

**MINUTES OF THE
STATE DEBT POLICY ADVISORY COMMISSION
MEETING OF SEPTEMBER 23, 2010
STATE CAPITOL, ROOM 243
SALEM, OR 97301**

Members Present: Treasurer Ted Wheeler, Chair
Representative Phil Barnhart
Scott Harra, Director of Administrative Services
Senator Rick Metsger
Tim Duy, Public Member

Members Absent: None

Staff Present: Laura Lockwood-McCall, Debt Management Division, OST
Lee Anaya, Debt Management Division, OST
Jennifer Bingham, Debt Management Division, OST

Attendees Present: Jen Lewis, Legislative Assistant (Sen. Metsger)
Jack Kenny, DAS
Darren Bond, OST
Tom Rinehart, OST
Daron Hill, Legislative Fiscal Office
Steve Bender, Legislative Fiscal Office

Treasurer Wheeler, Chair, called the meeting of the State Debt Policy Advisory Commission (SDPAC) to order at 1:00 p.m.

Senator Metsger moved to approve the January 26, 2010 minutes, Mr. Harra seconded the motion and the minutes were approved by unanimous vote.

Ms. Lockwood-McCall presented the results on general fund debt capacity based on the September 2010 revenue forecast. She explained that revenue forecast over the six year period is down 5% since the last SDPAC report and because revenues are down so much, General Fund debt capacity going forward is greatly reduced for the next biennium. The 2009 Legislature authorized \$985 million in General Fund supported debt, of which \$383 million was sold in fiscal year 2010 and \$45 million has already been sold in fiscal year 2011. State Mental Hospital and OWIN are the two primary projects for which bonds have been authorized, but have not yet been sold this fiscal year.

Representative Barnhart asked for the amounts on those projects. Mr. Jack Kenny, Finance Manager for DAS, reported the General Fund portion of OWIN is about \$191 Million and the next tranche of bonds for the State Mental Hospital is about \$70-80 Million. He reported the overall balance is scheduled to be about \$350 Million and reported there is a planned COP sale planned for later this fiscal year.

Ms. Lockwood-McCall continued explaining that the six year capacity model has two basic ways to view capacity. One is to keep the General Fund debt service as a percentage of general fund revenues at no more than 5% in any given year. Alternatively, we often try and average out our debt capacity over the six year period, so that we don't use up all available capacity right away.

If we continue to use this averaging approach however, we will go beyond the 5% level, possibly resulting in our debt ratio reading above 6% in the next biennium. To keep to the level closer to the 5% target each year, she suggests that the Legislature not authorize any new General Fund backed debt next biennium. Because of the drop in General Fund revenues, the model suggests that if we sell all the debt that has already been authorized this biennium, we will hit a debt ratio of about 5.5% even without issuing any new debt next biennium.

Treasurer Wheeler asked Ms. Lockwood-McCall to go over the forecast of the State's net tax supported debt. Ms. Lockwood-McCall explained what additional debt is included in the definition of net tax supported debt and a discussion ensued.

Senator Metsger asked if the next Legislative Assembly ignored the SDPAC's recommendation, what sort of credit rating risk would be expected and what would it potentially cost the state? Ms. Lockwood-McCall responded that the rating impact would differ depending on why the State debt was being sold above our self-imposed limits. If the debt is used to complete construction on high priority capital projects, the risk of downgrade for this reason alone is minimal, but if debt issuance is linked to funding a budget deficit, there is a very high likelihood of a credit downgrade.

Representative Barnhart asked what interest rates are doing and how does that affect what happens with our debt capacity? Ms. Lockwood-McCall said rates are at historic lows, with state bonds sold now below the 4% range, but there is no guarantee these rates will stay at these historically low levels when selling bonds several years from now. If bonds are sold to balance the budget, we will be downgraded and the rates we will pay will increase substantially.

Senator Metsger said our job is to advise the Legislature as to what the risks would be and asked Ms. Lockwood-McCall to clarify the various risks of using debt to balance the budget versus using debt for infrastructure so they can adequately pass that along to decision-makers.

Treasurer Wheeler suggested that SDPAC make two recommendations to the Governor and Legislature as they prepare for the 2011-13 biennium. The first is to consider a moratorium on the issuance of new General Fund-supported debt next biennium. The second recommendation is to evaluate the need to move forward on bond financed projects that have already been authorized by Legislature, but not yet issued and to see what can be scaled back, delayed and/or stopped entirely.

To that end, Treasurer Wheeler asked Mr. Harra to look at where projects currently are in their construction schedules to help decision-makers in evaluating whether the State should move forward with new bonding.

Tim Duy asked Ms. Lockwood-McCall if she could give the committee an idea of what the basis point increase might be on state bonds based on the last downgrade. Ms. Lockwood-McCall said that while credit spreads vary over time, there is at least 20-25 basis points increase for each one notch rating change. Right now it matters a lot that we have a good credit rating as investors are penalizing issuers with lower credit ratings.

Darren Bond, Deputy State Treasurer, said it is important to remember and keep in context when we issued the appropriations credits to balance the 2001-03 budget, we were literally up against the wall financially at the end of the biennium, as revenue projections continued to decline up to the end of the two year budget cycle. Mr. Bond explained this is a fundamentally different situation than if we come out of the next budget building process planning to issue bonds simply to make the budget balance. You're not against the wall if you're issuing deficit bonds to balance the budget when you have a two-year biennium in front of you.

Ms. Lockwood-McCall said California has balanced its budget for the last 8-10 years using deficit bonds as an operational revenue source. That kind of debt financing has led to multiple levels of downgrades and interest rates 2.00% above the State of Oregon's rates. We did get recalibrated on a global scale by Moody's and Fitch this spring, so our current State General Obligation credit ratings are now AA with S&P, Aa1 with Moody's and AA+ with Fitch. In 2004 after issuing deficit bonds, Oregon was in the AA-/A+ rating category. We have done a great job collectively in terms of promoting our fiscal discipline coming out of the 2003 budget situation, have rebuilt our balance sheet through PERS reform, and established a meaningful Rainy Day Fund. Unlike other states, we have used our debt capacity in recent years to invest in the State's long term capital and infrastructure needs, which is important to our overall state economy and long-term prospects.

Representative Barnhart asked how the current situation compares to the situation in 2002 in terms of the way the Legislature and the Executive branch are managing through revenue shortfalls. Daron Hill, Deputy Legislative Fiscal Officer, said this time we have a Rainy Day Fund and the Educational Stability Fund has more funding in it than did in 2002. The current situation is less chaotic, but we may still have to

use debt to balance the 2009-11 budget if revenue forecasts continue to worsen throughout the spring of 2011. Mr. Bond concurred with Mr. Hill's assessment of the current situation.

Mr. Harra expressed concerns about OWIN and the State hospital projects that are mandated by the federal government. He said OWIN is scalable and that ODOT is working on options and presenting those to the Emergency Board in December. The State Hospital is a project that has been federally mandated and is already under construction.

Senator Metsger asked Tim Duy if there are any changes in his economic outlook compared to a month ago. Mr. Duy said there are no changes. He said he thinks we have avoided a double dip recession nationally, but a significant slow down on a national basis slowed down and will extend out another 6 months before we see any job recovery. He said he does not see forecasts that are looking for stronger growth next year that would bring us up beyond what the state economists are forecasting and doesn't think things will change until the 2013-15 biennium. Mr. Duy continued to say that the Legislative Assembly should accept that the cuts they make now are more permanent than temporary in nature.

Treasurer Wheeler asked if there was any disagreement on his recommendation to hold off on new General Fund debt in 2011-13. A discussion ensued about current projects and how to best inform the Governor and the Legislature. Having heard no objection, Treasurer Wheeler suggested drafting a letter with recommendations to inform legislators of the situation. He also clarified that this recommendation is being driven by deteriorating economic forecasts and that the Legislature has a very long record of strong fiscal discipline around managing state debt. Treasurer Wheeler made a motion that the SDPAC adopt two recommendations: The first is to put a moratorium in effect for additional new General Fund debt in the next biennium. The second decision is to have DAS evaluate the feasibility of stopping General Fund bond financed projects already authorized or underway. The motion passed unanimously.

Ms. Lockwood-McCall briefly talked about the Lottery bond program. She explained at the 4-times coverage level, we may not have enough capacity to sell all the bonds that have been authorized in 2009-11 because the revenue forecasts have dropped in this realm as well. Ms. Lockwood-McCall mentioned that staff is exploring some restructuring options to allow these and future lottery bonds to remain at the 4 times coverage level. She said for the next SDPAC meeting, the Committee will need to think about whether it wants to stay at the 4 times coverage target or change its policy to a lower debt service coverage target.

Another topic being planned for the 2011 SDPAC report will be a discussion about the future direction of the Oregon School Bond Guarantee program. Ms. Lockwood-McCall reported that while the State has never had to pay the actual debt service for any school district in the program, the program has grown quite large over the past few years and needs to be examined in light of the recent passage of Article XI-P, authorizing state general obligation bonds for school capital projects.

Treasurer Wheeler thanked everyone for their time and recognized Senator Metsger for his years of service on the committee. He then adjourned the meeting at 2:10 p.m.