- debt administration applicable to the issue,
- description of the capital improvement program,
- any contingent liabilities,
- tax exemptions,
- ratings,
- certificates from necessary officials,
- assessed valuation and tax rate,
- tax levies and collections,
- fund revenues and expenditures, and
- comparative statement of financial conditions.

The GFOA "Disclosure Guidelines for Offerings of Securities by State and Local Governments" is the best guide to preparing a prospectus. It provides essential guidance, and the financial community recognizes it as the authoritative source. The Oregon Bond Disclosure Guidelines is an excellent practical digest.

The government or its agent prints and distributes the prospectus with the *notice of sale*. It is sent to investment bankers, a list of large investors, financial newspapers, and ratings and information agencies. The *notice of sale* includes the following:

- the correct legal name of the issuing bond as well as the special law under which the government organized and granted the authority to issue the bonds;
- the type of bonds issued, the amount and purpose of the issue, the maturity schedule, and the call feature;
- the date, time, and place of sale and the manner in which the government will receive the bid;
- limitations as to interest rate, payment dates of interest, and when and where the investor will pay the principal;
- denomination and registration privileges;
- basis for bidding;
- amount of good faith check required;
- bid form and basis for award;
- name of approving attorney and statement on legality;
- provisions made for payment of principal and interest;
- total tax rate in the government unit and legal limits;
- methods and place for settlement and delivery of the bonds; and
- the right to reject any or all bids.

The bond market accepts some practices fairly well. For example, governments date bonds as near as possible to the delivery date to avoid improper interest charges. Government typically issues bonds in $5,000 denominations except for odd amounts that governments should retire the first year. Government pays interest semiannually, and bond owners often have the option of registering principal only or principal and interest. If the government sells the issue on a wide market, then the government makes payments at large financial centers for the convenience of the bondholders. Government must make prompt payments or default occurs.

Highly competitive investment *syndicates* that underwriters organize just for the purpose of buying the issue often buy large issues. The practice of these limited partnerships is to resell the issues as soon as possible to other investors. The syndicate members make their profit on the slight difference (called the *spread*) of what they bought and sold for each issue. Thus, factors (such as maturity, coupon structure, points, rate limits) under the control of the issuer permit easy syndicate reselling of municipalities and thus make syndicates more interested in bond offerings. If syndicates can easily resell bonds, then the municipality should get a lower interest rate on its bonds.

Most of the information in this section assumes that governments will use open competitive bidding rather than direct negotiations. Generally speaking, one is wiser to use open competitive bidding, but experienced governmental negotiators can often secure the lowest interest rates as well as better terms through negotiations. Robert L. Bland noted a positive correlation between experienced negotiators and lower interest costs, but there was a limit to the advantage of having more experience. Using experienced negotiators for sale of securities might be advisable, but government should not use them for first-time or very infrequent issuers.

For larger issues, a government might decide to contract with a fiscal or paying agent. Paying agents typically are in large financial centers, and they make the necessary principal and interest payments on bonds. Fiscal agents have broader powers, including replacing lost or destroyed original bonds, exchanging coupons for registered bonds, canceling paid bonds and coupons, cremating canceled bonds and coupons, answering routine correspondence, and signing bonds. The advantage of having an agent at a financial center is the saving of time in the movement of credit, coupons, bonds, and checks. This translates to the government saving money.

Debt Records and Reporting

Reputation is important. The local government must develop among investors a reputation for accuracy and integrity so that investors can place full trust in the local government debt records, reports, and payment calendar. Governments should avoid surprising the investment community. Thus, government should apply scrupulous attention to each detail of its issue. If it does not pay such attention to detail, the market automatically discounts its credit and the government must pay higher interest on later issues. Government bond dealers, bond-rating agencies, and, of course, the investors require reports.

Essentially, the investor wants to know primarily about the government's ability to make timely payments of principal and interest. The investor makes this judgment call on the basis of accounting data and reports. The National Committee on Government Accounting, in *Governmental Accounting, Auditing, and Financial Reporting,* has established basic standards for reporting on debt, and Chapter 7 discusses the necessary information. The issuer cannot segregate this information from the other financial reports of a government because of the interrelationship of the data and the potential significance of other financial data in understanding the government's debt and financial condition. Briefly, the investor wants to see the balance sheet, the amount of debt outstanding, the status of the debt reserves, the record and the ability of the government to meet the payments, willingness of officials to use their power to service debt, and the record of the community in debt and other financial management. Also the investor wants to know the assessments, the area's economic condition, the market value of its property, the tax habits of its citizens, and any overlapping of debt with other local governments.

Timely information is important to investors. Therefore, the issuer should make every reasonable effort to provide reports promptly and frequently.

Bond Ratings

Private firms (such as Standard and Poor) rate state and local government bonds when they issue new bonds, and those ratings reflect the likely interest rate that the government will get on its new issues in the marketplace. The fact that a government spends less per capita and thus has lower budgets does not necessarily mean better bond ratings. There is wisdom in the adage: "Reduce your debt and increase the value of taxable property." Investors do look at such ratios, and both factors may be within the control of the government. The use of budget controls or a certificate from the Government Finance Officers Association will not lower rates. However, as noted by Earl R. Wilson, the use of budgets to plan and manage government does often result in lower interest rates.

The Standard and Poor's municipal bond rating process involves four broad factors: *economic, debt, administrative,* and *fiscal. Economic factors* include the economic diversity of the tax base as well as the diversity and growth of area economic opportunities. *Debt factors* include debt burden, debt history, trend, and type of security. *Administrative factors* include tax rate, levy limitations, debt limits, and other information indicating the likely ability to meet debt payments. *Fiscal factors* include the assets and liabilities in the balance sheet as well as trends in assets and liabilities, especially pension liabilities and the use of derivatives in their investment portfolio. In the fiscal factors, rating companies and investors make comparisons between assets and liabilities to see if assets exceed expenditures in the present and the foreseeable future. The bond rating process does not proceed without the necessary information. Since the 1970s, rating companies require more meetings on the issues, more extensive field trips, and more extensive analyses of state or municipal government bonds. Rating companies base their rating decisions, in varying degrees, on the following:

- the likelihood of default, which is a rating company's determination of the capacity and willingness of the obligator to observe the timely payment of interest and repayment of principal in accordance with the terms of the obligation;
- the nature of provisions in the obligation; and
- the protection afforded by and the relative position of the obligation in the event of bankruptcy, reorganization, or other arrangement under the laws of bankruptcy and other laws affecting creditors' rights.

Moody's Investors Services, which is another major rating company, considers factors similar to but not the same as those considered by Standard and Poor. Moody focuses on debt, economic, administration, and financial factors. The two most frequently used statistical ratios are *debt burden* and *net debt per capita.* The former is a ratio of the government's net debt (gross debt less bonds fully supported by enterprise revenues, and short-term debt plus overlapping debt) to the estimated full value of taxable property. Those ratios are helpful in understanding the total tax-supported debt. The rating company compares both indicators to national medians for governments of similar size. With inflation of property values, another supplemental indicator is *debt service as a percent of local expenditures.* A high or rapidly rising figure is often a significant warning. For revenue bonds, a commonly used measure is *debt service coverage* (defined as net revenue) divided by principal plus interest requirements for the year. Another measure is the *safety margin* (that is, the net revenue less debt service requirements for the year divided by gross revenue and income). Clearly, today the use of derivatives is another important factor. Moody also looks at the government's fund balance and, generally, considers a fund balance of 5 percent of the budget as prudent and indicative of the capability to meet the debt obligation in a full and timely manner. See Exhibit 8–9 for the information required by Moody's to rate a debt issue.

A common Moody national distribution of general obligation bond ratings by category is: Aaa - 1%; Aa1 - 2%; Aa - 9%; A1 - 19%; A - 37%; Baa1 - 16%; Baa - 15%; and Ba1 and below - 1%.

Ratings provide the investor and others with an informed opinion of the creditworthiness of a particular issue. Ratings do not establish interest rates, but higher ratings usually translate into lower interest cost to the issuer. Larger investors conduct their own analyses of issues, but Moody's and Standard and Poor's rating services provide additional guidance on creditworthiness, and rating services influence small investors in particular.

REVIEW QUESTIONS

1. What is a government debt? What are the various types and forms of debt? Why do they exist? What are the alternatives to debt and why are municipalities likely to incur debt?
2. Compare and contrast revenue bonds, general obligation bonds, short-term borrowing, and creative financing.
3. What criteria can you use to judge the correct level of state and local debt? Justify the criteria cited.
4. Explain the significance of the New York City and Orange County financial crises for (a) each government, (b) other local governments, and (c) the bond market, including prospectus requirements (GFOA, federal, others).
5. Why is the term "bankruptcy" inaccurate and somewhat misleading for municipal governments? What can a local government do to anticipate and remedy its own financial crisis?
6. Explain the advantages and disadvantages of the various debt instruments.

EXHIBIT 8–9 Information Requirements for Debt Ratings

DOCUMENTS	TAX-SUPPORTED BONDS	REVENUE BONDS	BOND ANTICIPATION NOTES	REVENUE BOND ANTICIPATION NOTES	TAX AND/OR REVENUE ANTICIPATION NOTES	LETTER OF CREDIT
PRIMARY:						
Official statement or prospectus	X	X	X	X	X	X
Notice of sale (if public)	X	X	X	X	X	
Annual reports or audits (last 3 years)[1]	X	X	X	X	X	
Most recent budget for operations	X	X	X	X	X	
Capital budget or planning document	X	X				
Legal opinion	X	X	X	X	X	X
Law(s) under which notes are to be issued[2]	X	X		X	X	
Note resolution or ordinance			X	X	X	
Bond resolution or ordinance, trust indenture, and any other legal documents relevant to the bonds and notes		X	X	X		X
Engineer's report (if available)		X	X	X		
Bond purchase commitment letter, if sale of the bonds has been prearranged (i.e., to an agency of the United States Government)			X	X		
Copy of local charter or document which describes governmental structure	X					
For school districts; ten-year enrollment trend and projection; school plant description, including facilities and capacity	X					

(continued)

DOCUMENTS	TAX-SUPPORTED BONDS	REVENUE BONDS	BOND ANTICIPATION NOTES	REVENUE BOND ANTICIPATION NOTES	TAX AND/OR REVENUE ANTICIPATION NOTES	LETTER OF CREDIT
Cash flow statements[3]					X	
Financial feasibility study including projections (if available)		X				
Rate study (if available)		X				
SUPPORT: (for information not contained in any of the above documents)						
Maturity schedule for bond anticipation notes, including final statutory maturity date for this and outstanding notes			X	X		
Interest rate computation, 360 or 365 day basis			X	X		
Complete debt statement of issuer, including debt-incurring capacity	X	X	X	X		
Interest rate limitations on bonds and notes	X	X	X	X		
List of last five bond issues of type that will fund notes, including amount, sale date, number of bids received (if public sale), and net interest cost			X	X		
Enterprise system description[4]		X		X		
Descriptions of rate setting process; record of revisions for past five years		X		X		
Investment policy; formal document or brief description of practices	X	X			X	
Public employees: number employed and trend, status of contracts, unions, pension funds, latest actuarial study (if available)	X	X			X	
Tax assessment and collection procedures, including due dates and penalty rates	X				X	
Tax and levy limitations	X				X	
List of ten largest taxpayers, their assessed valuation, and type of business	X				X	

(continued)

EXHIBIT 8–9 Information Requirements for Debt Ratings, *(continued)*

DOCUMENTS	TAX-SUPPORTED BONDS	REVENUE BONDS	BOND ANTICIPATION NOTES	REVENUE BOND ANTICIPATION NOTES	TAX AND/OR REVENUE ANTICIPATION NOTES	LETTER OF CREDIT
Economic data for service area	X	X				
List of operating loan borrowings[5]					X	
Assumptions used in preparing cash flows					X	
Assessed valuation for last five years	X				X	
Equalization ratios for last five years	X				X	
Current population and latest census estimates	X				X	
Statement of direct debt and debt of overlapping debt issuers, including allocable share	X				X	
Future borrowing plans	X	X	X	X	X	X
Number of building permits—last five years, plus the dollar amount	X	X			X	
Local and area unemployment rates	X	X				
List of ten major employers, number of employees, and type of business	X	X				
Area of the issuer (in square miles) and percentage of land that is developed	X	X				
Current number of government employees; whether unionized and contract status	X	X			X	
Debt (outstanding and new); segregate by security; actual principal maturities and interest requirements for each year, pro-forma debt service schedule for new debt including interest rate assumptions	X					

(continued)

Letter of credit and reimbursement agreement						X
Loan or lease agreement						X
Bank counsel enforceability opinions (domestic and foreign)						X
Preference (bankruptcy) opinion						X
Remarketing agent agreement						X
Tender agent agreement						X
Pledge and security agreement						X
Standby bond purchase agreement						X
Mortgage and/or other collateral documents						X
Other documents as applicable						X

[1] For revenue bonds, include interim financial results for recently concluded but unaudited period of year-to-date results and comparable period in prior year.

[2] This requirement is waived if the law(s) have been previously submitted and have not been subsequently amended.

[3] Include at least one full fiscal year actual; current fiscal year actual/estimate; and projections for the next fiscal year through note maturity. *Note:* These are strictly cash basis and should not include or show negative receipts or disbursements or negative balances.

[4] For revenue bonds, include system capacity and trend of usage, particularly customers and consumption (output) by year for past five years, percent of service purchased by each major user.

[5] Over last five fiscal years, including type and amount issued in fiscal year, amount outstanding at year end, and interest rates on the notes.

Source: Moody's Municipal Issues, 4, 1 (February 1987). Used by permission.

7. Explain why deciding on using competitive versus negotiated sale is often a difficult decision.
8. How does the decision-making process differ in capital versus operating budgeting?
9. Why is judgment central to any capital budget decision? What analytical questions are especially useful and why?
10. What takes place in designing an issue? What is particularly important and why? Why are syndicates significant? Why is a prospectus important?
11. What can a government do if it gets low bond ratings?

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