

Local Government Snapshot



NEW YORK STATE OFFICE OF THE STATE COMPTROLLER

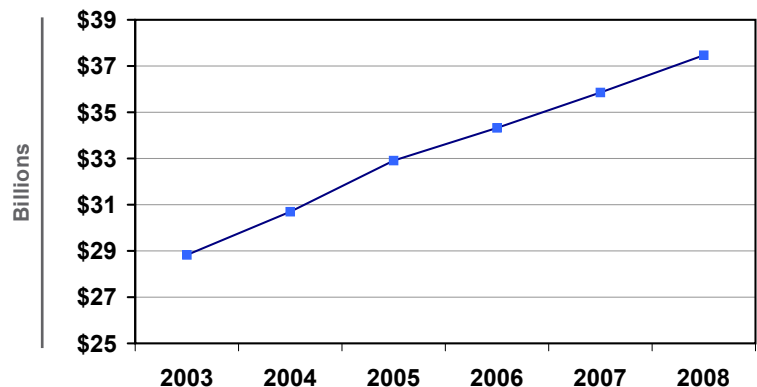
Thomas P. DiNapoli • State Comptroller

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Municipal Strategies for Managing Debt Service Costs

- The Great Recession has put unprecedented strain on New York State's local government finances. As local governments address fiscal challenges posed by stagnant or declining State and local revenues, increased demand for social services and growing fixed costs, local government officials should be mindful of the impact that budget decisions can have on the cost of borrowing. These costs can increase significantly if prudent budget decisions are not made within the context of multiyear capital planning.
- Local government debt burdens continue to increase. From 2003 to 2008, total long-term outstanding debt has increased by \$8.6 billion, or 5.4 percent on an average annual basis, compared to an inflation rate of 3.0 percent.¹
- Consequently, debt service costs have also increased, consuming 7.5 percent of local government revenues in 2008 (up from 6.4 percent five years earlier). Since debt service is a fixed cost, outstanding debt and the cost of borrowing can have a significant impact on a local government's finances.
- Local officials can help keep debt service costs down by protecting their municipality's credit rating, by securing lower interest rates on existing debt through advance refunding opportunities and, in certain cases, by taking advantage of new federally backed bonding programs.

Long-Term Outstanding Debt for New York's Local Governments
(Excluding New York City) (2003 - 2008)



Interest Costs Associated with Municipal Ratings (\$10 Million Bond with a 20-year Maturity Schedule)

	AAA	AA	A	BBB
Interest Rate	3.16%	3.32%	3.95%	4.97%
Interest Cost	\$3,319,750	\$3,490,950	\$4,147,000	\$5,214,600
Present Value Interest Cost	\$1,942,860	\$2,044,571	\$2,461,482	\$3,121,239

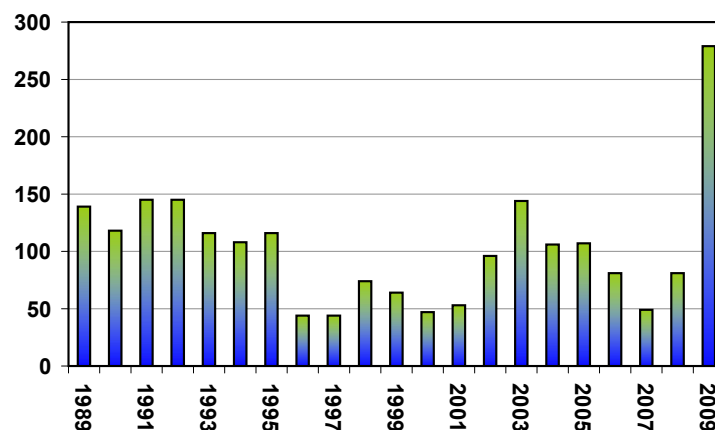
(As of 5/7/10)

¹ United States Bureau of Labor Statistics; Consumer Price Index, U.S. City Average-Urban Consumers

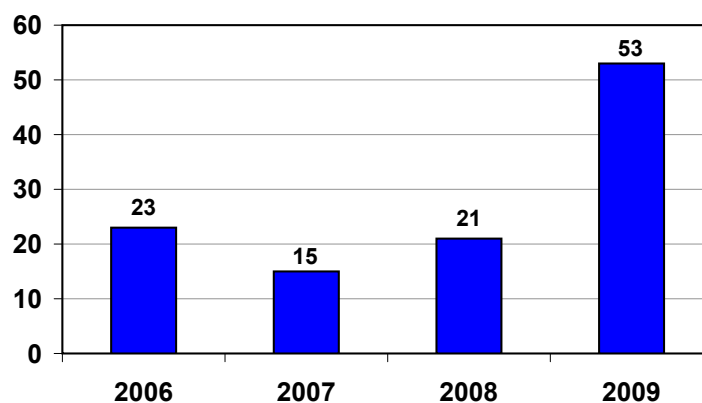
The Importance of Credit Ratings

- Credit ratings can have a significant impact on a local government's borrowing costs. For example, the interest associated with issuing 20-year \$10 million bonds with a BBB rating costs \$2 million more than the same issuance at an AAA rating over the life of the bonds.
- During 2009, Moody's downgraded 279 entities in the state and local government sector nationwide, by far the most in the last 20 years. In New York State, the number of municipal downgrades more than doubled from 21 in 2008 to 53 in 2009.² Out of these 53 downgrades, 23 were local governments including counties, cities, towns, villages, fire districts and school districts.
- All three major rating agencies are moving to rate municipal bonds based on the likelihood of default (similar to a corporate rating scale). Since municipal debt has had a historically low incidence of default, municipalities will benefit from upwardly revised ratings. Consequently, many of New York's local governments may have a better opportunity to attain a highly desired AA or AAA rating.³
- In April of 2010, Moody's and Fitch began the recalibration process. Standard and Poor's maintains that they have already adopted a universal ratings scale. New York's local governments that issue general obligation bonds may benefit from an increase of one to three notches in ratings.

Number of Moody's Downgrades State and Local Government Sector 1989 - 2009



Number of Municipal Rating Downgrades for New York State (2006 - 2009)



² Municipal downgrades include not-for-profit institutions, authorities, the State and local governments.

³ Rating revisions will affect the cost of new borrowing, not existing debt unless it is refunded.

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Credit Factors That Local Officials Should Consider

■ A local government's credit rating is a measure of its ability to repay debt to bondholders in a timely fashion. A rating is assigned by a credit rating agency after an examination of a government's overall financial condition. In addition to default risk, four factors are of particular importance:

- **Economy:** This factor incorporates local economic factors, including but not limited to property tax base, population, transportation networks and an evaluation of the major employers located within the municipality. Although largely outside the control of local officials, continued loss of population and declining full value of real property are examples of trends that may contribute to a rating downgrade.

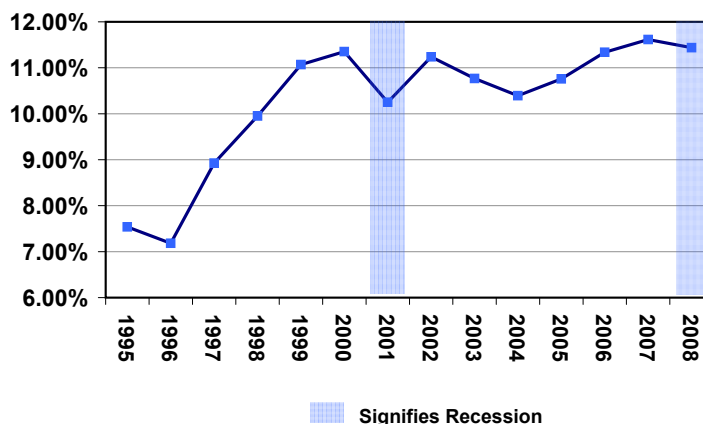
- **Financial Performance:** Financial indicators may include financial reporting methods, revenue and expenditure trends, financial planning and future financial obligations such as other post-employment benefits. Diminishing local revenues, significant budget variances, overreliance on nonrecurring revenues, and excessive use of fund balance are factors that may reflect negatively on a local government and contribute to a rating downgrade.

- **Reserves:** An adequate fund balance is important for protecting or improving a bond rating. However, during economic downturns, it may be necessary to access these funds. Since 2007, the median fund balance as a percentage of revenue for counties, cities, towns and villages (excluding New York City) has remained above 11 percent per year, but may decline as a result of the economic downturn.

- **Debt Burden:** Debt burden measures typically evaluate debt service trends and rapidity of debt repayment in the context of current and future borrowing needs. Excessive debt service costs relative to total expenditures may contribute to a rating downgrade.

- **Management:** Management factors include financial management, management experience and financial planning history. By adopting reasonable capital, reserve and debt management policies and demonstrating a commitment to long-term multiyear financial and capital planning, local officials can strengthen their overall fiscal profile.

Median Unreserved and Unappropriated Fund Balance as a Percentage of Revenue for Counties, Cities, Towns and Villages (1995 - 2008)



The Benefits of Long-Term Planning

- A sound financial plan can demonstrate that a local government is well prepared to respond to unexpected expenditures or losses in revenue. A multiyear capital plan that is integrated into a multiyear financial plan as well as the budgeting process is looked upon favorably by the rating agencies.
- By utilizing a multiyear financial plan, local officials are able to project revenues and expenditures for several years into the future and illustrate what will happen to their government's ability to pay for and provide services, given a set of policy and economic assumptions. These projections help policy makers assess expenditure commitments, revenue trends, financial risks and the affordability of new services and capital investments. The Office of the State Comptroller has developed a management guide and various tools to assist local government officials with developing a multiyear financial plan and with capital planning.

American Recovery and Reinvestment Act Bond Programs

- The American Recovery and Reinvestment Act of 2009 created **Build America Bonds (BABs)** which may allow state and local governments to obtain financing at lower borrowing costs for new capital projects, such as construction of schools and hospitals, development of transportation infrastructure, and water and sewer upgrades. Instead of a tax exemption, the federal government provides a 35 percent interest subsidy directly to a local government to help offset borrowing costs. Issuers have seen significant savings using BABs, particularly at the long end of the yield curve. Local officials should consult with their financial advisors and/or bond counsel to investigate opportunities to take advantage of Build America Bonds.
- Other bond programs instituted by the American Recovery and Reinvestment Act include:
 - **Recovery Zone Bonds** – These bonds are similar to BABs, but carry a more generous subsidy, and must be issued for economic revitalization purposes.
 - **Qualified School Construction Bonds** – Qualified School Construction Bonds are a new form of tax-credit bond to finance construction, rehabilitation or repair of public school facilities. The credit is intended to cover the interest cost of the bonds fully.
- More information on these programs can be found on the United States Internal Revenue Service website at www.irs.gov/taxexemptbond/article/0,,id=206034,00.html.



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