



CALIFORNIA DEBT ADVISORY COMMISSION

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REPORT

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KATHLEEN BROWN

*State Treasurer and Chair*

**CALIFORNIA DEBT ADVISORY COMMISSION  
1992 ANNUAL REPORT**

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**CALIFORNIA DEBT ADVISORY COMMISSION**  
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## **EXECUTIVE SUMMARY**

The year 1992 brought several fiscal challenges to the State and local governments throughout that also affected various aspects of public finance. Throughout the year, the California Debt Advisory Commission, charged with assisting state and local governments on public finance matters, endeavored to carry out its mission through a variety of programs and activities.

This *Annual Report* reviews the events pivotal to public finance and the Commission's activities in 1992. It covers the history of the Commission, profiles its members, discusses topical events in California public finance for 1992, 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 1993.

### **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 on behalf of the Governor, Senator Robert Beverly, Senator Lucy Killea, Assemblymember Jim Costa, Assemblymember Pat Nolan, Sonoma County Treasurer-Tax Collector Don Merz, and Los Angeles Department of Water and Power Chief Financial Officer Phyllis E. Currie. 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 28 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 1992**

The deteriorating state of the California economy continued to wreak havoc on state and local finances in 1992. At the State level, policymakers struggled to bridge a budget gap estimated to be in the \$6 to \$10 billion range. The difficulty of bridging a gap of this magnitude resulted in a protracted budget battle that lasted 64 days into the 1992-93 Fiscal Year. To meet its obligations in the absence of a spending plan, the State, for the first time since the Great Depression, issued registered warrants (popularly known as IOUs). This action, in turn, resulted in a downgrade of the State's credit rating by the three major rating agencies. The State Treasurer's Office estimated that the downgrades cost the State \$98 million, plus an additional \$157 million in higher interest costs for authorized but yet to be issued bonds.

Part of the budget agreement that the Governor eventually signed on September 2, 1992 called on local government agencies across the state to help make the 1992-93 State Budget whole by giving up \$1.3 billion of their property tax revenues. Consequently, counties, cities, redevelopment agencies, and special districts saw reductions in their share of property tax revenues. Sensing a fundamental change in the State-local fiscal relationship, State Treasurer and CDAC Chairperson Kathleen Brown called for a series of public hearings to determine the impact of the 1992-93 revenue reductions on local government finance.

Based on over 10 hours of testimony from over 50 witnesses and the written comments submitted, the Commission found that the local governments affected by the reductions would be able to meet their debt obligations in the current year, although the credit ratings of some local agencies did suffer partly because of the reductions. The Commission also found that infrastructure investment has slowed down as a result of the property tax reductions. Moreover, local officials reported that economic development activities could be severely curtailed due to the shift of tax increment revenues from redevelopment agencies.

On the bond financing front, two types of financing were the focus of attention in 1992: leases/certificates of participation (COPs) and Mello-Roos. Local governments' increasing reliance on lease transactions to finance improvements had given pause to some taxpayers who view these financings as a way to circumvent taxpayer consent and debt limitations as these instruments do not require voter approval. Moreover, Richmond Unified School District's decision not to honor a \$9.8 million COP obligation -- issued in 1989 in part to solve its budget problems -- and the subsequent litigation related to that decision caused grave concerns within the public finance industry regarding the credit integrity of COPs. CDAC responded to these concerns by holding a public hearing on the issue in June of 1992. As a result of the hearing, the Commission approved the development of lease/COP guidelines intended to assist public officials on leasing matters.

The tumbling California real estate market and concerns expressed by homeowners, investors, and others convinced the Commission to hold a public hearing on the Mello-Roos Act in January 1992. While the Commission found that most Mello-Roos districts

in the state were in reasonable financial shape, witnesses at the hearing raised several concerns that warranted legislative attention. Some of the Commission's recommendations were ultimately incorporated into Chapter 772, Statutes of 1992 (SB 1464, Mello), the first major reform of the Mello-Roos Act since its passage in 1982.

As the economy continued to plunge, interest rates hit their lowest levels in nearly two decades. California public issuers responded to the low rates by issuing a record \$43.7 billion in long-term and short-term debt -- a 26 percent increase over the debt issuance volume in 1991. This high issuance volume was fueled by increases in refundings and short-term borrowing. In fact, the amount issued to refund prior debt almost doubled from \$5.5 billion in 1991 to \$10.7 billion in 1992. By the same token, short-term cashflow borrowing rose 71 percent from 1991's \$10 billion to 1992's \$17 billion.

## ACCOMPLISHMENTS IN 1992

Responding to the various public finance issues that cropped up in 1992, the Commission undertook a series of projects and activities designed to define the problems and devise solutions. Among those activities were five public hearings, eight new publications, six training seminars, and the development of a new publication called *Issue Brief*.

The Commission's public hearings addressed some of the most salient public finance issues in 1992. In January 1992, the Commission delved into concerns regarding Mello-Roos financings in a hearing held in Santa Ana. As a result of the hearing, the Commission recommended various changes to the Mello-Roos Act to the Legislature and the Governor. In June of the same year, the Commission again held a hearing, this time focusing on the issues surrounding municipal lease financings, particularly COPs. Based on its hearing findings, the Commission approved the development of lease/COP guidelines. Finally, spurred by concerns regarding the impact of the property tax reductions on local government finances, the Commission held a series of hearings on the issue in December 1992. The Commission plans to submit its findings and recommendations to the Legislature and the Governor in the spring of 1993.

To supplement the public hearings, the Commission's 1992 publications included several documents dealing with Mello-Roos and lease/COP financings. For instance, *Recommended Changes to the Mello-Roos Act of 1982: Report to the Legislature and the Governor* [CDAC 92-2] includes the Commission's findings from the hearing, the recommended changes to the Mello-Roos Act, and other related issues for consideration by the Legislature and the Governor. *COPs in California: Current Issues in Municipal Leasing* [CDAC 92-6] contains a background paper that identifies the major issues affecting COPs in California, a transcript of the hearing, and copies of the written testimony submitted to the Commission.

On the technical assistance front, the Commission unveiled its *Issue Brief* series in September 1992. The *Issue Briefs* are short reference documents which provide an analysis of topical public finance issues and suggest approaches for addressing these issues. The first in the series dealt with one of the most hotly debated subject in public finance over the last two decades: competitive versus negotiated sale.

One of the mainstays of the Commission's technical assistance program, its public finance seminars, continued to flourish in 1992. Building on the trend that started in

1991, the Commission worked with various statewide organizations to develop seminars specifically suited to their memberships. Among the organizations that co-sponsored seminars with CDAC were the California Association of School Business Officials, the Association of Bay Area Governments, 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. New in the Commission's docket in 1992 was a symposium on education issues, *Discussions on School-Capital-Financing and on School Restructuring*, co-sponsored by Standard and Poor's Corporation. The symposium served as a forum for a policy discussion on critical issues dealing with the education of California's children.

### **THE OUTLOOK FOR 1993**

With the many challenges facing state and local governments, the Commission plans to remain vigilant in its mission to assist California public debt issuers in 1993. At the top of the Commission's agenda is to help local governments cope with the property tax reductions imposed by the State. CDAC plans to apprise State policymakers of how local governments are responding to the reductions by submitting its findings and recommendations based on its December 1992 hearings on the topic. The Commission will also endeavor to preserve the credit integrity of California public debt as the Legislature and the Governor develop the 1993-94 State Budget.

The Commission anticipates the completion of two leasing-related projects in 1993. The first project is a survey of State and local agencies' use of tax-exempt leasing, to be completed in the spring. The Commission intends to use the results of the survey to develop technical assistance programs in this area. The second project, the guidelines for issuance of leases, including COPs, is scheduled for release in the summer. These guidelines will look at leasing decisions from a debt management context. Included will be discussions of debt burden and debt capacity, as well as approaches for demonstrating voter accountability.

*New Issue Briefs* are also in line for 1993. CDAC plans to release the second installment in the series, *Understanding the Underwriting Spread*, in March. This will be followed by *Refunding Municipal Bonds (Issue Brief #3)* and two to three others to be issued later in the year.

Finally, the Commission's seminar program will continue its expansion to include several new seminars in 1993. Among those slated are a seminar primarily geared for county professionals and county policymakers, a seminar on short-term debt issuance, and up to four seminars on health financing. CDAC also plans to co-sponsor its second symposium on emerging California policy issues in 1993, this time focusing on transportation.

## **AN INTRODUCTION TO THE COMMISSION**

At the beginning of the 1980s, California policymakers were becoming increasingly concerned about the financial difficulties facing local agencies who were not only adjusting to the impacts of Proposition 13, but also coping with historically high interest rates in the municipal marketplace. Moreover, 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 from 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 (CDAC), 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 became a reality with the passage of Chapter 1088, Statutes of 1981 (AB 1192, Costa). Since 1982, CDAC 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, by providing assistance to local governments upon request, and by analyzing policy issues concerning public debt. Pursuant to Chapter 1088, the Commission is specifically required to:

- o Serve as the state's statistical center for debt information.
- o Publish a monthly newsletter.
- o Maintain contact with all participants in the municipal debt industry to improve the market for public debt.
- o Provide technical assistance to state and local governments to reduce cost and protect the issuer's credit.
- o Undertake or commission studies on methods to reduce costs and improve credit ratings.
- o Recommend legislative changes to improve the sale and payment of debt.
- o 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. Finally, pursuant to legislation enacted in 1992 (Chapter 772, SB 1464, Mello), the Commission is now required to collect specified fiscal information on Mello-Roos community facilities districts which issue bonds after January 1, 1993.

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## 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 12-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; including the California Debt Limit Allocation Committee, the California Pollution Control Financing Authority, the California Health Facilities Financing Authority, and the Commission on State Finance. The State Treasurer also serves on the State's two biggest pension boards, the Public Employees' Retirement System and the State Teachers' Retirement System.

Treasurer Brown's election as State Treasurer follows a 15-year career as financial manager and public policymaker: serving two terms as a member of the Los Angeles Board of Education, and also as 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. By statute, the State Treasurer serves as the Chairperson of the California Debt Advisory Commission.

**Honorable Gray Davis**  
*State Controller*



Gray Davis assumed the office of State Controller of the State of California in January 1987. In that capacity, 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, Gray Davis represented the 43rd District in the State Assembly. And from 1974 through 1981, he served as Chief of Staff to former Governor Edmund G. Brown, Jr. 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**  
*27th 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. He currently serves on the Appropriations Committee as Vice Chairperson, and on the Banking, Commerce, and International Trade Committee, the Elections and Reapportionment Committee, the Governmental Organization Committee, the Senate Rules Committee, and the Select Committee on the Maritime Industry.

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 in 1982.

**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 Business & Professions Committee, the Insurance, Claims and Corporations 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 Water, Parks and Wildlife Committee and the 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.

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

**Honorable Patrick Nolan**  
*43rd 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 Rules Committee, Governmental Organization Committee, Higher Education Committee, and the Ways and Means 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 of the National Association of County Treasurers and Finance Officers. State Treasurer Kathleen Brown appointed Treasurer Merz to the Commission in 1991.

**Phyllis E. Currie**  
*Los Angeles Department of Water and Power Chief Financial Officer*

Phyllis Currie was appointed to her current position with the Los Angeles Department of Water and Power in August 1992.

Prior to her position with DWP, Ms. Currie served the City of Los Angeles as Assistant City Administrative Officer. In that capacity, she oversaw long-term debt management for the City. Thus, Ms. Currie brings a wide array of experience to the Commission in long-range financial planning and budgeting, and the debt-issuance process.

Treasurer Kathleen Brown appointed Ms. Currie to the California Debt Advisory Commission on October 23, 1992.

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## **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 transactions; and
- 2) To assure a proper technical review of public finance 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 the contents of 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, investors, 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 Technical Advisory Committee that served during calendar year 1992 are listed in Appendix B.

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## 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, policy research and development, and technical assistance.

### 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 has compiled 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. A sample of the data reported to CDAC includes 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 typically 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 primarily of two components. The first component is the *California Debt Issuance Primer*, a CDAC publication designed as a reference manual for public debt issuers in the state. The *Primer* contains information on the roles and responsibilities of public debt issuers and provides a comprehensive overview of the various debt financing options available to California issuers. It also describes and discusses the roles of the participants in a debt financing, the steps in the debt issuance process, State debt oversight and financing programs, and key terms and concepts in public finance.

The second component is CDAC's seminar program, which was inaugurated in June 1984. Offered several times a year at different locations statewide, CDAC seminars are designed to meet two 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 in 1984, about 1,500 public officials and staff have participated in seminar workshops. Most of the participants come from local agencies, while the remainder represent 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, the Commission's 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 staff responds to over 1,000 requests for information or assistance.

## CALIFORNIA PUBLIC FINANCE IN 1992

### OVERVIEW

The dark fiscal and economic clouds that loomed over California public finance during the 1991 calendar year continued into 1992. California experienced a loss of jobs in 1992 at a rate not experienced since the Great Depression. The resulting impact on public sector finance was both severe and comprehensive. In particular, the protracted delay in the passage of the 1992-93 State Budget, and the revenue reductions that were ultimately imposed as part of its adoption, were the major forces shaping the State's weakened credit outlook for 1992. The State issuance of registered warrants (popularly known as IOUs) in July 1992 resulted in all three major rating agencies downgrading the State's bond rating. Ironically, the adoption of the State Budget on September 4 had a ripple effect on local government finance as the State reduced local property tax revenues by \$1.3 billion for the 1992-93 fiscal year. This action, along with the recessionary impacts already being experienced by local agencies, created concerns for the credit picture of many local governments as the year came to a close.

Increased public attention was directed at two specific types of debt obligations in 1992: certificates of participation (COPs) and Mello-Roos bonds. COPs, which are the predominant form of public leasing conducted in California, generated significant press coverage in 1992, largely due to the default of the Richmond Unified School District on \$9.8 million of COPs and the subsequent litigation. At the same time, more people became sensitive to the fact that public agencies were entering into major lease/COP arrangements with limited involvement or knowledge of the electorate and with no dedicated revenue stream to repay such obligations. As for Mello-Roos bonds, the state's weakened real estate market raised concerns that foreclosures or bond defaults might be imminent. Although major Mello-Roos foreclosures or defaults did not occur in 1992, concerns raised by investors and taxpayers over issues such as disclosure and expenditure of bond proceeds did lead to the first major reform of the Mello-Roos Act in many years.

Fortunately, one bright development in 1992 was the continuing downward trend in interest rates. Thus, despite the dour fiscal and economic picture in California last year, public agencies in the state still issued a record \$43.7 billion in debt in 1992. This strong showing was primarily the result of California agencies being able to lower existing debt service payments through refundings, and to a marked increase in the use of short-term debt instruments such as tax and revenue anticipation notes. For instance, nearly 40 percent (\$10.7 billion) of all long-term debt issued in 1992 was to refund prior debt. At the same time, public agency use of short-term notes and commercial paper to even out cash-flows nearly doubled in 1992. Thus, despite the fact that financing of new projects actually declined by over \$3 billion, total debt issuance in the state increased by nearly \$9 billion over 1991.

This chapter takes a look at some of the significant events affecting public debt issuance in 1992. In addition, the chapter includes a summary of California public debt which looks at the purposes, types and structure of debt obligations last year.

### **Anemic State Economy Slows Capital Improvements**

Just as it had commanded the attention of the national electorate during last year's presidential campaign, the economy was central to the events shaping California's public finance environment in 1992. In particular, the sluggish California economy continued to place a strain on real estate, job growth, and taxable sales. As a result, the ability of the State and its local governments to finance infrastructure and other capital improvements was constrained throughout the year, despite the influx of nearly 700,000 new residents in 1992. By year's end, the total statewide investment in long-term capital projects had dropped by \$3.4 billion (a decline of 17 percent) from the total invested in 1991. This compares with only a three percent decline in new-money issues at the national level for 1992.

The impact of a declining state economy on public finance is multi-dimensional. In California, for instance, much of the support for capital improvements comes from land-backed assessments such as Mello-Roos taxes and special assessments. Thus, declines in the value of real estate directly impact the ability of local governments to use these financing tools to support development and growth. At the same time, sales tax revenues have also declined. Thus, debt obligations which depend on taxable sales also suffer from an economy under siege. And even in areas where fees and user charges directly service debt obligations, future debt issuance can be severely constrained by economic considerations such as job growth and business development. Possibly, the most notable casualty of the state's weakened economy was the 1992-93 State Budget.

### **State's Fiscal Woes Lead to IOUs**

With an economy that was showing no signs of recovery, the State's fiscal picture took a turn for the worse in the early months of 1992. In the spring, estimates of the 1992-93 State Budget gap ranged from \$6 to \$10 billion, depending on the assumptions used. And although estimates were lower than the \$14 billion gap that had been bridged in 1991, there were also fewer options because (1) additional tax increases had been ruled out, and (2) many of the one-time and "painless" adjustments had been made the year before.

As a result, it was not surprising that State policymakers were unable to adopt a budget by July 1st, the constitutional deadline for adoption of a State Budget. While the adoption of a State Budget after July 1st had become an accepted practice in Sacramento over the past decade, it had special significance in 1992. In previous years, the State was able to draw from its internal "borrowable" resources to continue meeting its obligations to employees, vendors, and other creditors while budget negotiations proceeded into the summer. By July 1992, however, those borrowable resources were extinguished, leaving the State with no other option but to issue registered warrants, or IOUs.

The issue of registered warrants led to further downgrades by all three major rating agencies, with Standard & Poor's taking the harshest view of the situation and placing

the State's general obligation debt at A+, a rating level that is equal to or above only four other states. The downgrades not only cost the State additional dollars when it issues general obligation or lease revenue bonds, it also penalizes those investors holding California bonds who may choose to sell such bonds prior to their maturity. The State Treasurer's Office estimates that the downgrades cost the State \$98 million, with an expected future cost of \$157 million in additional interest for bonds authorized but yet to be issued.

While the State Budget was eventually adopted 64 days late on September 2, 1992, its resolution turned attention to new problems in California public finance -- this time focusing on local governments.

### **Budget Impacts Felt Far and Wide**

No form of local government in California escaped the pain inflicted by the 1992-93 State Budget. The dramatic reduction of \$1.3 billion in property tax revenues directly touched every city, county, special district, and redevelopment agency in the state which receives such revenues. Even school districts, which were kept at the previous year's level of State funding, are anticipating cutbacks in 1992-93 because of the loss of purchasing power inherent in their stabilized apportionments. Recognizing that a "seismic shift in State-local fiscal relations" had been created by the 1992-93 State Budget, State Treasurer Kathleen Brown, Chair of CDAC, called on the Commission's staff to convene a series of hearings throughout the state to determine the fiscal and debt-related impacts of the funding shift. Specifically, Treasurer Brown wanted to discern (1) how the State revenue reductions would affect the outstanding debt of local communities, (2) whether local governments would be able to continue investing in their infrastructure, and (3) what impact the cutbacks would have on economic development at the local level.

The Commission received nearly 10 hours of testimony from over 50 local agency representatives and private finance professionals on how their debt, investments, and economic development activities will be affected. With regard to the local credit picture, it appeared that all local governments would be able to meet their debt obligations for the budget year. Nevertheless, the Commission learned that the Counties of San Diego, Los Angeles, and San Francisco have all suffered credit downgrades which can at least be partially traced to reduced State support. In addition, the state's largest school district, the Los Angeles Unified School District, has also seen its credit rating drop as a result of the revenue cutback.

The outlook for local infrastructure investment is also bleak. Most local officials testified that they were severely curtailing plans for new capital projects, a decision made all the more certain by the cutback in property tax revenues. Possibly more important, many officials testified that their ability to finance economic development activities, which would keep businesses in their community and help pave the way for new businesses, was being gutted by the significant revenue cuts being administered to redevelopment agencies.

The Commission staff spent the latter part of 1992 preparing a report to the Legislature which will include recommendations on how the State can assist local governments in meeting their infrastructure and public finance needs in the face of these devastating revenue reductions.

## **COPs Come Under Greater Scrutiny**

A recent trend that has gone somewhat unnoticed is the growing reliance of public agencies on lease forms of debt to support their capital improvements and equipment purchases. Most notably, increased issuance of certificates of participation (COPs) has made public leasing the predominant form of long-term financing in the 1990s. In 1991, for instance, State and local agencies issued over \$6 billion in lease instruments, with COPs accounting for over \$5 billion of that total. By contrast, general obligation bonds, the most secure form of public debt, registered only \$4.6 billion in total issuance for 1991. While 1992 figures indicate that the lease/COP market has dropped off from 1991 issuance, lease financing still represents a major force in California public finance.

The increased use of lease debt has generated two concerns. First, unlike almost all other forms of debt, leases and COPs do not require voter approval because they are not legally considered debt. Because California case law has consistently held that leases with an *abatement clause* (which makes payment contingent on use or occupancy) or a *nonappropriation clause* (which makes payment subject to appropriation) are not debt, public agencies can enter into long-term lease arrangements without the approval of the electorate, a fact which has sometimes raised questions of public accountability. Second, the vast majority of COPs which are issued today are secured by general operating revenues, thereby placing an additional strain on public operating budgets.

In addition to these concerns, at least one other significant event in 1992 helped draw attention to the lease/COP area. The decision by the Richmond Unified School District not to honor a \$9.8 million COP obligation it entered into in 1989 sent shock waves through the public finance industry. The Richmond case was especially notable because the use of COPs represented a last-ditch effort by a financially troubled school district to use a public finance tool to solve its budget problems. The ongoing legal maneuverings (which began in 1991) involving the school district, the COP trustee (on behalf of investors), the State Department of Education, and the State Attorney General, ensured that COPs would remain in the news throughout the year and served as an ever-present reminder of how COPs could be abused.

A CDAC-sponsored public hearing in June 1992 pointed to some of the problems with inadequate controls over lease financing and to the need for greater understanding and education among lease participants. The findings from this hearing eventually led the Commission to approve the development of lease/COP guidelines intended to assist public officials on both technical and policy matters related to leasing.

## **Mello-Roos Financing is the Focus of Reform**

The year was barely under way when CDAC held its first public hearing on the Mello-Roos Act. The hearing was largely in response to complaints from homeowners, investors, and others who believed that the Mello-Roos Act was in need of legislative reform. Moreover, the Commission became concerned that the weakening real estate market in California could lead to foreclosures or bond defaults in places where developers were stretched too thin. Accordingly, the hearing sought to identify specific problems associated with the administration of Mello-Roos community facility districts (CFDs) and to ascertain whether foreclosures or defaults were imminent.

By and large, almost all the Mello-Roos districts in the state were judged to be in reasonable financial shape. However, persons testifying at the public hearing raised a

number of issues warranting legislative attention, including (1) the level of disclosure to homeowners concerning the amount and nature of the Mello-Roos special tax and to potential investors regarding the financial condition of the CFD; (2) the disparate tax rates between developed and undeveloped property; (3) developers "shopping" among public agencies to find the best financing terms; (4) inadequate public involvement in decisions to change projects being financed; and (5) Mello-Roos taxpayers being denied access to schools financed by Mello-Roos funds. Proposed remedies to these and other concerns would ultimately find their way into SB 1464 (Mello), which was signed by the Governor (Chapter 772, Statutes of 1992).

With housing sales remaining in a slump throughout most of the year, the number of Mello-Roos bond transactions dropped to 46 in 1992, with a par amount of \$552 million. These figures can be contrasted with Mello-Roos activity in 1990, when there were 73 issues totaling \$977 million. In addition, it should be noted that as the curtain closed on 1992, at least three community facilities districts (in Sacramento, Roseville, and Ione) initiated foreclosure proceedings on property within the CFDs, a possible indicator of problems on the horizon.

#### **A Bright Spot: Falling Interest Rates**

Under the circumstances, public agencies issuing debt did have one reason to celebrate: interest rates were at their lowest in nearly two decades. As a result, public agencies that were in the position to finance new projects were able to reap substantial savings over what those same projects would have cost only one or two years before. And there were significant savings to be enjoyed by those agencies with the ability to refinance prior debt, either through current or advance refundings. The number of California agencies falling into this category increased significantly in 1992, as refundings totalled \$10.7 billion, or nearly 40 percent of all long-term debt issued in 1992. By contrast, refundings only represented \$5.5 billion in 1991, or 22 percent of that year's total. At the national level, refundings represented 50 percent of long-term volume. (California's lower share of refundings is attributable to the high percentage of non-callable bonds issued in this state.)

While rates were relatively low all year, there were significant fluctuations throughout the course of 1992. At the beginning of the year, for instance, the *Bond Buyer's* index of 11 high-grade general obligation bonds was at 6.39 percent, ultimately peaking at 6.67 percent in March. By July 1992, the average for these same bonds had dropped to 5.80 percent, a decline of nearly 90 basis points over a four-month period. (For purposes of comparison, lowest rates for these bonds in 1991 and 1990 were 6.44 percent and 6.87 percent, respectively.) High-grade G.O. bond rates would rise again slightly in October, and finally settle at 6.09 percent at the end of year. (While the high-grade G.O. bond index is used here for illustrative purposes, rates for lower quality bonds followed the same general pattern in 1992.)

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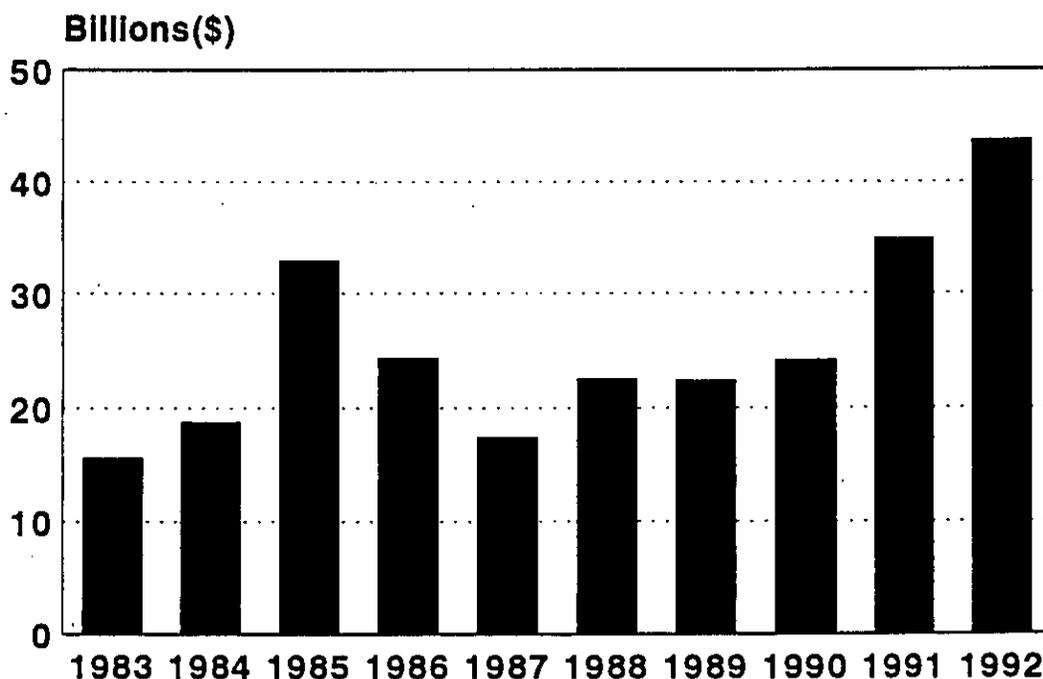
#### **CALIFORNIA DEBT ISSUANCE IN 1992**

California public agencies recorded an unprecedented level of debt issuance in 1992. Although the percentage growth in the dollar volume was not quite as large as the

growth experienced in the prior year, the new plateau exceeds the former peaks reached in 1985 and 1991, as shown in Chart 1. According to reports submitted to the Commission, total State and local debt issued in 1992 was \$43.7 billion. This section summarizes California public debt statistics and highlights the major purposes for which new debt was issued in 1992. A more detailed treatment of public debt issued in California in 1992 is provided in the Commission's two companion publications, *1992 Calendar of Debt Issuance* and *1992 Summary of California Public Debt*.

Chart 1

**California Public Debt Issuance  
1983 through 1992**



SOURCE: CDAC

**California Agencies Issue Record Level of Debt**

Taking advantage of low interest rates for both long-term and short-term debt, California public agencies issued \$43.7 billion in debt during 1992. This amount represented an increase of 26 percent over the \$34.8 billion issued in 1991, and marked the second year in a row that the California issuers have broken the record for total dollar volume issued. The debt issuance for 1992 reflects extensive refinancing of prior debt, a significant jump in short-term borrowing, and a decline in the dollar amount of new long-term issues.

Total long-term debt issued in 1992 for all agencies was \$26.7 billion, up 7.6 percent from the \$24.8 billion sold in 1991. Of the long-term debt total, \$10.7 billion (40 percent) was used to refund prior debt issues. By contrast, 1991 refunded debt amounted to \$5.5 billion, only 22 percent of that year's long-term total. New long-term debt issues accounted for \$16 billion in 1992, down 17 percent from new long-term debt issuance of \$19.4 billion in 1991. Short-term cashflow borrowing totalled \$17 billion for the year. This is an increase of almost 71 percent from the \$10 billion issued in 1991. Table 1 on exhibits long-term vs. short-term debt issued for the past two years.

Table 1

**California Public Debt Issuance  
Long-Term vs. Short-Term  
1991 and 1992  
(dollars in millions)**

	1991	1992
Long-term Debt	\$24,828	\$26,702
(Refundings)	( 5,450)	(10,738)
(New Projects)	(19,378)	(15,965)
Short-term Debt	<u>9,994</u>	<u>17,039</u>
Total	\$34,822	\$43,741

**Interim Financing and Capital Works Projects Lead the Way**

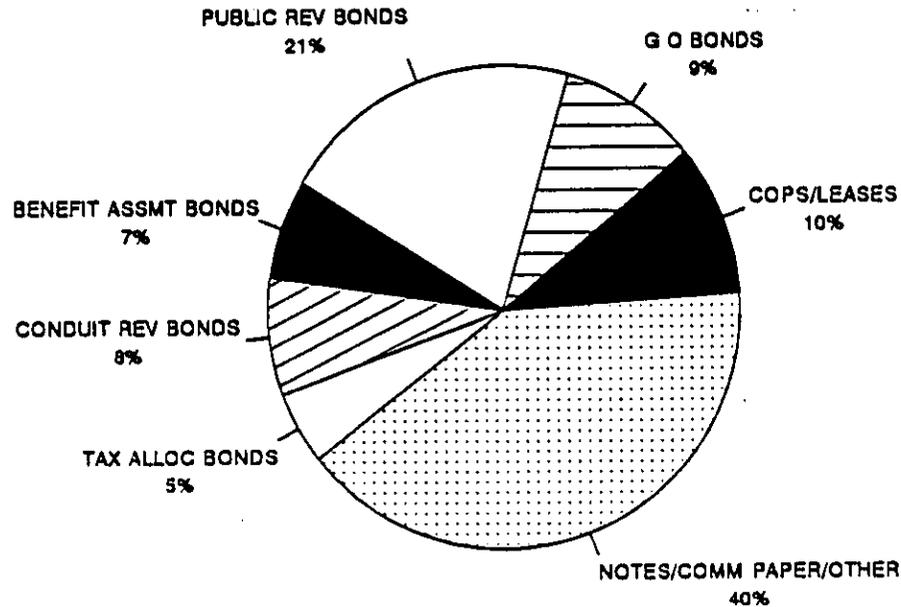
As a percentage of all debt issued, the \$17 billion in short-term borrowings comprised a whopping 39 percent of statewide totals. The volume of issuance for capital improvements and public works projects totalled \$15.9 billion in 1992, a 12 percent increase from the prior year's total. Capital improvements and public works projects accounted for 36 percent of all debt issued in 1992. Funding for educational purposes was \$4.4 billion (10 percent of 1992 debt), up slightly from 1991 figures.

The use of bonds was up 19 percent in 1992, while lease and certificate of participation (COP) financing dropped by approximately the same margin. Types of bonds showing an increase in issuance included tax allocation bonds (up 128 percent); public revenue bonds (up 59 percent); and benefit assessment bonds (up slightly by six percent). General obligation bonds (down 12 percent) and conduit revenue bonds (a decline of 18 percent) saw their levels drop from 1991, while the use of notes and commercial paper rose by 60 percent. Chart 2 shows the relative percentage of each type of debt issued in 1992.

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Chart 2

**California Debt Issuance by Type  
January 1, 1992 - December 31, 1992**



Source: CDAC

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**State Increases Reliance on Short-Term Debt; Housing Issuance Way Down**

Annual debt statistics for the State of California revealed increased use of short-term borrowing to meet operating needs and a precipitous decline in issuance for housing purposes. Total State of California debt issuance was \$16.7 billion, up slightly from the \$14.5 billion issued by the State in 1991. The increase occurred primarily in the area of short-term interim financing necessitated by the long State Budget delay. Over \$10.8 billion in various interim financing debt instruments (64 percent of the total State volume) was sold in 1992. This figure included tax and revenue anticipation notes as part of the annual interim financing sale, and revenue anticipation notes and reimbursement warrants to cover cash-flow payments until the budget was signed.

A notable drop in State activity could be found in the housing area. While the State issued over \$1.7 billion for housing purposes in 1991, housing bond totals declined to only \$124 million in 1992. This appears to be largely due to the steep drop in conventional mortgage rates which has created a backlog of State housing bonds. Because these bonds were issued at rates which are no longer competitive with conventional mortgage rates, the proceeds of the bonds may never be allocated to first-time homebuyers.

Bond financing at the State level was used primarily for education (K-12 school facilities and college/university projects). The \$2.6 billion of issuance was almost identical to the amount issued in 1991 for education purposes. Capital improvement and public works projects garnered \$2.5 billion, down 28 percent from the 1991 issuance of \$3.4 billion. Comparisons of 1991 and 1992 State debt issuance figures, by purpose, are in Table 2.

Table 2

**State of California  
Public Debt Issuance by Purpose  
1991 and 1992  
(dollars in millions)**

	1991	1992	Percent of Change
Interim Financing	\$5,750	\$10,775	+87.4
Capital Improvements	3,399	2,454	-27.8
Commercial/Industrial	141	338	+139.7
Education	2,611	2,611	--
Hospital/Healthcare	911	446	-51.0
Housing	<u>1,710</u>	<u>124</u>	<u>-92.8</u>
Total	\$14,522	\$16,748	+15.3

Total long-term debt issuance by the State was just shy of \$6 billion, with \$1 billion of that total used to refund prior debt. Although refunding issues were just 17 percent of total State long-term issuance, over half of the State debt issued for hospital/health care facilities and housing projects was for refunding of prior debt.

**Local Agency Debt Issuance Tops \$26 Billion**

Total local agency debt issuance was \$26.6 billion in 1992, up 33 percent from the \$20 billion issued in 1991. The characteristics of local agency debt issuance differed markedly from the State issuance, with short-term debt accounting for \$6.3 billion (just 24 percent of the local total) and long-term issuance totalling \$20.4 billion (76 percent).

Refundings represented a major portion of local debt issuance with almost half (\$9.4 billion or 46 percent) of the total long-term debt being sold to refund prior issuance. Refundings constituted a significant percentage of the debt issued in the following areas: commercial and industrial development (77 percent); housing (82 percent); and redevelopment (59 percent). Table 3 displays the comparison between the 1991 and 1992 figures for local debt issuance by purpose.

Table 3

**California Local Agencies  
Public Debt Issuance by Purpose  
1991 and 1992  
(dollars in millions)**

	1991	1992	Percent of Change
Interim Financing	\$4,244	\$6,264	+47.6
Capital Improvements	10,876	13,478	+23.9
Commercial/Industrial	35	204	+489.6
Education	1,445	1,391	-3.8
Hospital/Healthcare	1,020	1,352	+32.5
Housing	1,076	1,030	-4.3
Redevelopment	1,268	2,679	+111.2
Other	<u>99</u>	<u>243</u>	<u>+145.5</u>
<b>Total</b>	<b>\$20,063</b>	<b>\$26,640</b>	<b>+32.8</b>

The total dollar volume of bonds issued at the local level in 1992 was \$15.3 billion, a 60 percent increase from the \$9.6 billion sold in 1991. Major increases occurred in the area of public enterprise/lease/other revenue bonds (which includes Marks-Roos pool bonds), which saw total activity rise to \$9.1 billion, up 59 percent from the 1991 level of \$5.7 billion. Conversely, 1992 local issuance of COPs and leases (\$4.4 billion) was down 20 percent from the \$5.5 billion issued in 1991, while the level of limited tax obligation bonds (primarily Mello-Roos and local sales tax revenue bonds) remained virtually the same at \$2.2 billion. Local note issuance of \$6.6 billion was up 43 percent from the \$4.6 billion in short-term debt sold in 1991.

The \$13.5 billion issued for capital improvement/public works projects represented over half of all local agency debt financing, an increase of 24 percent over 1991. Redevelopment financing (\$2.7 billion) was the second most popular purpose for local debt, constituting over 10 percent of all debt issued. The amount issued on behalf of redevelopment agencies was over double that issued in 1991. Other purposes realizing significant increases in support included commercial and industrial projects and hospital/health care financings.

**Agencies in L.A. County Record Highest Totals; Mello-Roos Issuance Drops Again**

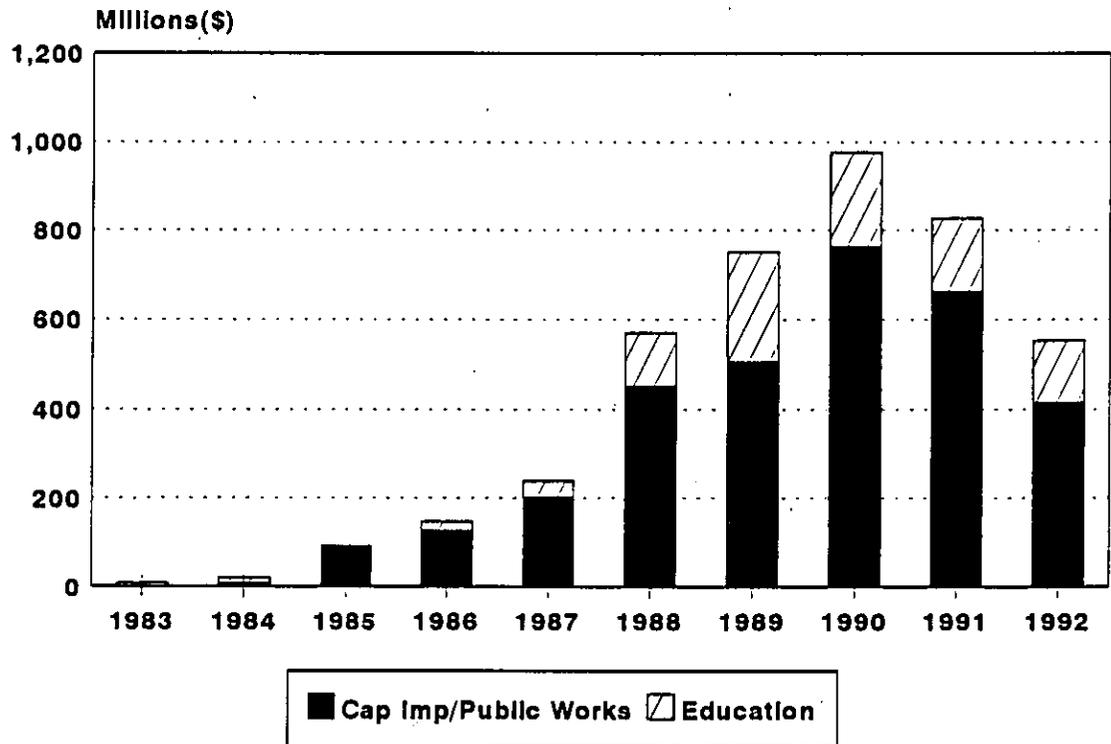
Local agencies in Los Angeles County once again led the State in debt issuance with over \$7 billion (16 percent of the total volume) issued in 1992. Issuers in seven other counties reported debt issuance volume of \$1 billion or more. They include: Orange, \$2.2 billion; San Diego, \$1.8 billion; San Bernardino, \$1.3 billion; Alameda, Riverside, and San Francisco, \$1.2 billion each; and Santa Clara, \$1 billion. Fifty-five of the 58

counties reported debt issuance for the year. Multi-county agencies (i.e., JPAs, transit districts, non-profit corporations, etc.) issued 10 percent of the total volume, accounting for \$4.5 billion in debt.

Total issuance by Mello-Roos community facilities districts (CFDs) dropped in 1992 for the second straight year. CFD issuance figures totalled \$553 million, down 33 percent from the 1991 issuance of \$828 million. The number of issues also dropped to 46 from the 73 sold in 1991. Three-fourths of the total CFD issuance (\$415 million) was for capital improvements and public works projects. The remaining quarter (\$138 million) was issued for education purposes. The overall decrease in Mello-Roos activity mirrors the continued decline in residential construction and land-based development in California. Chart 3 depicts Mello-Roos issuance by purpose.

Chart 3

**Mello-Roos Issuance by Purpose  
January 1, 1983 - December 31, 1992**



Source: CDAC

### Negotiated Sales Regain Market Share

As shown in Table 4, the volume of negotiated sales bounced back in terms of market shares after a steady decline since 1987. Of the \$43.7 billion issued statewide in 1992, \$34.3 billion, or 78 percent of all issues was sold through negotiated sales. The remainder, not quite \$9.5 billion, or 22 percent, was sold competitively.

As Table 4 indicates, negotiated transactions represent, by far, the most prevalent method of selling debt California -- a trend that has existed since the mid-1970s. It should be noted that the continuous downward trend in the market share for negotiated sales prior to 1992 was primarily due to the steady increase in the sale of general obligation bonds by the State of California, all of which were sold competitively. Thus, with the drop-off in the issuance of State G.O.s in 1992, it is not surprising that the proportion of debt issued competitively also declined in 1992.

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Table 4

**State and Local Debt Issuance  
Competitive vs. Negotiated Financings  
1987 through 1992  
(dollars in millions)**

<b>Year</b>	<b>Competitive</b>	<b>% of Total</b>	<b>Negotiated</b>	<b>% of Total</b>
1992	\$ 9,446	21.6	\$34,296	78.4
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

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## ACCOMPLISHMENTS IN 1992

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### THE COMMISSION'S PUBLICATIONS

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 finance matters, the Commission strives to make the information at its disposal as accessible to the public as possible. To meet this goal, CDAC disseminates a variety of publications throughout the year. With the exception of the *California Debt Issuance Primer* -- a reference manual for issuers of public debt -- reports and other publications are available to any interested party free of charge.

In 1992, CDAC continued with its regular publication of *DEBT LINE*, the Commission's monthly newsletter, developed a new series called *Issue Briefs*, and released eight new publications, which are described below. (A listing of all CDAC publications currently in print is available upon request.)

#### **Recommended Changes to the Mello-Roos Act of 1982: Oral and Written Testimony [CDAC 92-1]**

This report, a companion volume to *Recommended Changes to the Mello-Roos Act of 1982: Report to the Legislature and Governor* [CDAC 92-2], presents the testimony that was received at the Commission's January 15, 1992 Mello-Roos public hearing. The contents of the report are divided into three main sections: (1) oral testimony, (2) written testimony, and (3) comments received on the Commission's draft report to the Legislature and the Governor. The report is rounded out with the agenda of the public hearing, opening and closing remarks made by California State Treasurer and Commission Chairperson Kathleen Brown, and a listing of the witnesses providing oral and written testimony.

#### **Recommended Changes to the Mello-Roos Act of 1982: Report to the Legislature and Governor [CDAC 92-2]**

Because of continuing concerns regarding public debt issued under the Mello-Roos Act of 1982, the Commission conducted a public hearing on this subject on January 15, 1992. This report (1) summarizes the Commission's findings based on the oral and written testimony presented at that hearing, (2) recommends changes to the Mello-Roos

Act, and (3) highlights related issues for consideration by the Legislature and the Governor.

The findings attest to the continuing importance of the Mello-Roos Act as a flexible financing vehicle to meet local infrastructure needs in the post-Proposition 13 era. However, for this debt financing instrument to remain a viable tool, there appears to be a need for improving disclosure to homebuyers and for the dissemination of more information to participants in the bond market.

The recommendations in the report address the concerns expressed by the testimony received at the hearing: (1) amend the notice of special tax requirement to improve disclosure to homebuyers, (2) establish an annual reporting requirement for Mello-Roos community facilities districts, (3) limit the annual increase in the maximum special tax on residential properties to two percent for landowner-approved financings, (4) require timely joint financing agreements which insure greater involvement of responsible agencies, (5) require that substantial redirection of funds be subject to majority protest provisions, and (6) require that school district attendance policies give priority consideration to the residents of community facilities districts. This report adds to the insights gained from an earlier study of the Mello-Roos Act, *Mello-Roos Financing in California*, which was released in September 1991.

#### **1991 Annual Report [CDAC 92-3]**

As the first annual report on Commission activities since 1984, the *1991 Annual Report* introduces the Commission and its members, gives an overview of California public finance activities during 1991, summarizes CDAC's accomplishments in the same year, and outlines major new projects planned by the Commission for 1992. The report provides a digest of the Commission's programs and activities, with a broad perspective on the events that shaped California public finance in 1991.

#### **1991 Summary of California Public Debt [CDAC 92-4]**

This report provides a profile of the level of public borrowing by all levels of government in the state, based on unaudited data for public debt issuance from January 1 through December 31, 1991. The first part of the contents is a brief narrative of the volume of state and local issuance for 1991, including discussions of state and local debt financings, taxable debt financings, refundings, and financing techniques with a focus on Mello-Roos and Marks-Roos bonds. The bulk of the report is devoted to tables that summarize 1991 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 type of issuing agencies (State, cities, counties, etc.). This report is the seventh *Summary* published since 1986.

## **1991 Calendar of Debt Issuance [CDAC 92-5]**

This report contains detailed information on each California debt issue sold in 1991, based on unaudited data submitted to the Commission. The information presented in the *Calendar* is organized by county and by issuer to portray each agency's debt issuance activity for the year. Details include the type of debt instrument sold, the sale date, the purpose for which the funds are raised, and related information of relevance to issuers, analysts, and others interested in California's public debt portfolio. This report is the seventh in a series published annually since 1986.

## **COPs in California: Current Issues in Municipal Leasing [CDAC 92-6]**

On June 18, 1992, the Commission conducted a public hearing on the increasing use of leasing to finance capital projects and equipment purchases. The hearing focused on certificates of participation (COPs), the predominant form of leasing in California, as well as the issues of public accountability and cost effectiveness of COPs.

Section I of the report contains a background paper prepared for the hearing, which identifies and outlines some of the major issues affecting the use of COPs in California: (1) the default of \$9.8 million of COPs by the Richmond Unified School District; (2) grand jury investigations into the lease financing practices of Santa Barbara County and Nevada County; (3) a proposal by the City of San Jose to finance the construction of a major league baseball stadium by issuing \$200 million in COPs; and (4) probes that have led to greater scrutiny of COPs elsewhere in the country. Section II of the report contains a transcript of the oral testimony presented by twenty witnesses at the hearing, as well as opening and closing remarks by State Treasurer Kathleen Brown. Section III completes the documentation of this public hearing with reproductions of additional written testimonies received by the Commission.

Based on the testimony received at the hearing, the Commission found that (1) increased reliance on COPs for infrastructure financing can be largely attributed to the difficulty of getting general obligations bonds passed because of the two-thirds approval requirement; (2) despite adverse publicity surrounding the Richmond case and other problematic leasing arrangements, the speakers expressed continued market confidence in California COPs; and (3) there is a need for public officials to demonstrate greater accountability for their leasing decisions to assure that confidence in the market for COPs is not diminished.

## **Glossary of Leasing Terms [CDAC 92-7]**

This publication is intended to be of use to public officials who are responsible for making decisions about leasing activities. As such, it is designed to serve as a handy reference guide to the technical terms that apply to both municipal bonds and tax-exempt leases. The terms are arranged in alphabetical order for quick reference. Because of the specialized subject matter, the terms defined in this publication largely supplement the glossary contained in CDAC's *California Debt Issuance Primer*.

## **1992 Annual Summary: The Use of Housing Revenue Bond Proceeds [CDAC 92-8]**

This is the eighth edition in a series of reports designed to summarize information on local agencies' use of tax-exempt housing revenue bond proceeds, based on unaudited data reported to the CDAC by the issuing agencies. Included in the report is 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 1992 edition of the report indicates that housing revenue bonds issued between January 1, 1985 and June 30, 1992 totalled \$7.6 billion. However, since not all agencies complied with the reporting requirements, detailed data on only \$6.8 billion (89.5 percent of the total \$7.6 billion) could be presented in this report.

Based on the reports received by the Commission, local housing agencies have issued \$5.5 billion in bonds to fund the construction of 91,694 *multifamily* units. Of these units, almost 22 percent (19,908 units) are targeted for lower-income households. Additionally, the 1992 report shows that approximately \$1.3 billion in *single-family* housing bonds were issued. Although nearly \$1.2 billion of these proceeds were available for mortgage loans through June 30, 1992, only \$475 million (41 percent) have been used to originate 5,061 mortgages. The bulk, over \$691 million (59 percent), remain available for loan origination within a time limit of three years from the date of issuance.

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## **OTHER COMMISSION PUBLICATIONS**

### **DEBT LINE (Monthly)**

In 1992, about 1,000 public and private subscribers received 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. Although subscriptions to *DEBT LINE* were reduced in 1992, (the reduction is a result of the Commission's periodic purge and update of its mailing list), the Commission is receiving an average of 20 new subscription requests every month and expects to have 1,400 subscribers by the end of 1993.

*DEBT LINE* provides three basic 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 -- volume of debt issuance, 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 1992, for instance, the October issue of *DEBT LINE* was dedicated to the subject of investing public funds. Included in this issue were articles on State investment regulations, investing in a debt deflation, federal income tax rules, the role and use of financial advice, and various investment vehicles. *DEBT LINE*'s "Legislative Status Report" also continued to provide information on state legislation that affect 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.

### **Issue Briefs**

To round out its technical assistance function, the Commission developed the *Issue Brief* series, which are reference documents on topical public finance matters. As such, these documents present objective analyses on important current issues, including suggestions for addressing these issues. Being somewhat more technical than a typical *DEBT LINE* article, but not lengthy enough to be published in report form, these treatments are made available separately in the *Issue Brief* format.

*Issue Brief No. 1, Competitive Versus Negotiated Sale of Debt*, focuses on one of the most controversial issues in public finance over the last two decades. This *Issue Brief*, which was released in September 1992, outlines the advantages and disadvantages of both sale methods to highlight the tradeoffs involved, discusses the factors to consider when deciding which method of sale to use, and explores some alternate hybrid techniques. Also included in this *Issue Brief* is a set of recommendations intended to provide issuers with information that is helpful in choosing the method of sale which will result in the lowest overall issuance cost. The Commission will be releasing three to four additional *Issue Briefs* in 1993.

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## **THE COMMISSION'S SEMINARS AND SYMPOSIUMS**

CDAC's ongoing educational program is constantly evolving to meet the varied and changing needs of the financial community it serves. In 1992, the Commission expanded its seminar program by offering more events which are co-sponsored by statewide associations. Co-sponsored seminars and symposiums are uniquely designed

to serve the needs of specialized groups and to bring various players in the financial market together for a broader exchange of views and a fresh outlook on persisting problems.

### **Symposium on Education Issues**

A symposium on education issues, *Discussions on School Capital Financing and on School Restructuring*, was offered jointly by the CDAC and Standard and Poor's Corporation (S&P) on February 27, 1992 in San Francisco. Over 100 participants from the education, public policy, and financial communities attended to discuss critical issues facing California educators with two panels of experts.

The first session of the symposium focussed on the future of school capital finance in California. The panelists -- Harry Weinberg, Superintendent of Schools for San Diego County; Duwayne Brooks, Director of the School Facilities Planning Division of the Department of Education; James Knapp Director of Finance for Elk Grove Unified School District; and Jeff Thiemann, a Director in Standard & Poor's Corporation -- discussed the need for K-12 facilities and explored various alternatives for extending the use of existing facilities and for raising needed funds. The panel also discussed proposed Assembly Constitutional Amendment 6 (ACA 6), which would change the required approval for school bonds to simple majority vote to facilitate the sale of general obligation bonds as a source of funding for school construction.

The focus of the second session of the symposium was on fundamental school changes, through restructuring, to improve the quality of education. The discussants -- Jere Jacobs, Vice President of the Pacific Telesis Group; Judy Coddling, Principal of Pasadena High School; Assemblymember Delaine Eastin; and Stanford University Professor Terry Moe -- emphasized the need for fundamental rethinking of the educational system if educational quality is to be improved, by debating ideas such as personalizing the learning environment to bring about more effective learning, legislation to authorize teacher-run charter schools that would be amenable to innovation by easing top-down control, and the freedom for students to attend either public or private schools with public support.

### **Seminar on Understanding the Debt Issuance Process**

Together with the California Association of School Business Officials (CASBO), the Commission offered a seminar entitled *Understanding the Debt Issuance Process* on June 15 and 16, 1992 in San Diego. Designed for education officials new to the public finance arena, workshop sessions focussed on terms and concepts of debt issuance, the major steps in the debt issuance process, and debt instruments that are typically used by school districts. The faculty for the seminar was drawn from local school districts and from the private investment community.

## **The Underwriting Process and Minority/Women Business Enterprise Participation Seminar**

Working in conjunction with the Association of Bay Area Governments (ABAG), the Commission developed a two-part seminar designed to acquaint participants with the mechanics of the bond underwriting process and to explore various approaches for issuers to achieve minority/women business enterprise (M/WBE) policy objectives. The seminar included workshops on understanding the roles of the members of the underwriting team, marketing and pricing, establishing an M/WBE policies for investment banking services, ensuring effective M/WBE participation, and implementing and evaluating compliance with established M/WBE policies. The seminar was held in San Francisco on October 5, 1992 and drew over 70 participants.

## **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. 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 Commission's Technical Advisory Committee, and public officials with extensive experience in public finance. The spring seminar was co-sponsored by the California State Association of Counties (CSAC) and the California Association of County Treasurers and Tax Collectors (CACTTC) and the fall seminar was co-sponsored by the California Special Districts Association (CSDA) and the Association of California Water Agencies (ACWA).

In 1992, two *Fundamentals of Debt Financing* seminars were presented by the Commission in Irvine (spring) and South San Francisco (fall). 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 *Fundamentals* seminar includes a presentation on *Ethics and Public Finance Transactions*. This session addresses 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 offered two *Mechanics of a Bond Sale* seminars in 1992. Held in Irvine (spring) and South San Francisco (fall), 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, as well as discussions on how conflict of interest and the receipt of gifts should be handled.

The spring seminar was again co-sponsored by CSAC and CACTTC. The fall seminar was co-sponsored by CSDA and ACWA. About 140 State and local agency officials participated in the seminars.

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## **THE COMMISSION'S PUBLIC HEARINGS**

Among a multitude of mandated tasks, CDAC is required to maintain contact with municipal issuers, investors, underwriters, credit rating agencies, and others to improve the market for state and local government debt issues. To help meet this requirement, the Commission schedules public hearings on topics of widespread interest. CDAC's public hearings are held at various locations throughout the State, often on consecutive days in both northern and southern California. This allows for timely input from all interested parties. The hearings conducted in 1992 attest to the Commission's commitment to providing public oversight and input on issues affecting debt issuance in California.

### **Public Hearing on the Mello-Roos Act**

On January 15, 1992, the Commission conducted a public hearing in Santa Ana to assess the status of Mello-Roos bond financing in California. The Mello-Roos Act of 1982 authorizes the formation of community facilities districts (CFDs) to raise special taxes to support bonds for infrastructure projects and specified services. The bonds must be approved by two-thirds of the registered voters or landowners within a district. Typically, this type of financing is used for the development of raw land. Both the benefits and costs are passed on to the ensuing homeowners.

Because of slumping real estate values in California, recent press reports focused on the credit quality of Mello-Roos bonds and the possibility of defaults and delinquencies. Moreover, homeowner groups have come to question the fairness of the Mello-Roos tax burden, since Mello-Roos bonds may be used as a financing vehicle by landowners for improvements which do not necessarily benefit specific properties within a community facilities district (unlike improvements financed through special assessments which must benefit the property upon which the tax is levied), but rather confer a general benefit to residents within the district. To give all parties in Mello-Roos financings an opportunity to voice their concerns, the public hearing allowed for the presentation of views from taxpayers, public agencies, developers, and the public at large, as well as from industry specialists.

The results of this public hearing have been published by CDAC in two reports -- *Recommended Changes to the Mello-Roos Act of 1982: Oral and Written Testimony* [CDAC

92-1] and *Recommended Changes to the Mello-Roos Act of 1982: Report to the Legislature and Governor* [CDAC 92-2]. A detailed description of these reports is contained in this Annual Report.

### **Public Hearing on Leases/Certificates of Participation (COPs)**

Growing concerns over lease financings in California prompted the Commission to hold a public hearing on this issue on June 18, 1992 in Oakland. The primary focus of the hearing was on certificates of participation (COPs) which are increasingly used for financing capital improvements and the acquisition of equipment. For local agencies, COP issuance rose from \$3.1 billion in 1990 to \$5.2 billion in 1991, an increase of 69 percent. By comparison, all other local debt instruments grew by 41 percent over the same period. Thus, one of the goals of the hearing was to uncover the reasons for the increasing utilization of the lease financing option.

Lease financings have gained popularity as an alternative means of raising funds in the post-Proposition 13 era, as local governments' ability to finance projects from property taxes was greatly diminished. Moreover, certificates of participation often appear to be the only viable means of debt financing since general obligation bonds -- the more traditional and secure form of municipal debt -- must be approved by two-thirds of the voters. Because leasing arrangements do not require voter approval, the growth in COPs raises several concerns. Of particular concern to participants at the hearing was the public accountability of elected officials and possible dangers from devoting ever larger shares of operating budgets toward lease payments. Also, questions regarding the cost-effectiveness of lease financings and the ability and willingness of issuers to pay their lease obligations were addressed.

One particular concern voiced during the hearing was the possibility of repercussions from the default of the Richmond Unified School District on \$9.8 million of COPs. The school district had used a majority of the proceeds to close a budget deficit. As attested to during the hearing, however, the use of COPs to finance an operating deficit is not representative of public leasing practices in California. Most people testifying agreed that the market for California certificates of participation is basically sound, despite the negative publicity surrounding the Richmond Unified School District default. The testimonies received by the Commission have been published in a staff report under the title *COPs in California: Current Issues in Municipal Leasing* [CDAC 92-6].

### **Public Hearing on the State Budget's Impact on Local Government Finance**

Prompted by the uncertainty over the ability of local agencies' to cope with \$1.3 billion in reduced property tax revenues, the Commission conducted a series of public hearings on the impact of the 1992-93 State Budget on local government finance. The hearings were held in Los Angeles, Oakland, and San Diego on December 1, 2, and 3, 1992, respectively. Oral testimony was provided by over 50 local government officials and industry representatives. An additional 20 persons submitted written testimony.

It was clear from the testimony given that the 1992-93 State Budget will adversely affect local government's ability to meet infrastructure and capital equipment needs through debt financing in the future, unless stable revenue sources can be found for the repayment of such debt. While most speakers testified that they will be able to honor existing debt commitments, the uncertainty created by the State's reduction of property tax revenues makes future infrastructure investment less likely.

Numerous suggestions were made to minimize the impact of reduced State funding, including (1) general support for changing the approval requirement for general obligation bonds from two-thirds of those voting to a simple majority; (2) advocacy of a credit-enhancement program for local governments issuing debt, with the suggestion that the Public Employee Retirement System (PERS) and the State Teachers Retirement System (STRS) function as potential sources of bond insurance and letters of credit in return for a fee; (3) greater sensitivity in the shaping of future State budgets and policies respecting public enterprises and the California business climate; (4) calls for reforming workers' compensation, tort liability, and environmental regulations; and (5) a request for the timely resolution of future State budgets to allow for the development of more efficient and equitable local budgets, particularly in the event of further budget cuts.

The Commission plans to share the testimony and provide recommendations to the Legislature as a result of these hearings.

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## **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 1992, CDAC made presentations and conducted workshops for the following groups:

- Association for Governmental Leasing & Finance
- California Association for Local Economic Development
- Government Finance Officers Association
- Local Agency Investment Fund Conference
- Miller & Schroeder Public Finance Conference
- Municipal Finance Bureau of Dalian, People's Republic of China
- National Federation of Municipal Analysts
- 2nd Annual *Bond Buyer* Conference on Public Finance

Shearson Lehman Finance Seminar  
State Debt Management Network  
Stone & Youngberg Conference on Land-Backed Financing  
UC Davis Extension Program on Mello-Roos

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## **THE COMMISSION'S DATA REPOSITORY**

Calendar year 1992 was another record-breaking period for state and local debt issuance in California. The data collection unit of the Commission processed 1,672 reports of proposed debt issuance in 1992. CDAC also received 1,554 reports for issues sold during the year. These included issues that were reported as proposed sales in 1989 through 1992 but were actually sold in 1992. Each of the over 3,000 reports CDAC processed in 1992 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 1992, the Commission collected 401 housing bond issuance reports from 132 local agencies -- 77 cities and counties, 32 redevelopment agencies, 20 housing authorities, and three housing finance agencies. The Commission also reviewed 76 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 1993

The California Debt Advisory Commission's 1993 agenda includes a combination of ongoing and new programs, as CDAC enters its 12th year. This chapter highlights the new programs for 1993.

### **Helping Local Governments Cope With the Impact of the 1992-93 State Budget**

As a follow-up to the series of public hearings conducted by CDAC during December 1992 on the impact of the 1992-93 State Budget on local government finance, the Commission plans to provide the Legislature with policy recommendations to help local governments cope with cutbacks in property tax revenues, maintain credit quality, and preserve their ability to foster economic development.

The Commission believes that communication between all levels of California governments is vital for the assessment of and successful implementation of State policies. The findings and recommendations from the December 1992 hearings are of particular importance insofar as California will likely face ongoing budget problems. For this reason, the Commission plans to make State policymakers fully aware of how local governments are responding to the 1992-93 revenue reductions and those that may be forthcoming. A verbatim record of the testimony given by local officials and industry experts, *The Impact of the 1992-93 State Budget on Local Government Finance: Transcript of Public Hearings*, is scheduled for publication in February 1993. In March 1993, the Commission will release its findings and recommendations in a document entitled *The Impact of the 1992-93 State Budget on Local Government Finance: Report to the Legislature*.

### **A Closer Look at the Marks-Roos Act**

Lingering questions 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. Although this study was slated for completion in 1992, it was delayed due to the need to address other Commission priorities.

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.

## **Guidelines for the Issuance of Leases, Including Certificates of Participation (COPs)**

Testimony presented at a CDAC hearing held on June 18, 1992 on the public issuance of certificates of participation indicated a need for the Commission to provide technical assistance on the subject. In follow-up consultations with local government officials, it became clear that the most useful approach would be a set of guidelines that would (1) help local governments evaluate whether leasing arrangements are appropriate for their needs and (2) provide advice on how to structure a leasing arrangement.

Because the development of the guidelines requires specialized expertise and knowledge in this area of debt financing, the Commission has entered into a contract with a consulting team comprised of the following firms: American Government Financial Services Company; Stone and Youngberg; Orrick, Herrington & Sutcliffe; and Government Financial Strategies, Inc. CDAC staff will closely supervise the project to assure that the needs of California public debt issuers will be met.

Since leasing is only one debt financing option, the guidelines will present leasing decisions within a broader context of debt management policy. From this perspective, the text will touch on debt burden and debt capacity. Because of concerns over certain types of leasing arrangements and the lease-financing of controversial projects, the guidelines will also include recommendations on how public officials may demonstrate accountability to voters in making leasing decisions and discuss conditions which may warrant voter approval. The guidelines are due for release during the summer of 1993.

## **A Summary of 1992 Tax and Bond Ballot Measures Elections Results**

Slated for publication in the Spring of 1993, the Commission's *State and Local Tax and Bond Ballot Measures: Results of the 1992 Primary and General Elections* will cover the results of the elections held in June and November 1992. Although this report will be the fifth in the series, it will be the first to combine the results of the Primary and General Elections.

This report is intended to provide a snapshot of how the electorate voted on several state and local tax and bond ballot measures presented for their approval in 1992. The report will include a listing of the ballot measures along with the voting breakdown for each, as well as summaries of the voting patterns by types and purposes of the measures. The information used in this report will come from the Secretary of State's Office and the offices of the 58 County Clerks.

## **Symposium on Transportation Issues**

A Symposium entitled *On the Road Again: California Transportation Issues for the 1990s* will be offered jointly by the CDAC and Standard and Poor's Corporation on March

11, 1993 in San Francisco. First offered in 1992 on education issues, this will be the Commission's second annual co-sponsored symposium with Standard and Poor's Corporation.

Designed to provide a forum for experts representing both public and private sectors, the symposium will explore today's challenges and tomorrow's opportunities in the State's developing transportation trends. Among the topics to be discussed are the estimation of sales tax revenue, repercussions from the Rider vs. San Diego decision, implication of the defeat of Proposition 156, credit rating criteria for transportation agencies, privatization of transportation services, and future prospects for high-speed rail in California.

#### **Seminar on Public Finance in Times of Crisis**

A seminar co-sponsored by the Commission, the California State Association of Counties (CSAC), and the California Association of County Treasurers and Tax Collectors is set for January 7-8, 1993, in Sacramento. The program includes general sessions on county fiscal issues, ethics and public finance, and the California counties' legislative agenda for 1993, as well as concurrent sessions on topical information relating to the issuance and management of public debt.

This seminar is primarily geared to county professionals and county policymakers.

#### **Seminars on Health Facilities Financing**

In conjunction with the California Health Facilities Financing Authority (CHFFA), the Commission plans to offer a series of half-day seminars throughout the state on methods of financing health facilities in California. These events will draw from existing Commission seminar programs, with a focus on finance issues that health professionals should be aware of as they consider new facilities or refinancing existing debt. Officials from CHFFA and the Cal-Mortgage program will also be on hand to lend their views and expertise to the seminar program. As many as four seminars are expected to be held throughout the state from June through September of 1993.

#### **Seminar on Short-Term Debt Issuance**

Short-term borrowing comprised 39 percent of all debt issued in the state in 1992, and roughly 24 percent of locally issued debt. To help issuers wade through the intricacies of short-term debt issuance, the Commission, in conjunction with Moody's Investors Service, will be offering a one-day seminar on the basics of short-term borrowing. Tentatively scheduled for November 1993, this seminar will include sessions on cash management, legal and tax considerations for short-term debt issuance, the tax and revenue anticipation note (TRAN) issuance process, credit analysis of TRANs, and

TRANS marketing considerations. The seminar will be open to all California public agency officials.

### **Issue Brief Series**

In 1992, the Commission launched its latest technical assistance program known as the *Issue Brief* series. The Commission's first *Issue Brief* took a look at competitive versus negotiated sale of debt. In 1993, the Commission is anticipating the publication of *Issue Briefs* on five new public finance topics. First on the Commission's list for 1993 is *Understanding the Underwriting Spread (Issue Brief #2)*, scheduled for release during the first quarter of the year. Underwriting spread, which compensates the underwriter for its services, is one of the major cost component of public debt issuance. Thus, it is important that issuers are well informed about the factors that affect the amount of underwriting spread paid, particularly in a negotiated transaction. This *Issue Brief* will be designed to enhance issuers' understanding of how underwriters are compensated and to provide some tips to assist issuers in negotiating the spread.

The Commission plans to follow the *Underwriting Spread Issue Brief* with a look at the refunding decision. Entitled, *Refunding Municipal Bonds (Issue Brief #3)*, this document will be structured to help public debt managers develop an analytical framework for evaluating the efficacy of refunding debt obligations. Other topics slated for issue brief treatment in 1993 include the request for proposal (RFP) process, short-term debt issuance, and the use of derivative products. As with every *Issue Brief*, these reference documents are intended to bolster the public finance expertise of California public agency officials and to help them lower their costs of issuance.

### **Lease Survey Will Guide Future CDAC Efforts**

In September 1992, the Commission surveyed 466 State and local agencies on their use of tax-exempt leasing in order to guide future CDAC activities in the area of public leasing. The results of the survey will be compiled and presented to the Commission early in 1993 to assist in directing the Commission's effort to inform, educate, and guide public officials on the myriad of policy and technical issues associated with leasing. Early results indicate that issuers would be receptive to general guidance on leasing (to be addressed by the release of Lease/COP Advisory Guidelines in the summer of 1993) and specific training on the mechanics of lease negotiations, which may result in the development of a Commission seminar on this topic. There is also the possibility that part of the *Issue Brief* series may be devoted to treating specific lease issues identified by the survey. The survey was conducted in response to a 1991 Commission report, *Leases in California: Summary and Recommendations*, which highlighted the need for more information about public lease activities in California.

**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.

<b>COMMISSION TECHNICAL ADVISORY COMMITTEE</b>
--

**PUBLIC MEMBERS**

**Debbe Bailey**  
Modesto City Schools

**Sandra Davis**  
Los Angeles County

**Henry Gardner**  
City of Oakland

**Jim Harrington**  
*League of California Cities*

**Murphy McCalley**  
*San Diego Metro Transit  
Development Board*

**Art Vargas**  
*Castro Valley Sanitation District*

**Daniel J. Wall**  
*California State Association of  
Counties*

**Donald White**  
*Alameda County*

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*Charles A. Bell Securities Corp.*

**Almee Brown**  
*Artemis Capital Group, Inc.*

**Edward B. Burdett**  
*Goldman Sachs & Co.*

**Michael Patrick George**  
*J.P. Morgan Securities, Inc.*

**David E. Hartley**  
*Stone & Youngberg*

**Catherine Pfeiffenberger**  
*Lehman Brothers*

**BOND COUNSEL MEMBERS**

**Jan M. Brockman**  
*Orrick, Herrington & Sutcliffe*

**Stanley Dirks**  
*Orrick, Herrington & Sutcliffe*

**Jerome N. Duncan II**  
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**Karen Hedlund**  
*Skadden, Arps, Slate, Meagher & Flom*

**Sharon Stanton White**  
Jones Hall Hill & White

**FINANCIAL ADVISOR MEMBERS**

**Wes Hough**  
*Public Resources Advisory Group*

**Jeffrey Lelfer**  
*Leifer Capital*

**John M. Lemmon**  
*Government Finance Associates, Inc.*

**Lawrence G. Rolapp**  
*Fieldman, Rolapp & Associates*

**Timothy Schaefer, Chairperson**  
*Evensen Dodge, Inc.*

**RATING AGENCY MEMBERS**

**David Brodsky**  
*Moody's Investors Service*

**Amy Doppelt**  
Fitch Investors Service

**Steven Zimmermann**  
*Standard & Poor's Corporation*

**INVESTOR REPRESENTATIVE**

**Thomas Kenny**  
*Franklin Fund*

## 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 required over \$1.1 million in fiscal year 1991-92 to conduct its mandated functions. This was partially offset by \$776,804 in new revenues. The remainder was drawn from the CDAC Fund reserve. At the start of the 1992-93 fiscal year, the CDAC Fund balance exceeded \$1.5 million.

Table 5

### California Debt Advisory Commission Operating Revenues and Expenditures Fiscal Year 1991-92

CDAC Fund:	
Beginning balance (7/1/91)	\$1,893,000
New revenues	<u>776,804</u>
Total resources	\$2,669,804
Expenditures:	
Staff salaries	\$509,987
Staff benefits	133,770
General expense	16,071
Printing	57,832
Communications	5,165
Postage	12,788
In-state travel	16,142
Out-of-state travel	3,256
Training	3,020
Facilities Operation	49,199
Consultant and professional contracts	267,877
Data processing	4,417
Central administrative services	27,226
Seminar and Primer Expenses	26,533
Equipment	<u>5,037</u>
Total expenditures	\$1,138,320
CDAC Fund:	
Ending balance (6/30/92)	\$1,531,484

**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**

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