CDAC

CALIFORNIA DEBT ADVISORY COMMISSION

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KATHLEEN BROWN

State Treasurer and Chair

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CALIFORNIA DEBT ADVISORY COMMISSION
915 Capitol Mall, Room 400
P.O. Box 942809
Sacramento, CA 94209-0001
(916) 653-3269

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EXECUTIVE SUMMARY

As the California Debt Advisory Commission completes its 10th year of operation, it is an opportune time to review the accomplishments and achievements of the Commission, and to take a look back at 1991, a tumultuous year for public debt issuance in the state.

This *Annual Report* covers the history of the Commission, profiles its members, discusses topical events in California public finance for 1991, and reviews debt issuance statistics and Commission activities for the past year. The report closes by previewing the areas and programs the Commission will cover in 1992.

AN INTRODUCTION TO THE COMMISSION

The California Debt Advisory Commission (CDAC) is the state clearinghouse for all information concerning the issuance of public debt in California. The Commission was created in 1981 to help public issuers obtain the most favorable financing terms on their debt issuance and to provide State policymakers with information and counsel on matters of public finance.

The Commission consists of nine-members, including State Treasurer Kathleen Brown (Chairperson), State Controller Gray Davis, Department of Finance Director Thomas Hayes, Senator Robert Beverly, Senator Lucy Killea, Assemblymember Jim Costa, Assemblymember Pat Nolan, Sonoma County Treasurer-Tax Collector Don Merz, and Anaheim City Treasurer Mary Turner. The Commission meets at least four times a year to provide guidance to CDAC staff.

In order to assist the Commission in carrying out its responsibilities, a Technical Advisory Committee (TAC) was established in 1983. Made up of 25 individuals representing various groups involved in municipal finance, the TAC provides valuable advice on a variety of issues, ranging from CDAC's quarterly agenda to emerging issues in public finance.

The work of the Commission is divided into three major program areas: *(1) data collection and dissemination, (2) policy research and analysis, and (3) technical assistance and public outreach.* As part of its data collection efforts, the Commission maintains two major databases: one containing information on the statewide issuance of debt, the other focused on housing bond activity. In the area of research and analysis, CDAC prepares in-depth studies and reports designed to address problem areas of public finance and to increase understanding and awareness of the debt issuance process. And through its technical assistance programs, the Commission provides public officials with education and training in the art of debt management.

CALIFORNIA PUBLIC FINANCE IN 1991

Issuers of public debt in California faced plenty of challenges in 1991. First and foremost, the longest recession since World War II hammered California public agencies in 1991, placing tremendous pressure on revenues and expenditures alike. In addition, reduced defense outlays and prospective base closures negatively affected many California communities last year. And the fifth consecutive year of drought slowed development activity in areas where water shortages were of concern. Given these conditions, it is easy to understand why the credit quality of California debt was a focal point throughout the year.

Although the State of California was able to close an unprecedented budget gap of $14 billion in 1991 through a series of tax increases and budget reductions, the outlook for 1992 remained so gloomy that Standard & Poor's Corporation (S&P) downgraded the State's general obligation debt to AA in December of last year. Other issuers in the state did not fare much better. In fact, for every California municipal credit that received an upgraded rating from S&P in 1991, there were 13 downgraded.

Despite these challenges, California public agencies were still able to finance improvements at a record pace. Total debt volume for 1991 reached $34.8 billion, an increase of $10.7 billion, or 44 percent over 1990 issuance figures. Although infrastructure projects and interim financing were the two major recipients of these expanded debt activities, almost all areas of public finance (i.e., education, housing, health care, etc.) realized greater support through the issuance of bonds. Refunding of prior debt also increased significantly in 1991.

While there may be many explanations for the high level of debt issued in 1991, a few major reasons stand out: issuers were able to take advantage of the lowest interest rates in two decades; deferred public investment in infrastructure for most of the 1980s created added pressure for construction projects; fiscal uncertainties brought on by the recession necessitated greater short-term note borrowing; and issuance of public debt was viewed as one way of providing a countercyclical stimulus to a sluggish economy.

As a result of this increased activity, the programs of the California Debt Advisory Commission have become especially critical in assisting public agencies properly manage their debt.

ACCOMPLISHMENTS IN 1991

The Commission issued nine reports in 1991. Two areas of pivotal concern addressed by the Commission in 1991 were the use of tax-exempt leases in California and Mello-Roos financing. *Leases in California: Their Form and Function*, looked at the growing reliance of public agencies on leases to finance public infrastructure and equipment needs. The report provided the history and background of leasing in California, and detailed exactly how tax-exempt leasing arrangements work. A companion document outlined steps the Commission should take to inform and educate public issuers about leasing and served as the impetus for a lease survey which is being conducted in 1992.

Mello-Roos special tax financing also received intense scrutiny in 1991. Because of concerns about the California real estate market and the proliferation of Mello-Roos bonds in the marketplace, the Commission undertook an exhaustive review of the Mello-Roos Act. The result was *Mello-Roos Financing in California*, a report which covered the history of the Act and provided guidelines to local issuers on how to improve their use of Mello-Roos financing. CDAC's work on the Mello-Roos Act has been recognized nationally and continues into 1992.

In addition to reports, the Commission expanded its seminar program in 1991 to meet the specific needs of local debt issuers. Working in concert with statewide organizations such as the California Association of School Business Officials (CASBO), the Commission developed seminar programs tailored for local officials who are interested in particular aspects of the bond process. At the same time, the Commission continued to serve the more generalized interests of issuers with the popular *Fundamentals of Debt Financing* and *Mechanics of a Bond Sale* seminars which helped over 300 officials with their debt responsibilities last year.

Finally, the Commission continued to meet the ongoing needs of public and private officials involved in debt transactions by responding to over 1000 requests for assistance and information in 1991, and through the publication of DEBT LINE, the Commission's monthly newsletter which goes out to over 3,300 subscribers and keeps readers informed of innovations and topical events in the field of public finance.

THE OUTLOOK FOR 1992

The Commission anticipates that 1992 will be an active year for debt issuers throughout the state. To assist public agencies, CDAC is expanding its collaboration with statewide associations to provide technical assistance seminars that are tailored to meet the specific needs of local issuers. In addition to continuing co-sponsorship of an education finance seminar with CASBO, the Commission will be co-sponsoring seminars with the California State Association of Counties, the California Association of County Treasurers and Tax Collectors, the California Special Districts Association, the Association of California Water Agencies, and the Association of Bay Area Governments.

The Commission also expects to publish *City Debt Profiles*, an examination of debt and fiscal indices for over 450 cities in California, and to release the first installment of *Issue Briefs*, a series of individual reference guides intended to provide public issuers with the latest information on products, services, and emerging issues in the public finance industry.

Finally, on the research front, the Commission will have the following projects underway in 1992: (1) an ongoing examination of the Mello-Roos Act, including suggested legislative changes to improve homeowner and taxpayer accountability; (2) a review of the Marks-Roos Bond Pooling Act of 1985, including a look at the benefits and potential problems associated with local bond pools; (3) a statewide lease survey which will help identify the volume and types of tax-exempt leases being entered into by public agencies; and (4) a public hearing and study of certificates of participation (COPs) in California, which are quickly becoming the debt instrument of choice for many local agencies, especially school districts.

AN INTRODUCTION TO THE COMMISSION

At the beginning of the 1980s, California policymakers were becoming concerned about the financial difficulties facing local agencies who were adjusting to the impacts of Proposition 13 while coping with historically high interest rates in the municipal marketplace. The defaults of New York City on its municipal debt obligations in the mid-1970s served as a warning of the consequences of ignoring growing fiscal pressures. It became clear that California could benefit from collecting better information on municipal debt issuance and providing technical assistance to public agencies issuing debt. To address these deficiencies, State Treasurer Jesse Unruh proposed the creation of the California Debt Advisory Commission, to serve as a central repository of public debt information and to assist public agencies in achieving the best financing terms on their bond issuances.

The Commission, also known as CDAC, became a reality with the passage of Chapter 1088, Statutes of 1981 (AB 1192, Costa). Since 1982, the Commission has helped protect and improve the credit standing of public agencies in the state and ensured their continued access to the public debt markets. The Commission achieves these goals by collecting information on the issuance of debt, providing assistance to local governments upon request, and analyzing policy issues concerning public debt.

Pursuant to Chapter 1088, the Commission is specifically required to:

- Serve as the state's statistical center for debt information.
- Publish a monthly newsletter.
- Maintain contact with all participants in the municipal debt industry to improve the market for public debt.
- Provide technical assistance to state and local governments to reduce cost and protect the issuer's credit.
- Undertake or commission studies on methods to reduce costs and improve credit ratings.
- Recommend legislative changes to improve the sale and payment of debt.
- Assist the Housing Bond Credit Committee and all state financing authorities and commissions in carrying out their responsibilities.

Since the Commission's creation in 1981, the Legislature has given CDAC additional responsibilities. Chapter 1399, Statutes of 1984 (AB 4025, Waters) requires CDAC to collect, summarize, and report annually to the Legislature specific information on the use of proceeds from the sale of housing bonds. Chapter 1399 also requires CDAC to certify to the Legislature local agencies' compliance with housing bond reporting requirements.

Moreover, the Legislature requires issuers to report specified information to CDAC when they (1) sell refunding or revenue bonds through negotiation or private placements or (2) issue bonds payable in a foreign currency.

THE COMMISSION MEMBERS

The Commission consists of nine members, including the State Treasurer, the Governor or the Director of Finance, the State Controller, two local government finance officials, two Assembly members, and two Senators. The State Treasurer serves as the Chairperson and appoints the two local government officials. The Speaker of the Assembly appoints the Assembly representatives and the Senate Rules Committee appoints the Senate representatives. Appointed members serve four-year terms, or at the pleasure of their appointing power. The Commission meets at least four times a year to direct the activities of the 11-member staff.

Honorable Kathleen Brown, Chairperson
State Treasurer

Kathleen Brown was sworn in as California's 28th State Treasurer on January 7, 1991. By virtue of her office, she became the Commission's fourth Chairperson. In addition to her responsibilities as the state's official banker, she chairs over 40 other boards, authorities, and commissions.

Treasurer Brown's election as State Treasurer follows a 15-year career as financial manager and public policy maker. She served two terms as a member of the Los Angeles Board of Education. She was also a corporate attorney specializing in public finance with the law firm O'Melveny & Myers. In 1987, she was appointed to the Los Angeles Board of Public Works.

Treasurer Brown became Chairperson of the California Debt Advisory Commission in 1991.

Honorable Gray Davis
State Controller

Controller Gray Davis assumed the office of State Controller of the State of California in January 1987. As State Controller, he receives and disburses public funds, reports on the financial condition of the state and local governments, collects certain taxes, and enforces the unclaimed property laws.

Prior to his election, State Controller Davis represented the 43rd District in the State Assembly. He had also served as Chief of Staff to former Governor Edmund G. Brown, Jr. from 1974 through 1981.

Controller Davis has been a Commission member since 1987.

Thomas Hayes
Director of Finance

Director Thomas Hayes was appointed Director of the Department of Finance by Governor Pete Wilson in January, 1991 and represents the Governor on the Commission. In his capacity, Director Hayes serves as the Governor's chief fiscal advisor and is responsible for the development and management of the state's budget.

Prior to his appointment, Director Hayes served as California's 27th State Treasurer and chaired CDAC while in that capacity. Director Hayes held the position of State Auditor General for ten years before he was appointed State Treasurer.

Director Hayes has been representing the Governor on the Commission since 1991.

Honorable Robert Beverly
29th Senatorial District

Senator Beverly has been a member of the California Legislature since his election to the Assembly in 1967. He was first elected to the Senate in 1976. In the Senate, he serves as the Vice Chairperson of the Appropriations Committee, and is a member of the Banking, Commerce, and International Committee, the Elections and Reapportionment Committee, the Governmental Organization Committee, the Rules Committee, and the Veterans Affairs Committee, among others.

Prior to his election to the Legislature, Senator Beverly served in various local government capacities, including city attorney, mayor, and council member.

Senator Beverly has been a member of the Commission since its first year of operation.

Honorable Lucy Killea
39th Senatorial District

Senator Killea was elected to the State Senate in 1989, after serving four consecutive terms in the Assembly. She chairs the Senate Appropriations Subcommittee on Bonded Indebtedness & Methods of Financing and the Select Committee on Source Reduction & Recycling Market Development. In addition, she is a member of the Senate Education Committee, the Energy & Public Utilities Committee, the Housing & Urban Affairs Committee, and the Transportation Committee.

Prior to her state legislative career, Senator Killea served as a San Diego City Council member and as San Diego City Deputy Mayor.

Senator Killea was appointed to the Commission by the Senate Rules Committee in 1991.

Honorable Jim Costa
30th Assembly District

Assemblymember Jim Costa first won election to the California State Assembly in 1978. In addition to his capacity as the Chairperson of the Assembly Democratic Caucus, Assemblymember Costa chairs the Assembly Ways and Means Subcommittee No. 3 on Resources, Agriculture, and the Environment. He also serves on the Assembly Agriculture Committee, Elections Committee, Reapportionment and Constitutional Amendments Committee, and Transportation Committee, among others.

Before Assemblymember Costa's election to the Legislature, he served as a congressional aide to Congressman B.F. Sisk, a special assistant to Congressman John Krebs, and an administrative assistant to Assemblymember Richard Lehman's.

Assemblymember Costa carried the legislation that established CDAC in 1982, and has been a member of the Commission since that time.

Honorable Patrick Nolan
41st Assembly District

Assemblymember Pat Nolan has served in the California State Assembly since 1978. In the Assembly, Assemblymember Nolan sits on various committees, including the Banking, Finance, and Bonded Indebtedness Committee, the Insurance Committee, the Ways and Means Committee, and the Elections, Reapportionment, and Constitutional Amendments Committee.

Assemblymember Nolan is one of the original members of the Commission.

Honorable Don Merz
Sonoma County Treasurer-Tax Collector

Treasurer Don Merz was first elected Treasurer-Tax Collector of Sonoma County in 1978. Prior to his election, he served as Assistant Department Head in the Treasurer-Tax Collector's Office and as Senior Engineering Manager at Aerojet General Corporation.

Treasurer Merz has assumed leadership positions in several professional organizations, including the position of President of both the California Association of County Treasurers and Tax Collectors and the State Association of County Retirement Systems. He is currently the President-Elect of the National Association of County Treasurers and Finance Officers.

State Treasurer Kathleen Brown appointed Treasurer Don Merz to the Commission in 1991.

Mary Turner
Anaheim City Treasurer

Treasurer Mary Turner was appointed City Treasurer by the Anaheim City Council in 1984, after a 23-year career with the City of Fullerton's Treasury Office. She is a Past President of the California Municipal Treasurers Association and is currently a member of its Board of Directors. Turner is also a Past President of the Municipal Treasurers Association of the United States and Canada, and has served as the President of the League of California Cities - Fiscal Department.

A Certified California Municipal Treasurer and a Certified Municipal Financial Administrator, Treasurer Turner was the recipient of the Sixth Annual Dr. Jackson R. E. Phillips Award, the highest award of the Municipal Treasurers Association of the United States and Canada.

Treasurer Turner began her term with the Commission in 1991, upon State Treasurer Kathleen Brown's appointment.

THE TECHNICAL ADVISORY COMMITTEE

To assist the Commission in its decision-making responsibility, a Technical Advisory Committee (TAC) was established in 1983. The TAC serves two primary functions:

1) To assist the CDAC in its deliberations by providing a forum for initial discussion of issues, problems, and opportunities related to public agency debt.

2) To assure a proper technical review of subjects by initially exposing them to professionals who have expertise in both the public and private aspects of public agency debt.

Since its inception, the TAC has continually provided Commission staff with valuable advice on a wide variety of issues, ranging from CDAC's reporting forms to emerging issues in public finance. Many of the TAC members also serve as faculty for the Commission's technical assistance seminars.

The TAC is composed of 25 individuals representing various groups involved in municipal finance, including bond counsel, underwriters, financial advisors, credit rating agencies, and local bond issuers. The State Treasurer appoints TAC members to staggered two-year terms. All TAC members serve without compensation. Members of the TAC for 1991 are listed in Appendix B.

THE COMMISSION'S PROGRAMS

In order to carry out its mission of assisting state and local agencies on matters related to debt issuance and debt management, the Commission engages in a wide range of activities and functions. These activities can be classified into three general program areas: data collection, technical assistance, and policy research and development.

Data Collection

In compliance with its statutory requirements, CDAC operates two data repositories: the debt issuance data bank and the housing bond proceeds data bank. These repositories are considered two of the most comprehensive and accessible databanks of their kind.

As the state's clearinghouse for public debt financing information, the Commission compiles data on all public debt issued in California since January 1, 1982. All issuers of state and local government debt are required to submit issue-related information to the Commission 30 days prior to the sale and after completion of the sale. A sample of the data reported to CDAC include the sale date, the name of the issuer, the type of sale, the principal amount, the type of debt instrument, the source(s) of repayment, the purpose of the financing, the rating of the issue, and the members of the financing team.

CDAC's other data program, the housing bond proceeds databank, produces statewide information on the costs and benefits of tax-exempt mortgage revenue bonds issued by local entities. A critical feature of CDAC's housing revenue bond proceeds databank is its capacity to illustrate to policymakers and to the public the scope of low-income housing in the state financed by tax-exempt revenue bonds. Since January 1, 1985, CDAC has been collecting annual information on *multifamily* and *single-family* housing bond issues sold by cities, counties, and redevelopment agencies in California. Housing authorities began reporting in January 1, 1986. Housing bond data compiled by CDAC include project name and location, developer information, occupant incomes and family size, unit size, and rents or mortgage payments.

Policy Research and Development

To complement its data collection activities, CDAC undertakes various research and development projects. CDAC takes care to select projects that have practical relevance to public finance practitioners. These projects are usually designed to (1) keep issuers apprised of emerging trends in public finance, (2) develop ways of reducing issuance costs, (3) provide financing options for local issuers, (4) raise the issuers' sophistication level with regard to debt issuance and debt management, and

(5) preserve the integrity and viability of existing debt instruments by alerting policymakers to potential problem areas.

Technical Assistance

The Commission's activities go beyond data collection and policy research. The data and expertise accrued by CDAC would be of limited value if it were not made available to public agencies in a useful form. It is with this goal in mind that the Commission developed its technical assistance program.

CDAC's formal technical assistance program consists mainly of two components. The first is the *California Debt Issuance Primer*, a CDAC publication designed as a reference manual for public debt issuers in the state. The second component of the formal technical assistance is CDAC's seminar program, which was inaugurated in June 1984. Offered up to six times a year at different locations statewide, these seminars are designed to meet two primary goals: (1) to introduce public officials who are new to the field of public finance to the debt issuance process and (2) to strengthen the expertise of those who are already familiar with debt issuance and management concepts. Since its inception, over 1,200 public officials and staff have participated in seminar workshops. Approximately three-quarters of the participants have come from local agencies, while the remainder have been representatives from federal, legislative, and state agencies.

Of course, CDAC does not limit its technical assistance program to the *Primer* and the seminars. As the state agency responsible for the oversight of state and local debt, public and private individuals routinely contact the Commission with inquiries related to California public debt. Hence, CDAC staff responds to numerous technical assistance requests throughout the year. These requests include simple referral requests, data inquiries, and questions on the nature and application of specific debt instruments, among others. In a typical year, CDAC responds to over 1,000 requests for information or assistance.

CALIFORNIA PUBLIC FINANCE IN 1991

OVERVIEW

For California public issuers, 1991 was a year of harsh fiscal and economic realities. In some cases, these challenges placed a tremendous strain on the ability of California issuers to address their growing infrastructure needs. At the same time, the interest rate environment in 1991 was extremely favorable for debt financing. As a result, California public issuers flocked to the market during 1991, breaking the state's record for debt issuance, which was set in 1985 just prior to changes in federal tax laws.

This chapter describes the factors which influenced debt issuance in 1991 and examines some of the topical issues in the California public finance arena. This chapter also provides a detailed picture of total debt issuance volume for 1991, broken down by type, purpose, and structure of California public debt issued during the year.

The Recession Weakens Municipal Credits

The nation's economy plunged in 1991 and took the California economy right along with it. In sharp contrast to the tremendous growth and expansion experienced by the state during the 1980s, the California economy slowed to a standstill in 1991. According to the Commission on State Finance, the state lost an estimated 600,000 jobs. A "normal" year would have yielded the state an increase of 300,000 jobs. When combined with a slumping real estate market, the job loss placed a tremendous strain on public finance.

The current California recession, considered the longest recession to hit the state since the 1930s and the most severe of the post-World War II era, posed an enormous fiscal challenge for the State and local governments. At the state level, the Governor and the Legislature struggled to close an unprecedented $14 billion state budget gap during the first half of 1991. Local governments did not fare much better. In most cases, city, county, and special district revenues lagged. And as the State grappled with its fiscal dilemma, local governments became recipients of new fiscal responsibilities previously undertaken by state government.

As a result, municipal credits were not immune to the 1991 recession. The biggest casualty in this area was the loss of the State of California's coveted AAA credit rating. Municipal credit ratings, of which AAA is the highest, are generally accepted as a barometer of an issuer's ability and willingness to pay its debt. The higher the credit rating, the lower the investor risk, and the more attractive the interest rate. In December 1991, Standard & Poor's Corporation (S&P), citing chronic deficit problems and the elimination of budget reserves, downgraded the State's credit rating to AA. Moody's Investors Service and Fitch's Investors Service would follow suit shortly thereafter.

The State of California's predicament was certainly not unique. According to S&P, seven other states (Connecticut, New Jersey, New Hampshire, Rhode Island, Vermont, Maine, and Illinois), suffered the same fate in 1991. In addition, of the 227 California municipal rating changes S&P issued in 1991, 211 or 93 percent were downgrades while only 16 or seven percent were upgrades. It should be noted, however, that most of these downgrades were related to the State of California's rating downgrade.

Falling Interest Rates Invite Greater Debt Issuance

With the national economy retracting, the Federal Reserve Board took actions in 1991 to lower the cost of borrowing for banks and other major institutions. One of the outcomes of the Fed's actions was that interest rates on municipal bonds pushed downward during most of the year. Increased investor interest in tax-exempt bonds also provided public issuers with a competitive market for their bonds.

In California, the low interest rate environment more than offset the rating downgrades which took place in 1991. For instance, despite the lowering of the State of California's rating from AAA to AA by Standard & Poor's, the State realized the lowest interest rates on its general obligation (G.O.) bond offerings since 1978. Whereas the interest rate on State G.O. bonds was as high as 7.048 percent in August 1990, by October 1991 the rate had dipped to 6.057 percent. This difference of nearly one whole percentage point (99 basis points) is especially significant given the volume of G.O. debt issued by the State (over $4 billion) in 1991.

Interest rates for most types of public debt dropped during the course of the year. For instance, the Bond Buyer's 20-Bond Index of medium-grade general obligation bond yields, which was at 7.14 percent at the beginning of the year, dropped to 6.58 percent by the end of 1991, a drop of 56 basis points. Rates for high-grade G.O. bonds (like California G.O.'s) dropped 54 basis points during 1991, and revenue bonds dropped even more dramatically, with rates going down by 63 basis points from December 1990 to December 1991.

Mello-Roos Bonds Buck the Trend

While interest rates for most types of credit were falling in 1991, yields on Mello-Roos bonds experienced an upward trend toward the end of the year. These special tax bonds received substantial attention in 1991, as the industry became increasingly concerned with the underlying creditworthiness of these securities.

This concern stemmed, at least in part, from three factors: (1) a series of defaults of special districts with similar types of taxing authority in Colorado; (2) the increasing volume of Mello-Roos financing in the state; and (3) the real estate slump resulting from California's troubled economy.

In addition to concerns over credit quality, the press and public officials began to focus more attention on some of the tax inequities posed by the Mello-Roos Act. In some cases, new homeowners were being asked to shoulder significant new tax burdens without receiving proper disclosure or a commensurate level of new services. In other instances, it appeared that a large share of the tax burden was being shifted to residential property, while owners of undeveloped land were paying little or no special taxes. The California Debt Advisory Commission conducted extensive research in 1991 to address the credit quality and tax equity concerns surrounding Mello-Roos transactions.

The Drought Takes its Toll

As California was experiencing its fifth year of drought in 1991, investors paid greater attention to the finances of state and local water agencies and to the outstanding indebtedness of development projects dependent on new water hook-ups. The focus of this attention was on (1) the ability of individual agencies to continue debt service payments in the face of decreasing water supply, and (2) the impact of drought-related building moratoria on new development.

Given these concerns, in February 1991 the Commission reviewed the likely impact of the drought on California issuers and reached four major conclusions. First, the drought would have a minor impact on the ability of the State Department of Water Resources (DWR) to pay debt service for the outstanding debt issued for the State Water Project. Second, local agencies were responding to reduced water flows by imposing rate increases to raise adequate revenues to pay debt service costs on outstanding revenue bonds and certificates of participation.

The third finding was that local agencies in heavily agricultural areas were likely to encounter higher delinquency rates among their taxpayers as a result of reduced agriculture income. These agencies, however, should be able to meet their debt service requirements by tapping into bond reserve funds and imposing rate surcharges. The Commission found no evidence of specific districts on the brink of default on their debt obligations.

Finally, CDAC found that some districts were coping with the drought through the imposition of building moratoria. To the extent that these moratoria are long-lasting, they could have an impact on the ability of developers to make debt service payments on outstanding Mello-Roos bonds and special assessment bonds. In the long run, chronic water shortages could severely restrict housing development in California. Although the heavy rains which occurred in March 1991 greatly reduced the impact of the drought, continued drought conditions into 1992 and beyond will likely have a negative impact on water-related debt.

Ethics and Integrity Take Center Stage

Several factors brought ethics and market integrity to the fore in 1991. First, new provisions to the California Political Reform Act that limit honoraria and gifts public officials receive became effective in January 1991. Second, numerous press articles zeroed in on the financing practices of certain public and private officials which resulted in unreasonably-sized bond transactions, lavish closing dinners, and gifts to public officials from underwriters. In many cases, such transgressions were associated with financings taking place pursuant to the Marks-Roos Act. Finally, a Stanislaus County grand jury report noted dubious, and probably illegal, practices related to bond activities of county elected officials and staff.

The Commission responded to concerns over ethics in public finance by increasing its commitment to provide public officials with information on applicable conflicts of interest rules, as well as general counsel on the types of transactions which have proven troublesome. This was accomplished through information provided via *DEBT LINE* and by the addition of an ethics presentation to the Commission's seminar programs. Commission staff also assisted with the preparation of a pamphlet on conflict of interest rules which was published by State Treasurer Kathleen Brown.

In light of the questions raised regarding Marks-Roos bond transactions, the Commission also conducted a preliminary inquiry into this issue. CDAC's findings indicate that while Marks-Roos can provide certain benefits to local agencies, it is also vulnerable to abuse. The most dramatic abuse would appear to be the practice of issuing a volume of Marks-Roos bonds that far exceed what a jurisdiction can reasonably expect to utilize. These oversizings can lead to increased profits for underwriters, while providing no value to issuers. To fully address this issue, the Commission will launch a review of the Marks-Roos Act in 1992.

CALIFORNIA DEBT ISSUANCE IN 1991

Despite some of the challenges discussed above, calendar year 1991 proved to be a banner period for California municipal debt issuance. The Commission's final figures indicate that State and local agencies sold a record $34.8 billion in 1991, an increase of $10.7 billion, or 44 percent more than the amount of debt issued in 1990. For a more detailed treatment of public debt issued in California in 1991, interested parties can refer to the *1991 Calendar of Debt Issuance* and the *1991 Summary of California Public Debt*, two companion volumes to the *1991 Annual Report*.

State and Local Agencies Share in Record Debt Levels

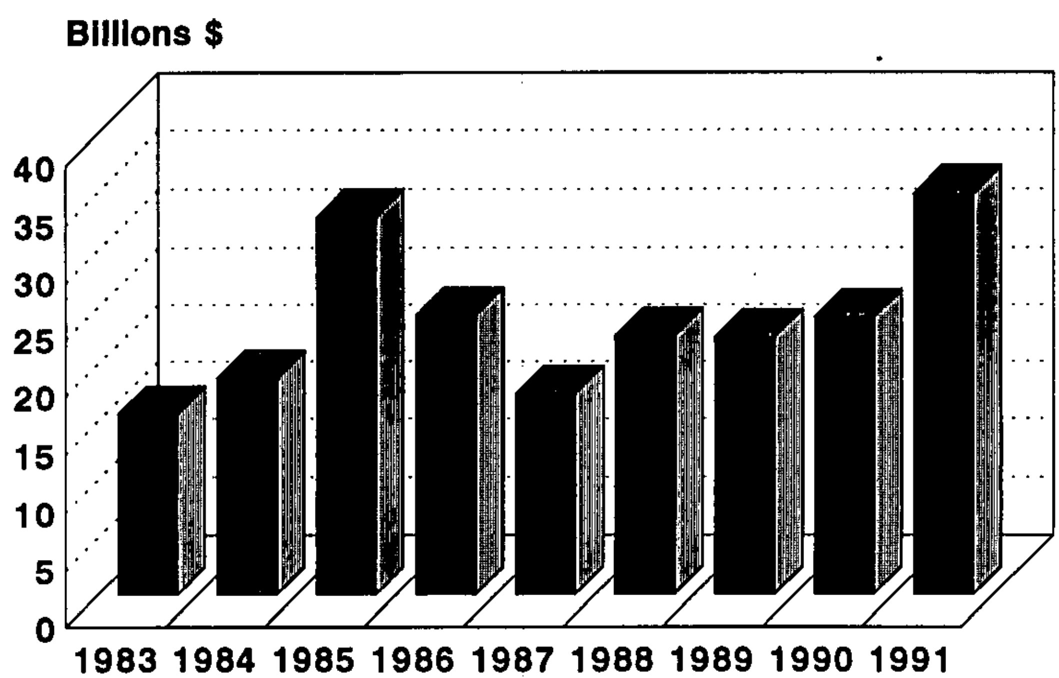
State and local agencies in California were active participants in the public finance market, leading to a record issuance of municipal debt in 1991. For instance, the State of California reduced its massive voter-approved general obligation bond backlog by over $4 billion. In sum, the State of California and its agencies issued $14.5 billion in debt, an increase of $4 billion, or 39 percent over the previous year. Local governments also took advantage of the low interest rates in 1991 by aggressively issuing tax-exempt debt. They borrowed $20.1 billion last year, $6.4 billion, or 47 percent higher than the amount they borrowed in 1990. A $200 million refunding of previously issued debt by a nonprofit student loan corporation rounded out statewide debt issuance for the year.

While numerous causes undoubtedly contributed to 1991 debt totals, it would appear that low interest rates, revenue uncertainties, a growing backlog of unfinished capital projects, and economic considerations were all major factors.

Chart 1 shows total statewide debt issuance levels from 1983 to 1991. As Chart 1 indicates, there have been two dramatic jumps in the annual volume of debt issuance in the state. The first was recorded in 1985, when state and local governments rushed to the market in reaction to a May 1985 federal government proposal to impose severe restrictions on municipal bond issuance. The second jump occurred in 1991 as municipal issuers took advantage of the low interest rates to fund infrastructure needs and to refinance prior debt.

Chart 1

California Public Debt Issuance
1983 through 1991



SOURCE: CDAC

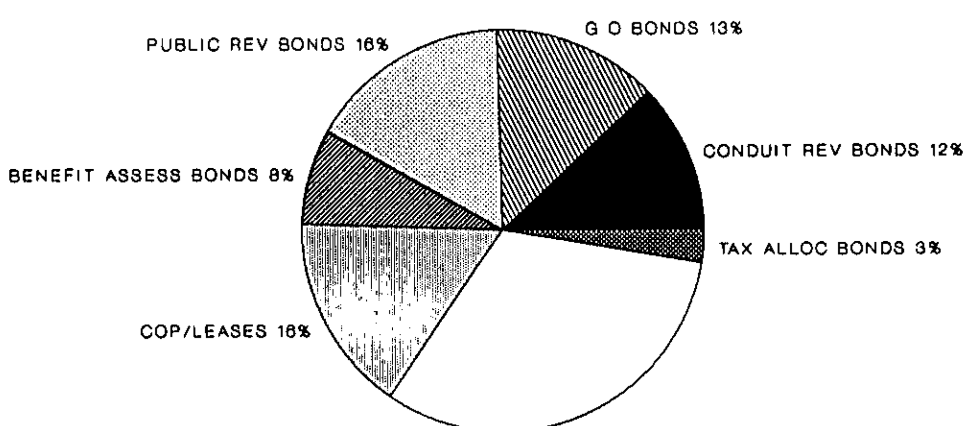
All Types of Debt Increased in 1991

As in the past, bonds constituted the majority of statewide debt issued in 1991. Information displayed in Chart 2 indicates that bonds, consisting of general obligation, public revenue, conduit revenue, benefit assessment, and tax allocation bonds, made up 52 percent of total debt issuance last year. Notes and commercial paper took up 32 percent of the borrowed amount, while certificates of participation (COP) and leases made up the remaining 16 percent.

Public revenue bonds saw the biggest jump in issuance, increasing to $5.7 billion in 1991--almost double the previous year's volume. Certificates of participation and leases followed with a 79 percent increase. State and local general obligation bonds, fueled by an additional $1 billion in State of California general obligation bonds, increased 28 percent statewide. Note issuance increased to $11.1 billion in 1991, 26 percent above its 1990 issuance level.

Chart 2

California Debt Issuance by Type
January 1, 1991 - December 31, 1991



Source: CDAC

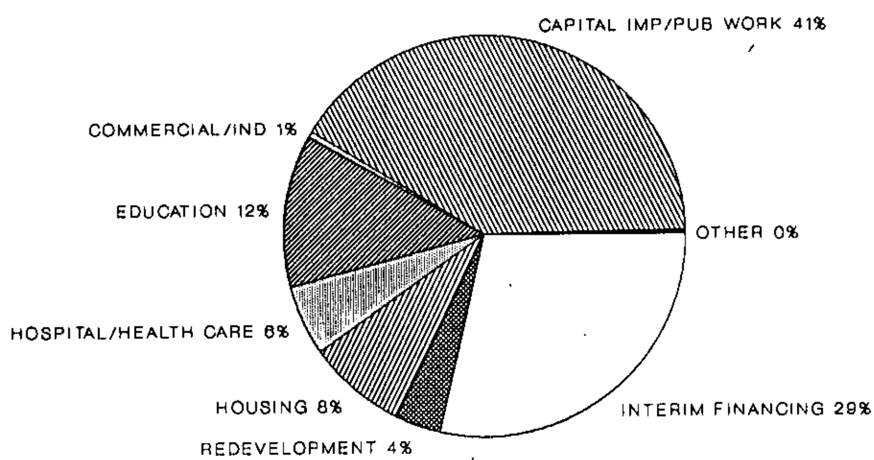
Debt Issuance Targets Capital Improvements

As in 1990, CDAC data shows that capital improvements and public works projects were the biggest beneficiaries of debt issued in the state in 1991. As shown in

Chart 3, 41 percent of the debt issuance volume in 1991 was used to finance capital improvements and public works projects. This was followed by interim financing, with 29 percent of the total. Education received the next biggest share accounting for 12 percent of the debt issued in the state. The remainder of the debt issued was targeted at housing (eight percent), hospitals and health care (six percent), redevelopment (four percent), and commercial/industrial (one percent) purposes.

Chart 3

California Debt Issuance by Purpose
January 1, 1991 - December 31, 1991



Source: CDAC

Low Interest Rates Spur Refundings

The low interest rates that prevailed through most of 1991 prodded many issuers to refund previously issued debt. Refundings for the year amounted to $5.5 billion, breaking the record high $3.1 billion in refundings conducted in 1990. Of this total, $1.8 billion was refunded by the State, $3.4 billion was refunded by local agencies, and $200 million was refunded by a nonprofit student loan corporation. As is the case with new debt issuance, capital improvements and public works projects were the biggest beneficiaries of refunded debt in California .

The 1991 refunding issuance level made up 16 percent of the total debt issuance in the state. While this figure is certainly noteworthy, it should be mentioned that across the nation, refundings constituted nearly 25 percent of all state and local debt issued in the United States in 1991. Two reasons commonly cited for California's below-average level of refundings are (1) the large percentage of general obligation bonds issued in California which do not carry call provisions, and (2) the relatively low amount of debt issued by California agencies during the early 1980s when interest rates hovered at all-time highs.

State G.O. Bonds Skew Competitive/Negotiated Ratio

Of the $34.8 billion issued statewide in 1991, $10 billion, or 29 percent, were sold through competitive bids. The remaining $24.8 billion, or 71 percent of the issues, were sold through negotiated sale.

Despite the continued dominance of negotiated sales in the California market, Table 1 indicates that its market share has been declining for the past five years. Whereas 90 percent of the bond issuance volume statewide was negotiated in 1987, only 71 percent was sold in this manner in 1991. It should be noted, however, that the high competitive sales volume in 1991 is primarily due to the increase in the sale of State of California's general obligation bonds, all of which were sold competitively.

Table 1

State and Local Debt Issuance
Competitive vs. Negotiated Financings
1987 through 1991
(dollars in millions)

Year	Competitive	% of Total	Negotiated	% of Total
1991	10,001	28.7	24,821	71.3
1990	6,043	25.4	18,091	75.0
1989	4,545	20.3	17,812	79.7
1988	3,418	15.2	19,068	84.8
1987	1,591	10.1	14,088	89.9

ACCOMPLISHMENTS IN 1991

THE COMMISSION'S REPORTS

One of CDAC's many challenges is to keep the public informed about issues that affect public finance. As a statewide resource agency on public financing matters, the Commission strives to make information at its disposal as accessible to the public as possible. To meet this goal, CDAC publishes a variety of reports throughout the year. With the exception of the *California Debt Issuance Primer*, these reports are available to any interested party free of charge.

In 1991, CDAC released nine reports. In addition, the Commission published 12 editions of *DEBT LINE*, CDAC's monthly newsletter, and continued distribution of the *Primer*. A description of all reports issued in 1991 follows.

Annual Report 1990: Summary of California Public Debt

This two-volume report provides a detailed look at public debt issuance in California for 1990. Information contained in this report covers unaudited data for public debt issuance from January 1 through December 31, 1990, reported to the Commission by February 15, 1991.

The *Annual Report 1990: Summary of California Public Debt* provides a profile of the level of public borrowing which took place in the state. Included in this report are brief narrative discussions concerning the volume of state and local issuance for 1990, with a focus on the variety of debt instruments available to public issuers, including Mello-Roos bonds, Marks-Roos bonds, and Minibonds. The bulk of the report, however, is devoted to tables that summarize 1990 state and local debt issuance by type of debt instrument (general obligation bonds, certificates of participation, etc.); use of proceeds (single-family housing, education, etc.); federally taxable financings; financings to refund existing debt; and types of issuing agencies (state, cities, counties, etc.).

Annual Report 1990: Calendar of Issues

The companion volume to the *Summary* is the *1990 Calendar of Issues*, which includes a detailed description of each reported debt issue sold in 1990. The information presented in the *Calendar* is organized by county and by issuer to portray each agency's debt issuance activity for the year.

Annual Summary 1991: The Use of Housing Revenue Bond Proceeds

This annual report presents CDAC data on local agencies' use of tax-exempt housing revenue bond proceeds in 1991. This report includes information on the incomes, family size, rents or mortgage payments of housing occupants; the number, size, sales price, and geographic distribution of the units that are developed; the length of time the units have to comply with income-targeting requirements; and the type of developers or sponsors of housing projects.

The 1991 edition of the report shows that between January 1, 1985 and June 30, 1991, local agencies issued a total of $7.5 billion in housing revenue bonds. However, the report only contains data for $6.5 billion of that total due to the failure of some agencies to comply with CDAC reporting requirements.

The 1991 edition also shows that in the *multifamily* housing area, local housing agencies have issued $5.2 billion in bonds to fund the construction of 86,325 units. Of these units, 22 percent (18,884 units) are targeted for lower-income households. In addition, the report suggests that while over $1.4 billion in *single-family* housing bond proceeds were available for mortgage loans through June 30, 1991, only $637 million (44 percent) has been allocated, resulting in the origination of 6,975 mortgages as of mid-1991. Housing agencies have three years from the date of issuance to allocate *single-family* bond proceeds or the bonds must be redeemed.

State and Local Tax and Bond Ballot Measures: Summary of General Election Results (November 6, 1990)

Released in February 1991, this report features the 147 state and local bond and tax measures presented to California voters at the November 6, 1990 General Election. The report notes the sponsoring agency, the purposes, and the voting results of 19 state and 128 local measures on the November ballot.

As this report indicates, the November 1990 General Election was significant for statewide bond measures for two reasons. First, the number of statewide ballot measures presented to the voters for approval was the highest ever recorded. Second, the voters rejected an overwhelming majority of the state bond proposals on the ballot--another first for the state. Specifically, only three of the 19 state measures presented for voter approval passed. This translates to a passage rate of 16 percent.

Local measures fared much better at the polls. Of the 128 local tax and bond measures on the ballot, 51 measures (40 percent) were approved. The report provides a brief narrative summarizing the voting results, as well as a more detailed breakdown of these measures.

Review of the State's 1991 Capital Outlay and Infrastructure Report

In 1991, the Department of Finance (DOF) released the state's first *Capital Outlay and Infrastructure Report*, as required by Chapter 1435, Statutes of 1990 (SB 1825, Beverly). The report outlines the projected capital outlay and infrastructure needs of the state for the next ten years and the potential sources for financing these needs.

In keeping with its mission, CDAC provided a review of the DOF report, focusing on the methodology employed by DOF to estimate future infrastructure needs and the implications for future debt issuance and management in California.

CDAC's review yielded three recommendations. First, the Commission recommended that the report be broadened to include all program areas traditionally considered the responsibility of the state. Second, the Commission suggested that the Department of Finance employ a consistent approach for evaluating needs and program requirements among program areas. Finally, CDAC stressed that there should be a greater link between capital needs and a schedule of bond authorization and issuance for each program area discussed in the report.

The review indicated that future debt projections by DOF are extremely sensitive to various assumptions about voter support for future bond proposals, future interest rates, and the pace at which bonds are sold. The review also compared debt management policies in other states with the policy employed in the DOF report.

Leases in California: Their Form and Function

Recognizing the importance of tax-exempt leasing as an alternative to traditional forms of capital and equipment financing, CDAC commissioned a study on lease financing in the state. The study culminated in a report entitled *Leases in California: Their Form and Function* which was released in April 1991.

This report is intended as an informational and educational tool for state and local officials who are interested in learning more about the use of lease financing in California. It provides detailed information on the types of lease financing employed by state and local governments. It also discusses debt restrictions and California case law related to lease financings, federal and state legislative and regulatory issues, lease documentation, accounting for leases, credit analysis and credit enhancements, and lease marketing.

This report contains two other informative features. It includes a case studies section which profiles ten actual California lease transactions, including the documentation, the structures, and the purposes of these financings. In addition, the report provides a glossary of leasing terms.

Leases in California: Summary and Recommendations

A companion piece, entitled *Leases in California: Summary and Recommendations*, outlines recommended steps the Commission can take to improve the use of tax-exempt lease financing in the state. The recommendations cover three areas where the Commission can play an active role: research, education, and administration.

In 1991, CDAC received almost 600 requests for the two *Leases in California* publications.

Mello-Roos Financing in California

With a distribution of almost 900 copies (between September and December 1991), *Mello-Roos Financing in California* has been one of CDAC's most popular publications ever. This report contains a comprehensive review of the Mello-Roos Community Facilities Act of 1982. The Mello-Roos Act provides California local governments with a flexible revenue source for financing public facilities and services, especially in high-growth areas. Specifically, the Act authorizes local agencies to form community facilities districts in order to levy a special tax to finance infrastructure and/or services. In most cases, these special taxes are used to secure bonds.

Because of public and industry concerns regarding the increasing volume of Mello-Roos special tax bond transactions and the impact of the California real estate slump on the security of those bonds, CDAC launched an in-depth examination of the Act. This study was intended to offer an objective look at many issues raised by Mello-Roos financing, and to provide local agencies with some guidance in developing and implementing policies that govern Mello-Roos financings.

CDAC's Mello-Roos report encompasses all facets of the Act. It starts out with a review of the post-Proposition 13 fiscal and political realities which spurred the need for a flexible financing tool and ultimately led to the enactment of the Mello-Roos legislation. It discusses the mechanics of forming, administering, and issuing bonds for a Mello-Roos district and analyzes Mello-Roos bond issuance data. The report also explores the public policy issues associated with Mello-Roos financing, including expenditure and taxation issues. In view of the growing problems with real estate-backed financing, the report also looks at the credit quality issues associated with Mello-Roos special tax bonds. The report culminates with two sets of guidelines (planning and project evaluation) designed to assist local governments in taking full advantage of the benefits offered by Mello-Roos financing, while avoiding its pitfalls.

Guidelines for Mello-Roos Financing

To accommodate the specific needs of public officials, CDAC released a companion document called *Guidelines for Mello-Roos Financing*. Excerpted from the *Mello-Roos Financing in California* report, this publication focuses solely on suggested guidelines for local agencies to help them shoulder their debt management responsibilities. CDAC received over 160 requests for the *Guidelines* in 1991.

OTHER COMMISSION PUBLICATIONS

DEBT LINE (Monthly)

Every month, over 3,300 public and private subscribers receive a copy of *DEBT LINE*, CDAC's monthly newsletter. This publication contains a calendar listing of all proposed and sold debt issues reported to the Commission, summary tables on the types of debt and the purposes of the financing, as well as various informational articles.

DEBT LINE is a valuable source of three types of information. First, it is where issuers and other public finance professionals find information on municipal bond financing transactions occurring in the state. For example, those agencies which are considering a financing transaction often consult *DEBT LINE* for vital information--such as volume, interest costs, type of sale, and members of the financing team--on similar issues in the market. Others may consult the newsletter for an indication of potential new trends or innovations in public finance.

Second, *DEBT LINE* serves as a forum for discussion of critical issues in public finance. While some articles are intended to inform readers of developments taking place in the marketplace, other articles present differing views on a particular topic. In 1991, for instance, *DEBT LINE* published articles discussing the need for disclosure in the secondary market and articles debating the security and benefits of private activity bonds. The past year also saw the premiere of *DEBT LINE*'s "Legislative Status Report" section which highlights state legislation that affects the issuance and management of public debt.

Finally, *DEBT LINE* is the primary vehicle for advising the public of the Commission's activities. It frequently includes announcements concerning new CDAC publications, programs, and seminars, as well as summaries of the Commission's meetings and hearings.

California Debt Issuance Primer

In 1991, CDAC received almost 200 requests for the *California Debt Issuance Primer*, bringing its total distribution to 1,500 copies since the Commission released it in 1988. Designed as a reference handbook, the *Primer* provides a comprehensive overview of the various debt financing options available to California public issuers. The *Primer* also describes and discusses the participants in a debt financing, the steps in the debt issuance process, the types of debt instruments, State debt oversight and financing programs, and key terms and concepts in public finance.

THE COMMISSION'S SEMINAR PROGRAM

The Commission's seminar program took a new direction in 1991. As in previous years, CDAC offered introductory and advanced seminars on debt financing. In addition, however, CDAC launched an effort to expand its seminar program by providing more specialized seminars. At the advice of the Commission's Technical Advisory Committee, CDAC embarked on a campaign to reach out to various local government associations to design seminars that are specifically suited to the needs of these groups. Given the success of the initial co-sponsored seminar in 1991, CDAC is expecting to co-sponsor up to six events in 1992.

The CDAC/CASBO Seminar

CDAC's first co-sponsored seminar was held in November 1991, in conjunction with the California Association of School Business Officials (CASBO). According to CDAC data, school districts incurred a total of $1.4 billion in debt in 1991, an increase of 34 percent from the previous year. Recognizing the schools districts' increasing participation in the debt market, and the need for general and technical information on school debt issuance and debt management, the Commission developed a two-day seminar to provide school officials with in-depth information on school capital finance.

The seminar was broken down into two separate workshops. The first workshop, called *Fundamentals of Debt Financing*, introduced school officials to terms and concepts which are basic to debt issuance. The faculty of the *Fundamentals* workshop also discussed the roles and responsibilities of school officials as issuers and those of their financing team.

The second workshop, called *Understanding the Debt Issuance Process*, was designed to give participants a more advanced understanding of the bond issuance process. The faculty explored the major steps in the debt issuance process and examined the typical debt instruments used by school districts, such as G.O. bonds, Mello-Roos bonds, and certificates of participation.

The faculty of the CDAC/CASBO seminar consisted of experts in the municipal finance industry, including some members of the TAC, and school finance officials. The seminar attracted over 100 participants from all over the state and drew a highly favorable response.

The Fundamentals of Debt Financing Seminars

While specialized seminars represent the future of CDAC's technical assistance efforts, the Commission's regular seminar series remained the mainstay of these efforts in 1991. Offered in both Southern and Northern California, these popular seminars are open to any and all interested public agency officials and staff. Seminar workshops are given by municipal finance industry experts, including members of the TAC, and public officials with extensive experience in public finance.

As in previous years, CDAC presented *Fundamentals of Debt Financing* seminars at two sites, Irvine and Oakland. These seminars are designed to provide public officials with an introductory view of public finance. The 150 participants at the seminars learned about the basics in debt financing, including the roles and responsibilities of the issuer, the roles and responsibilities of each member of the financing team, the various debt instruments available to them, and the steps in the bond issuance process.

Given the increasing amount of public scrutiny and concern regarding the integrity of public finance transactions, the Commission offered *Ethics and Public Finance Transactions* as part of the *Fundamentals* seminar for the first time. This session addressed issues related to conflicts of interests and receipts of gifts associated with public finance transactions.

The Mechanics of a Bond Sale Seminars

For public officials who require more advanced training in public finance, CDAC once again offered the *Mechanics of a Bond Sale* seminars in 1991. Offered in Irvine and Oakland, the *Mechanics* seminars focused more on the technical aspects of bond issuance. These seminars included in-depth examinations of each step of the bond issuance process, starting from the capital outlay planning stage to the bond sale evaluation stage. Attending the seminars were 140 state and local agency officials.

THE COMMISSION'S NETWORKING EFFORTS

Public Outreach

As the state's central repository for debt information, the Commission is often invited to conferences and other gatherings to address various issues related to California debt issuance and debt management. CDAC uses these opportunities to share the Commission's views on various public finance matters and to learn about issues of concern to constituency groups who have an interest in how state and local agencies issue and manage debt. In 1991, CDAC made presentations to the following groups:

- Association of California Water Agencies
- Association for Governmental Leasing & Finance
- Bond Buyer Conference on Public Finance
- California Association for Local Economic Development
- California Association of Sanitation Agencies
- California Public Finance Conference
- Local Agency Investment Fund
- Los Angeles Airport Chamber of Commerce
- Los Angeles County Health Department
- State Debt Management Network
- Southern States Treasurers Conference

State Debt Management Network

Representing the State Treasurer's Office, CDAC was a founding member of the State Debt Management Network in 1991. The Network is an association of state officials throughout the country committed to fostering and promoting better debt management practices. Members of the Network meet periodically to discuss and share innovative measures for improving disclosure to investors and the public, and realizing the most cost-effective use of bond proceeds. The Executive Director of the Commission currently chairs the membership committee of the Network and also serves on the Network's Steering Committee.

THE COMMISSION'S DATA REPOSITORIES

Calendar year 1991 was a record-breaking period for state and local debt issuance in California. The data section of the Commission processed 1,577 reports of proposed debt issuance in 1991. CDAC also received another 1,452 reports for issues sold during the year. These included issues that were reported as proposed sales in 1989, 1990, and 1991 but were actually sold in 1991. Each of the over 3,000 reports CDAC processed in 1991 contains detailed information on the sale of public debt.

In addition to debt issuance reports, CDAC compiled data on the use of housing revenue bond proceeds. In 1991, the Commission collected 368 housing bond issuance reports from 121 local agencies--71 cities and counties, 31 redevelopment agencies, 17 housing authorities, and two housing finance agencies. The Commission also reviewed 55 requests for certification of compliance with housing revenue bond reporting requirements.

The data which support all CDAC publications, as well as information provided to the public upon request, are culled from the individual debt issuance reports that CDAC receives each year.

THE OUTLOOK FOR 1992

The California Debt Advisory Commission's 1992 agenda includes a combination of ongoing and new programs, as CDAC completes its 10th year. In addition to the Commission's regular programs, 1992 planned activities include new studies of critical public finance topics, expansion of CDAC's seminar program, and pursuit of legislative changes, among others.

Next Steps for Mello-Roos

In 1992, CDAC intends to continue its efforts to address concerns regarding Mello-Roos bonds. Specifically, the Commission will direct its attention to advising the Legislature and the Governor on potential changes to the Mello-Roos Act which will strengthen its security features while making it more equitable for homeowners and taxpayers. As part of this effort, the Commission will welcome public testimony and comments on what types of changes will best address the concerns of credit quality and tax equity.

The Commission remains convinced that the Mello-Roos Act is a viable and critical financing tool for meeting local infrastructure needs. However, in light of the negative publicity and increasing concerns about the Act, and in the interest of preserving a useful local financing mechanism, the Commission believes it vital to properly identify the problems and address them accordingly. To this end, CDAC plans to closely monitor Mello-Roos legislative and market developments in the upcoming year, and to stand prepared to provide assistance to taxpayers, local governments, the Legislature, and the industry throughout 1992.

A Closer Look at the Marks-Roos Act

Lingering questions that have been raised about Marks-Roos pool financings moved the Commission to order an in-depth evaluation of the Marks-Roos Bond Pooling Act in December 1991. An in-depth review will give the Commission a full understanding of the benefits and the problems that have materialized since 1985, and will allow CDAC to formulate various options to address any problems which have been identified.

This study will employ an approach similar to that used to evaluate the Mello-Roos Act. Specifically, the Marks-Roos study will review the history of the Act, evaluate the effectiveness of Marks-Roos bonds in supporting local infrastructure, and assess compliance with recent changes to the Marks-Roos Act.

An Examination of Competitive vs. Negotiated Sale of Debt

In an attempt to assist issuers statewide, CDAC will wade into one of the most enduring and contentious debates in public finance -- competitive vs. negotiated sale of securities. Conventional wisdom states that competitive sale will yield the lowest borrowing costs to the issuer. However, since the mid-1970s, negotiated underwriting has become the more popular method of sale. CDAC's data also indicate that negotiated sales predominate in almost every type of security in the state.

While it may never be possible to settle the competitive vs. negotiated sale dispute, part of the Commission's responsibility is to assist issuers in obtaining a clearer understanding of the factors involved in the decision to use one method of sale over the other. The Commission will review why negotiated sales continue to be more popular in spite of the conventional wisdom, and the process an issuer should follow in deciding to go one way or the other. CDAC's findings, to be issued in issue brief format in 1992, will include discussions on the benefits and drawbacks of each method of sale, the factors to be considered in making a method of sale determination, and other related issues.

City Debt Profiles

Scheduled for release in the Summer of 1992, CDAC's *City Debt Profiles* will provide local officials with a statistical summary of debt issued and outstanding for every city in California. The purpose of the *Profiles* is to allow city officials to assess and measure their public debt issuance against common fiscal and economic benchmarks, thereby promoting better debt management. The report will also contain statistical medians which will allow for comparisons between cities of similar population size. The information provided in this report will be drawn from CDAC's database, the State Controller's Office, the Board of Equalization, and the Secretary of State, among others.

Statewide Lease Survey

As a follow-up to the lease studies completed in 1991, the Commission will conduct a statewide survey of lease financings in 1992. One of the recommendations that evolved from the 1991 study was for CDAC to survey agencies in California to determine informational and educational needs surrounding the use of tax-exempt leases.

While the Commission generally agreed that additional assistance to state and local agencies may be necessary, it determined that formulating policies based only on the limited information on leasing in the state currently available would not be prudent. To address this information gap, and to develop a solid foundation for eventual leasing assistance policies, CDAC will launch a survey in 1992 to (1) determine the volume of state and local agency leasing, and (2) identify principal participants of lease transactions.

A Review of Certificates of Participation (COPs)

One particular form of leasing, certificates of participation (COPs), has been the recipient of increasing attention, particularly on the heels of the 1991 Richmond Unified School District bankruptcy and its subsequent COP default. CDAC has witnessed rising concern regarding (1) the credit integrity of COPs, especially given their lack of a dedicated source of repayment, in many cases, and (2) the increasing local agency reliance on COPs to finance capital needs. While COPs, like other lease mechanisms, are considered a debt obligation by rating agencies, they are not legally considered long-term debt. Consequently, COP transactions do not require voter approval. The lack of voter approval has been a concern to some taxpayers insofar as they perceive COPs as a way of circumventing taxpayer consent and local debt limitations.

In order to better understand the issues behind the concerns expressed by both public and private officials about COPs, the Commission expects to intensify its review of this financing technique. This review will likely include an informational public hearing on the topic in 1992. CDAC's primary purpose for this hearing is to obtain additional information regarding the mechanics behind COPs and the problems being encountered in certain COP issues.

A Credit Enhancement Program for Schools

In keeping with its statutory mission, CDAC will pursue a legislative measure designed to decrease short-term borrowing costs of school districts throughout the state. The proposal will provide inexpensive credit enhancement for short-term debt issued by school districts. Patterned after a similar program for city and county long-term debt, the plan will allow school districts to guarantee payment of their short-term notes by pledging to use part of their school apportionments, in the unlikely event that debt service payment on a note is missed.

The additional security provided by the credit enhancement program will lower investor risk and, consequently, lower short-term borrowing costs to participating school districts. CDAC is expecting to work with school district representatives, rating agency officials, and public finance professionals to ensure that the credit enhancement provides sufficient safeguards to school officials and noteholders alike.

Seminar Program Expansion

CDAC's debt financing seminar program expansion will continue in 1992. In addition to the California Association of School Business Officials, the Commission plans to work with other groups, including the California State Association of Counties, the California Association of County Treasurers and Tax Collectors, the California Special Districts Association, and the Association of California Water Agencies to develop introductory and advanced seminars specifically tailored to their membership. The Commission will also co-sponsor a seminar on the underwriting process and allocation of bonds with the Association of Bay Area Governments.

A new venture for CDAC in 1992 will be a symposium on education issues, to be co-sponsored by Standard & Poor's Corporation. The symposium will serve as a forum for discussion of critical education issues among education practitioners, policymakers, and the financial community. Symposium participants will exchange ideas on various financing alternatives available to meet the projected $33 billion school capital need over the next decade. There will also be a discussion on ways to improve the quality of public education in the state through school restructuring. CDAC anticipates sponsoring symposiums on other topical issues facing public agencies in the 1990s.

APPENDICES

STATE OF CALIFORNIA
Government Code
Division 1 of Title 2 (Excerpt)

Chapter 11.5. CALIFORNIA DEBT ADVISORY COMMISSION

8855. Creation, composition, term; officers; compensation; powers and duties

(a) There is created the California Debt Advisory Commission, consisting of nine members, selected as follows:

(1) The Treasurer, or his or her designate.

(2) The Governor or the Director of Finance.

(3) The Controller, or his or her designate.

(4) Two local government finance officers, appointed by the Treasurer, one each from persons employed by a county and by a city or a city and county of this state, experienced in the issuance and sale of municipal bonds and nominated by associations affiliated with such agencies.

(5) Two Members of the Assembly appointed by the Speaker of the Assembly.

(6) Two Members of the Senate appointed by the Senate Committee on Rules.

(b) The term of office of an appointed member is four years, but appointed members serve at the pleasure of the appointing power. In case of a vacancy for any cause, the appointing power shall make an appointment to become effective immediately for the unexpired term.

Any legislators appointed to the commission shall meet with and participate in the activities of the commission to the extent that the participation is not incompatible with their respective positions as Members of the Legislature. For purposes of this chapter, the Members of the Legislature shall constitute a joint interim legislative committee on the subject of this chapter.

(c) The Treasurer shall serve as chairperson of the commission and shall preside at meetings of the commission. The commission, on or after January 1, 1982, and annually thereafter, shall elect from its members a vice chairperson and a secretary who shall hold office until the next ensuing December 31 and shall continue to serve until their respective successors are elected.

(d) Appointed member of the commission shall not receive a salary, but shall be entitled to a per diem allowance of fifty dollars ($50) for each day's attendance at a meeting of the commission not to exceed three hundred dollars

($300) in any month, and reimbursement for expenses incurred in the performance of their duties under this chapter, including travel and other necessary expenses.

(e) The commission shall do all of the following:

(1) Assist the Housing Bond Credit Committee and all state financing authorities and commissions in carrying out their responsibilities as prescribed by law, including assistance with respect to federal legislation pending in Congress.

(2) Upon request of any state or local government units, to assist them in the planning, preparation, marketing, and sale of new debt issues to reduce cost and to assist in protecting the issuer's credit.

(3) Collect, maintain, and provide information on state and local debt authorization, sold and outstanding, and serve as a statistical center for all state and local debt issues.

(4) Maintain contact with state and municipal bond issuers, underwriters, credit rating agencies, investors, and others to improve the market for state and local government debt issues.

(5) Undertake or commission studies on methods to reduce the costs and improve credit ratings of state and local issues.

(6) Recommend changes in state laws and local practices to improve the sale and servicing of state and local debts.

(f) The commission may adopt bylaws for the regulation of its affairs and the conduct of its business.

(g) The issuers of any proposed new debt issue of state or local government shall, no later than 30 days prior to the sale of any debt issue at public or private sale, give written notice of the proposed sale to the commission, by mail, postage prepaid. This subdivision shall also apply to any nonprofit public benefit corporation incorporated for the purpose of acquiring student loans.

(h) The notice shall include the proposed sale date, the name of the issuer, the type of debt issue, and the estimated principal amount thereof. Failure to give this notice shall not affect the validity of the sale.

(i) The commission shall publish a monthly newsletter describing and evaluating the operations of the commission during the preceding month.

(j) The commission shall meet on the call of the chairperson, or at the request of a majority of the members, or at the request of the Governor. A majority of all nonlegislative members of the commission constitutes a quorum for the transaction of business.

(k) All administrative and clerical assistance required by the commission shall be furnished by the Office of the Treasurer.

8855.5 Bond issuing agencies, authorities, governmental units, or nonprofit corporations; reports to commission

(a)(1) Any redevelopment agency which issues revenue bonds to finance residential construction pursuant to Chapter 7.5 (commencing with Section 33740 or Chapter 8 (commencing with Section 33750) of Part 1 Division 24 of the Health and Safety Code, (2) any housing authority which issues revenue bonds to finance housing developments or residential structures pursuant to the Housing Authorities Law, Chapter 1 (commencing with Section 34200) of Part 2 Division 24 of the Health and Safety Code, (3) any local agency which issues bonds to finance residential rehabilitation pursuant to the Marks-Foran Residential Rehabilitation Act of 1973 (Part 13 (commencing with Section 37910), Division 24, Health and Safety Code), (4) any city or county which issues bonds for purposes of a home financing program carried on pursuant to Chapter 1 (commencing with Section 52000) to Chapter 6 (commencing with Section 52060), inclusive, of Part 5 of Division 31 of the Health and Safety Code or for purposes of financing the construction, acquisition, or development of multifamily rental housing pursuant to Chapter 7 (commencing with Section 52075) or Chapter 8 (commencing with Section 52100) of Part 5 of Division 31 of the Health and Safety Code, (5) any local agency, including any charter city or city and county, that issues revenue bonds to finance the purchase, construction, or rehabilitation of housing pursuant to any statute or under the authority of its charter, and

(6) Any nonprofit corporation that has qualified under Section 501(c)(3) of the federal Internal Revenue Code and which issues indebtedness for which the interest is exempt from federal income taxation to finance the purchase, construction, or rehabilitation of housing in this state, shall report to the California Debt Advisory Commission the incomes, family size, and rents or mortgage payments of the occupants, the number, size, cost, sales price, location by zip code, and geographical distribution of the units developed; the length of time the units are required to be held for occupancy by targeted income groups, and, if applicable, the number of years the units are required to be held as rentals; and the distribution of housing developments among for-profit, limited dividend, and nonprofit sponsors. For the purposes of this section, "nonprofit sponsors" includes public agencies.

(b) The information required to be reported by subdivision (a) shall be reported at least annually during the time that a percentage of the units are required to be occupied by, or made available to, persons or families within a particular income group. The report required by subdivision (a) shall only apply to housing units financed with the proceeds of bonds that are authorized to be issued, and which are issued, on and after January 1, 1985, pursuant to any of the provisions described in subdivision (a) or implementing provisions supplementary thereto, such as the authorizations contained in Chapter 5 (commencing with Section 6500) of Division 7 of Title 1. For purposes of this section, "bonds" means any bonds, notes, interim certificates, debentures, or other obligations issued under the authority of the provisions, or as otherwise, described in subdivision (a), and "issues" includes the issuance of bonds to refund previously issued bonds pursuant to the statutory provisions authorizing the original issuance or pursuant to supplementary authorization, such as Article 10 (commencing with Section 53570) of Chapter 3 of Part 1 of Division 2 of Title 5.

The redevelopment agency, housing authority, local agency, or city and county may charge a fee to the recipient of agency financing not to exceed the cost of making the reports required by this section.

8855.7 Reports required by Section 8855.5; analysis of compliance with subsection (d) or Section 142 of Internal Revenue Code; certification of compliance with filing requirements.

(a) The reports required by Section 8855.5 shall also contain an analysis by the reporting agency of compliance with the targeting requirements of subsection (d) of Section 142 of the Internal Revenue Code of 1986 (26 U.S.C. Sec. 142) with respect to any issue of its bonds subject to those requirements for federal tax exemption under Section 103 of the Internal Revenue Code of 1986 (26 U.S.C. Sec.103). The analysis shall identify the numbers of rental units subject to this reporting requirement by categories based on the number of bedrooms per unit, and shall report as to each of these categories.

(b) No public agency or nonprofit corporation subject to the reporting requirements of Section 8855.5 may issue any bonds, including bonds to refund previously issued bonds, subject to the reporting requirements of that section until the Treasurer certifies to the Legislature that the public agency or nonprofit corporation has filed the information required by Section 8855.5 and this section with the California Debt Advisory Commission.

8855.8 Commission compilation and summary of reports; contents

The commission shall compile and summarize the information reported to the commission pursuant to Section 8855.5 and issue that summary to the Legislature and the Legislative Analyst on or before November 1 of each year that the information is received by the commission. This summary shall also list any redevelopment agency, housing authority, local agency, city, and county which issued bonds under the authority of any of the programs specified in subdivision (a) of Section 8855.5 without first obtaining a certification from the Treasurer required pursuant to Section 33760, 34312.3, 52097.5, or 52045 of the Health and Safety Code.

8856. Fees

In providing services under paragraph (2) of subdivision (e) of Section 8855, the commission may charge fees in an amount not to exceed the fees established by the Department of General Services for the provision of contract services. In carrying out all the other purposes of this chapter, the commission may charge fees to the lead underwriter or the purchaser in an amount equal to one-fortieth of 1 percent of the principal amount of the issue, but not to exceed five thousand dollars ($5,000) for any one issue. However no fees shall be charged to the lead underwriter or the purchaser for any water district issue which is subject to the jurisdiction of the Districts Securities Commission. Amounts received under this section shall be deposited in the California Debt Advisory Commission Fund, which is hereby created in the State Treasury. All money in the fund shall be available, when appropriated, for expenses of the commission and the Treasurer.

Until such time as fees are received by the advisory commission and appropriated pursuant to this chapter for the expenses of the commission and the Treasurer, the commission may borrow such moneys as may be required for the purpose of meeting necessary expenses of initial organization and operation of the commission.

8857. Employees

The chairman of the commission, on its behalf, may employ an executive secretary and other persons necessary to perform the duties imposed upon it by this chapter. The executive secretary shall serve at the pleasure of the commission and shall receive compensation as fixed by the commission.

8858. Review of capital improvement financing; report

The commission shall comprehensively review the financing of capital improvements by all agencies of local government and study the comparative debt of local governmental agencies for capital improvements and the use of bond financing as a source of the indebtedness. The review shall include an analysis of all general obligation and revenue bond financing laws. On or before January 1, 1983, the commission shall submit to the Legislature a report of its findings and recommendations, if any, for revising the laws governing such financing devices.

8859. Advice regarding local bond pooling authorities

The commission may, upon request, advise local agencies regarding the formation of local bond pooling authorities pursuant to Article 4 (commencing with Section 6584 of Chapter 5 of Division 7 of Title 1, and may advise the authorities regarding the planning, preparing, insuring, marketing, and selling of bonds as authorized by that article.

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COMMISSION FUNDING AND EXPENDITURES

The Commission is funded out of the California Debt Advisory Commission Fund, established under Chapter 1088/81. The CDAC Fund is supported by fees levied on debt issues reported to the Commission. Specifically, Chapter 1088 authorizes the Commission to charge a fee, equal to one-fortieth of one percent (2.5 basis points), up to $5,000 for each issue, to the lead underwriter or purchaser of a debt issue. By Commission policy, however, current CDAC fees are limited to one-hundredth of one percent (one basis point), up to $1,500.

The Commission has reduced its fee schedule twice since 1982 to provide a more equitable fee schedule for short-term and long-term debt issues sold in California, and to reduce the reserve in the CDAC Fund to a level equal to one year's appropriation. In 1986, the Commission also rebated $1.2 million to state and local government agencies which remitted fees based on the schedule set in law for debt issues sold in 1982 and 1983.

As Table 2 indicates, the Commission expended approximately $1.1 million in fiscal year 1990-91. This was partially offset by over $812,000 in new revenues. The remainder came out of the CDAC Fund reserve. Table 2 also shows that the CDAC Fund had a balance of $1.9 million at the beginning of 1991-92.

Table 2

California Debt Advisory Commission
Operating Revenues and Expenditures
Fiscal Year 1990-91

CDAC Fund:	
Beginning balance (7/1/90)	$2,181,000
New revenues	812,050
Total resources	$2,993,050
Expenditures:	
Staff salaries	$466,836
Staff benefits	114,047
General expense	42,133
Printing	53,223
Communications	4,559
Postage	22,991
In-state travel	11,230
Out-of-state travel	4,586
Training	4,410
Facilities Operation	37,633
Consultant and professional contracts	240,000
Data processing	56,759
Central administrative services	40,045
Equipment	1,121
Total expenditures	$1,099,573
CDAC Fund:	
Ending balance (6/30/91)	$1,893,477

CALIFORNIA DEBT ADVISORY COMMISSION STAFF

EXECUTIVE DIRECTOR

Steve Juarez

STAFF

Charmette Bonpua

Carol Campbell

Janae Davis

Christel Konang, Ph.D.

Kathie Mullen

Eileen Park

Martha Riley

Mary Scharosch

Stephen Shea

Berma Williams

California Debt Advisory Commission
915 Capitol Mall, Room 400
Sacramento, CA 95814
(916) 653-3269

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