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## Texas Keeps Local Issues Covered

*Offers Alternatives To Bond Insurance*

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DALLAS — For issuers who need it, bond insurance nowadays is very expensive, even if it is available. But local governments in Texas are still finding their way to market with state guarantees that offer low up-front costs and result in attractive long-term rates.

The Texas programs include the Permanent School Fund for local school districts and the Permanent University Fund for higher education. There also is triple-A rated coverage for local water utilities and a series of new bond guarantee provisions to keep transportation projects on track.

Nationally the amount of new issues backed by “other guarantees” — those other than traditional bond insurance — increased 195% to \$24 billion in 2010. At the same time, issues backed by bond insurance fell nearly 24%, to just below \$27 billion, according to Thomson Reuters.

Nearly one-third of those other guarantees were provided by the PSF. The fund was sidelined by capacity limits in 2009. But when the Internal Revenue Service approved higher coverage limits for 2010, Texas school bond issues rebounded 28% to \$7.8 billion. While that was a big increase from the \$6.1 billion in 2009, it still fell 25% below the 2007 record of \$10.4 billion.

Without the PSF, only issuers with underlying ratings of double-A or better found the municipal market readily accessible in 2009. Other districts decided to wait until the PSF guarantee returned, despite pressure from growing enrollments.

“We had a huge rush of applications when we opened the program back up,” said Lisa Dawn-Fisher, deputy associate commissioner for school finance at the Texas Education Agency. “We normally would process 10 or 20 applications a month. [Suddenly], we got a hundred. So there was a huge pent-up demand when we got the program back up.”

The cost of the PSF’s triple-A guarantee is \$2,300, regardless of a district’s rating or how much debt it intends to issue, Dawn-Fisher said. The fee, based on the cost of administering the program, was as low as \$300 in 2003 but climbed to \$1,500 that year.

By contrast, the cost of credit enhancement through traditional insurance is typically two-thirds of the savings provided by coverage. Only one insurer, Assured Guaranty Ltd., still has ratings high enough to provide savings for lower investment-grade issuers.

For example, the Jacksonville Independent School District last week achieved a present-value savings of nearly \$264,000 on \$44.3 million of bonds backed by the PSF. The 10-year yield on Jacksonville ISD’s bonds was 3.74%, or 66 basis points lower than what it would have paid relying solely on its underlying A-plus credit. With PSF backing, the district’s yield was only five basis points higher than Municipal Market Data’s double-A yield curve.

Assuming that Assured would have charged the district the typical two-thirds of savings, insurance would have cost about \$175,000. Moreover, the MMD insured scale indicates that private insurance would have given

Jacksonville ISD a 4.25% borrowing cost for its 10-year bonds — 51 basis points higher than what the PSF wrap accomplished.

The bond guarantee program is a product of a constitutionally protected fund made up of assets that include state lands worth about \$24.4 billion as of September. In addition to backing local school bonds, the PSF provides annual allotments to school districts to help cover operations. Started 156 years ago with a value of \$2 million, the fund has helped Texas schools continue to grow in times of economic turmoil.

“We’re uniquely situated in that we have this fund in the first place,” Dawn-Fisher said. “There are other states that do bond guarantee programs, but none of them are really structured like this. They just don’t have access to a corpus of funds the way we do.”

In a fashion similar to the PSF, the Permanent University Fund backs some bonds issued by the University of Texas and Texas A&M University systems. The value of the Permanent University Fund — derived from state lands and investments — grew \$1.1 billion, or 10.9%, in fiscal 2010, which ended Aug. 31. That’s a dramatic turnaround from the nearly 15% plunge in fiscal 2009.

Based on a 1978 state attorney general’s opinion, interest on the Permanent University Fund began to be used to pay interest on outstanding bonds and to finance construction. Six years later, the bond capacity was raised to 30% of the Permanent University Fund. At the same time, the state created the Higher Education Assistance Fund to help public higher education institutions not covered by the Permanent University Fund. Its debt, administered by the UT System, is limited to 20% of the book value of the Permanent University Fund.

What the PSF does for local school districts, the Texas Water Development Board does for local water utilities, providing triple-A coverage that lowers interest cost on bond issues.

Instead of guaranteeing local bonds, however, the TWDB serves as a bond bank that buys the local debt and then issues its own bonds to cover the costs.

“For many of these smaller utilities, there’s no way to go to the market because there’s no bond insurance,” said J. Kevin Ward, executive administrator of the TWDB.

Born from the worst drought in modern history in 1957, the TWDB became one of the first bond banks of its type, providing the financing for reservoirs and other infrastructure to serve the state’s booming cities.

At the end of fiscal 2010, the TWDB had \$3.5 billion of debt, including \$1.5 billion of outstanding general obligation bonds. The board also issues revenue bonds administered by the Texas Water Resources Finance Authority. Assets at the end of the fiscal year were \$6.4 billion, Ward said.

With the Legislature currently in session, the TWDB has asked for a total debt capacity of \$6 billion, which would include its current outstanding debt.

“We feel we could actually issue quite a bit per year, as long as we pay it off at a steady rate,” Ward said.

Financing transportation infrastructure is another chronic concern. Texas is seeking detours around financial and political barriers as Congress continues its stalemate on federal funding for projects.

With revenue from fuel taxes flat and traffic growing, the Texas Transportation Commission in recent years has found ways to leverage the state’s triple-A credit rating to aid local and regional issuers, particularly toll road authorities.

On Wednesday, the North Texas Tollway Authority could decide whether to proceed with a \$1.1 billion toll - project that would be the first to receive state loan guarantees. The President George Bush Turnpike Western Extension is already under construction with financing from the state. But the NTTA would complete the fourth and final section, then assume management of the 11.5-mile tollway on the western edge of Dallas.

Another off-system project to be funded by the December issue is the Southwest Parkway/Chisholm Trail Parkway south of Forth Worth in Tarrant and Johnson counties. NTTA bonds would be issued under the heading of "Special Projects System," whose debt service comes from the new tollway rather than authority system - revenue.

To build the projects without damaging its credit rating and violating existing bond covenants, the agency needed some kind of enhancement to be able to bring new bonds to market. Because insurance proved too costly, the NTTA worked out a deal with the Texas Department of Transportation to guarantee debt service on the new bonds in the event that project revenue proved insufficient.

The so-called Toll Equity Loan Agreement from TxDOT is a backup plan that is not likely to be needed, according to the NTTA. But to achieve marketable credit ratings – likely in the double-A category – the guarantee was needed.

Analysts from Moody's Investors Service, who rate the authority's first-tier bonds A2, consider a shortage of revenue from the projects "a remote possibility given the experience of NTTA as operator and the willingness in recent past to raise tolls as necessary."

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