Senate Finance and Revenue Committee

2017 State Debt Policy Advisory Commission Report

Office of the State Treasurer
Debt Management Division

March 1, 2017

Introduction

Purposes of Report

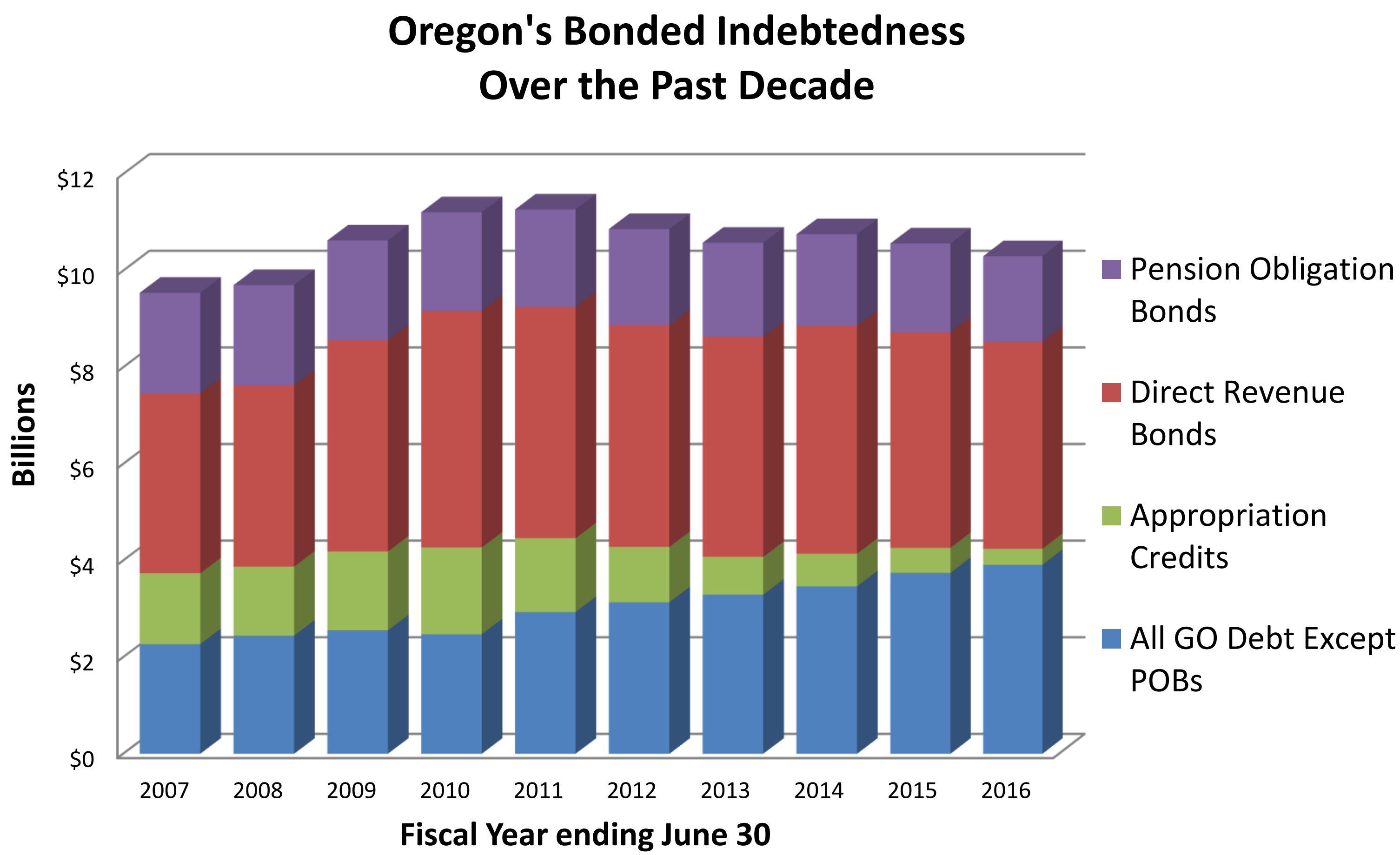
1. Annual Capacity Forecast Update Required by ORS 286A.255
2. Provide a Framework for Measuring, Monitoring and Managing the State's Debt Position
3. Provide Information to Assist Governor and Legislature in Formulating Long-term Capital Spending Plans
4. Highlight Emerging Debt Policy Issues of Concern

Debt Capacity Concepts

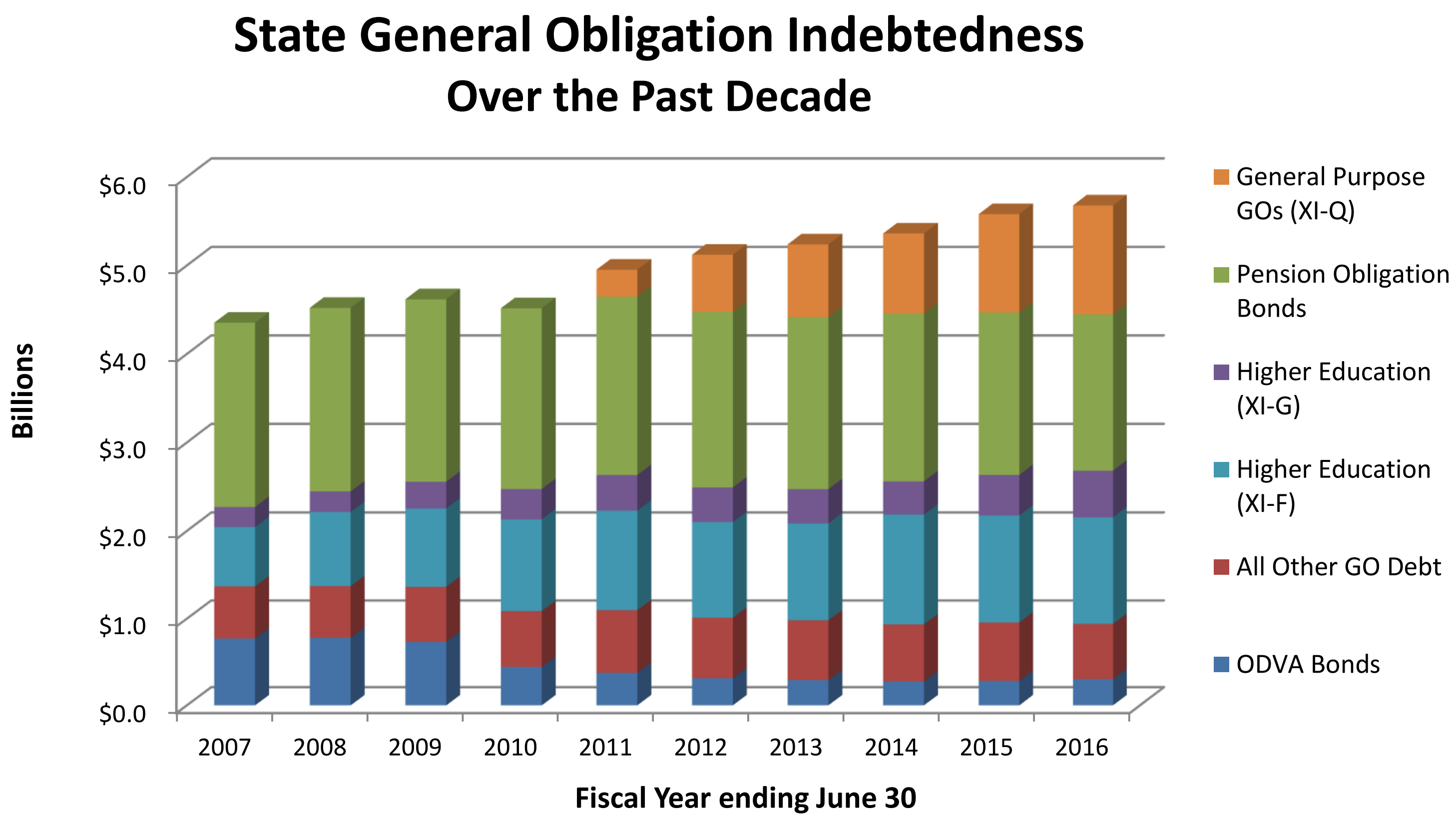
Four Types of Long-Term Debt

1. General Obligation Bonds	• Requires voter approved constitutional amendment • Pledges the full faith & credit of the State • Includes both GF-supported <u>and</u> non GF-supported bond programs
2. Direct Revenue Bonds	• Generally created by the Legislature through statute • Not secured by the State's pledge to pay • Fully self-supporting through program revenues
3. Appropriation Credits	• Historically, Certificates of Participation (COPs) were used to finance real or personal property owned by the State • Generally payable by State agencies from GF sources • Not secured by the full faith and credit of the State • With passage of XI-Q GO bond authorization in 2010, higher cost COPs are not often used for State capital projects
4. Conduit Revenue Bonds	• State is the issuer but has no obligation to pay debt service – no General Fund or other State support • Debt service paid by the entities on whose behalf the bonds are issued

Debt Capacity Concepts

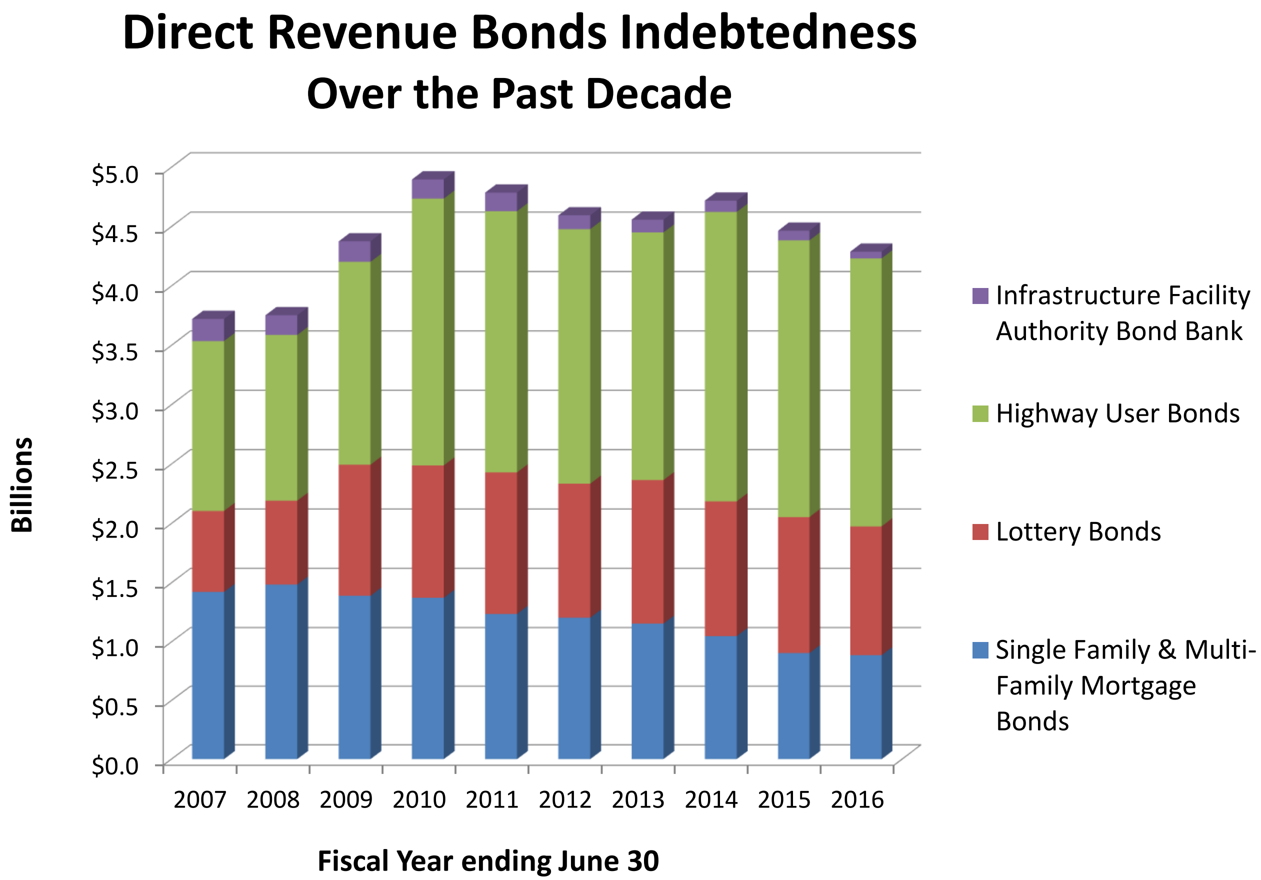


- The State's overall debt levels peaked in FY 2010, but has declined and remained relatively stable since then, as existing debt retirement has generally kept pace with new debt issuance

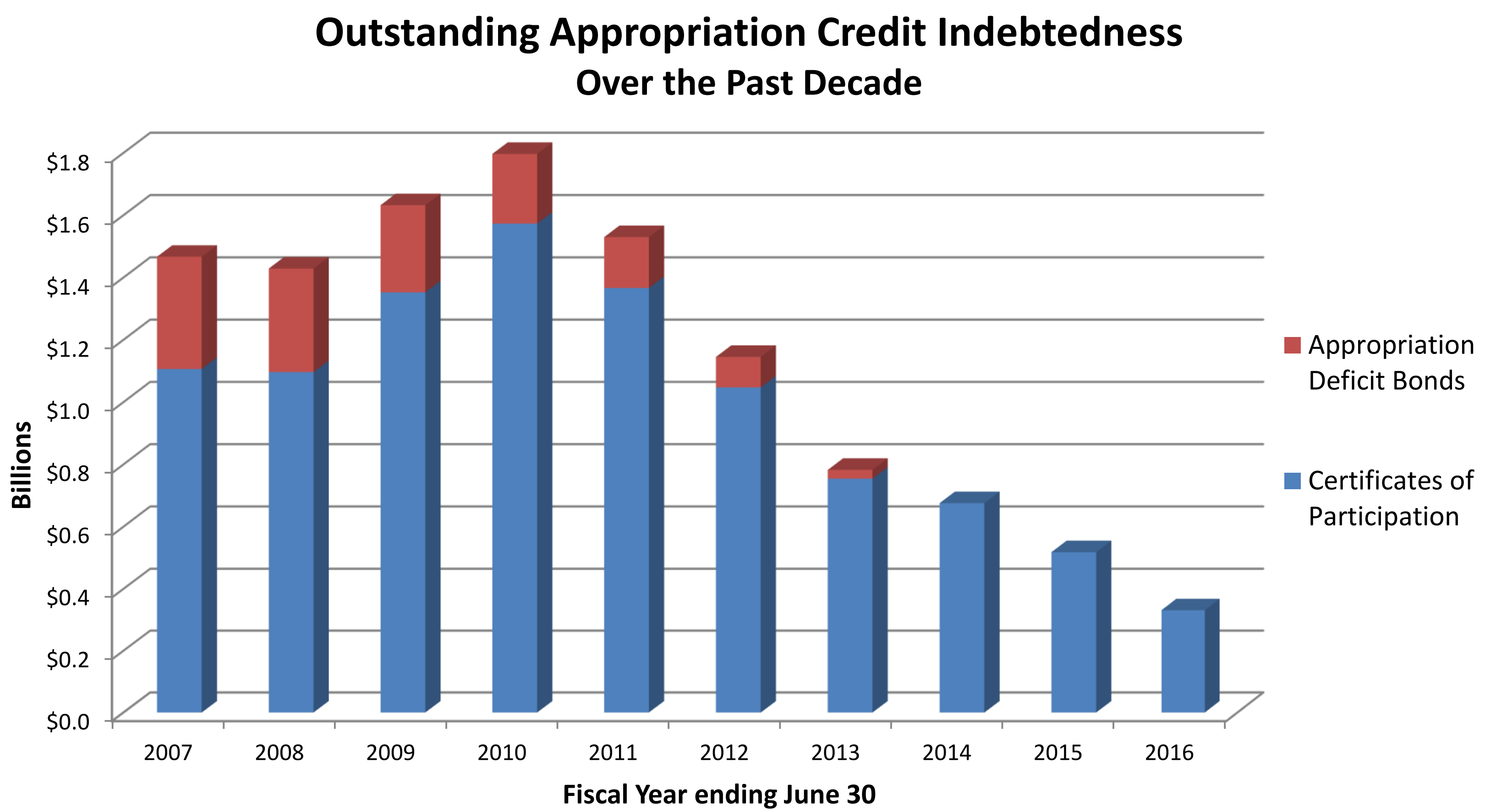


- In FY 2004, the State issued $2.4 billion in Pension Obligation Bonds, of which $1.8 billion remained outstanding at the end of FY 2016
- In recent years, most new GO bonds were issued to fund building projects at public universities and community colleges
  - $1.8 billion of debt for this purpose was outstanding as of June 30, 2016
- A substantial portion of the State's outstanding COPs have now been refunded as lower cost XI-Q GO bonds

Debt Capacity Concepts



- The issuance of $2.4 million Highway User Tax Bonds over the past several years to fund ODOT's multi-year bridge and highway improvement and congestion management programs is responsible for the majority of the growth in outstanding state revenue bonds
- The overall amount of Lottery revenue bond issuance has grown due to the added revenues received through the introduction of video line games
- The volume of annual issuance of single and multifamily housing revenue bonds has declined sharply over the past decade



- The final payment on the appropriation deficit bonds sold in 2003 was made in September 2013
- The State has refunded $580 million in COPs to date with lower cost Article XI-Q GO bonds, saving an estimated $92.4 million in interest costs on a present value basis
- The State continues to monitor the market for opportunities to refund the remaining balance of COPs whenever financially and legally feasible

Four Debt Capacity Categories

1. General Fund-Supported Debt	• SDPAC Recommended Target Limit -- 5% of General Fund Revenues
2. Lottery-Backed Debt	• Legal Bond Covenant Limit: 4x Coverage (no more than 25% of net lottery revenues) • Moral obligation pledge of State
3. Net Tax-Supported Debt	• National bond rating agency perspective. • States compared with each other using "apples-to-apples" measurement approach
4. Non Tax-Supported Debt	• No generic capacity limit or measurement. • State programs in this category are managed based on revenue streams available

General Fund-Supported Debt Programs

GF-Supported State Debt Programs

General Obligation Bonds

- Higher Education Facility Bonds (XI-G)
- Community College Bonds (XI-G)
- Pollution Control Bonds (42% of total)
- Alternate Energy Bonds (37% of total)
- Oregon Opportunity Bonds (OHSU)
- Pension Obligation Bonds (32% of total)
- Seismic Rehabilitation Public Education Buildings (XI-M)
- Seismic Rehabilitation Emergency Service Buildings (XI-N)
- State General Purpose (XI-Q) (82% of total)

Appropriation Credits

- Certificates of Participation (85% of total)

Outstanding as of June 30, 2016 -- $2.83 Billion

Model Inputs & Assumptions

- Accounts for all debt outstanding as of June 30, 2016 and assumes **$1.15 billion** in planned issuance during the current biennium based on 2015 and 2016 legislative authorizations for General Fund-supported GO bonds, including:
  - *$433.5 M for State Buildings (XI-Q) (General Fund-supported only)*
  - *$550.8 M for Higher Education Facilities , OHSU 's Cancer Research Center, and Community College projects (XI-G)*
  - *$207.3 M for school and public safety building seismic upgrade grants (XI-M & XI-N)*
  - *$126.2 M for school construction grants (XI-P)*
  - *$35.5 M for state highway projects (XI, Sec 7)*
- Uses December 2016 General Fund revenue forecast over ten year horizon
- New debt issued as level debt service over 20 year term at **4.50%** interest rate (32 basis points above average BB-20 over last 10 years)
- Target of 5.0% of General Fund revenues used to make payment on General Fund debt service

Projected General Fund-Supported Debt Capacity
over the Next Four Biennia

Fiscal Year Ending June 30	Maximum Amount that can be Issued within Target Capacity* ($ Millions)	Debt Service as a % of General Fund Revenues
2017	-	3.4%
2018	$ 1,301.5	5.0%
2019	450.4	5.0%
2020	285.1	5.0%
2021	546.4	5.0%
2022	568.8	5.0%
2023	316.7	5.0%
2024	485.4	5.0%
2025	612.4	5.0%
Additional General Fund Capacity Over the Forecast Period	**$4,566.6**	

*These amounts do not Include the $1.15 billion in GF-supported bonds authorized by the 2015 and 2016 Legislatures.

Factors that Could Impact Projected General Fund Debt Capacity

(in millions)

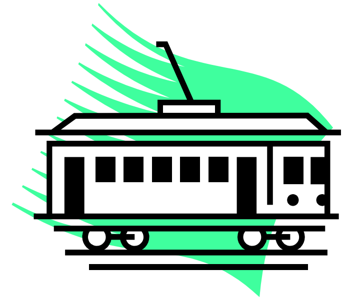
	FY 2018 – 2025*	Per Biennium **
Base Case	**$ 4,567**	**$ 1,142**
Change in General Fund forecast		
10% decline	3,710	927
10% increase	5,423	1,356
Change in interest rate forecast		
1.0% higher	4,117	1,029
1.0% lower	5,067	1,267

* Includes the $1.15 billion in GF supported bonds authorized by the 2015 Legislature

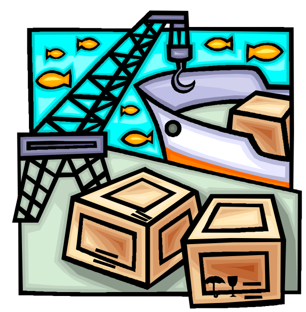
** May not total exactly due to rounding

Lottery-Backed Debt

Lottery Bond Projects & Programs



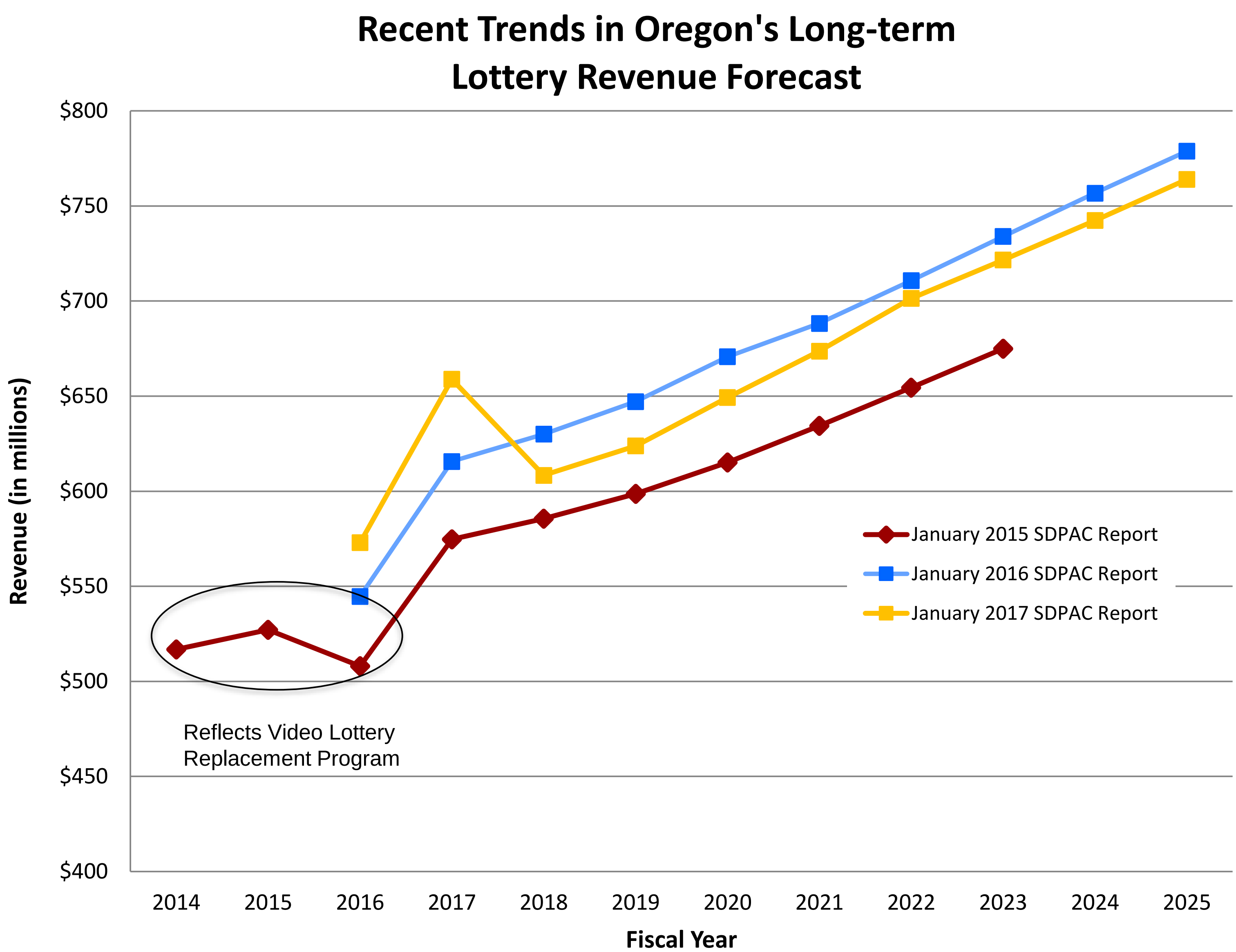
- **$1.08 billion** in bonds outstanding as of 6/30/16
- Programs funded to date include:
  - Light Rail Projects
  - State Parks
  - Drinking Water
  - Schools & Education
  - State Fair & Oregon Gardens
  - Community Loans & Grants
  - Economic & Rural Development
  - “Connect Oregon” Grants
  - Regional Port and Airport Improvements
  - Supportive Housing



Model Inputs & Assumptions

- Accounts for all Lottery debt now outstanding and planned issuance of **$213.1 million** in new lottery bonds, as authorized by the 2015 and 2016 Legislatures
- Incorporates December 2016 Lottery revenue forecast for the next ten years
- New debt issued as level debt service over 20 year term at 4.50% interest rate (32 basis points above average BB-20 over last 10 years)
- Target based on 4x debt service coverage or maximum of 25% of net lottery revenues

Lottery-Backed Debt



Projected Lottery Revenue Bond Capacity
Over the Next Four Biennia

Fiscal Year Ending June 30	Maximum Amount That Can be Issued within Debt Service Coverage Ratios* (in millions)	Projected Debt Service Coverage Ratio (Times)
2017	--	5.6
2018	$ 249.6	4.0
2019	95.5	4.0
2020	139.8	4.0
2021	80.9	4.0
2022	63.6	4.0
2023	70.3	4.0
2024	67.5	4.0
2025	70.2	4.0
Lottery Debt Capacity Over the Forecast Period*	**$837.5**	

* Does not include the $ 213.1 million in Lottery bonds authorized by the 2015 and 2016 Legislatures.

Factors that Could Impact Projected Lottery Bond Capacity
(in millions)

	Fiscal Years 2018 - 2025	Average Per Biennium**
Base Case	**$837**	**$209**
Change in lottery revenue forecast		
10% decline	589	147
10% increase	1,086	271
Change in long-term interest rates		
1.0% higher	752	188
1.0% lower	935	234

* Includes the $213.1 million authorized by the 2015 and 2016 Legislatures.
** May not total due to rounding

Net Tax-Supported Debt

Net Tax-Supported Debt Programs Include:

All

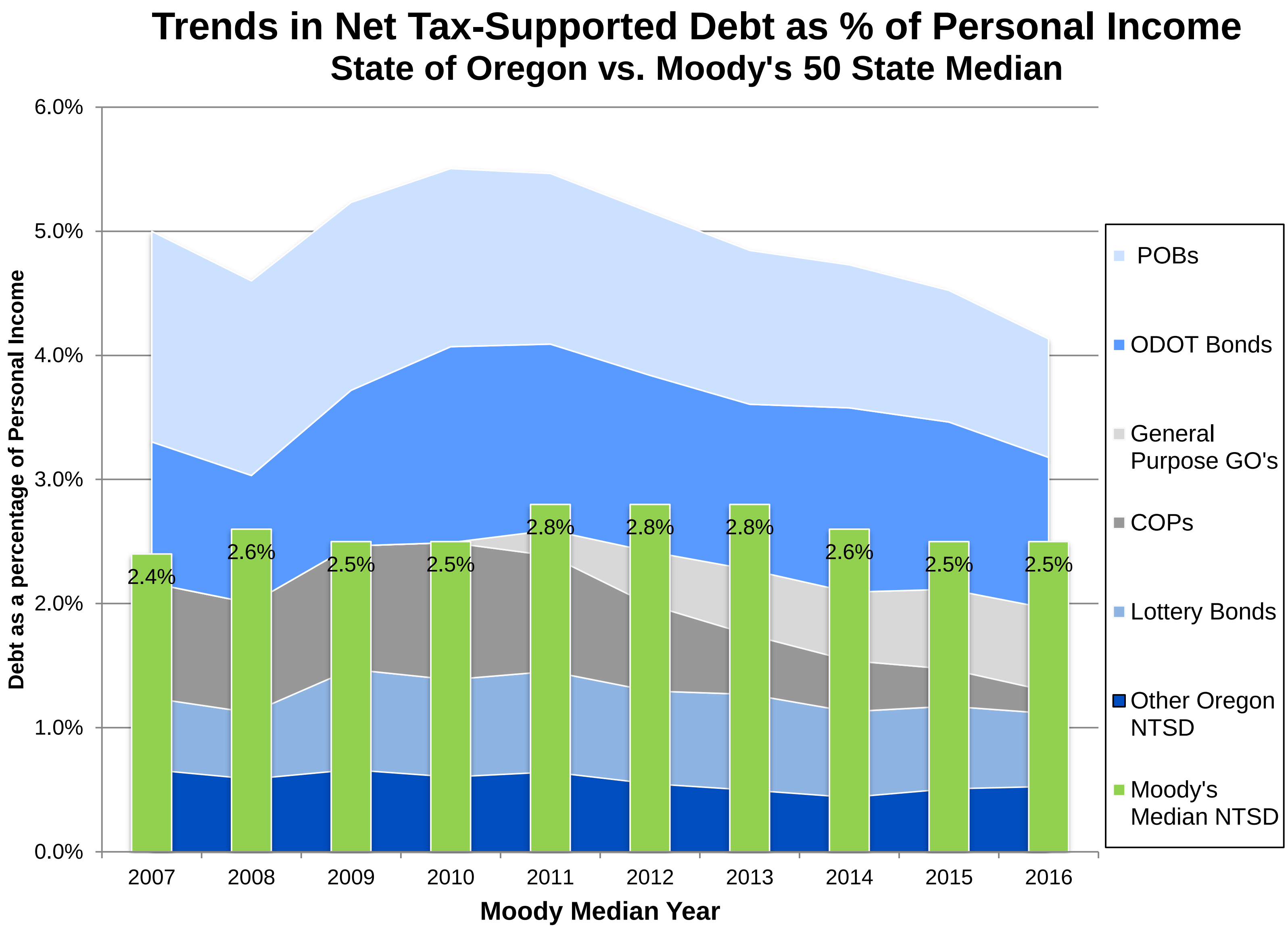
General Fund-Supported Debt Programs

Plus

- Balance of Pension Obligation Bonds
- Balance of COPs and XI-Q bonds
- Lottery Revenue Bonds
- Highway User Tax Revenue Bonds

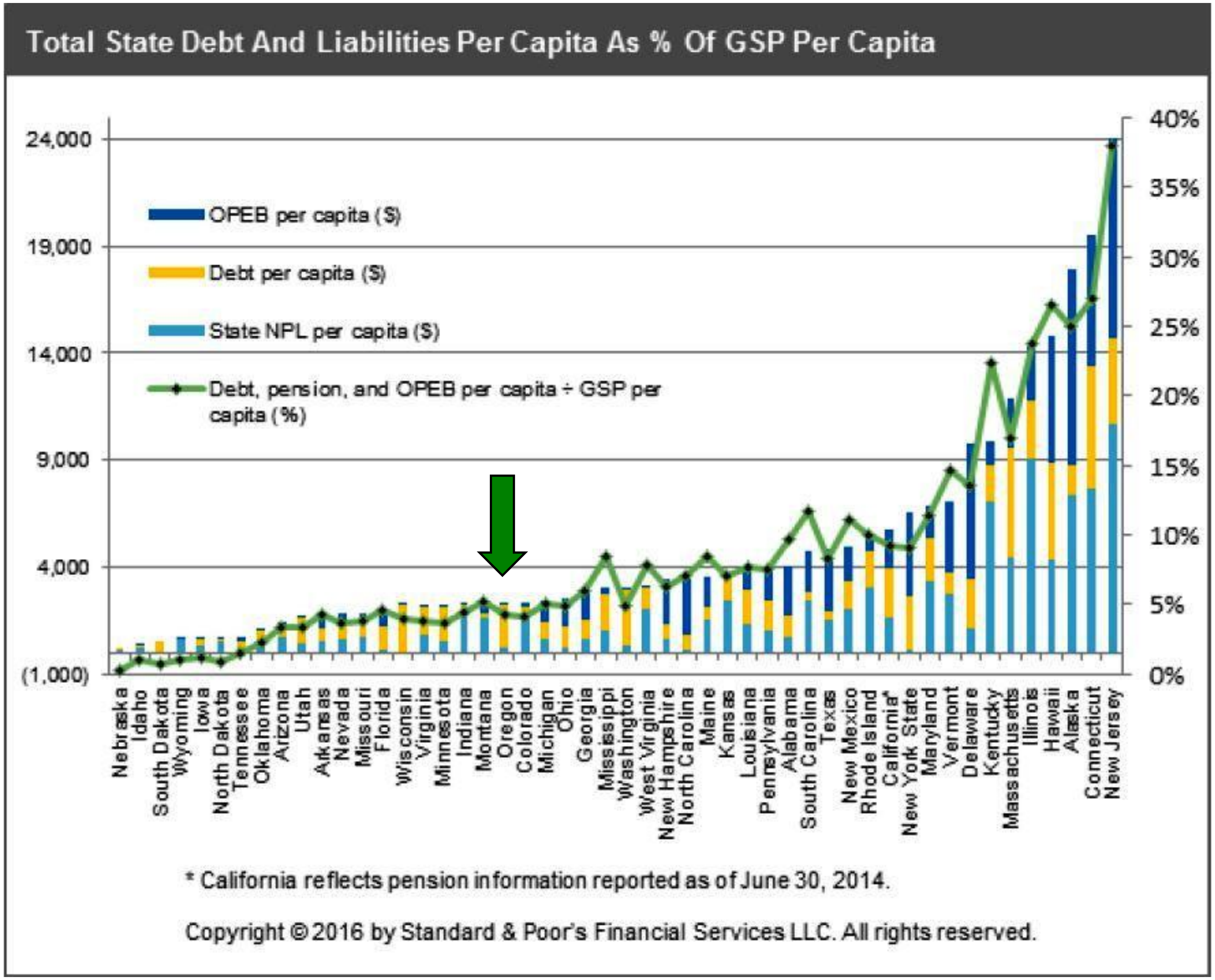
State of Oregon
Net Tax-Supported Debt Ratios

	Fiscal Year Ending June 30th		
	FY 2015 (Actual)	**FY 2016** (Actual)	**FY 2017** (Projected)
Net Tax-Supported Debt (in Billions)	$ 7.8	$7.6	$8.8
NTSD Per Capita	$1,944	$1,876	$2,120
NTSD as % of Personal Income	4.4%	4.1%	4.5%
Excluding Pension Obligation Bonds			
NTSD Per Capita	$1,487	$1,442	$1,712
NTSD as a % of Personal Income	3.4%	3.2%	3.6%



Sources: Moody's State Debt Medians Reports, 2007–2016

Net Tax-Supported Debt



Source: S&P pension report published on Sept 12, 2016, based on fiscal year 2015 state comprehensive annual financial reports. State of Oregon data does not reflect the impact of the *Moro* decision and other actuarial assumption changes made in the 2015 or 2016 actuarial valuation periods.

Non Tax-Supported Debt

Non Tax-Supported Debt Programs

General Obligation Programs

- Veteran’s Welfare Bonds
- Elderly & Disabled Housing Bonds
- Higher Education Facility (XI-F) Bonds
- Alternate Energy Bonds (63% of d/s)
- Oregon School Bond Guarantee Program

Direct Revenue Bond Programs

- Single & Multifamily Housing Bonds
- Economic Development Bond Bank

Conduit Revenue Programs

- Economic Development Revenue Bonds
- Oregon Facilities Authority Bonds
- Multi-Family Housing Revenue Bonds

Update on ODOE's Alternate Energy GO Bond Program (SELP)

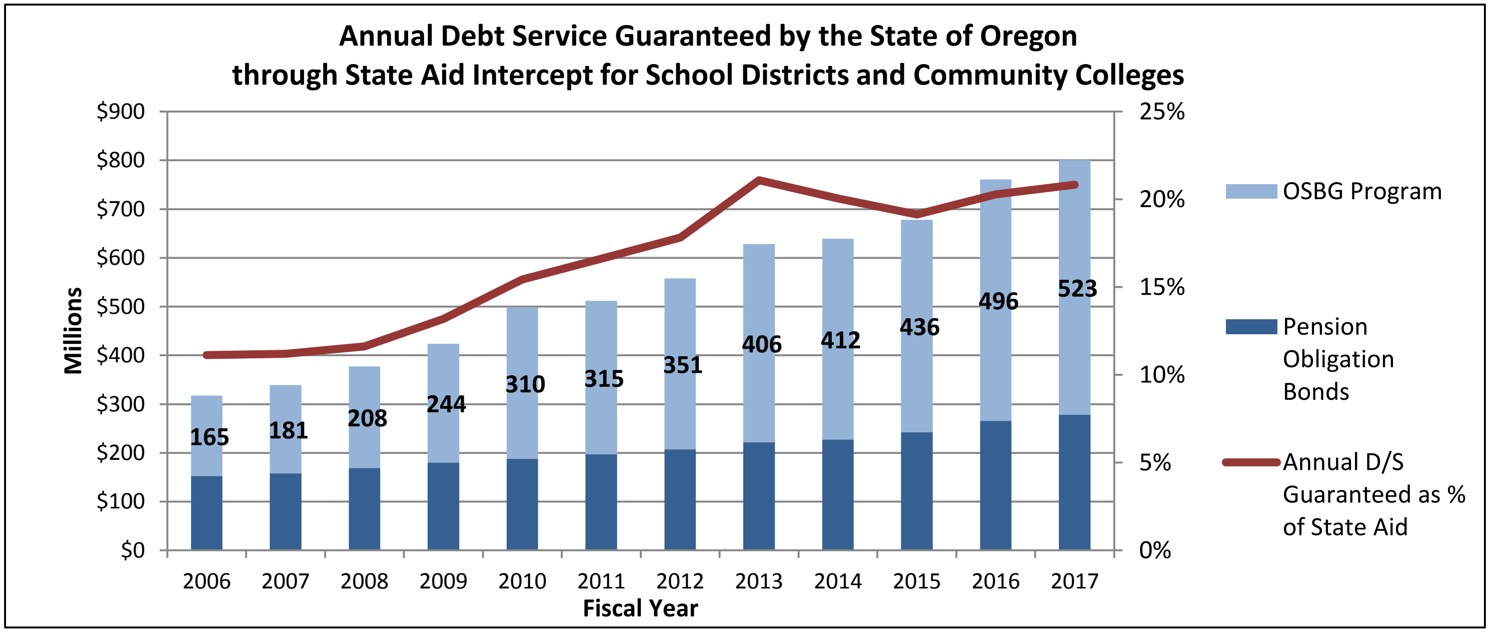
- The Oregon Department of Energy's SELP gradually built up loan reserves over the past thirty years by charging a loan rate to its' borrowers that was a bit above the State's cost of borrowing
- Over the past several years, SELP's loan reserves have deteriorated severely due to the default of several large loans to private borrowers and a growing number of delinquent loans that are 91 days or more days past due
- The most recent consultant report estimates that SELP will need cash infusions from the General Fund from FY 2021 through FY 2034, totaling approximately **$16 million** overall, in order for the Department to meet its' scheduled GO debt service payments
    - Treasury recently refinanced a portion of this GO debt as part of a larger state borrowing, saving approximately $5.7 million in interest costs that will be split between the State and the underlying borrowers over time
- While the refunding has helped the projected cash flows, the timing and size of the General Fund appropriation could change if more SELP loans become delinquent and/or are written off as uncollectible

Update on ODOE's Alternate Energy GO Bond Program (continued)

- The Joint Interim Committee that has been reviewing ODOE's overall operations has made several recommendations about the continued management, operations, and funding of the SELP bond program
  - Return the Small Energy Loan Program (SELP) to its original mission and establish a cap on loan size
  - Transfer SELP to the Oregon Business Development Department with a continued ODOE role in project qualification
  - Direct OBDD to work with the State Treasurer's Office to review past loan defaults and strengthen loan underwriting and other program requirements where needed
  - Remove statutory authority for Governor to override ODOE/OBDD decisions on loan applications
  - Repeal the Alternative Vehicle Fuel Revolving Loan Program and transferring remaining funds (approximately $3 million) to SELP to rebuild its loan reserves
  - Restart the loan program to help generate a repayment revenue stream to reduce the program's cash shortfall if supported by OBDD/Treasurer Office review

Other State Debt Programs of Concern

- With the demise of the AAA municipal bond insurer market during the Great Recession, requests for state guaranties for repayment of local school and community college GO bonds through the Oregon School Bond Guaranty program (OSBG) has increased dramatically
- Currently, the State is guarantying over **<u>$500 million per year</u>** in debt service payments through the OSBG program
  - While no state school funds have been diverted under the OSBG program to cover debt service paid on behalf of participants, the dramatic increase in the State's **contingent liability** to cover the debt service payments guarantied through this program is of growing concern to the Treasurer's office
  - Since bond insurance is once again available in the municipal bond market, albeit at the AA rating level, the Oregon Treasury has begun evaluating the appropriate cap on the overall size of the OSBG program and whether to limit its future use to those districts who can demonstrate that they are unable to obtain bond insurance
- The State also provides a guarantee on the repayment of Pension Obligation Bonds issued by school and community college districts. In FY 2017, approximately $278 million, or over 7% of state school aid, will be diverted by the Department of Education to pay the debt service on these bonds
  - The amount diverted will continue to increase over the next decade, with most of the existing POBs paid off by 2027



Conclusions

- Tax-exempt interest rates have declined over the past several year, allowing the State to issue bonds at historically low interest rate levels
- Based on current bond sale and interest rate assumptions, there is $4.57 billion in additional General Fund-supported debt capacity available over the next four biennia while remaining within the SDPAC's 5% debt service limit
- The Commission has historically recommended that the State conserve General Fund debt capacity by averaging out available capacity over time
  - For the 2017-19 biennium, this averaging approach suggests a maximum GF debt capacity of **$1.14 billion**

Conclusions (continued)

- Based on the December 2016 forecast of long-term Lottery revenues and the planned sale of $213.1 million in Lottery bonds in the spring of 2017, there will be $837 million in additional Lottery bond capacity over the next four biennia
- Based on the capacity "averaging" approach historically recommended by the Commission, 2017-19 Lottery bond capacity is projected to be **$209 million**

Conclusions (continued)

- While Oregon's net tax-supported debt ratios remain above national averages, the State's <u>overall</u> liability (which is the sum of both its public debt and its unfunded PERS liability) will likely remain below the national average among U.S. states
- Given the continuing deterioration of loan loss reserves associated with the SELP program, the Legislature and Governor should review and take action on the recommendations of the Joint Interim Committee on Department of Energy Oversight
- There is rapidly growing liability associated with the various state school aid intercept bond guaranty programs