

Virginia Viewpoint

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How to Lose a AAA Bond Rating: A Primer

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Summary

Virginia's bond rating assesses both revenues and obligations. The commonwealth's bond rating, like an individual's credit rating, is an assessment of the probability of default given revenues to existing debt burden. Because rating agencies already think the Virginia taxpayer is in danger of becoming overburdened, Governor Warner's proposal to raise taxes won't necessarily stabilize the commonwealth's credit rating and may even contribute to a downgrade.

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Why is Virginia's bond rating in jeopardy? Because rating agencies think the Virginia taxpayer is in danger of becoming overburdened. Higher taxes hardly solve the problem.

Apparently, Governor Warner believes that Virginia's AAA bond rating is threatened by the depletion of the state's reserve fund and declining revenues. The Governor claims that increasing the overall tax burden on Virginia's families by about \$1 billion will solve the problem.

He really should know better. Virginia's bond rating, like your own credit rating, assesses revenues and obligations. Most pundits talk as if the commonwealth's rating existed in isolation, but that is not the case. The credit rating process considers the *total* burden falling on the taxpayer from all sources. In Virginia, a complex web of legal decisions and statutes disfranchises taxpayers, freeing irresponsible public officials to bury our children, our grandchildren, and us under mountains of debt.

The real threat to Virginia's AAA bond rating is profligate debt issuance. Higher taxes are not going to solve the problem. The commonwealth's bond rating is, like your personal credit rating, an assessment of the probability of default. Economic conditions affecting revenues and existing debt burden drive the rating process. We all know Virginia's economy suffered in the last few years. The economic downturn affected the entire nation. The explosion of state and local borrowing in recent years is not so well known.

When economic conditions change, credit rating analysts assess how a state reacts and how quickly it does so. In June, all three rating agencies confirmed Utah's AAA rating, citing careful economic monitoring, quick and aggressive action when shortfalls were identified, and moderate levels of debt. While keeping its commitment to education, Utah made difficult choices, reducing spending, postponing capital construction, and employing sound fiscal management to reduce its budget and debt burden.

However, Virginia's budget and debt burdens have grown. The commonwealth's direct debt burden is only part of the problem. Overlapping debt, including authority debt and local government obligations, grew even faster. Why is Virginia's bond rating in jeopardy? Because rating agencies think the Virginia taxpayer is in danger of becoming overburdened. Higher taxes hardly solve the problem.

Governor Warner is eager to tell Virginia's taxpayers about the "rating crisis." What he apparently forgot is that the commonwealth's general obligation rating was not placed on the watch list for a possible downgrade solely because of the GO debt burden. Many ties link Virginia's GO rating to other obligations, obligations citizens cannot control.

In their recent announcement, rating agency analysts made it clear that the commonwealth's AAA GO rating was placed on the watch list "in conjunction with" the Virginia Localities Intercept Program. The commonwealth uses the Intercept Program to guarantee payment on defaulted local government GO bonds. Essentially, this allows local governments to inject fixed costs into the state budget without legislative approval.

Tragically, the Intercept Program is only the tip of the iceberg because GO bonds represent only a small part of the total debt burden. As a direct result of the outrageous debt issuance practices described in the Virginia Institute for Public Policy's recent report (<http://www.VirginiaInstitute.org/>), authorities and local governments, with Richmond's blessing, run wild, burying taxpayers under mountains of unnecessary debt. The commonwealth's disfranchised voters have almost no control over most debt issued in their name.

Let's look at just a few examples. In December 2003, Pocahontas Parkway bonds dropped into junk territory, to BB from BBB-minus, and remain on the watch lists of all three rating agencies. The action affects \$355 million of the Authority's outstanding bonds. The commonwealth is one "partner" in the Authority.

Outstanding Virginia Resources Authority bonds totaling \$61.9 million were downgraded last year. According to rating agency analysts, the Authority looks more like "an over-collateralized airport deal than a revolving fund, which is what this was set up to be." This bait-and-switch puts the commonwealth's taxpayer on the hook because VRA's bonds are guaranteed by a "moral obligation" pledge. This wink-and-a-nod method of avoiding citizen oversight, invented in New York State and now illegal there, somehow lives on in Virginia. The growing number of local authority bond defaults in the commonwealth and skyrocketing burdens imposed by failed industrial revenue bond issues, compounds the problem.

As a final insult, Virginia's citizens must endure, and pay for, debt hiding under the convenient fiction that lease-backed bonds are not really debt. The delusion originated in Virginia's courts. Many in Richmond, apparently including Governor Warner, like the fantasy enough to look the other way when citizens, hoping to re-establish some hint of sanity in government debt issuance, protest and sue to preserve a vestige of public control over government.

Governor Warner claims, "It would be wrong to deny our responsibility to our children and grandchildren." I agree, but the problem is not going to be solved by giving the debt junkies another fix. If the Governor is serious, he can safeguard the commonwealth's credit rating by stemming the tide of debt that threatens to drown future generations and forget about raising taxes that only add to the existing burden.

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