SUBJECT: Allowing counties to issue commercial paper to pay for improvements

COMMITTEE: County Affairs — committee substitute recommended

VOTE: 6 ayes — R. Allen, W. Smith, Casteel, Laney, Naishtat, Olivo

0 nays

3 absent — Coleman, Farabee, Otto

WITNESSES: For — (*Registered but did not testify*: Robert Collie Jr.; Davis Flores, Williamson County; Don Henderson, J.P. Morgan Securities; Julie Kiley; Donald Lee, Texas Conference of Urban Counties)

Against — None

BACKGROUND: Under Government Code, ch. 1371, debt obligations, including commercial paper, for public improvements may be issued by a county that has a population of 3.3 million or more (Harris County). Currently, Harris County issues voter-approved debt in commercial paper notes — unsecured, short-term loans, with maturation ranges typically from 2 days to 270 days. Commercial paper is available in a wide range of denominations. It can be either discounted or interest-bearing and usually has a limited or nonexistent secondary market.

Before a county can issue obligations, the attorney general must review and approve all contracts and agreements. Refinancing is permitted.

DIGEST: CSHB 647 would allow any county with outstanding property tax-backed debt of at least $100 million to issue debt obligations, but only if a nationally recognized rating agency had given the county one of the four highest credit ratings for a long-term obligation. In addition, if a county planned to refinance an obligation or loan with bonds, the attorney general would review commercial debt-issuance as long-term debt.

The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2005.

SUPPORTERS SAY:

CSHB 647 would allow a number of large counties to finance the start-up costs of capital projects with funds obtained at lower interest rates. Commercial paper would create flexibility in funding projects between long-term bond issues. By using commercial paper proceeds for project start-up costs, bonds for these projects then could be amortized over fewer years. Savings would be realized on the overall rate of interest paid.

Using commercial paper would help eliminate negative arbitrage — essentially, losing money by buying in one market and investing in another. When a city issues long-term bonds for a specific project, the money is invested in a fund where it may gain interest pending completion of the project. Meanwhile, the county has to pay interest on the bonds. Often times, the paid interest exceeds the earned interest. Commercial paper issuance, in the short term, would lower interest payments and allow counties initially to finance projects for significantly less cost.

CSHB 647 would allow for refinancing. Commercial paper pay out occurs over a much shorter period than long-term bonds. A county could pay out the commercial bonds for a short period, then refinance using bonds, as a county would not be able to cover substantial commercial paper debt in a short period of time. Refinancing would avoid counties reaching their debt limitation. When a county planned to refinance the commercial paper with bonds, the attorney general would review the commercial paper as long-term debt.

The bill would enhance county financial management. Counties have limited authority and revenue raising ability, while municipalities already are granted such authority and successfully issue commercial paper. The bill would improve the ability of counties to complete public projects. Commercial paper investments would be relatively low risk, as the bill only would grant this authority to counties with high credit ratings.

OPPONENTS SAY:

CSHB 647 would increase financial risk for certain counties. Commercial paper is unsecured debt, usually backed by an unsecured promissory note that calls for the payment of money over short period of time. Without collateral backing and with short repayment periods, there is increased risk that counties could default on their obligations. Commercial paper has higher interest rates than long-term bonds, and these interest rates are susceptible to fluctuations. Commercial paper tends to yield smaller returns than longer-term debt because securities with shorter maturities typically have lower effective yields than those with longer maturities.

NOTES: The committee substitute removed from the original bill language that would have allowed authorized but unissued obligations to be paid by property taxes without approval of voters. It also added that the attorney general would review commercial debt-issuance as long-term debt when a county planned to refinance with bonds.