

HOW CERTIFICATES OF PARTICIPATION WORK FOR OREGON

What are Certificates of Participation or COP's?

COP's are tax-exempt government securities used to raise funds to improve and construct buildings or purchase equipment. COP's are used to finance capital costs related to construction or acquisition and may not be used to finance ongoing operating costs. COP's are sold to investors who like the good credit quality of Oregon. In return, the investors receive COP payments which include interest income that is exempt from federal and Oregon income tax. COP's are used very selectively in Oregon to implement projects essential to delivering public services.

How do COP's differ from general obligation bonds?

General obligation bonds are secured by the full faith and credit of the government issuing them. The government's taxing powers may ultimately be called upon to repay the bonds. In Oregon, general obligation bonds are authorized by amendments to the Oregon Constitution. COP's on the other hand, are not secured by the full faith and credit of the issuer. Instead, in Oregon the Legislature must approve the COP repayment amounts prior to each biennium for which payments are scheduled. In other words, the Legislature could deny a budget request to make the COP payments scheduled for a future biennium. As a legal consequence in that event, the state would be denied use of the building(s) or the equipment financed by the COP's whose payment had been denied.

The estimated difference in repayment costs between an Oregon general obligation bond and an insured COP is summarized below. A comparison of the use of both forms of financing of a \$100 million project that would be repaid over 20 years produces the following estimated costs, assuming market rates as of November 2002.

<u>Financing Tool</u>	<u>True Interest Cost</u>	<u>Est. Total Payments</u>
<i>General Obligation</i>	4.28%	<i>\$151.44 million</i>
<i>Insured COP</i>	4.31%	<i>\$151.78 million</i>

The present value of the difference in the total repayment amounts is about \$2,105.

Oregon Supreme Court validated the COP authority.

On December 4, 1989, the Oregon Supreme Court dismissed a case challenging the constitutionality of the Oregon COP authority passed into law by the 1989 legislative session.

Oregon has strong controls on the use of COP's.

Oregon law and the COP Program procedures provide a strong structure to process requests for financing projects by state agencies. The Department of Administrative Services (DAS) manages the COP Program as a central service function. It operates as part of the Budget and Management Division's, Capital Investment Section. Centralized control assures that COP's are only used for projects approved by the Legislature and the Executive Branch.

The COP financing request is a four step process that begins every two years as part of the state budget preparation.

Step one starts with agencies responding to a survey asking them to identify all project requests they recommend be financed. COP financing requests are evaluated in terms of the type of project and appropriateness of the use of COP financing. The requests are then considered within the context of the agency's total budget, source of funds for repayment and the Governor's policy and spending priorities. This review determines which requests are included in the Governor's recommended budget.

Step two is the legislative budget review process. The project and financing requests are presented as part of each agency's comprehensive budget. Either the project or the financing request can be denied at this stage of the review.

Step three provides the Legislature a second look at the COP financing authority requests as part of the debt limit legislation required by ORS 286.525. This review is usually scheduled late in the session to give legislators the "big picture" view of the individual COP financings approved in the agency budget review process. This look considers the financings within the context of the total COP, general obligation and revenue bond authority the Legislature has been requested to approve for the upcoming biennium.

Step four controls the use of COP's throughout the course of the biennium. The express approval of both the State Treasurer and the DAS Director is required as part of the issuance of COP's to finance approved projects. This step provides a safeguard in the event circumstances have changed between the budget approval and the time financing is requested.

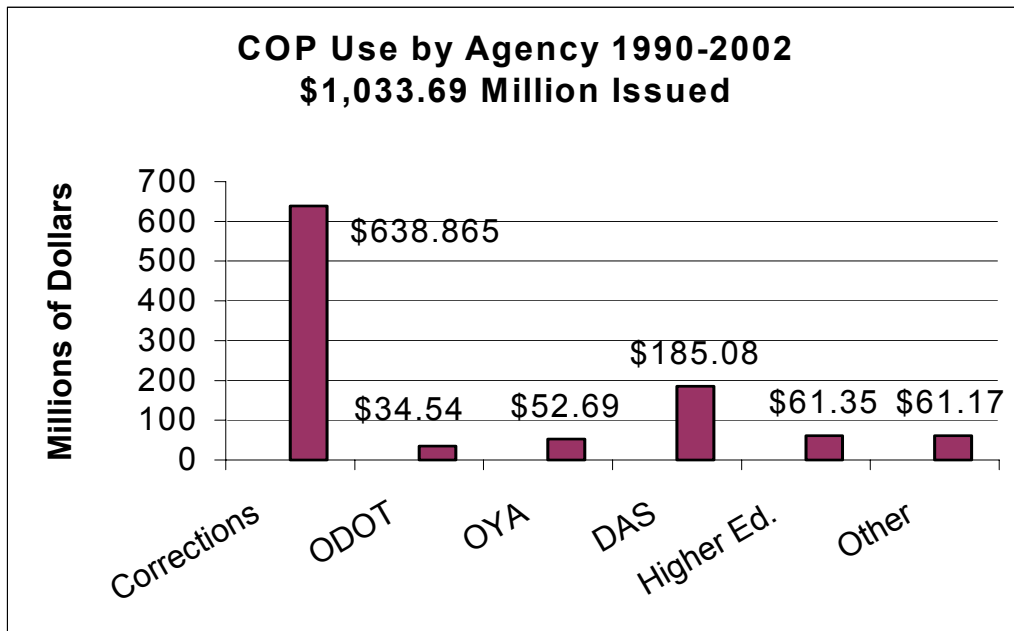
The attached exhibit A shows the process the Legislature and Executive Branch uses to control the use of state COP's.

Oregon has been very selective in its use of COP's.

During the period from 1990 through October 31, 2002, Oregon has sold \$1,033.69 million new issue COP's. The proceeds have for the most part financed projects for four core purposes. The chart below illustrates that 67% of COP funds have been used for **public safety** (Corrections 62% and Youth Authority 5%), **transportation** (3%), **higher education** (6%), and **central services** (24%) projects. A large share of the financing for central services projects was used to remodel and construct office space in Salem and

Portland. Those projects include the Public Service Building, the Public Utility Commission Building, and the Human Resource Building in Salem.

The “Other” category on the chart is made up of agencies whose total use is less than 6% of all the COP’s issued to date. It includes agencies such as Fish and Wildlife, Forestry, Employment and PERS.



How many COP’s are currently outstanding?

As of November 15, 2002, a total of \$808.15 million of COP’s issued under ORS 283.085 were outstanding.

How many additional COP’s can be issued?

The Oregon Debt Policy Advisory Commission addressed debt capacity models in its April 1, 2002 annual report. The report recognized debt programs as either **net tax-supported** or **non tax-supported**. Certificates of Participation are included as net tax-supported obligations. The other Oregon bond programs in the net tax-supported class include:

- Higher Education Facility & Community College Bonds;
- Eighty-five percent of Pollution Control Bonds;
- Water Resource Bonds;
- State Highway Bonds;

- School Bond Guaranty;
- Highway User Tax Revenue bonds;
- Oregon State Fair & Exposition Center Bonds.

The Commission took a position on debt capacity based on the determination that maintaining net tax-supported debt service requirements below a target ratio of five percent of general fund revenues will allow the State to maintain its favorable debt standing in financial markets. This position translates into an available capacity to issue an average of \$500 million additional net tax-supported obligations per year over the next four years. This capacity applies to net tax-supported obligations as a whole. As stated in the Commission's report, specific amounts of each net tax-supported program's use are a decision left to future budgetary and legislative actions.

Some advantages COP's offer.

Financing spreads the capital costs of projects of over several years. Often the current general funds of the state can handle the cost of repaying the financing over time, but not the outright purchase price of essential facilities or equipment. In effect, the financing leverages general fund revenues to acquire the resources needed to implement cost effective or mandated projects today.

Some of the capital costs of providing an asset such as a prison are spread to future public beneficiaries of the asset. This matches public user benefits to public user charges over time.

The state's decisions to finance the acquisitions of office space for essential agency operations will save money over the lives of the buildings. The buildings Oregon has constructed using COP's are expected to have useful lives between 40 to 60 years. The financings will be fully repaid over the first 20 to 25 years. Over the balance of its useful life the state will own the property free and clear.

Just like Oregon general obligation and revenue bonds, the interest received by COP investors is exempt from both federal and Oregon income taxes. Hence, the interest rate is lower than conventional financings. As an example, the 25 year financing for the purchase of the land to build the Oregon State Police crime lab executed in May 2002 has an annual total rate of 4.13%. The interest rates and payment amounts are fixed over the period of the repayment.

The central management of the COP Program provides several strengths. Central management helps assure the financings are consistent with approved budgets. Using financing documents that include uniform provisions that protect the state's best interests also serves state agencies that are unfamiliar with the public finance sector. The COP approval and issuance work is a team effort. The user agency, budget analysts, assistant attorney generals, Treasury, bond counsel, legislative fiscal officers, and others work together to achieve cost effective financing terms for projects approved by the legislature.

COP responsibilities exist through the life of the financing.

Oregon's responsibilities extend beyond the COP approval and issuance phases.

Key responsibilities include:

- Investing proceeds during project implementation to maximize earnings;
- Tracking, calculating and documenting earnings and fund use to comply with federal arbitrage regulations;
- Continuing disclosure of certain financial information annually;
- Timely disclosure of certain material events specified by the Securities and Exchange Commission;
- Complete and timely COP payments as approved by the Legislature;
- Retaining adequate property loss insurance on the assets pledged.

Additional information regarding Oregon COP's can be obtained from Greg Jeffrey, Finance Manager, Department of Administrative Services, (503) 378-3107.

EXHIBIT A

CERTIFICATES OF PARTICIPATION LEGISLATIVE REVIEW AND CONTROL PROCESS

<p>Step One:</p> <p>REQUEST</p> <p>Projects are proposed by agencies as part of their budget request to the Department of Administrative Services.</p>	<p>ACTION</p> <p>Requests are analyzed and either denied or recommended in Governor's budget.</p>
<p>Step Two:</p> <p>REQUEST</p> <p>Each recommended project is presented to Legislature for approval as part of agency budget and/or the Capital Construction Bills.</p>	<p>ACTION</p> <p>Legislature makes two decisions on every project:</p> <ul style="list-style-type: none">- Project approval or denial- Financing approval or denial
<p>Step Three:</p> <p>REQUEST</p> <p>The total COP financing authority for the biennium is requested for projects approved for financing in Step Two. Comprehensive bond limit bill, HB 2345 2003 session.</p>	<p>ACTION</p> <p>Legislature confirms its decision to approve individual project financings within the context of the total COP authority approved for the biennium.</p>
<p>Step Four:</p> <p>REQUEST</p> <p>Issue COP financings during the course of the biennium.</p>	<p>ACTION</p> <p>Confirmation by Budget Analysts and User Agency that project is still appropriate. Approval by Treasurer and DAS Director is required.</p>