Policy Basics

# Bonding is a vital tool for building a stronger Maine for future generations

by Jody Harris, Associate Director | February 21, 2020

A strong and thriving economy depends on long-term investments in roads and bridges, clean water and schools, and other public goods that benefit people and businesses now and in the future. Just like generations before us who built the infrastructure we benefit from today, we have an obligation to maintain and improve existing infrastructure to strengthen the foundations of our economy. However, while the benefits of those investments are spread out over decades, the cost is often large and immediate. Bonds are a vital tool available to states to spread out the cost and make those economy-boosting investments affordable today. These investments create opportunity and jobs in the near- and long-term.

## Bonding is a responsible way to set future generations up for success

### Bonding for long-term investments preserves General Fund revenue for today's urgent needs

Even if it were possible to pay for billions of dollars of needed investment with annual tax revenue, it would be unwise. The General Fund is designed to pay for today's needs, such as education, public safety, and critical services for children and seniors. It may seem prudent to use General Fund revenue rather than borrowing. But doing so would reduce our ability to meet today's needs, while funding only a small portion of what's needed for our future. Bonding provides the up-front funding necessary to make smart, long-term investments without requiring immediate service cuts or tax increases.

### Bonding ensures that everyone who benefits from investments share their cost

A new road or other public asset benefits future generations and should be expected to last 20 to 30 years or more, if funding is appropriate for regular maintenance and servicing. Bonding ensures that today's taxpayers aren't on the hook for the full cost of investments and maintenance that will benefit generations of Mainers to come.[1]

### Smart bonding improves the state's credit rating

Bond rating companies — the companies that assess the state's fiscal health for investors—look at whether the state

## What is bonding?

**Simply put, bonding is how states borrow money.**

The state sells bonds to investors, who provide up-front funding and are paid back, with interest, over the agreed-upon term of the bond.

The bonds described in this report are general obligation bonds, which are backed by the taxing authority of the state.

Other types of bonds also exist, such as those backed by revenue to be generated from the project funded by the bond.

has a responsible financing plan to keep up with needed investments. A backlog of large unfunded infrastructure needs will lower our credit rating and increase interest rates.[2]

## Bonding facilitates investments and boosts the economy

### Bonding improves capital investment

Roads and bridges, schools, high-speed broadband, clean water, and other infrastructure are assets that attract new business investment and residents, improve the productivity of Maine's workers and businesses, and fuel economic growth.

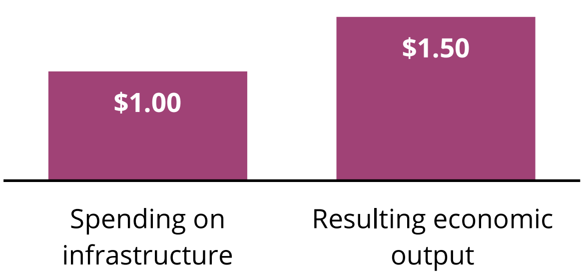
The large costs of building and maintaining these infrastructure systems vital to a strong economy become more affordable when the state spreads the costs out over several years using bonds.

### Bonding creates jobs

Every dollar the state invests in infrastructure using bond money creates jobs and generates an additional $1.50 in economic activity.[3]

In the short-term, bonds create construction and related jobs, with workers spending their earnings at local businesses for food, clothing, and other items. In the long-term, bonds provide infrastructure for businesses to startup, grow, and create permanent jobs.

#### Chart 1: Bonding stimulates the economy




*Source: Economic Policy Institute. See: epi.org/publication/the-potential-macroeconomic-benefits-from-increasing-infrastructure-investment/.*

### Bonding reduces costs

Bonding provides sustainable funding to prevent decay in Maine's roads, bridges, and other infrastructure and reduces high replacement costs. By increasing the amount of funding available in the near term, bonding also unlocks additional public and private investment, such as federal matching dollars available to states that invest in capital projects.

Over the past 25 years, Maine's transportation bonds on average leveraged an additional $1.80 in federal and other funds for every state dollar invested, reducing the overall cost of capital projects and stretching state funds further.[4]

## Maine is well positioned to increase bonding

### Bond ratings are excellent and interest rates are low

Bond ratings are a good measure of Maine's financial health. Like an individual's credit score, ratings from credit agencies tell would-be investors how much risk they may face in buying a government entity's bonds. In evaluating a state's ability to repay bondholders, companies such as Moody's Investor Services assign a credit rating ranging from Aaa (best quality) to C (substantial risk of default).

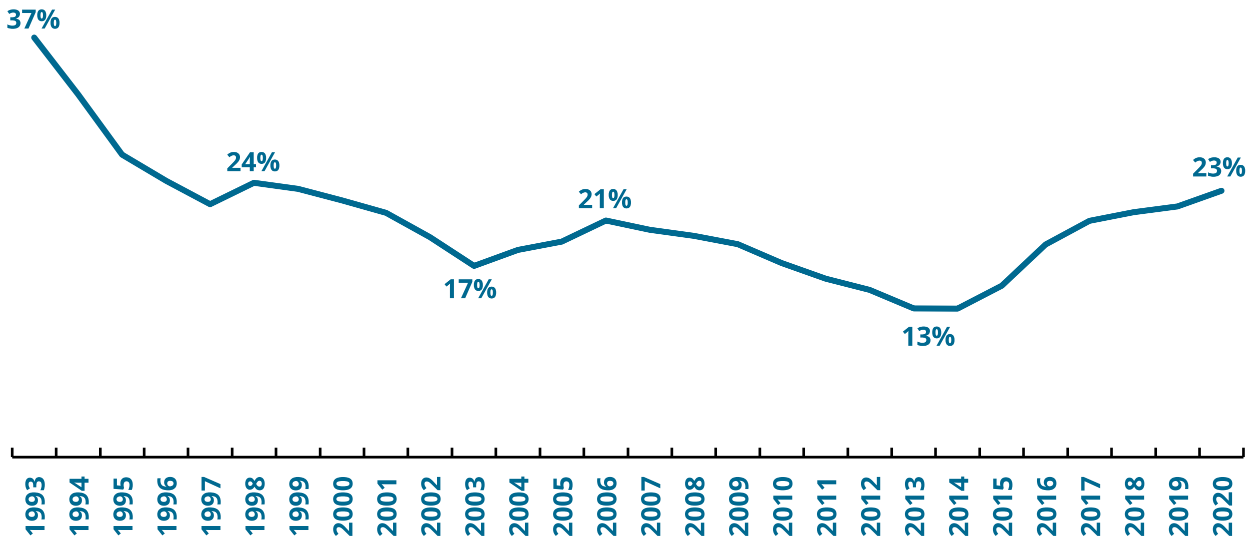
Maine's bond rating has varied over time but has always been strong. In the 1970s the state had a triple A rating (Aaa). Today it is double A+ (Aa2).[5] Investors consider the credit rating in their decision whether to buy a state bond and what interest rate they require.

Rates have increased slightly as the economy has improved since the Great Recession. However, Maine's excellent credit rating makes state bonds appealing to investors and keeps interest rates low.

### Maine's interest payments remain low

Maine's repayment of debt has fluctuated over the years, but the interest the state has paid overtime has remained low. Maine has a quick 10-year repayment schedule for bonds and maintains low interest rates because of its excellent credit rating.

Chart 2: Interest payments as a share of Maine's debt service remain low even as rates have increased slightly with economic recovery




*Note: Figures represent interest payments as percentage of total debt service. Source: Office of the Maine State Treasurer. See: [http://www.maine.gov/treasurer/debts_bonds/debt_service_summary.html](http://www.maine.gov/treasurer/debts_bonds/debt_service_summary.html)*

The Congressional Budget Office predicts that interest rates will continue to stay low.[6] Combined with Maine's good credit rating, this means borrowing is a low-cost option to finance projects with big economic pay off.

## Bonding levels are sustainable

Lawmakers must balance the state's capital and operating needs with the cost of annual debt service, making sure that debt does not undercut other public needs.

The Federal Reserve Bank of Boston recommends using two measures to assess how much debt a state can afford: debt measured as a share of state revenue, and debt as a share of the personal income of state residents.[7] Maine performs well under both comparisons and can afford to borrow more.

- **Debt as a percentage of state revenue** compares how much Maine borrows as a percentage of its total annual general and highway fund revenues and is an indicator of the impact of debt service on the state budget. According to US Census Bureau data, Maine's 4.14 percent debt-to-revenue ratio is lower than neighboring states.[8]

- **Debt as a share of personal income** reflects the impact of debt service on taxpayers. Maine's debt as a percentage of total combined personal income has been consistently lower than the median of all states.[9]

- **Interest payments as a percent of all spending** shows that Maine is under-investing in capital projects and other long-term infrastructure. Nationally, the average state and local interest payment as a percent of all spending was just 3.4 percent in 2016. Maine is far behind the national average at just 2.3 percent.[10]

# Conclusion

Just like most people don't expect to buy a house without taking out a loan, states should not fund large capital investments without using bonds. Bonds provide a way to efficiently spread costs over time and make available funds go further, all while drawing down significant matching funds from the federal government and contributing to economic growth.

Bonding is a crucial strategy for Maine to meet its long-term goals without sacrificing current needs.

## About MECEP

The Maine Center for Economic Policy is a nonprofit research and policy organization dedicated to economic justice and shared prosperity by improving the well-being of low- and moderate-income Mainers. Since its founding in 1994, MECEP has provided policymakers, advocates, media organizations, and the public with credible, rigorous research and analysis. MECEP is an independent, nonpartisan organization.

## About the author

**Jody Harris** is MECEP's Associate Director. In her role, she provides financial management, oversees grants administration, manages board relations, and serves as MECEP's policy lead on consumer financial protection. She also contributes to other policy research and analysis, drawing from her 30 years of experience in public management in Maine state government under four governors and as town manager in two Maine towns. She has a master's degree in public administration from the University of Maine.

### Endnotes

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**2** Du Houx, Ramona. "All Three Credit Rating Agencies Have Warned Maine to Get Economic House in Order Since LePage." *Maine Insights.* June 5, 2012. http://maineinsights.com/all-three-credit-rating-agencies-have-wa; and Harris, Jody. "Too Little, Too Late." *Maine Center for Economic Policy Blog.* August 27, 2013. http://blog.mecep.org/2013/08/too-little-too-late/
**3** Bivens, Josh. "The potential macroeconomic benefits from increasing infrastructure investment." *Economic Policy Institute.* July 18, 2017. https://www.epi.org/publication/the-potential-macroeconomic-benefits-from-increasing-infrastructure-investment/
**4** MECEP analysis of federal matching funds as described in bond language published by the Maine Department of the Secretary of State, as presented to voters, 1993-2019.
**5** Bond Ratings and Designations, Maine Office of the State Treasurer. https://www.maine.gov/treasurer/debts_bonds/bond_ratings.html. Accessed February 14, 2020.
**6** "An Update to the Budget and Economic Outlook: 2019 to 2029." *Congressional Budget Office.* August 2019. https://www.cbo.gov/system/files/2019-08/55551-CBO-outlook-update_0.pdf
**7** Weiner.
**8** Vermont is the only state with a lower debt-to-state revenue ratio. Vermont's ratio is 4 percent compared to Maine's 4.14 percent. The other New England states are: Connecticut, 7.5 percent; Massachusetts, 8.6 percent; New Hampshire, 6.9 percent; and Rhode Island, 9.4 percent. Source: US of Government Finances data as compiled by the American Legislative Exchange Council, https://www.richstatespoorstates.org/variables/debt_service_share_of_tax_revenue/. Note: Maine does not have a statutory debt cap, but legislators take seriously their policy to restrict the amount of bond debt to assure that annual repayments take up no more than 5 percent of the state's total revenues. For many years Maine bonded under a 7 percent rule and later under a rule that allowed no more than 90 percent of retiring debt to be rolled over to new bonds. The 5 percent rule has been in place since 1999. Source: "Maine 2005 Debt Summary." *Maine Office of the State Treasurer.* http://www.maine.gov/treasurer/debts_bonds/2005_debt_summary.html
**9** "Fiscal 50, State Trends and Analysis." *The Pew Charitable Trusts.* https://www.pewtrusts.org/en/research-and-analysis/data-visualizations/2014/fiscal-50#ind4. Accessed February 18, 2020.
**10** US Census of Government Finances data.