March 1, 2019

Joint Committee on Ways and Means

Subcommittee on Capital Construction

Oregon Debt Capacity and Pension Obligation Bonds

Debt Management Division

OREGON STATE TREASURY

Building a stronger financial future

Debt Management Division

We issue bonds to finance capital projects and infrastructure that will benefit Oregon's citizens, economy and long term quality of life – while also facilitating short-term construction jobs.

$14 B

State debt issued and tracked

In 2018

$6.1 B

General Obligation Debt

As of 6/30/2018

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What is a bond issue?

Bond issuance is the process of borrowing money from investors.

- A bond is a financial instrument whereby the borrower has a legal obligation to repay investors who loaned money to the borrower.

- Bonds have debt service schedules for payment of principal and interest, just like home mortgages and car loans.

$14 B
State debt issued and tracked
In 2018

$6.1 B
General Obligation Debt
As of 6/30/2018

Oregon’s credit ratings

The state’s general obligation credit ratings are an independent evaluation of Oregon’s financial health and are based largely on fiscal discipline. A stronger credit rating also means you are a better credit risk, which means you can borrow money at a lower rate of interest to pay for infrastructure and other projects.

AA+ Standard and Poor’s

Aa1 Moody’s Investors Service

AA+ Fitch Investors Service

Establishing prudent biennial debt capacity

State Debt Policy Advisory Commission

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State Debt Policy Advisory Commission

The State Debt Policy Advisory Commission (SDPAC) has established overall guidelines for prudent biennial borrowing levels that have helped us maintain strong credit ratings over the years

Current commission members:

- State Treasurer Tobias Read (chair)
- Senator Betsy Johnson
- Representative Nancy Nathanson
- DAS Director Katy Coba
- Tim Duy, University of Oregon economist (public member)

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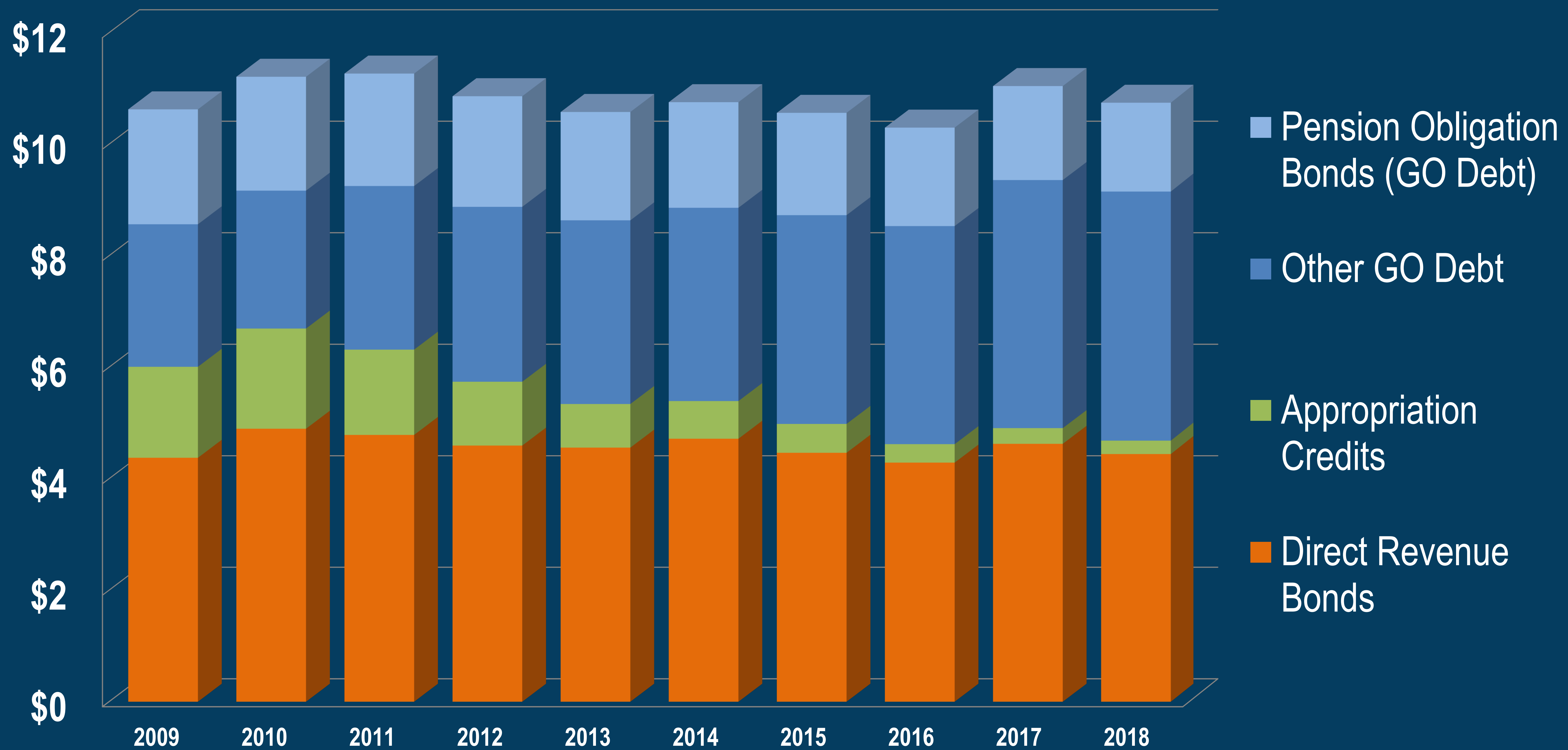
State of Oregon debt outstanding



* Does not include Conduit Revenue Bonds

SDPAC recommendations for maximum new debt issuance, 2019-21

$1.15 B General Fund Debt Capacity*	**$305 M** Oregon Lottery Debt Capacity

Recommendations are based on:

- Oregon Office of Economic Analysis long-term revenue forecast;
- Projections of the amortization of existing debt;
- Conservative assumptions regarding term of bonds and future interest rates; and
- Assume all bonds authorized in 2017-19 will be issued by June 30, 2019.

* Issuance of new POBs would count against general fund debt capacity that might otherwise be allocated for other purposes.

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What is a pension obligation bond?

- Pension obligation bonds are sold to fund the unfunded actuarial liabilities (UAL) of the Public Employee Retirement System (PERS).
- Under federal tax law, they cannot be sold on a tax-exempt basis. Therefore, POBs must be sold at a higher, taxable interest rate.
- POBs are an authorized use of state General Obligation debt under Article XI-O of the Oregon Constitution.

$1.6 B

POBs outstanding – State of Oregon

As of 6/30/2018

$3.4 B

POBs outstanding – local governments

As of 2/20/2019

State Pension Obligation Bonds

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Arbitrage and short-term budget savings

Oregon 2003 Pension Obligation Bond issuance

- Oregon voters authorized Measure 29 in 2003.

- The State issued $2.1 billion with the proceeds deposited in a "side account" at PERS, to be invested by the Oregon Investment Council in a fashion similar to the larger Oregon Public Employees Retirement Fund (OPERF).

- At that time, PERS was amortizing its UAL at **8.0%**, and the taxable state POBs sold at an interest rate of **5.75%**. This 2.25% reduction in interest cost was considered compelling given the State's budget situation during the 2001-03 biennium.

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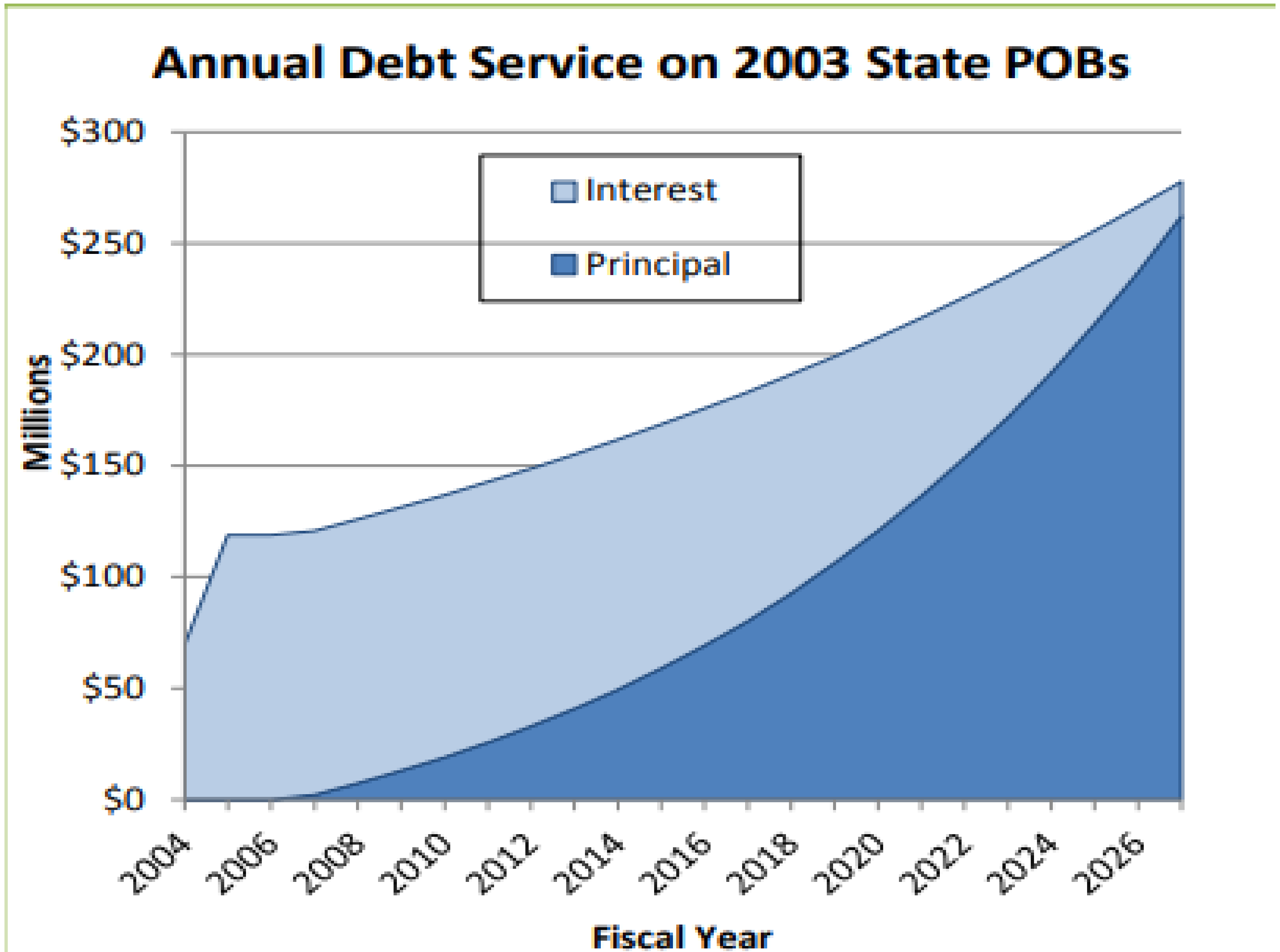
2003 Pension Obligation Bonds - State



The State POBs will be repaid in full in FY 2027.

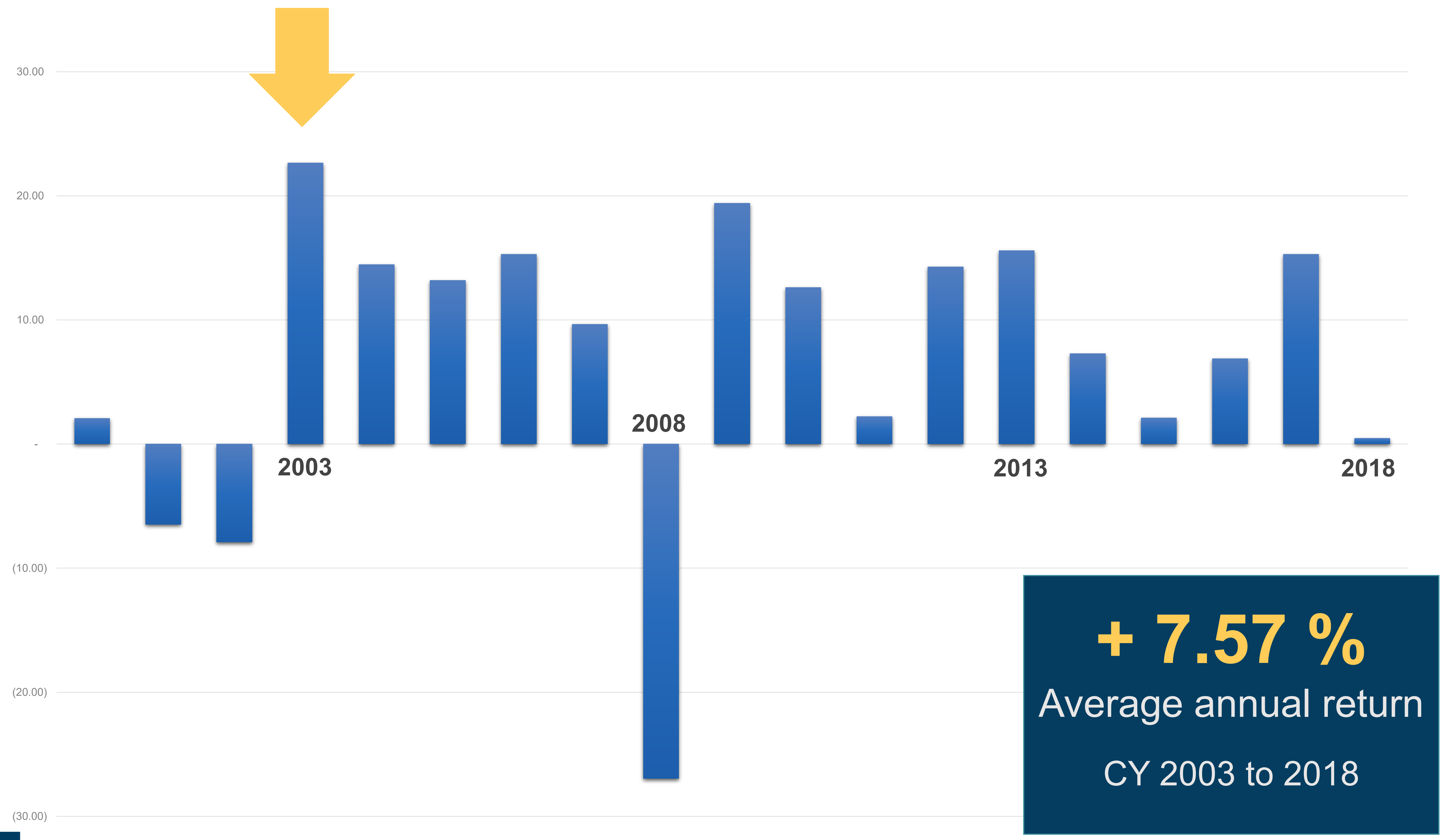
Arbitrage and short-term budget savings

Payments delayed for short-term budget relief

- The $2.1 billion in POBs were structured with a 25-year repayment term.
- They did not include any principal repayment for the first five years, with upward sloping principal amortization thereafter.
- While this structure provided short-term budget relief, it means that as of June 30, 2018, there still remained **$1.6 billion** of State POBs outstanding.
- 2003 State POBs continue to absorb significant state debt capacity.

Timing of POB issuance is critical to success

Oregon Public Employees Retirement Fund, annual performance 2000 to 2018



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Credit rating agency view

- All states must report net pension and other post-employment liabilities (GASB).
- Previously, states with pension obligation bonds were graded more negatively
- Oregon now compares favorably under and has received high marks from all three major ratings firms for long-term liability management.
- Issuing POBs transforms a "soft" long-term liability into a "hard" long-term liability

S&P's state rankings, 2017 report

		Funded Ratio of State PERS	Net Pension Liability ($M)	Net Pension Liability per capita	Debt, pension and OPEB Liability per capita
1	South Dakota	100.1%	- $2	$ -2	$ 590
2	Wisconsin	99.1%	$231	40	2,598
3	New York	96.7%	$4,735	239	7,175
4	North Carolina	90.7%	$1,927	188	3,919
5	Idaho	90.6%	$431	245	358
12	**Oregon**	**83.1%**	**$2,788**	**$ 673**	**$ 2,728**
	AVERAGE	69.5%	$4,195	$ 1,111	$ 3,630

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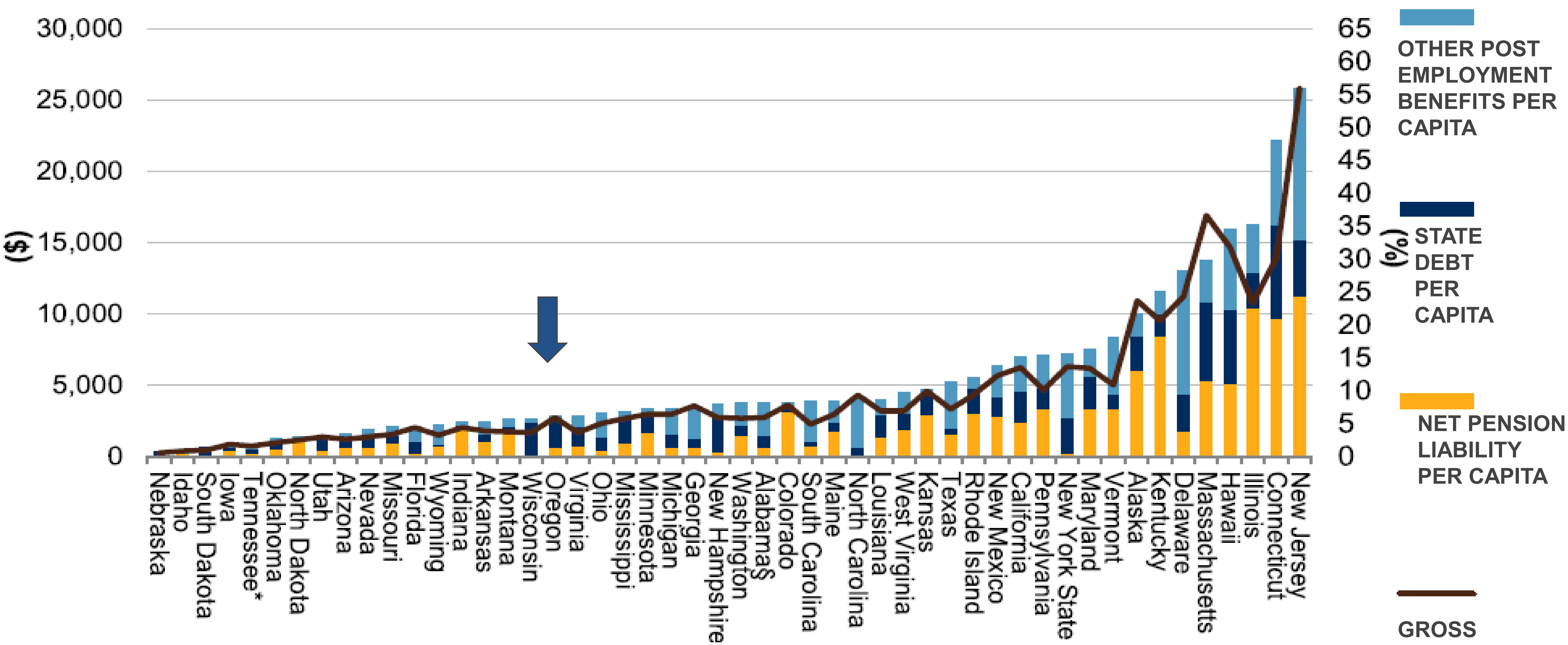
Long-term liabilities of states relative to their annual economic output

Fiscal 2017 State Debt And Liabilities Per Capita As % Of Gross State Product Per Capita



Source: Standard and Poor's *U. S. Pensions Struggle for Gains Amid Market Shifts and Demographic Headwinds*, October 30, 2018, which uses information reported in state Comprehensive Annual Financial Reports at the end of fiscal year 2017.

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Local Pension Obligation Bonds

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POB – Oregon local governments

Local bonds, state money

- Local government POBs cannot be issued as general obligation bonds, but rather as taxable, limited obligation bonds.
- In many instances, state resources help pay for POBs, through **Fund Diversion agreements** whereby school aid is diverted to pay debt service on these bonds issued by school districts and community colleges.

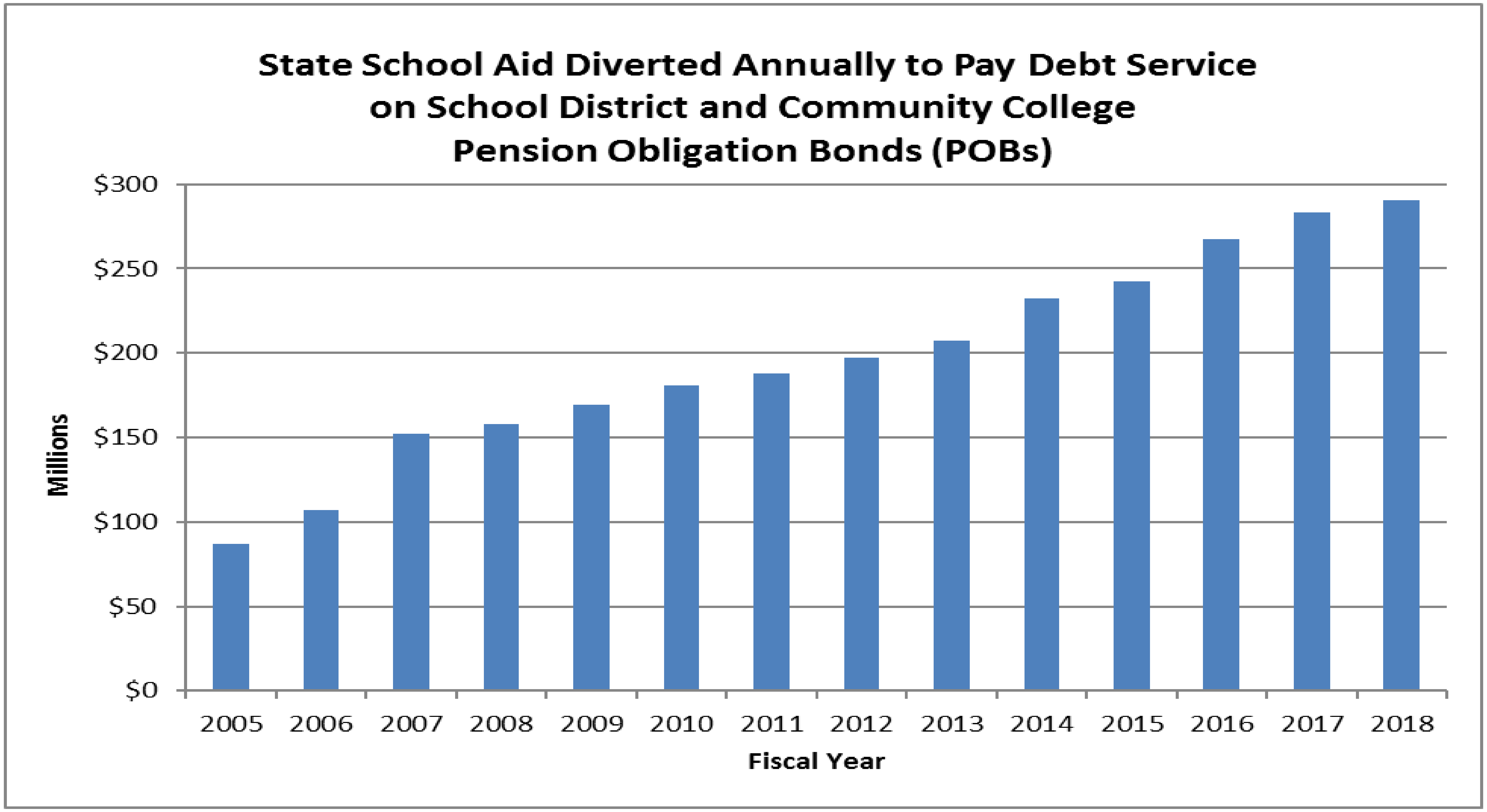
213
Oregon local governments with POBs
As of 2/20/2019

$4.9 B
POBs issued since 1996 by local governments

$3.4 B
POBs outstanding – other governments
As of 2/20/2019

~ 62%
POBs attributable to school districts
As of 2/20/2019

State aid for fund diversions



Between 2002 and 2007, there were 9 separate pooled financings totaling $3.16 billion under this program, with annual debt service representing $290 million, or just under 7% of school aid appropriations in FY 2018.

Local control over pension obligation bond issues

- As staff to the Municipal Debt Advisory Commission (MDAC), Treasury tracks state and local debt including Pension Obligation Bonds, but the structure and issuance is strictly a matter of local control (ORS 287A).

- MDAC requires Oregon jurisdictions to report detailed information on its bond sales both prior to and after completion of each transaction, and makes this bond information available to the public.

- The SDPAC recently suggested that it would be wise for the Legislature to require local governments to seek an independent financial review of the risks of POBs that would be available to the public before voting on future issuances of these bonds.

Risk, Capacity and Current Markets

Conditions are different now than in 2003

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Things to consider

Understand the risk

- While communities that sold POBs in the early 2000s were able to earn an overall rate of return on their PERS side accounts that to date remains higher than the interest cost on their POBs, many Oregon jurisdictions who sold POBs later in the decade have not been so fortunate.

- These latter jurisdictions are worse off than if they had never borrowed because of lower capital market returns in 2008 and beyond.

- Economic modelling suggests that the likelihood of POBs being a good "bet" often depends on the investment earnings realized in the first few years after the POBs are sold.

Things to consider

Understand the long term budgeting implications

- The Government Finance Officers' Association (GFOA) recommends that due to their speculative nature, state and local governments avoid issuing pension obligation bonds, especially if the issuance is not part of a more comprehensive plan to address pension funding shortfalls.

- The state already pays the debt service for a large percentage of outstanding local school district and community college POBs.

Understand the state debt capacity limitations

- Any new state POB issuance will further crowd out investments in state infrastructure, affordable housing and other capital projects.

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