

State of Oregon
Department of Environmental Quality

Memorandum

Date: Feb. 26, 2013

To: Environmental Quality Commission

From: Dick Pedersen, Director

Subject: Agenda item D, Action item: Refunding of selected DEQ Pollution Control Bonds March 20-21, 2013, EQC meeting

Why this is important By adopting the resolution seen in attachment A, the commission would authorize the Department of Environmental Quality and the State Treasurer to issue and sell State of Oregon General Obligation Pollution Control Bonds to “refund” existing 2003A series Orphan Site Cleanup Bonds. This action would allow the state to take advantage of lower interest rates and reduce future debt service obligations. If the resolution is approved, DEQ and the State Treasurer could proceed to sell the Bonds as early as April 2013.

Need for EQC action Under ORS 286.033, state agency issuance of bonds requires a resolution of the agency’s governing body. The commission’s resolution will give DEQ the authority to authorize both the issuance of bonds and the use of bond proceeds under ORS 468.195 to 468.260.

DEQ recommendation and EQC motion DEQ recommends that the commission adopt the resolution seen in attachment A authorizing DEQ and the State Treasurer to refund the 2003A Orphan Bond Series, provided that the refunding meets the savings target as set out in this agenda item, and provided the refunding occurs in the 2011-13 biennium.

Background DEQ has used bonding for several decades to finance solid waste disposal facilities, municipal sewage treatment facilities, water pollution control facilities and cleanup of contaminated “orphan sites.” DEQ works with financial advisors, bond counsel and the state treasurer in issuing and selling bonds. For a more detailed explanation of the uses and history of pollution control bonds, please see attachment B.

The current low interest rate environment is conducive to refinancing existing bonds that have higher interest rates. For bonds, the technical term is refunding, which refers to replacing old debt with new debt at lower interest rates, without materially increasing the term of repayment. The net result is that the repayment timeframe remains the same, but with a lower average interest cost.

DEQ’s financial advisors and bond counsel have assessed the agency’s bond portfolio and have identified one specific bond issue, the 2003A Orphan Bond

issue as a potential candidate for refunding.

Most bonds sold by DEQ have a “call” feature, allowing the state to retire the bond early, without penalty, after some period of time, but before the maturity date. Bonds that are currently within their call period, usually after ten years of issuance for DEQ bonds, when refunded are termed “current” refunding. Bonds that haven’t yet reached their call date fall under the category of “advance” refunding, which have specific additional provisions mostly surrounding the requirement to continue paying current bond holders the original interest rate until the call date of the old bond. The Oregon State Treasury requires that an “advance” refunding must achieve at least three percent aggregate savings (under OAR 170-062-0000). A “current” refunding has no such minimum savings requirement.

DEQ proposes to proceed with a “current” refunding strategy to concentrate debt service savings in the upcoming 2013-15 biennium, and will proceed only if the net interest savings with future debt service are more than \$50,000 for that series.

Taking into account bond market conditions as of Feb. 1, 2013, a “current” refunding of the 2003A Orphan Bond Series is estimate to cut remaining interest payments roughly in half, generating \$261,000 of savings over the remaining ten-year life of the bond series. These savings reduce the general fund requirement for debt service on these bonds.

The timing of the savings will depend upon how DEQ structures the revised debt service schedule. The final amount of savings will vary daily with market interest rates. Between now and the sale date, bonds may move into or out of contention for refunding.

Key issue	Approval of this bond sale will allow DEQ to realize debt service savings on existing bonds. Lower debt service payments will reduce DEQ’s use of general funds for payment of debt service. It is uncertain if the General Fund savings will simply revert back to the state, become available to fund other DEQ work or forestall potential future General Fund reductions.
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EQC action alternatives	If the commission does not adopt the resolution, refunding of the existing bonds cannot proceed, and DEQ will continue making bond debt service payments under the existing interest rates and schedules. The opportunity to realize debt service savings may be lost or deferred to some future date when interest rates are again favorable for refunding.
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Attachments	A. Resolution Authorizing and Requesting Issuance of Bonds
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B. Pollution Control Fund and State Pollution Control Bonds

Approved:

Division: _____

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RESOLUTION AUTHORIZING AND REQUESTING ISSUANCE OF BONDS

Section 1. Findings. The Environmental Quality Commission of the State of Oregon finds:

- A. The Department of Environmental Quality (the "Department") may be empowered, by resolution of the Environmental Quality Commission, to authorize and request the issuance of general obligation pollution control bonds for the purpose of refunding \$2,360,000 par amount of the 2003A Orphan Bond Series;
- B. It is now desirable to authorize and request the issuance of general obligation pollution control bonds for this purpose.
- C. Oregon Revised Statutes, Section 286.031, provides that all bonds of the State of Oregon shall be issued by the State Treasurer.

Section 2. Resolutions. The Environmental Quality Commission of the State of Oregon hereby resolves:

- A. The State Treasurer of the State of Oregon is hereby authorized and requested to issue State of Oregon general obligation pollution control bonds ("Pollution Control Bonds") in amounts that the State Treasurer determines, after consultation with the Director of the Department or the Director's designee, will be sufficient to provide funding for the purposes described in Section 1.A of this resolution, and to pay costs associated with issuing the Pollution Control Bonds. The Pollution Control Bonds may be issued in one or more series at any time during the 2011-13 biennium, mature, bear interest, be subject to redemption, and otherwise be issued and sold upon the terms established by the State Treasurer after consultation with the Director of the Department or the Director's designee.
- B. The Department shall comply with all provisions of the Internal Revenue Code of 1986, as amended (the "Code") that are required for interest on tax-exempt Pollution Control Bonds to be excludable from gross income under the Code, and shall pay any rebates or penalties that may be due to the United States under Section 148 of the Code in connection with the Pollution Control Bonds. The Director of the Department or the Director's designee may, on behalf of the Department, enter into covenants for the benefit of the owners of Pollution Control Bonds to maintain the tax-exempt status of the Pollution Control Bonds.

Section 3. Other Action. The Director of the Department or the Director's designee may, on behalf of the Department, execute any agreements or certificates, and take any other action the Director or the Director's designee determines is desirable to issue and sell the Pollution Control Bonds and to provide funding for the purposes described in this resolution.

Pollution Control Fund and State Pollution Control Bonds

The **Pollution Control Fund** is authorized in statute (ORS 468.215) to separately account for the receipt and expenditure of **State Pollution Control Bonds**.

State Pollution Control Bonds are authorized under Article XI-H of the Oregon Constitution, which empowers the state “to lend credit for financing pollution control facilities or related activities.” Indebtedness can be incurred to provide funds “for the purpose of planning, acquisition, construction, alteration or improvement of facilities for or activities related to, the collection, treatment, dilution and disposal of all forms of waste in or upon the air, water and lands of this state.” It allows funds to be advanced “by contract, grant, loan, or otherwise” to state agencies and local units of government. It also permits the state to purchase financial instruments issued by units of local government, to enable them to take advantage of the state’s credit rating in financing pollution control facilities. Article XI-H was adopted in 1970 and amended in 1990.

Authorized Uses of the Pollution Control Fund

The Department of Environmental Quality is responsible for the administration of the Pollution Control Fund. ORS 468.220 authorizes its use for several purposes, including:

- Financing municipal sewage treatment facilities or sewerage systems (as defined in ORS 468B.005), and related planning
- Financing local government solid waste disposal facilities and related planning
- Funding the Orphan Site Account for the cleanup of contaminated sites where the responsible party is either unknown, unwilling, or unable to pay for necessary cleanup
- Funding the Assessment Deferral Loan Program Revolving Fund, which funds local government financial assistance programs associated with water pollution control projects, typically to homeowners who can’t afford increased assessments
- Providing matching funds for federal grants made available to capitalize the Water Pollution Control Revolving Fund, commonly called the Clean Water State Revolving Loan Fund or SRF.

Historical and Current Uses of the Pollution Control Fund

The Fund was used in the 1970s and 1980s to finance solid waste disposal facilities and municipal sewage treatment facilities. Those debts have been retired. In the early 1990s, State Pollution Control Bonds were issued to provide funds to purchase debt issued by the Cities of Portland and Gresham to finance water pollution control facilities, and to establish a Sewer Assessment Deferral Loan Program. As of 2004 all these Bonds had been fully paid out.

Bonds have been issued since the early 1990s primarily to provide funding for the Clean Water State Revolving Loan Fund, and the Orphan Site Account. The attached “Pollution Control Bonds History and Status” chart shows the amounts issued and outstanding for each of these programs.

Repayment of Bonds Issued

The Oregon Constitution (Article XI-H) allows for repayment of Pollution Control Bonds through an ad valorem tax to be levied on all taxable property in the State. The tax has never been levied, and bond debt has been serviced with diverse funding: repayments of loans from the Water Pollution Control Fund, Assessment Deferral Loan Revolving Fund, and the Clean Water State Revolving Fund; General Fund and Lottery appropriations; fees levied specifically to repay Orphan Site debt; payments of interest and principal from municipalities whose bonds were purchased by the state; and user fees on borrowers. Funds used for debt service, except General Fund and Lottery, are deposited to and expended from the **Pollution Control Sinking Fund**, as directed by ORS 468.230.

Accounting for Bonds and Debt Service

Proceeds from the sale of Pollution Control Bonds are deposited to the Pollution Control Fund. Each bond issue is tracked separately. Similarly, funds received for repayment of bond issues (except General Fund and Lottery) are deposited to the Pollution Control Sinking Fund, and tracked by bond issue. Maintaining separate funds for bond proceeds and debt payments (sinking fund) is standard government accounting practice. Some additional accounting practices are mandated by statute for the Orphan Site Account, at least in part to ensure that no cost recoveries from responsible parties are used for debt service. This additional control was established to ensure that bond administration meets IRS tests for tax free bonds.