

TED WHEELER
STATE TREASURER

DARREN BOND
DEPUTY STATE TREASURER



OFFICE OF THE STATE TREASURER
DEBT MANAGEMENT DIVISION

LAURA LOCKWOOD-MCCALL
DIRECTOR
350 WINTER STREET NE, SUITE 100
SALEM, OREGON 97301-3896
(503) 378-4930

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To: House Committee on Veteran's Affairs and Emergency Preparedness

From: Laura Lockwood-McCall
Director, Debt Management Division

A handwritten signature in blue ink, appearing to read "LLM", is placed over the printed name and title of the sender.

Re: Impact of HB 3048 on State Bonding Programs

HB 3048 requires that 2% of the bond proceeds for all future state-issued bond programs, regardless of underlying purpose, be set aside to fund resiliency projects and programs. While the goal of improved resiliency of state and local government buildings is important and worthwhile, HB 3048, as currently written, would result in other consequences the legislature may want to avoid. HB 3048 would increase the legal costs incurred with each bond sale, and result in higher interest costs on state bond sales. Additionally, the detailed set aside requirements in the bill would add time delays and a layer of administrative complexity to the debt issuance and debt management process, as described below. For these overall reasons, the Oregon State Treasury opposes the bill in its current form.

The most problematic part of HB 3048 is the requirement that 1% of future state bond issues be set aside in a reserve that would be invested, which a resiliency committee would eventually allocate to resiliency projects around the state. Since the date that these funds would be spent would be indeterminate at the time of sale, both the Department of Justice and the state's bond attorneys have advised that this portion of each bond sale would likely have to be sold on a taxable, rather than tax-exempt basis, in order to comply with Federal tax law that requires that bond proceeds be spent within a three year time frame. Since taxable interest rates may be as much as 250 basis points (or 2.50%) higher than tax-exempt interest rates, this provision of the bill will raise the interest cost for future state bond issues.

Bond investors rely on the unqualified legal opinion of bond counsel when purchasing state bonds -- if HB 3048 were enacted as written, it may prove very difficult for bond counsel to provide an unqualified opinion unless the funds deposited in this 1% reserve are restricted for expenditure to only the authorized purposes outlined by the state Constitution and state law for the type of state bond from which the funds were derived. For example, Article XI-J of the state Constitution authorizes the issuance of General Obligation (GO) bonds for loans related to small scale energy efficiency and renewable energy projects. Therefore, the 1% of bond proceeds linked with future XI-J GO bonding that would be deposited into this "resiliency reserve" would have to be tracked carefully by state agency staff in order to assure that these funds were spent only on the types of small scale energy projects that meet this Constitutional definition, and not for any other resiliency project or purpose.

A similar legal restriction would be attached to other state GO bonds, as each type of authorized state GO bond program is linked to a provision of Article XI of the State Constitution. These constitutionally authorized purposes range from making mortgage loans for veteran single family and elderly and

disabled multi-family housing, to construction of various state agency and higher education facilities, to making matching grants to fund various Oregon K-12 and community college districts and local government capital projects. Given the broad language in the current bill, it appears that HB 3048 would also apply to each of the state's revenue bonding programs, including ODOT's Highway User Tax Revenue Bonds, Oregon Housing and Community Services' Single-Family and Multi-family Housing Revenue Bonds, the Infrastructure Facilities Authority's Oregon Bond Bank Bonds, Lottery Revenue Bonds, as well as conduit bonds issued for capital construction projects of non-profits, multi-family housing developers and small businesses.

In essence, under HB 3048, each state agency that has an active bonding program would need to determine whether the bonds it is issuing are for the purpose of a "capital construction project" within the meaning of the bill. Bond counsel will also need to analyze each bond sale in order to determine which portion of a bond issue meets this definition in order to determine how to calculate the 1% set aside. It may not always be easy to determine if the sale proceeds "are raised to finance *** the construction, modification, replacement, repair, remodeling or renovation of a structure." Once this determination is made by bond counsel, each related agency for which HB 3048 applies will need to maintain detailed accounting records to track how the resiliency committee chooses to allocate the 1% of bond proceeds generated by their bond sales in order to assure that funds are spent in accordance with state law.

Next, HB 3048 requires another 1% of bond proceeds to be spent on improving the resiliency of the projects funded within each bond issue. This requirement leads to threshold questions that must be answered before each bond is sold. As mentioned above, the state issues GO bonds to finance loans and to make grants for various legal purposes; it is unclear whether the bill's requirement that 1% of bond proceeds be spent on improving the resiliency of projects is meant to refer only to projects in which the state is directly constructing or modifying a structure, or whether it also applies to loan and grant programs under which other entities undertake those activities. Because the Constitutional provisions authorizing loan and grant programs are listed in Section 4 of the bill, it is likely a court would find that bill applies to bonds issued to provide loans and grants for capital construction as it is defined in the Act. In that instance, the agency will need to make detailed inquiries as to the activities carried on with each loan or grant to determine if there is a structure involved that falls within the scope of the bill. Because the threshold for falling within the scope of the bill is 50% of the gross proceeds, programs will have to determine how to calculate that figure – such as whether it applies to the entire sale, or each series of bonds within a sale, and where the sale finances multiple projects how the allocation is done among bond series and the projects, or among loan and grant financed projects.

The second part of this threshold analysis is whether the object of the bond financed activity is a considered a "structure." The definition of "structure" in the bill is very broad and could sweep in things that are not commonly considered a "structure." For instance, roads, bridges and infrastructure may not commonly be viewed as a "structure." But, they arguably fall within the definition of the bill as an "improvement" that is constructed on or attached to real property, above or beneath, the surface. The standard for resilience, however, refers to "building codes enforced under ORS chapter 455," leading to the inference that the term "structure" may not be as broad as the language used in the bill. It is unclear whether something that meets the definition of a structure, but is not subject to the building codes in ORS chapter 455 would be within the scope of the bill.

If it is determined that an agency's bonds fall within the scope of the bill, 1% of the gross proceeds must be spent to improve a project's resilience to damage or deformation. The determination that such a

requirement has been met will be folded into the analysis by bond counsel as to whether the bond proceeds are being used for the authorized purpose, which will require an analysis by both the agency and bond counsel of each project's details prior to the bond sale. This level of due diligence on a project by project basis will undoubtedly require significant additional staff time and legal expense to assure that this 1% resiliency requirement is met on each state bond sale.

As stated above, the Oregon State Treasury is very supportive of the goal of improved resiliency of state and local government buildings, but we do not believe that HB 3048 is a workable or cost-effective approach to achieving this goal. We have communicated these concerns to the bill's sponsor and are willing to provide assistance in shaping this concept into something more workable. Given the many complexities of Federal tax law, as well as the Constitutional and statutory restrictions on the use of state bond proceeds, we recommend that the Legislature explore a more straightforward approach to achieving higher levels of resiliency, including the review, evaluation, and possible upgrade of current state building codes and resiliency standards as applied to critical state and local public facilities.

