WATER RESOURCES 2010 REVENUE BOND

EXECUTIVE APPROPRIATIONS COMMITTEE
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ISSUE BRIEF

SUMMARY

The State Bonding Commission issued $65.8 million of "AA" rated Water Resources revenue bonds in February 2010. Under current statute, the State Bonding Commission does not need authorization or approval of the Legislature to issue revenue bonds on behalf of certain loan funds. However, the Legislature should be involved for at least two reasons: to decide the type of bond most appropriate and to allow for better coordination of resources. The Analyst recommends a change to the State Financing Consolidation Act (63B-1b) to require Legislative approval for all revenue bonds issued by revolving loan funds listed in this Act.

BACKGROUND

In February of 2010 (during the 2010 General Session) the State Bonding Commission issued $65.8 million of revenue bonds on behalf of the Board of Water Resources program in three series: 2010 A, B, and C. The bonds generated $1.9 million of premium with an average coupon of 4.194% (see Figure 1). The True Interest Cost[1] on the bonds was 2.751%. Moody's Investors Services rated the bonds an "Aa2" (two steps below an "Aaa" rating) and Standard and Poor's Rating Services assigned the bonds an "AA" rating (two steps below an "AAA" rating).

The State Bonding Commission issued these bonds under the authority of the State Financing Consolidation Act (63B-1b) for the Board of Water Resources. This Act does not require Legislative approval or authorization for the issuance of bonds. Of the $67.7 million generated by the selling of the bonds, the Board will use $60.0 million to provide loans for water development projects, $7.0 million to fund a debt service reserve fund for the life of the bonds, and $0.7 million for costs of issuance (see Figure 2).

The revenue bonds are backed by interest and principle repayments from 72 existing loans in two revolving funds. The primary loan fund (the Conservation and Development Fund which contains 61 of the 72 pledged loans) currently has 140 outstanding loans, with $204 million in principle receivable and $62 million in interest receivable through the year 2047. The 61 pledged loans represent 78% of the total principal receivable from loan assets in the Fund.

Summary of Series 2010 A, B, C	
Closing Date:	*Feb. 23, 2010*
Average Coupon:	*4.194%*
Avg. Annual Payment:	*$6,889,900*
Net Interest Cost:	*3.871%*
True Interest Cost:	*2.751%*
Last Maturity:	*July 1, 2022*
Moody's Bond Rating:	*"Aa2"*
S&P Bond Rating:	*"AA"*

Figure 1

Sources and Uses of Funds (Series 2010 A, B, C)	
Sources	
Par Amount of Bonds	$65,800,000
Premium	$1,927,491
Total Sources	$67,727,491
Uses	
Projected Construction	$60,000,000
Debt Service Reserve Fund	$6,993,808
Underwriter's Discount	$374,505
Cost of Issuance	$359,178
Total Uses	$67,727,491

Figure 2

[1] *True Interest Cost (TIC) is a measure of interest cost calculated to include the time value of money.*

The other loan fund, the Cities Water Loan Fund, has 53 loans with $24 million in principle receivable and $3 million in interest receivable through the year 2041. The 11 pledged loans represent 50% of the total principal receivable from loan assets in this Fund. In total, 72 loans amounting to $170.3 million of outstanding principal from 53 different borrowers are pledged as revenue for repayment of the bond.

DISCUSSION AND ANALYSIS

The 2010A, B, C Water Resources Revenue Bonds highlight two main issues:

- The difference between using a General Obligation (GO) bond and a Revenue bond; and
- Legislative involvement in the process of issuing revenue bonds to recapitalize loan funds.

General Obligation Bonds and Revenue Bonds

Compared to General Obligation bonds, the Revenue bonds have some advantages and disadvantages. The following is a list of some of the advantages of Revenue bonds:

1. Unlike GO bonds, revenue bonds do not count toward Constitutional debt limits.
2. Revenue bonds do not use the "full faith and credit" of the State.
3. Revenue bonds use entity-specific revenue sources for repayment in lieu of appropriations.

Revenue bonds, however, have certain drawbacks compared to General Obligation bonds:

1. Revenue bonds often require the establishment of a Reserve Fund as backing for default risk (in this case $7 million). These funds must be maintained for the life of the bond (12 years and used for the final debt service payment), thereby committing resources to unproductive uses.
2. The "AAA" rating (two steps above the "AA" rating of these revenue bonds) on GO bonds would have resulted in lower interest costs to the borrower (the Board of Water Resources). In this case, GO bonds would have resulted in $1.7 to $1.9 million of interest savings over the life of the bonds.

Legislative Involvement

The State Financing Consolidation Act (63B-1b) allows the Treasurer and the State Bonding Commission to issue revenue bonds on behalf of revolving loan funds without Legislative approval. In Chapter 53B-21 of the Utah Code the Legislature gives the Board of Regents a similar ability to issue revenue bonds for capital facilities on behalf of institutions of higher education. A key difference in the Higher Education statute is that 53B-21-113 states:

> *No bonds may be authorized or issued by the State Board of Regents or the board of any institution under this chapter without the prior approval of the Legislature.*

Involving the Legislature in the issuance of revenue bonds by the State Board of Regents allows for coordination and fiscal planning between capital and operational budgets. This coordination allows the Legislature to better allocate resources and make better budgeting decisions.

RECOMMENDATION

The Analyst recommends amending the State Financing Consolidation Act (63B-1b) to require Legislative approval for all bonds issued under this chapter similar to the language used in section 53B-21-113 for the Board of Regents.