Department of Legislative Services

Maryland General Assembly
2009 Session

FISCAL AND POLICY NOTE

Senate Bill 610 (Senator Jones, *et al.*) (Chair, Joint Committee on the Management of Public Funds)

Budget and Taxation

State Treasury - Permissible Investments of State Money

This bill authorizes the State Treasurer to invest any State money in bonds, notes, or other obligations issued by or on behalf of the State, any State agency, or local government. Under current law, the State Treasurer may only invest bond sale proceeds in such investments. The bill also authorizes the State Treasurer to provide liquidity for the purchase or redemption of State variable interest rate bonds.

Fiscal Summary

State Effect: Potential operational benefit for certain State agencies and the State Treasurer's Office. Indeterminate impact on expenditures but it is assumed the State Treasurer will not provide self-liquidity unless it offers a net savings to the State.

Local Effect: Potential meaningful impact for certain counties and municipalities that issue Variable Rate Demand Bonds (VRDBs).

Small Business Effect: None.

Analysis

Current Law: The State Treasurer may only invest bond sale proceeds in the bonds, notes, and obligations of a state, State agencies, and local governments, and may invest only in those instruments with the highest letter and numerical rating. Chapter 235 of 2003 authorized the State Treasurer to issue variable-rate bonds up to an amount equal to 15% of the State's outstanding general obligation bonds. There are different variable-rate bond arrangements that may be entered into, such as VRDBs and commercial paper.

Background:

Variable-rate – Liquidity Provider

Maryland's fixed-rate general obligation bonds are 15-year agreements between the State and bondholders. Because of the long-term nature of the bond, bondholders demand that the bonds provide a long-term interest rate, which is usually higher than the short-term rates. To date, the State has not issued variable-rate bonds. VRDBs do not have fixed interest rates throughout the life of the bond. Instead, VRDBs are constantly resold to lenders paying short-term interest rates. Unlike fixed-rate bonds, VRDBs do not have an underwriter. Instead, a remarketing agent manages bond sales. VRDBs also require a liquidity provider. Typically variable-rated debt is remarketed every week. If the remarketing agent cannot find another buyer for the debt, a liquidity provider is responsible for paying principal and interest for the bonds. Liquidity providers are usually banks with credit ratings of a least AA.

Bond sale proceeds are expended on a cash-flow basis, rather than on a project basis meaning that depending on the timing of the bond sale and the expenditures, bond sale proceeds may not be available for the State Treasurer to purchase state, State agency, or local bonds, as allowed under current law.

State Fiscal Effect:

Authority to Purchase Bonds of State Agency Issuers

The bill removes the restriction that the State Treasurer only use bond sale proceeds to purchase bonds of a State agency or local government. This expanded authority will benefit State agencies and local governments that are unable to remarket their variable-rate bonds by allowing the State Treasurer to use cash reserves to purchase the bonds. The State may hold these bonds until market conditions improve and then remarket the variable-rate bonds or convert the bonds to fixed-rate.

Providing Self-liquidity

If the State Treasurer issues variable-rate debt, some savings can be realized by allowing the State Treasurer to provide liquidity for this debt. Fees charged by liquidity providers erode a portion of the interest rate savings provided by the issuance of variable-rate debt. Furthermore, allowing the State Treasurer to provide liquidity creates an operational benefit due to onerous legal covenants or lien positions often required by liquidity providers. The State Treasurer advises that additional staff may be required to develop procedures, monitor the cash flows, and review investment maturities. However, additional staffing expenses are at least partially offset by the avoidance of fees charged by liquidity providers. It is assumed that the State Treasurer will not issue variable-rate debt and provide liquidity for that debt unless there is a net savings over fixed-rate debt.

By providing self-liquidity, the State may be forced to purchase its own variable-rate general obligation bonds if a remarketing fails. The timing of this purchase would be determined by financial market conditions. The State may be required to purchase variable-rate bonds at a time that is unfavorable to the State. The State Treasurer advises that the State can use cash reserves, which total $6 billion, should a general obligation bond remarketing fail. Current federal law requires that any bonds bought because of a failed remarketing need to be successfully remarketed as variable-rate bonds or reissued as fixed-rate bonds within 12 months.

Local Fiscal Effect: Allowing the State Treasurer to purchase bonds of a local government creates a potential meaningful benefit for counties and municipalities that issue debt, specifically when the local government issues variable-rate bonds and is unable to remarket the bonds. Pursuant to this legislation, the State Treasurer will be able to purchase the local bonds from available State cash reserves.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): State Treasurer's Office, Department of Legislative Services

Fiscal Note History: First Reader - February 24, 2009
mcp/hlb

Analysis by: Erik P. Timme

Direct Inquiries to:
(410) 946-5510
(301) 970-5510