OREGON STATE TREASURY

Tobias Read
Oregon State Treasurer

June 19, 2020

Governor Brown and Members of the Oregon Legislature:

The COVID-19 pandemic has introduced financial uncertainty and commensurate challenges to the state's budget in both the current and upcoming biennia. It also makes long-term funding plans for important state and local government capital projects more difficult. As Oregon takes on these challenges, we want to make sure you have up-to-date information about the state's debt capacity and details about how the state's bonding authority can be deployed to benefit Oregonians across the state.

Given the projected drop in revenues announced by the Office of Economic Analysis (OEA) in May, the State Debt Policy Advisory Commission updated its General Fund and Lottery debt capacity models to show state policymakers the likely impacts of reduced General Fund and Lottery revenue on the state's current and future debt capacity.

Key findings from this analysis, which is attached, reveal:

- Long-term General Fund debt capacity remains strong. While General Fund debt capacity is projected to drop around $300 million over the course of the decade compared to our projections in January 2020, the state can still finance all $946 million in legislatively authorized projects this biennium and up to $200 million in additional projects while staying within the SDPAC's 5% target limit. However, General Fund debt capacity in the 2021-23 biennium will be substantially affected by our target limit, with only an estimated $305-505 million available in the next biennium, depending on how much additional General Fund debt is authorized this biennium.
- Near-term Lottery debt capacity has also been significantly affected by the pandemic. Projected 2019-21 Lottery revenues are down approximately $364 million, or about 23%, compared to the March 2020 forecast, and will remain lower than previously projected for the 2021-23 biennium. As a result, the state will not be able to complete the planned sale of $302 million of Lottery revenue bonds in the spring of 2021 as we no longer meet the additional bonds test required by the Lottery bond indenture, which requires 4-times revenue to debt service coverage. Even without the planned 2021 sale, we now project that the Lottery debt service coverage ratio will only be at 3.1 in FY 2021.
- Assuming Lottery revenues and the Lottery bond debt service coverage ratio improve at the pace projected by OEA in the June 2020 Economic and Revenue Forecast, it may be possible to sell Lottery bonds in late FY 2022 for at least a portion of the projects originally slated to be financed in the spring of 2021, with the balance of projects financed in FY 2023.

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As new quarterly revenue forecasts are released this fall and winter, we will endeavor to update the SDPAC debt capacity models and share results with you in a timely fashion.

At the same time SDPAC was preparing this updated analysis, Treasury staff were also preparing for a $400 million bond sale in early June. In advance of the sale, my team met with the major ratings agencies, providing them with detailed information about Oregon's economy. In late May and early June, Treasury received updated ratings from Standard and Poors, Fitch Ratings, and Moody's Investors Service for general obligation bonds issued by the State of Oregon. My team and I are pleased that Oregon was assigned AA+/AA+/Aa1 ratings and a stable outlook for Oregon GO bonds. The new ratings are consistent with our previous ratings, and the pronouncement of a stable outlook is welcome news given pandemic-related market volatility.

The ratings and the accompanying agency analyses are a testament to the years of prudent budgeting and the accumulation of strong reserves, which were characterized by the S&P Global Ratings Report as a "generational high." Details of the now-completed bond sale are provided in this press release: https://www.oregon.gov/newsroom/Pages/NewsDetail.aspx?newsid=36815.

Oregon's strong fiscal management was integral to the success of our recent bond sale, and it will be important to future sales as well. To fully capitalize on our relatively strong position, I would offer the following advice:

- Maintain fiscal discipline and resist the use of short-term financial strategies to balance the budget. For example, I would caution against issuing bonds to fund operations.
- Take advantage of historically low interest rates and invest our remaining debt capacity in physical infrastructure projects. Focus on projects that will offer value to Oregonians for decades to come, not just on those that are deemed "shovel ready." I recommend prioritizing projects that will enhance our resilience to future disasters and economic tumult, such as expanding broadband internet access, constructing more affordable housing, upgrading water infrastructure, or building seismic and wildfire alert systems.
- Remember that our tradition of maintaining a maximum debt capacity of 5% General Fund debt service to General Fund revenue has served us well but is not set in stone. Rating agencies are interested in prudent financial management, not dogma. With interest rates so low and economic need so high, when making decisions about our long-term debt capacity, it would be prudent to exceed the 5% guideline modestly if we have worthy projects that meet the criteria described in the previous bullet.

Thank you for your attention and your commitment to Oregon's future. Please do not hesitate to reach out with questions about Oregon Treasury's debt management program.

Sincerely,

Tobias Read