April 3, 2019 House Committee on Rules

HB 3123 – Independent Financial Assessment prior to the Sale of Future Local Government Pension Obligation Bonds

OREGON STATE TREASURY

Building a stronger financial future for Oregon

Debt Management Division

- We issue state 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.
- We staff the State Debt Policy Advisory Commission.
- We track and report all local Oregon government bond issues.

$14 B
State debt issued and tracked
In 2018

$27 B
Local debt tracked
In 2018

OREGON STATE TREASURY

State Debt Policy Advisory Commission

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

Members of the Commission have on occasion sponsored legislation addressing policy issues regarding debt management.

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)

OREGON STATE TREASURY

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

Arbitrage and short-term budget savings

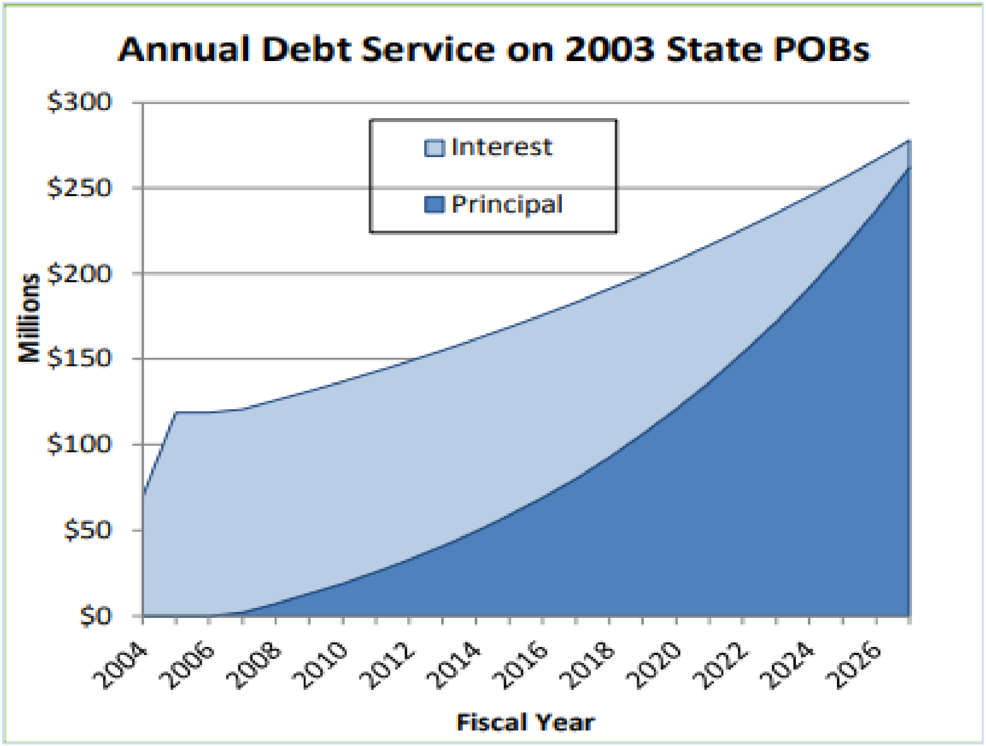
Oregon 2003 Pension Obligation Bond issuance

- 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.
- Subsequent to the issuance of POBs by the State of Oregon and other municipal issuers, the Government Financial Officers Association released a warning about the use of POBs, as they consider the issuance of these bonds speculative at best.

Arbitrage and short-term budget savings

Payments delayed for short-term budget relief

- The $2.1 billion in POBs were sold in 2003 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.



OREGON STATE TREASURY

Timing of POB issuance is critical to success

Oregon Public Employees Retirement Fund, annual performance 2000 to 2018

Local Pension Obligation Bonds

OREGON
STATE
TREASURY

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

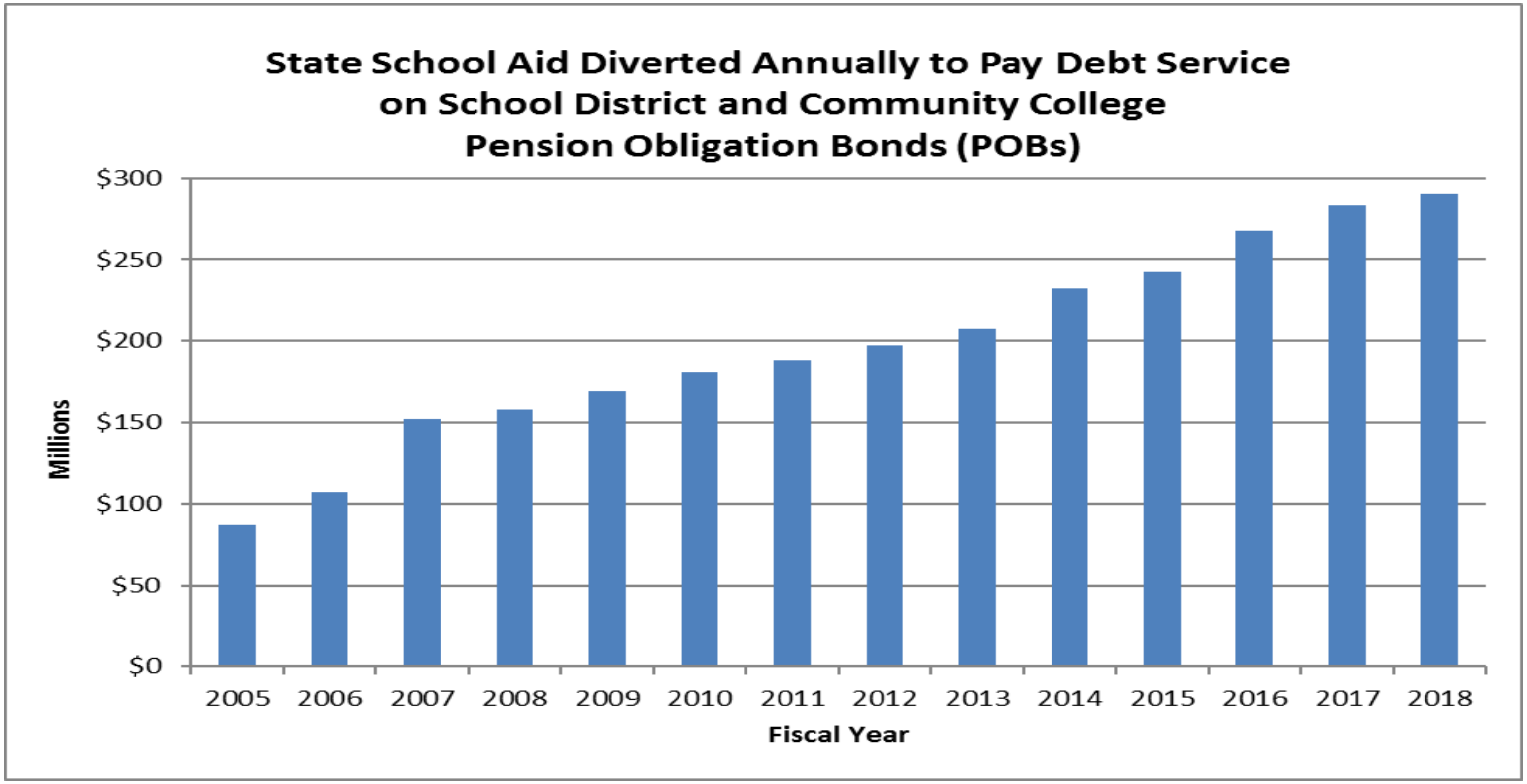
$3.4 B
POBs outstanding – other governments
As of 2/20/2019

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

State Guarantees on School District and Community College POBs

- In 2001, the Legislative Assembly authorized the Department of Education to enter into fund diversion agreements to improve the creditworthiness of Pension Obligation Bonds (POBs) issued by Oregon school districts and community colleges to prepay their accrued unfunded PERS liabilities (ORS 238.698).
  - Under these diversion agreements, the State Board of Education makes POB debt service payments directly to the POB bond trustee out of annual state aid funds allocated to participating school districts and community colleges.
- Between 2002 and 2007, $3.1 billion was issued in nine separate pooled POB borrowings using this fund diversion provision.
  - Like the OSBG program, the State guarantee of debt service repayment greatly enhanced the credit ratings and lowered the borrowing cost on these bonds.
  - Annual debt service on these POBs increases by 4.7% each year until the bonds are retired in FY 2028.
  - The use of this financing approach may increase in the coming years due to the increasing PERS UAL of Oregon school and community college districts.
- Under current state law, there is no mechanism for the independent review or approval of the POBs issued by the districts using this provision of state law.

Fund diversions for POB debt service represent a growing share of state school aid



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 officials to seek an independent financial review of the risks of POBs that would be available to the general public before voting on future issuances of these bonds – hence, the introduction of **HB 3123** by Representative Nathanson and Senator Johnson.

- Under Dodd-Frank legislation, municipal advisory firms are regulated by the Securities and Exchange Commission and the Municipal Securities Rules Board, and have a **fiduciary** duty to their local government clients, which assures that they will offer advice that is in the client's best long-term interests, unlike bond underwriters who have do not have this type of responsibility under federal securities law.