



TESTIMONY OF DEPUTY STATE TREASURER LAWRENCE A. WILSON
SUBMITTED TO THE FINANCE, REVENUE AND BONDING COMMITTEE
APRIL 25, 2017

Good morning, Senator Fonfara, Senator Frantz, Representative Rojas, Representative Davis and members of the Finance, Revenue and Bonding Committee. I am Larry Wilson, Deputy State Treasurer, and with me are Sarah Sanders, Assistant Treasurer for Debt Management, and David Ardayfio, Managing Director at Barclays. We are here on behalf of Treasurer Denise Nappier. Thank you for the opportunity to submit testimony in support of Treasurer Nappier's proposal to rebuild the Rainy Day Fund and lower borrowing costs, as presented in Raised Bill 7321, *An Act Establishing a Credit Revenue Bond Program*, through creation of a tax-secured bonding program.

We all know that the State faces fiscal challenges. In an effort to help address those challenges, we examined opportunities within the Treasury's areas of responsibilities, and identified these tax-secured bonds as a promising new tool that could help improve the State's fiscal health. The approach is consistent with our tradition of prudent debt management that has included more than \$1 billion in debt service savings from our refunding of outstanding debt to take advantage of lower interest rates during Treasurer Nappier's administration.

The bonds would be backed by a dedicated portion of the State's personal income tax revenues, a market-tested practice used successfully in other states. This structure would capitalize on the State's high wealth levels and insulate the bonds from budget and pension concerns, thereby earning higher credit ratings and lowering borrowing costs. The plan should reverse the trend we have seen over the last few years with the State's General Obligation credit, where ratings have slipped and relative borrowing costs have increased.

Before delving into the details, we would like to emphasize that these tax-secured bonds would be issued in lieu of, not in addition to, General Obligation bonds. Nothing in this proposal would increase the State's total borrowing. Decisions on borrowing levels would continue to reside with the General Assembly, Governor and Bond Commission. Our proposal, however, would give our Office a new and lower cost method of funding capital project decisions.

I would like to summarize four attractive elements of this legislation:

1. The establishment of a new tax-secured bond program should earn credit ratings that are two to three levels above current General Obligation credit ratings, targeted in the high double A to triple A categories, by giving investors first call

on the State's stable and strong personal income withholding tax revenue stream for repayment of the bonds.

2. Higher credit ratings should increase investor demand, which in turn would lower borrowing costs. We believe these tax-secured bonds would be especially attractive to investors who may have reached capacity limits for our General Obligation bonds or have concerns about the State's budgetary and pension challenges.
3. Debt service savings generated from the program would be dedicated to rebuilding the Rainy Day Fund. Preliminary estimates indicate that the State could realize nearly \$980 million in cumulative deposits to the Rainy Day Fund through Fiscal Year 2029, assuming a level of borrowing consistent with the current average annual sales of General Obligation bonds and a bond structure commonly used for tax-backed revenue bonds.
4. A commitment to funding the Rainy Day Fund explicitly addresses an ongoing concern of the major credit rating agencies. Solid progress on this front would improve our General Obligation credit ratings and improve borrowing costs for General Obligation bonds over time, allowing us down the road to choose the best tool to go to market with on a case-by-case basis.

This tax-secured bonding program would adhere to the State's borrowing, budgetary and governance processes and restrictions. The bonds would be subject to the State's debt cap and the same legislative authorization and Bond Commission approval process.

Moreover, the State's process for budgeting General Fund revenue and debt service and total amounts actually budgeted would not be materially affected. Personal income taxes and debt service would continue to be budgeted in the General Fund, just as they are with General Obligation bonds.

The bill, as currently drafted, contains two bond covenants: One would require that the savings be sent directly to the State's Rainy Day Fund and the other would limit withdrawals from the Fund to existing statutorily-authorized uses, which primarily is to cover a prior year deficit.

While Treasurer Nappier believes that those provisions would strengthen the program's stated purposes -- to rebuild the Rainy Day Fund and lower borrowing costs -- she is of the position that the General Assembly should decide whether to include

them as covenants or as statutory language for flexibility in the final version of the legislation.

The legislation also has a statutory provision that requires bond premium be used to fund previously authorized capital projects, beginning with the fiscal year starting July 1, 2019. Using premium to fund capital projects in both the General Obligation and tax-secured bonding programs would reduce the amount of bonds that would need to be issued for those projects. Over the long term, this would lower debt levels and debt service costs. An estimated \$757 million less debt would be issued over a five year horizon if this provision were adopted.

While she supports this approach to prudent debt management, Treasurer Nappier recommends giving the legislature the flexibility and authority to decide how to apply premium -- whether to pay project costs, reducing debt issued, or pay debt service -- with each biennium budget.

We appreciate the Committee raising this bill, and thank you for the opportunity to testify in support of this promising tax-secured bond program. We would be pleased to address any questions.