yields with monthly average yields on AAA rated bonds and on bonds with ratings similar to the issuer's uninsured rating. The data in Table 5.8 raise important questions concerning the practice of purchasing bond insurance by Alaska's localities. Yields on Alaska insured bonds generally are much higher than yields on other AAA rated bonds. For 5-year maturities, Alaska insured bonds carried yields that were 85.6 basis points higher on average than AAA rated bonds; for 10-year maturities, Alaska bond yields were 86.9 basis points higher.

Compared with uninsured bonds with similar ratings, Alaska insured bonds carried measurably higher yields. On 5-year maturities, Alaska bond yields were 25.9 basis points higher; on 10-year bonds, the differential was 5.6 basis points higher on average. This indicates that even with bond insurance, yields on Alaska's insured bonds were higher than the average yield for similarly rated bonds without insurance.

Combined with the comparisons derived in Table 5.7, the value of bond insurance appears to be approximately 13.1 basis points on 5-year maturities and 29.4 basis points on 10-year maturities. Although these estimates of yield savings from bond insurance are only approximate, they do suggest that the price Alaska's municipalities are paying for bond insurance may not be worth the slight savings in interest cost they are receiving. These preliminary findings suggest the need for a more thorough analysis that is beyond the scope of this study. Such an analysis should compare the present value of the annual savings in interest cost on insured bonds with the cost of the insurance premium.

A further observation based on Tables 5.6 and 5.7 is that while reoffering yields on the debt of Alaska's localities are higher, on average, than the national average, yields on the North Slope Borough's debt are vastly higher. Until February 1982, the 10-year reoffering yields on North Slope Borough debt were consistently at least 100 basis points (one percent) higher than the monthly average on similarly rated municipal bonds. On an April 1980 bond sale this difference rose to nearly 250 basis points (2.5 percent). Such a large discrepancy in reoffering yields indicates that investors required a higher than

Date	Issuer	Ratings (1)	Method Of Sale (2)	Type Issue (3)	* 5-Year Reoffer Yield/Average (4)	Basis Points Difference	* 10-Year Reoffer Yield/Average (4)	Basis Points Difference
2-16-82	Valdez	Aaa**/A	C	GO	10.50/9.20 10.50/10.00	+120 +50	12.00/10.50 12.00/11.17	+150 +83
3-2-82	Anchorage	Aaa**/A	C	R	10.00/9.57 10.00/10.08	+43 -8	11.50/11.28 11.50/11.84	+22 -34
4-6-82	Anchorage	Aaa**/A	C	R	10.40/8.87 10.40/10.06	+153 +34	11.40/9.87 11.40/11.54	+153 -6
4-26-82	Kenai Peninsula	Aaa**/A	N	GO	11.00/9.18 11.00/9.81	+182 +119	----- -----	----- -----
6-15-82	Anchorage	Aaa**/A	C	GO	10.50/9.50 10.50/9.99	+100 +51	12.25/10.73 12.25/11.24	+152 +101
6-1-82	Kenai Peninsula	Aaa**/A	N	R	10.20/9.67 10.20/10.08	+53 +12	----- -----	----- -----
6-29-82	Anchorage	Aaa**/Baa	C	R	11.00/9.67 11.00/10.74	+133 +26	12.15/10.88 12.15/12.25	+127 -10
7-22-82	Fairbanks-North Star	Aaa**/A	C	GO	9.75/9.26 9.75/9.82	+48 -7	11.00/10.30 11.00/11.01	+130 -1
9-29-82	Anchorage	Aaa**/A-1	N	GO	8.40/7.76 8.40/8.31	+64 +9	9.60/8.95 9.60/9.48	+65 +12
1-27-82	Anchorage	Aaa**/A	C	R	8.20/7.25 8.20/8.09	+95 +11	9.00/8.12 9.00/9.56	+88 -56
2-25-81	North Slope Borough	Aaa**/A	N	GO	9.10/7.66 9.10/8.42	+144 +68	9.70/8.12 9.70/9.41	+158 +29
6-3-81	North Slope Borough	Aaa**/A	N	GO	9.60/8.35 9.60/8.98	+125 +62	10.10/9.15 10.10/10.01	+95 +9
10-20-81	Anchorage	Aaa**/A	C	R	10.50/10.62 10.50/10.65	-12 -15	11.75/11.70 11.75/11.95	+5 -20
2-4-80	Valdez	Aaa**/A	C	GO	6.65/6.70 6.65/6.96	-5 -31	6.90/6.96 6.90/7.26	-6 -36
9-11-79	Anchorage	Aaa**/A	C	R	5.80/5.40 5.80/5.72	+40 +8	6.00/5.46 6.00/5.92	+54 +8
3-14-78	Anchorage	Aaa**/A	C	GO	----- -----	-- --	4.85/4.61 4.85/4.85	+24 0

Table 5.8
Analysis of Reoffer Yields on Insured
Alaska Local Government Bond Issues

- NOTES: (1) The first rating is the insured rating by Standard & Poor's Corporation
 **Indicates MBIA Insurance
 *Indicates AMBAC Insurance
 The second rating is the Moody's rating on the bond issue
- (2) C = competitive bid
 N = negotiated
- (3) GO = general obligation
 R = revenue bond
- (4) The first yield is the yield on the Alaska bond; the second yield is the monthly average yield on like-rated bonds. The upper pair uses monthly average Aaa-rated yields. The lower pair uses the monthly average yield on uninsured bonds with the same rating as the Moody's rating on insured Alaska bonds.

Table 5.9
Summary Statistics on Selected
State Municipal Bond Bank New Issues, 1978-82

Date	Issuer	Size (Millions)	Average Maturity (Years)	Method of Sale (1)	Rating (2)	Number of Bids	5-Year Roofer Yield/Average (3)	Difference in Basis Points	10-Year Roofer Yield/Average (3)	Difference in Basis Points
2-3-82	Alaska	10.8	7	C	A/A	3	11.25/10.00	+125	13.00/11.17	+183
2-3-82	Alaska	15.6	14	C	A/A	3	12.00/10.00	+200	13.20/11.17	+203
3-10-82	New Hampshire	9.7	7	C	Aa/Na	2	9.75/9.35	+40	10.70/10.69	+1
3-10-82	New Hampshire	10.4	7	C	A/A	2	10.00/9.83	+17	11.40/11.21	+19
4-28-82	Maine	2.1	5	C	Aa/Na	5	9.50/9.65	-15	10.60/10.98	-38
4-27-82	Alaska	4.4	—	N	BB/Na*	—	10.25/9.81	+44	11.20/11.10	+10
7-9-82	Vermont	9.6	—	N	A/A	—	10.50/9.82	+68	12.50/11.01	+149
9-29-82	Maine	8.4	12	C	Aa/Na	5	8.25/7.95	+30	9.30/9.08	+22
10-13-82	New Hampshire	6.5	8	C	A/A	3	7.25/7.60	-35	8.40/8.75	-35
6-5-81	Maine	13.6	12	C	Aa/Na	4	8.50/8.55	-5	9.50/9.35	+15
10-7-81	Maine	13.8	11	C	Aa/Na	5	10.70/9.84	+86	11.75/11.06	+69
5-28-80	Maine	10.1	11	C	Aa/Na	4	5.70/5.66	+6	6.20/6.08	+12
7-22-80	Alaska	16.2	14	N	A/A	—	6.20/5.86	+34	7.25/6.62	+63
7-18-80	New Hampshire	7.6	—	N	A-1/A+	—	6.00/5.86	+14	7.00/6.62	+38
10-22-80	Maine	8.1	10	C	Aa/Na	3	7.25/6.65	+60	8.25/7.33	+92
5-1-79	Alaska	5.3	12	C	A/A	7	5.75/5.39	+36	6.00/5.55	+45
7-19-79	New Hampshire	3.6	—	N	A-1/Na	—	5.40/5.13	+27	5.75/5.30	+45
9-19-79	Alaska	3.2	13	C	A/A	3*	5.95/5.64	+31	6.20/5.79	+41
9-26-79	Maine	19.9	11	C	Aa/Na	4	5.70/5.55	+25	5.85/5.66	+19
6-1-78	Maine	3.9	13	C	Aa/Na	7	4.90/4.82	+8	5.40/5.16	+24
6-7-78	Alaska	5.5	12	C	A/A	4	—	—	5.60/5.39	+21
11-30-78	Maine	9.9	12	C	Aa/Na	6	5.30/5.12	+18	5.50/5.24	+26
12-11-78	Alaska	1.6	14	C	A/A	3	5.70/5.49	+21	6.00/5.70	+30
12-4-78	New Hampshire	9.0	—	N	A-1/Na	—	5.40/5.30	+10	5.55/5.48	+7

* Means an insured bond.

Notes: (1) C= Competitive
N= Negotiated

(2) The first rating is the Moody's Rating; the second rating is the Standard & Poor's Rating.

(3) The first yield is the roofer yield on the bond bank issue; the second yield is the monthly constant yield on general obligation bonds with similar Moody's Rating.

average return on their investment in order to lend to the North Slope Borough. This observation is preliminary; an analysis of the market performance of any single locality is beyond the scope of this report. However, given the high levels of debt that have been issued from this and other localities, the much higher than average interest costs of Alaska's local debt, and the loss of State revenues from taxes levied by this Borough and others to pay the annual debt service on their debt, the State may wish to analyze further local market experience and State policies regarding local debt management.

The Market Performance of the Alaska Municipal Bond Bank

The State has established the Alaska Municipal Bond bank for the express purpose of assisting local communities in the financing of capital improvement projects. The Bank issues its securities and relends the proceeds to participating municipalities. As discussed in Section Three, Bond Bank bonds are secured by several tiers of protection, including pledges of the securities of participating municipalities, a State "pay-over" provision, a reserve fund, and the State's moral obligation to replenish the reserve fund. The "pay-over" provision requires the State to pay to the Bond Bank all State aid funds owed a municipality in the event of a municipal default on its Bond Bank debt obligations. As a result of these layers of security, the Bank's general resolution general obligation bonds carry an A rating.

Table 5.9 reviews selected information on recent Alaska Bond Bank sales and compares the results with bond bank issues from other states. In each case, 5-year and 10-year reoffering yields are compared with the monthly market average yield for general obligation bonds with similar ratings. Alaska Bond Bank issues carried yields that were, on average, 70 basis points (0.70 percent) higher for 5-year bonds and 74.5 basis points (0.745 percent) higher for 10-year bonds than the monthly market yields for like-rated bonds. By contrast, New Hampshire Bond Bank issues carried yields that exceeded the averages by 12.2 and 12.5 basis points respectively; for Maine, these differences were 26.6 and 26.7 basis points.

The discrepancy between the market reception of other state bond banks and that of Alaska's is most likely the result of investor unfamiliarity with the Alaska Bank. This comparison indicates that the Alaska Bank has the potential for saving as many as 50 basis points by undertaking an active national marketing effort. The relatively poor reception given the Bank's bonds also indicates that investors are probably not buying these bonds on the basis of the State's moral obligation pledge. If the bonds were purchased solely on the merits of the State's moral obligation, they would be expected to trade closer to the national average for A-rated bonds.

Table 5.10 summarizes gross underwriting spreads on state bond bank issues. While these data indicate that spreads on Alaska Bond Bank issues are alternately above and below other bond bank issues, most of these differences may be due simply to market timing. Since bond banks are not frequent issuers,

Table 5.10
Average Gross Underwriting Spreads*
State Bond Bank Issues

<u>State</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
Alaska	\$11.50	\$20.00	\$12.27	\$15.00	\$19.75
Maine	14.70	11.50	17.17	15.21	15.00
New Hampshire	15.90	15.46	17.83	—	16.00
Vermont	14.40	—	—	—	—
Average-All Local Issues in Alaska	NA	\$16.85	\$16.75	\$19.60	\$20.47

* Expressed in dollars per \$1,000 par value of bonds issued.

these comparisons do not appear to be particularly important. It is important, however, to note that one purpose of the Bank -- achieving economies in marketing costs -- has been partially accomplished. The average underwriting spread on Alaska Bond Bank issues in the past three years has consistently been less than the average spread for the State's local bonds sold directly in the market. Underwriting spreads continue to remain well above the costs of State general obligation issues, however, as summarized in Table 4.3.

Local Debt Management

Effective management of long-term debt by local governments is important to the localities and the State in order to preserve the overall long-term fiscal health of each. Abuses of the power to borrow funds reflects poorly on the locality and can have costly repercussions on the State. For example, improper debt management could cause credit ratings to worsen, forcing higher interest rates. In extreme cases, the local unit may be barred from access to the national credit markets altogether. The taxpayers of the municipality, and the entire State, are the ultimate losers when and if Alaska's local governments abuse their borrowing authority.

There are specific guidelines and practices that local governments can follow to assess their debt management procedures. Many of the conditions that signal potential debt-related problems are listed in Exhibit 5.1. Local government finance officers and financial officials should continually assess their debt position and debt management practices using such a checklist. The Department of Community and Regional Affairs currently receives the annual budgets and financial reports of the State's local governments. These reports are the primary sources of data on local fiscal management. Information contained in these reports could easily be compiled into a computer program that would monitor financial condition along the guidelines presented below. A positive response to any one item may be cause for concern and appropriate measures should be taken first to identify and then to rectify the problem.

In order to evaluate the debt management of individual localities, assessment of the debt position of each Alaskan municipality along the lines suggested by the checklist is necessary. This analysis would highlight those localities which have a problem with their debt management practices. Such an evaluation should be performed by both State officials and by the localities themselves.

The Role of the State in Local Government Borrowing

Analysis of the market experience of Alaska's local governments indicated that these units are paying a premium over similarly rated municipalities to borrow in the national market. In an attempt to lower the cost of borrowing, many localities in the State have taken out municipal bond insurance as was

Exhibit 5.1

Debt Management Checklist

- ___ an increasing amount of bonded debt per capita.
- ___ the percentage increase in debt per capita exceeding the percentage increase in taxable wealth per capita.
- ___ an increasing percentage of annual expenditures for debt service.
- ___ an increasing ratio of debt to assessed value.
- ___ current year operating deficit.
- ___ two consecutive years of operating fund deficit.
- ___ current general fund deficit (two or more years in last five).
- ___ short-term debt (other than bond anticipation notes) at end of year greater than 5 percent of main operating fund revenues.
- ___ short-term interest and current year debt service greater than 20 percent of total revenues.
- ___ total property tax collections less than 92 percent of total levy.
- ___ declining market valuations - two consecutive years on a three year trend.
- ___ overall net debt ratio 50 percent higher than four years ago.
- ___ current year operating deficit larger than previous year's deficit.
- ___ two-year trend of increasing short-term debt outstanding at end of fiscal year.
- ___ property taxes greater than 90 percent of tax limit.
- ___ a trend of decreasing tax collections.
- ___ overall net debt ratio 20 percent greater than previous year.

indicated in Table 5.8. However, the savings achieved by Alaskan municipalities appear to be slight, especially given the high initial premium required to insure bonds.

In addition to paying higher than average interest rates, the State's localities have debt ratios far higher than the national medians for similarly sized local governments. Most localities are unable to tap the vast oil-based revenue sources available to the State. Therefore, the high debt ratios which for the State's own debt do not cause immediate concern, are not as acceptable at the local level. The high levels of local debt, and its relatively high expense, are in themselves reasons for the State to re-assess its current role in local debt management.

Local borrowing costs and debt management practices should be of particular concern to the State for three major reasons. First, is the desire for its localities to be fiscally responsible and able to borrow on as near an equal footing with communities in the "lower 48" as possible. Second, is the State program to reimburse localities for a portion of the annual debt service on school construction bonds. High general obligation borrowing costs on local debt are passed on to the State directly through this program. Third, is the current interrelationship between the State and local property taxes as described in the Appendix to this report on the legal framework for debt issuance in Alaska. Because local governments are able to levy unlimited property taxes for the payment of debt service, and property taxes paid on oil production and transportation facilities to local governments are credited towards the State property tax liability, the State loses revenue to those three jurisdictions (Fairbanks North Star Borough, North Slope Borough, and Valdez) that have high tax rates in order to support high levels of debt issuance.

A high cost of borrowing, however, is not the only reason that the State should be concerned about local debt issuance. Another concern of the State should be the question of what would happen if a municipality were unable to repay its debt obligations. Although the State is not legally obligated to provide relief to localities in default, were this to occur there would likely be pressure on the State to arrange for some sort of "workout". For the above financial reasons, and to promote sound financial management practices at the local level, the State may wish to take the lead in implementing programs that encourage the prudent use, and guard against the misuse of local debt issuance.

The State has demonstrated its concerns over local borrowing costs by creating and administering the Municipal Bond Bank. The Bank helps smaller lesser known municipalities borrow at lower interest rates and issuance costs than they could achieve on their own through pooling the smaller local issues into one, relatively large, bond issue. The security behind the Bank's bonds is greater than that of the individual local governments because of the reserve fund requirements and the State's moral obligation pledge. Although the market performance of the Bond Bank has not been up to that of other state bond banks, it is still better, on balance, than that of separate local units. Our review of the Bond Bank's performance, however, indicated that only \$108 million of the \$1.3 billion in local general obligation debt outstanding, or 8

percent, has been issued through the Bond Bank. Therefore, a State policy to encourage wider use of the Bond Bank by local governmental units should result in lower aggregate borrowing costs.

There are several steps the State could take to improve the market performance of the Bond Bank. Our analysis concluded that, on average, the Alaska Bond Bank is paying a higher cost of borrowing both in terms of interest cost and underwriting spread than are other state bond banks. Although the Alaska Bond Bank is rated one notch below the Maine and New Hampshire bond Banks, the composition of its municipal borrowers is relatively the same as in the other states. According to Table 3.11, 78 percent of the Bond Bank's outstanding general obligation debt is payable from communities rated Baa or below. The similar percentage for the Maine bond bank is 72 percent. The relatively weak market performance of the Bond Bank would be improved if the State undertook an active promotional effort aimed at potential investors. Furthermore, the State could restructure the security behind the Bond Bank, to include a stronger moral obligation pledge or a pledge of the State's full faith and credit. The strengthening of security could be selective, applying only to bonds issued for certain purposes, or valid for all Bank Bonds. The State of New Hampshire Bond Bank issues two types of bonds; one backed by the State's general obligation and the other backed by a moral obligation pledge of the State.

Alternative Programs for Further State Involvement

There are several programs in use in other states which provide a model for Alaska to consider in determining the appropriate level of State involvement in local debt management. These state oversight and assistance activities range from state guarantees and approval of local debt issuance, through statutory limits on the amount of debt that may be issued, to the provision of technical assistance to localities in the debt issuance process. The decision as to the correct role for the State in local debt management is a complicated one, and involves a myriad of factors including the system of intergovernmental fiscal policy, the desired degree of local government autonomy, and cost to the State. In evaluating Alaska's role, the State should keep in mind the following factors:

- . the cost of alternative programs to the State both in terms of direct budgetary impact and indirect effects on the State's own borrowing costs.
- . the degree of assistance must be balanced against the amount of autonomy the State wishes its localities to enjoy. It is generally in the State's interest to place some constraints and conditions on recipients of its aid.
- . while the State may wish to improve local financial management practices, it must be careful that over depen-

dence on the State does not result from its assistance.

State Restrictions on Local Debt Issuance

The State of Alaska places few constraints on the issuance of debt by its local units of government. Except for the voter approval requirement for general obligation bonds, there are few limits on local borrowing. This is in contrast to most states where a limit is placed on the amount of debt that may be issued (generally expressed as a fixed percentage of the assessed value of property). Such debt limits typically apply to general obligation debt only, and it is debatable whether such limits are actually effective in limiting the total amount of debt issued. In those states with the most restrictive limits on local debt issuance, localities have typically issued larger than average amounts of revenue-supported debt in place of tax-supported debt.

Limits on local governmental debt issuance may improve the market reception of their debt, because investors place a value on scarcity and certainty. Debt limits ensure investors that localities will not issue bonds in amounts considered by the state to be excessive. The imposition of a local debt limit would also give the State more control over the revenue loss from localities that have oil production or transportation property within their boundaries, such as the North Slope Borough. Currently the State is being short-changed by those localities that levy a high amount of taxes on oil production property in order to finance debt service. Because taxes paid to the locality are credited towards State property tax liability, this represents a direct revenue loss to the State. Therefore, the State needs to address the absolute level of debt issuance by its localities.

The most common form of state limitation on the level of local debt issuance is a maximum ratio of outstanding debt to the assessed (or true) value of property. Because property taxes generally comprise the largest share of local government revenues, this form of limit ties the amount of debt issuance to the resources available to repay the debt. In states with large disparities in assessed value among jurisdictions, such as Alaska, a debt ceiling defined solely by property values may not be appropriate. An alternative would be to limit the ratio of outstanding debt per capita; however, the resident population of Alaska's jurisdictions and its distribution may not directly correspond to the need for public capital investment. Therefore, it is recommended that the State develop a two-tiered ceiling on local debt issuance that will meet the combined objectives of 1) treating all localities fairly, 2) providing the State with a degree of control over local debt issuance, and 3) encouraging prudent debt management by localities.

Direct State Involvement in Local Debt Issuance

A more effective alternative to debt restrictions is to become directly involved in the debt issuance process of local governments. It must be

recognized, however, that such involvement infringes upon local autonomy. Through the Alaska Municipal Bond Bank, the State has been active in this area for those municipalities that use the Bank. Other forms of direct State involvement could include the approval of local debt issuance, expanding the role of the Bond Bank to assist in the marketing of all local debt, the supervision of local debt management and financial planning, subsidizing local debt service costs, and State guarantee of local debt.

Of greatest assistance, in terms of savings in interest and issuance costs, would be the State guarantee of local debt. Such a program could involve the issuance of State general obligation bonds in lieu of Bond Bank bonds and loaning the proceeds to local governments for approved projects. According to the results of the market analysis of the State's general obligation debt in Table 4.6, the State trades at interest rates slightly better than the average AA issuer. Comparison of the market experience of Alaska's localities provided in Table 5.7 and the AA yields a State guarantee would be likely to bring, indicates that such a program could save localities as much as 100 basis points (one percent) in interest costs. This translates into a total savings of approximately \$395,000 on a 15-year, \$5 million borrowing. However, a State guarantee would encumber State debt issuance capacity for other purposes.

Active participation in debt issuance can include advisory review by the State of the legal provisions of local debt issuance and the fiscal soundness of the borrowing; providing detailed technical assistance in the structuring of the bond issue and in preparing the necessary documents for debt issuance as a surrogate financial advisor; or assisting in the marketing process itself by coordinating bond issues within the State or actually selling the local bonds.

State programs that provide varying degrees of technical assistance to local borrowers are in place in California, Oregon, Florida, New Jersey, Michigan, and Virginia.³ In Alaska, the scope of the Municipal Bond Bank could be expanded to assist all localities regardless of whether the Bond Bank's debt-raising services were used. Another State office which could provide financial management services is the Department of Community and Regional Affairs which already collects the annual budgets and financial reports of local governments.

The State could require that all local debt be approved before sale. Such approval could be based solely on legal and technical grounds, or on a review of the fiscal capability of the government to undertake the project given its existing levels of debt, the revenues generated by the project, if any, and the general financial condition of the borrower. The North Carolina Local Government Commission in the Department of the State Treasurer must approve all local debt issues. In addition, the Commission provides localities with technical assistance and actually markets the bonds; performing such functions as preparation of the official statement, presentations before bond rating agencies, evaluating bids and delivery of the bonds to underwriters.

Financial assistance to support local debt service costs would be similar to the program currently in use for school construction debt. The major problem

with this program, as indicated earlier, is the extra cost borne by the State because debt service on bonds issued directly by localities is higher than debt service on the State's own general obligation bonds would be. Alaskan localities have lower credit ratings and, therefore, higher borrowing costs than the State's own general obligation debt.

It is beyond the scope of this report to address the proper relationship between the State and its local governments. However, a more active State role in local financial management would enhance the creditworthiness of Alaskan localities and result in lower borrowing costs. According to a recent credit analysis of local borrowers in the State of New Jersey, "due to the close scrutiny of budgetary operations and debt management by the State, New Jersey tax-exempt local bond issues enjoy a high degree of market appeal for underwriters and investors."

A reasonable compromise between encumbering the State's debt capacity and providing greater financial assistance to local governments would be to expand the role of the Municipal Bond Bank. Such expansion could entail 1) Strengthening the security structure of the Bond Bank's bonds to take better advantage of the State's high creditworthiness, 2) action to increase the Bank's use by localities, and 3) the provision of financial management assistance to all localities.

Alternatives to the School Construction Assistance Program

Subsidation of school construction is an expensive undertaking; however, its cost could be minimized through attention to the cost of the project and to the means of financing during the approval process. Alternatives to the present programs which the State may wish to consider are given at the end of this Section. Education differs from other locally provided services because it is basically a state responsibility that is provided at the local level. Alaska's program to subsidize school construction evolves from this responsibility. However, because education is a state-level responsibility, the state subsidy should be as equitable and efficient as possible. An equitable subsidy would treat all localities alike in providing school construction assistance; an efficient subsidy would give the State control over its cost.

The present program is not equitable because each locality raises construction funds on its own; the ultimate cost of borrowed money depends upon the locality's credit rating (or the Bond Bank's), and the timing of the bond issuance. Therefore, Community X may spend several hundred thousand dollars more in debt service to build a \$10 million school than Community Y just because it entered the bond market later, or has a lower credit rating than that of Community Y.

From the standpoint of an efficient subsidy, none of the local governments in the State has a credit rating equal to or higher than the AA rating of the State. As a result, the State is paying a penalty on debt service reimbursements

through the construction aid program to local school districts. The additional interest costs over what the State would have to pay if it issued its own general obligation bonds increase as the gap between the credit quality of the locality and the State widens. Table 5.4 indicated that of the 13 school districts that have issued school construction bonds, six are A-rated, five are rated Baal and two are unrated. Juneau, Kodiak, Wrangell and Unalaska (all rated Baal or lower) have lessened the impact of their poorer credit quality by issuing school construction bonds through the Bond Bank. The issuance of school construction bonds, independent of the Bond Bank, by Petersburg, Sitka, Kodiak, Ketchikan, and Juneau (with one exception) occurred before the Bank was established in 1976. Since that time, all school debt from Baal or lower rated communities has been issued through the Bond Bank.

If the State were to issue general obligation bonds to lower its cost of financing school construction, the bonds would encumber the debt capacity of the State for other public purposes. The \$641 million of local school construction bonds currently outstanding represents 63 percent of the \$1.03 billion in State general obligation debt outstanding. Had the State issued 63 percent more debt over the past 10 years than it actually has, it is doubtful whether its credit rating would have improved from Baa to AA.

The additional cost the State is currently incurring may be worth the price if 1) it permits the State itself to borrow at a lower cost, 2) it enables the State to maintain its strong credit rating, and 3) it doesn't encumber capacity to pay debt service for other public purposes. Therefore, State issuance of its own general obligation bonds in lieu of local school bonds or other alternatives to the present system must be assessed against the chances that State borrowing costs would rise and the reduced availability of debt capacity for other State needs.

From a debt management standpoint, the choices available to the State are several:

- 1) The State could begin issuance of school construction bonds for independent school districts, realizing that this may limit its future bonding capacity and raise future State borrowing costs; however, the cost of the State subsidy would be lower than it is at present;

- 2) The State could require that the Municipal Bond Bank issue all school debt on behalf of the school district and that the Department of Education work with the Bank to establish guidelines for the debt structure and financing plan of each project. Such guidelines could establish maturity structure, issuance provisions, and maximum amount of debt issuance;

- 3) The State could establish an independent school building authority that would raise funds for school construction through the issuance of its own bonds. These bonds could be secured by local lease payments on the schools and a pledge of State education aid. A program such as this is an alternative to use of the Bond Bank and must be evaluated against the costs/benefits of using the Bank alone; or

4) The State could continue to reimburse localities for a portion of their debt service costs on school construction bonds. However, the Department of Education should have approval authority of school debt issuance based upon some State and local affordability criteria.

CHAPTER VI

STATE DEBT MANAGEMENT

Introduction

Conservative management of Alaska's outstanding debt and future debt issuance will ensure adequate debt capacity and retention of the State's strong creditworthiness. Our review of the State's debt management practices showed that while past practices have not been imprudent, there are areas where changes are recommended. Generally, we have found that: the scope of the State Bond Committee should be expanded to include oversight of all State-level debt issuance; the State should incorporate a capital financing plan into its budget process; and several debt issuance procedures such as the calculation of interest cost on competitively awarded bond issues and compensation of financial advisors should be reviewed.

These issues and others are addressed in the following chapter which surveys different aspects of State debt management. The specific subjects and the order in which they are covered are:

1. Origins of State Concerns and Actions Regarding Debt Management (pages 143-156)
2. Role of the Alaska State Bond Committee (157-160)
3. Alaska's Use of the Moral Obligation Pledge (161-164)
4. Capital Planning and Capital Financing (165-175)
5. Debt Ceilings and Limits (176-178)
6. Alternative Methods to Determine Lowest Bid: True Interest Cost vs. Net Interest Cost (179-181)
7. Differences Between Competitive and Negotiated Bond Sales (182-184)
8. Selection, Use, and Compensation of Financial Advisors and Underwriters (185-190)
9. Advance Refunding and Debt Defeasance (191-192)

Origins of State Concerns and Actions Regarding Debt Management

Historically, debt management has not been an area of primary concern to state elected officials such as legislators and governors. With the enactment of tight controls over the issuance of general obligation debt -- a product of the excesses of the nineteenth century and of the problems of the depression era -- state elected leaders tended to leave the actual management and issuance of debt to the treasurer, assuming that their function had been fulfilled with the designation of the project and size of the issue, as well as the authorization of the bond or the submission of it to the electorate. Because prior to 1970, most bonds issued were general obligation bonds which required legislative authorization and/or voter approval, there seemed to be plenty of checks to prevent unwise issues, and numerous opportunities for oversight.

In recent years, however, changes in both attitudes of elected officials and the bond market itself have led to a heightened awareness of the need for improved oversight of debt issuance, and the establishment of a variety of state activities to oversee debt issuance. This section provides background to these changes, examines selected state responses to their perceived problems, and discusses some of the strengths and weaknesses of these approaches.

Debt Issuance and Debt Markets

As discussed in Chapter Two, one of the most significant changes in the last decade or so has been the pattern of state debt issuance. While in the late 1960's and early 1970's general obligation debt issuance outpaced revenue and moral obligation debt by a nearly three to one margin, in recent years the pattern has been completely reversed, to where general obligation state debt makes up only about a third of all state debt, and general obligation debt represents only about thirty percent of all tax-exempt debt available in the market place.

Revenue debt is generally less subject to oversight and approval than general obligation debt; indeed, one reason for its growth has been a desire to find a way around constraints on general obligation debt, such as constitutional limits or requirements for voter approval. The use of revenue debt, then, represents an increasing transformation of debt from just a financing technique into an instrument of fiscal policy.

Long-term general obligation debt has historically been used to finance traditional capital outlays for states, such as roads or schools. As a rule of thumb, about half of all capital outlays were paid for with debt, and the balance financed on a pay-as-you-go basis. The choice was dictated by current interest costs, the number of projects to be financed in any one year, expected useful life of the facility to be financed, and the availability of general revenues of the government.

Departure from this tradition came with the creation of special purpose authorities given the power to issue debt payable out of fees imposed for services. These authorities were able to build bridges, ports, airports, tollroads, and other forms of infrastructure and generally avoid constitutional debt limitations or restrictions. By design, the authorities were frequently far removed from the purview of elected officials. Still other authorities were set up as building corporations, who issued debt to construct state offices and other facilities and repaid the debt from leases to the states. They function exactly as private landlords, but -- because of their access to tax-exempt borrowing and their freedom from property and income tax -- are able to provide much cheaper rentals to the state. Building authorities also offered states a way around debt limitations and increased the distance between elected officials and debt issuers.² While the creation of special authorities for capital construction meant a decrease in the frequency and quality of state oversight, the purposes of borrowing remained the same as general obligation debt -- that of matching

long-lived facilities with long-term financing, so that no one budget year was unfairly burdened with payment for a structure whose useful life lasted decades.

A second form of borrowing -- special purpose authorities whose goal was to channel tax-exempt financing to private users -- also changed borrowing into an element of fiscal policy. Beginning in the New Deal and proliferating up to the present, a new group of authorities was created to provide an interest subsidy to private borrowers whose activity was defined as being in the public interest. The recipients of these subsidies included homeowners and renters (through Housing Finance Agencies), hospitals, nursing homes, students (through loan authorities and dormitory construction -- at both private and public universities), utilities, private corporations (industrial development and pollution control bonds), professional sports teams, and a myriad of similar groups.

Like special tax treatment for certain groups, these borrowings were meant as a form of fiscal policy, another tool beyond direct appropriation to subsidize a politically worthy activity. And -- also like tax preferences -- they received far less scrutiny than would a direct expenditure of the same amount of money. The increasing recognition of the changed character of authorities was one important factor in a changed perception of them on the part of state officials. Since they were no longer financial technicians, but rather more like operating agencies of a state program, legislators in some states came to feel that they deserved the same scrutiny as any other operating program.

This changed perception was accentuated by the growth in revenue debt detailed in Chapter Two. Not only were the non-traditional borrowers changing the nature of borrowing, but the sheer size of their borrowing was making the change more obvious. Total new issues increased from \$7.1 billion in 1960 to \$76.0 billion in 1980, a more than ten-fold increase in two decades. Revenue-supported debt rose from 36 percent of outstanding tax-exempt debt in 1960 to over 50 percent in 1980.

A third factor which entered into the change was the long-term rise in interest rates, coupled with the volatility of the market. Since the end of World War II, tax-exempt interest rates have been about 30 percent lower than taxable ones. When interest rates were low, this difference amounted to only one and a fraction percentage points, but the difference became more striking in the eighties. As corporate rates ran up into double digits, the difference between taxable and tax-exempt rates amounted to as much as four or five percentage points. This differential made tax-exempt borrowing obviously more attractive; coming at a time of fiscal austerity in the state and local government sector, the opportunity to provide a subsidy at relatively little cost was very appealing to state policy makers.

All of these factors -- the changing nature of borrowing, the growth of revenue debt, and the rise in interest rates with a concomitant growth in debt service costs -- made states more attentive to debt policy and management. The major catalyst to action, however, was the temporary default of the Urban Development Corporation (UDC), a moral obligation authority of New York State, in 1975. With over \$2 billion in authorized bonding levels, UDC was one

of the largest authorities in the country. When it was unable to pay some short-term notes coming due, the State stepped in and created a new agency to loan money to UDC, as well as to purchase UDC-owned mortgages in order to provide extra cash. The State also appropriated funds directly to UDC to bring the debt service reserve fund up to required levels. As the first major "near-default" by a public authority in modern times, the plight of the UDC dramatically demonstrated both the commitment of "moral obligation" bonds, and the degree to which the State was inextricably intertwined with the actions taken by an ostensibly autonomous authority. "Even if the State is not obligated to underwrite every authority's specific bonds, the refusal of the State to support poor investment decisions by any independent authority would have a negative impact upon the entire public credit structure," said the Chairman of New York's Assembly Ways and Means Committee.

When the UDC default was followed by fiscal crisis in New York City and Yonkers, public attention was drawn to the need for more effective oversight of local bond issuance — an issue which was dramatically heightened by subsequent fiscal crises in Cleveland and Detroit. While there was a flurry of interest in state oversight of local debt practices, oversight of state debt became an increasingly recurrent issue. In recent years, New York, California, Oregon, Vermont, Maryland, New Hampshire, Michigan, Kentucky, Illinois, and Wisconsin have all undertaken significant reviews and reforms of their debt issuance practices. Such interest can be expected to continue. Public awareness of the deteriorating capital infrastructure has meant that states are paying increasing attention to the problems of capital planning and budgeting; debt policy review is a natural concomitant to the review of capital outlay procedures. Just as states became more interested in overall policy review, rather than reviewing individual projects or bond authorizations, they have also shown increasing interest in reviewing debt policy as a whole rather than considering each bond authorization without reference to the others.

Principal Concerns

We reviewed recent state actions in debt management and debt policy to discover what problem areas states were addressing, what their specific concerns were, what approaches they were adopting or considering to deal with these concerns. While selective, this review provides a representative sample of state activities from across the country; in addition, we use examples from other states as necessary to illustrate programs undertaken.

Generally, states have undertaken reviews of debt management and implemented new practices because of concerns over the size of debt and debt service commitments, and the quality of state credit ratings. States have also shown a growing interest in oversight of authorities and coordination of issues among various agencies. Nationally, state debt has risen dramatically in the last decade, but it has not risen faster than state spending; and although high, it has not grown as fast as either local debt or federal debt.

Those states that undertake analysis of their debt have generally concentrated on three distinct, but interrelated, areas. First, they have analyzed overall debt levels and debt service requirements. Such analysis generally focuses upon general obligation debt, and has been less concerned with revenue and authority debt. For example, the Maryland Debt Affordability Committee makes annual recommendations on general obligation debt authorization levels with the aim of adjusting debt authorizations so as to reduce steadily outstanding debt to 3.2 percent of Maryland personal income, and debt service to 8 percent of general fund and state property tax revenues. While no one guideline can serve each state, it is useful for a state to develop such guidelines to measure the need for debt. Unlike budgets, which must be weighed against available revenues, debt issuances frequently lack an explicit yardstick against which they must be measured; consequently, there is little incentive for competing projects to be measured against each other or to establish a debt authorization ceiling. Such a ceiling, however, is useful as an analytical tool where general obligation bonds are concerned.

Legislators and other state officials generally — and rightfully — separate out those projects which have a defined revenue stream to liquidate their obligations, and have been concerned not so much with total size of revenue-supported obligations as they have with process reforms, which give them some assurance that revenue bonds will not be issued unwisely. Therefore, the second area of emphasis has been the creation of oversight bodies for the issuers, which monitor issues to ensure that each one is prudent, and the creation of standard formats for issuance, bidding, measurement of interest costs, and other concerns. Finally, and perhaps less common, are the creation of bodies to recommend total debt authorizations, such as the Maryland Committee, and the creation of standing legislative committees or subcommittees to provide a single reference point in the legislature for all debt related legislation and oversight.

All of these policies can serve a state well; while no one state has enacted all of them, their record suggests that any state looking to reform its procedures and policies could usefully benefit from an analysis of other state actions.

Debt Ceilings

While revenue bonds have certain built-in ceilings, constrained by the amount of revenue available to liquidate their obligations, there is no such obvious measure for general obligation bonds. Some states have chosen (or have had thrust upon them) limits to the amount of general obligation debt outstanding, the amount that can be issued in any one year, or the amount of debt service. A summary of selected state debt limits and their calculation is provided in Exhibit 6.1. A debt limitations which is tied to an economic indicator, rather than a flat amount, makes intuitive sense. Like a spending limitation, it provides a baseline for evaluating whether debt is too large for a state to handle. The choice of a debt limitation need not be arbitrary, but there is no magic formula which a state must adopt either. In Vermont, for example, the Governor argued that the State should set as its goal that certain standard

Exhibit 6.1

Selected State Debt Limits

1) Aggregate Debt Levels

Wisconsin. The lesser of a) 3/4 of 1% of the aggregate value of all taxable property or b) 5% of the aggregate value of all taxable property less net indebtedness as of January 1.

Vermont. New debt issuance cannot exceed 90% of amount retired during previous year (statutory); maintain debt as a percentage of personal income to average for AAA states (governor's proposal).

Maryland. Maintain general obligation debt at 3.2% of state personal income.

2) Debt Service Levels

Maryland	8% of general fund and state property tax revenues
South Carolina	7% of general fund revenues
Tennessee	15% of general fund receipts
Connecticut	4.5% of previous year's tax receipts

ratios used by Moody's and Standard & Poors -- debt service as a percentage of general fund and highway revenues, debt as a percentage of state personal income, and debt as a percentage of assessed property valuation -- be held to the average for all other states enjoying AAA credit ratings. In other words, Vermont's "debt limit" would be to ensure that debt burden did not make Vermont stand out from other AAA rated states.

Similarly, as noted above, the Maryland Debt Affordability Committee adopted as its goal that general obligation debt be no more than 3.2 percent of State personal income, and that debt service be no more than 8 percent of State general fund and property tax revenues. In this case, the goals were to be met by gradually decreasing new authorizations until debt was lowered to the target levels. Wisconsin uses a different approach, which limits annual debt authorizations to the lesser of (1) $3/4$ of 1 percent of the aggregate value of all taxable property in the State, or (2) 5 percent of the aggregate value of all taxable property in the State less the State's net indebtedness as of January 1 of the current year. The Wisconsin limit was modeled on local government limits, where aggregate taxable property is an excellent measure of potential tax capacity of a jurisdiction; however, at the state level, where less than 2 percent of all tax revenues are from property taxes, its usefulness as a proxy for state capacity to pay is limited. South Carolina law limits debt service payments to 7 percent of its general fund revenues. Debt service in Tennessee may not exceed 15 percent of its general fund receipts. Connecticut limits debt service to 4.5 percent of the previous year's State tax receipts. Like Maryland, these three states tie their debt limitation to some measure of state income.

In reviewing indebtedness for their states, both the California Legislative Analyst and the Committee on Program Review and Investigation in Kentucky recommended that debt limitations, if adopted, should be tied to some flexible measure of either state revenues or the state economy. By holding debt to a percentage of state personal income, or debt service (for non-self-liquidating bonds) to a certain percentage of general fund revenues or expenditures, it is possible to manage debt and still retain flexibility. Such a limit may be adopted as a statute or as a written managerial policy, in order to provide the opportunity for later adjustment should there be a significant change in the mix of state revenues. For example, growth in dedicated revenues at the expense of general funds, or state assumption or shedding of significant service responsibilities could make the limit too generous or too constraining. It is important to note that a debt service limitation is only a management tool; the wide variety in such limits suggests that states have designed them to be rough measures of affordability, even when there was no present danger of being overbonded. The California report states: "There is always the possibility that excessive bonding might become a problem at some point in the future in which case a debt limit of some sort could provide a means for detecting problems at an early state. Even if debt limits are revised over time, their very presence increases the ability of the Legislature to oversee borrowing activities and consider the trade-offs between differing bond-supported activities."

Oversight and Controls

If there is no magic formula for deciding how much general obligation debt a state can afford, the optimum amount of revenue bonding is even more elusive to determine. Bonds which are financed out of user fees are, in a sense, self-determining. Toll roads, airports, sewerage plants, water supply systems, and the like have detailed feasibility plans accompanying them, and -- assuming there is no gross miscalculation in the amount of future revenues available for debt service -- the size of the issue and its composition are relatively straightforward. In the case of "on behalf of" financing -- such as mortgage loans, health facilities loans, pollution control and industrial development financing, and the like -- evaluation is usually on a case-by-case basis. The state's interest is not primarily in the size of the issue, since that is determined by demand, nor in its legal permissibility, since that is effectively determined by Congress and the Internal Revenue Service. Instead, a state must be concerned with the local social or economic usefulness of the financing and that its own credit and debt service costs will not be adversely affected by the quality and quantity of bond issues outstanding. It must also be concerned that financings are prudently planned and executed, and that the state is not left "holding the bag" on a contingent financing. Even where there is no legal or moral obligation for the debt of a particular authority or public corporation, nor any investment of state funds (since the interest subsidy provided is from the federal treasury rather than the state), the failure or threat of failure to make timely payment on debt is a default, and any default can create a political obligation for a state. The current controversy over the repayment of bonds for the Washington Public Power Supply System is testimony to that fact.

Because of the potential liabilities created by their actions, states seem generally to be concerned about the activity of public authorities and corporations. Yet, because of the specialized nature of their work, and because of the difficulty in ascertaining what an appropriate level of bonding should be, some states have concentrated on reviewing the process of bond issuance, rather than its size or fiscal impact. Few states have been as harsh in their judgment as Oregon, where the review panel stated:

...general agreement that the industrial development revenue bond program in Oregon, as it is presently constituted, is an ineffective public policy instrument. The state legislature should develop a clear statement of program goals and objectives against which public benefit can be evaluated...If the state legislature is unable to develop...(such) guidelines...the Panel would support discontinuation of such financings in Oregon.

Most states, accepting the legitimacy of revenue bond programs, have been more concerned with the quality of their administration. This creates a dilemma, since the purpose of creating an independent authority is to distance it from the political process. Moreover, it is neither practical nor appropriate for a legislature or governor to involve themselves too directly in the day-to-day administration of an agency. At the same time, states have expressed concern at the thought of agencies proceeding to unchecked issuance of debt and unsupervised distribution of proceeds.

The result has been a series of controls established to ensure that the process runs smoothly. For example, a number of states have established interest rate ceilings, hoping thereby to avoid the sale of bonds at excessive costs. The ceilings were originally set at fixed levels, but the rapid run-up in interest rates and the volatility of interest rate levels made such ceilings obsolete. Florida responded by creating a floating interest rate ceiling, which is set monthly at 150 basis points (1.5 percent) over the most recent Bond Buyer 20-Bond Index level. Florida also exempted bonds having the three highest credit ratings from the ceiling. The goal was to set up a screening mechanism: bonds that were highly rated, or issued at market rates, were allowed to go through without review. Bonds which could not meet this test (both State and local) were required to appeal to the State Board of Administration (composed of the Governor, Treasurer, and Comptroller). This Board is empowered to allow exceptions provided that the issuer can demonstrate that similarly situated projects pay similar rates, and that the project is financially feasible. "The State's principal objective has been to restrict the issuance of exceptionally risky debt." Minnesota has adopted a similar floating ceiling for interest rates.

This kind of ceiling can serve as an early warning system; unusually expensive issues will be called to the attention of whatever oversight body has authority to set ceilings, and bonds which are reviewed and found acceptable may move ahead. The use of such a ceiling is an example of the need to balance debt issuance accountability against the impetus to finance high cost or marginal projects.

State interest in several other areas of the issuance process is noteworthy. States have often imposed requirements for competitive sale of bonds, specified the form in which bids can be made, and proscribed discounts. The California Legislative Analyst's study looked at these issues in more depth than any other state review, and its conclusions are worth reviewing.

The California study suggested that bonds should be allowed to sell at a reasonable discount, roughly equivalent to the normal underwriting spread; that technical constraints (such as maximum interest rates, discounts and maturities, as well as restrictions on refunding and bond anticipation notes) be made uniform for all bonds; that negotiated sales be allowed as well as competitive bidding; and that bids be evaluated by the True Interest Cost (TIC) method.

There has been considerable technical and analytical discussion about discounting over the years. The general consensus seems to be that investors prefer to buy bonds at par value. Since underwriters cannot afford to buy bonds at par and reoffer them at the same price, an allowance for a discount of 1 1/2 to 2 percent of the issue value would seem to allow for underwriters to be more competitive on interest rates. Such bidding makes it easier to evaluate both competitive and negotiated bids, since the underwriters' profit is more clearly expressed rather than hidden in a complex interest rate structure.

A number of states have moved to the use of True Interest Cost (TIC) rather than Net Interest Cost (NIC) to measure the interest rate on bonds. The differences between the two methods of computing effective interest costs are discussed later in this chapter (page 179). TIC is more complex to calculate, but it is probably a superior method of measuring both competitive and negotiated offerings. Its complexities are no obstacle to a computerized world, and discounting to present value is an appropriate method of measuring the long-term cost of money.

There has been extensive discussion over the years as to the comparative costs of competitive versus negotiated bidding, and the major points of this argument are covered later in this chapter (page 179). Advocates of competitive bidding insist that it is the only way to force competition among underwriters; negotiated bidding supporters point to the fact that increasing complexity of issues requires that they be custom tailored, and that such tailoring saves money in the long run. Whatever merits may be, there is no doubt that negotiated sales are becoming increasingly more common. The continuing growth in negotiated sales, combined with the popularity of creative finance instruments, which almost always require a negotiated sale, suggest that states will do well to allow issuers a choice, rather than requiring only competitive sales. The key to improved debt policy seems to be flexibility, rather than an a priori assumption that competitive or negotiated sales are superior to the opposite approach.

Two related concerns which emerged in most state reviews were the overall level of debt which a state and its authorities had outstanding, and the maintenance or improvement of a state credit rating. Many states seemed to feel that even though individual issues were prudent, a total level of debt which was excessive by some measure could lead to a decline in the credit rating, and thus an increase in interest costs. In addition, there was some concern that overall debt levels might push interest cost up even where credit ratings were steady because of an oversupply of that state's debt in the market. Such an oversupply could lead to an interest penalty for both the state and its local governments.

The Oregon Bonded Debt Advisory Panel, for example, expressed concern that the frequency and size of borrowings under its Veterans Farm and Home Loan program had created an oversupply of Oregon debt in the market. They found that there was an interest penalty of 25 to 75 basis points on every issue for both State and local bonds. The penalty results from investor preferences for geographic diversity in their portfolios, with no one state being overrepresented. This is particularly a problem in recent years with a major shift to individuals as the primary purchasers of bonds, most of whom buy through mutual funds. These funds are managed with an eye toward geographic diversity, and a state which has what these managers perceive as an excess of bonds on the market will find that yields will have to increase to compensate for that perceived excess. Both the Maryland and Wisconsin Reviews noted the same concern for their states.

Oregon and Maryland both recommended the creation of a group to determine an overall state debt level, and suggest what new issues should be allowed. In Maryland's case, this group is the Capital Debt Affordability Committee, composed of the Treasurer, State Comptroller, and Secretaries of the State Planning and Budget and Fiscal Planning Departments and an appointee of the Governor. (See Exhibit 5.2) Aside from setting targets for general obligation debt (as discussed above), the committee recommended the creation of controls over the timing and amount of special authority debt, in order to avoid an oversupply of Maryland debt on the market, although this is not yet implemented. The Committee also recommended a cancellation of authorized but unissued debt, in order to reassure potential investors that their purchase of Maryland debt would not be diluted by large issuances of new debt. Oregon also recommended the creation of an authoritative planning committee chaired by the Treasurer to develop long-term capital outlay plans, recommend overall debt limitations, and assist in the coordination of sales. Oregon also urged the cancellation of outstanding unissued debt authorizations.

In California, a slightly different approach has been taken. While there has been no attempt to create a central oversight mechanism, the Treasurer has that authority de facto through his membership on, and chairmanship of, virtually every State agency or authority which issues debt in the State. While some observers think this is testimony more to the personal ascendancy of Jesse Unruh, the former Speaker of the Assembly who is the current Treasurer, it serves the same function as the Debt Affordability Committee in Maryland. Indeed, through the Creation of the California Municipal Debt Advisory Commission, which has review (although no veto) over virtually every local bond issuance in the State, the Treasurer's purview touches all State and local debt policy.

These actions reflect not only a state-level concern over potential investor reactions, but an active attempt to communicate more effectively with rating agencies, underwriters, and investors. The importance of effective communication was highlighted by the public finance director for Kidder, Peabody and Company when he identified improved and regularized communications between issuers and investment bankers as a key to a continued healthy market for state debt; he argues that a regular program of meetings and information can improve both working relationships and investor perceptions.¹⁰ The Oregon review explicitly argued for a program of improved investor relations.

There is some empirical evidence to suggest that the total amount of debt outstanding can contribute to the cost of debt issuance. Aside from the Oregon evidence -- which looks primarily at the value of Oregon bonds on the secondary market -- one study has suggested that for many states, the market for local debt is primarily state-wide and regional, rather than national. As a consequence, the conclusion is therefore that an appropriate state role is to monitor credit markets and local debt issuance in order to be aware of such problems and to ensure an orderly market for tax-exempt debt of all types.¹¹

Exhibit 6.2

Oversight Committees for State Debt

<u>State</u>	<u>Title</u>	<u>Composition</u>
Maryland	Capitol Debt Affordability Committee	Treasurer, Controller Planning Director, Budget Director
New York	Public Authorities Control Board	Budget Director, Senate Finance Chair Assembly Ways and Means Chairman
California	No formal mechanism, but treasurer chairs oversight bodies for all debt issues.	
Louisiana	State Bond Commission	Treasurer (chairman), Governor, Lieutenant Governor, Commissioner of Administration Secretary of State Attorney General, Senate Finance Comm- ittee Chairman, Senate Revenue and Fiscal Affairs Chair- man, Speaker of the House, House Ways and Means Chairman, House Appropriations Chair- man.

Several states have moved in this area, with the most famous effort being the North Carolina Local Government Commission. This group actually markets the bonds on behalf of the local governments. No other state has such sweeping powers of control, although the Louisiana Bond Commission holds veto power over all local and State bond issues. In Michigan, the Municipal Finance Commission reviews all local debt issues before they go to market, as does the California Municipal Debt Advisory Commission. Numerous other states have informational systems, review processes, or assistance programs. These range the gamut from merely collecting information to actively assisting local governments with access to the market.¹²

If a state is going to develop a comprehensive debt policy, then there must be some mechanisms for overseeing the implementation of that policy. Two approaches have been developed so far that show promise; one is to ensure that both governors and legislatures have a body to articulate and monitor ongoing debt policy. This is the function which groups like the Capital Debt Affordability Committee play in Maryland, or the State Treasurer in California. Virtually every state which has reviewed their policy has suggested that there be a legislative body with specific authority for debt policy as well. In New York, this is exercised by the Assembly Ways and Means Committee and the Senate Finance Committee, who already have jurisdiction over all bills with fiscal impact, whether they deal with taxes or spending. Oregon suggested a subcommittee of Ways and Means be created; in California, the Analyst argued for a joint subcommittee of the fiscal committees (Oregon's Ways and Means Committee is already joint). In Wisconsin, the Joint Finance Committee has jurisdiction; in Michigan, it is the Joint Subcommittee on Capital Outlay. Illinois uses a slightly different approach; here the legislature has a joint Economic and Fiscal Commission, which has responsibility for preparing revenue estimates and fiscal notes on tax bills. This commission also has a permanent charge to study the long-term debt position of the State, prepare debt impact notes on bills, assess capital plans and the State's ability to market bonds, and make special studies. Almost unique among the states, it even publishes a quarterly journal, The Illinois Bond Watcher. The intent is to ensure that there is informed observation of the debt issuance process.

New York State has two innovations which deserve further discussion: the Public Authorities Control Board (PACB) and the Securities Coordinating Committee (SCC). The PACB consists of three members, appointed by the Governor, the Senate Majority Leader, and the Speaker of the Assembly. Since its creation in 1976, it has consisted of the State Budget Director, the Chairman of the Senate Finance Committee, and the Chairman of the Assembly Ways and Means Committee. All major State authorities must have prior PACB approval before entering into any agreement or incurring any indebtedness for the purposes of acquiring, constructing, or financing any project. The PACB reviews all projects for feasibility, affordability, and coordination with the State's capital program as defined under New York's "Accounting, Financial Reporting, and Budget Accountability Act of 1981". Only the Louisiana Bond Commission, among state agencies, matches the PACB in its power to review and coordinate authority financing.

The SCC adds to the PACB review a scheduling mechanism for debt. The SCC is chaired by the State Comptroller, and includes the State Budget Director and the chairmen or chief operating officers of the ten largest authorities. It produces a quarterly schedule of proposed borrowings which ensures that the State and its authorities do not jostle each other in the market, and that the approach to the market is orderly.

Although these approaches provide New York with controls that only Louisiana and California -- to some extent -- can match, there are further reforms to be made. Both the Assembly Speaker and the Ways and Means chairman have suggested merging the PACB and SCC to broaden their coverage to all authorities, including interstate ones, and to include local borrowings in the scheduling process in order to coordinate better the marketing of New York securities.

These bodies provide a useful approach for other states to consider as well. As one observer of the markets has noted, all control mechanisms rest on trust; if elected officials trust authority boards and staff, no further oversight is needed. But even with oversight, trust must repose somewhere: with the Treasurer, the Governor, a legislative body, or some group. If it is true that debt issuance is an instrument of public policy and not just the technical translation of public fiscal decisions -- as this chapter has earlier argued -- it follows that trust should be reposed in those same elected officials whose function it is to make public policy decisions. Trust may be one part of the issue, but so is accountability; debt policy, like tax policy and spending decisions, is ultimately the responsibility of legislatures and governors, and their constituents as well as the marketplace will hold them accountable for the results of that policy. The preceding overview of state activities suggests that states have begun to recognize and act upon that responsibility.