State of Rhode Island
Office of the General Treasurer
State House – Room 102
Providence, Rhode Island 02903

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| DATE: | July 3, 2020 |
| TO: | Sharon Reynolds-Ferland, House Fiscal Advisor |
| | Stephen Whitney, Senate Fiscal Advisor |
| CC: | Jonathan Womer, Director, Office of Management and Budget |
| | Thomas Mullaney, Director, Budget Office |
| FROM: | Treasurer Seth Magaziner |
| RE: | Bonding in FY21 Budget |

Dear Colleagues:

The Covid-19 crisis has spurred the most severe recession our state has experienced in nearly a century, with more than 100,000 Rhode Islanders unemployed, thousands of small businesses on the brink of closure, and significant stress to the state's finances.

At the request of the Budget Office and Legislative Fiscal Offices, our Office has produced an updated set of recommendations for the amount and purpose of bonding to be included in the FY2021 budget. The key conclusions are:

- In addition to the $387.6 million of proposed borrowing in the Governor's recommended budget, we recommend the General Assembly consider including an additional $200 million of bonding in the FY21 budget for the purpose of spurring recovery from the current economic and health crisis.

- We recommend that the proceeds for all bonding be directed toward programs to support the recovery of Rhode Island's economy, to support those Rhode Islanders that have been most impacted by the Covid-19 recession, and to protect Rhode Islanders from future pandemics. This should include initiatives to contain the spread of Covid-19,improve public health, assist dislocated workers in finding employment, provide services to those communities that have been hardest hit by the virus, and support a broad economic recovery for our state.

- Our office finds this level of borrowing to be reasonable and affordable under the state's debt affordability guidelines. Additionally, we project that the proposed level of bonding will leave significant capacity for further bonding in future budget cycles.

**Background**

Rhode Island's economy faces a critical state with over 100,000 workers unemployed, thousands of small businesses on the brink of collapse, and significant stress to the state's finances. While economic activity is likely to increase somewhat as the state implements phased re-opening, many of the jobs that were lost will not return for an extended period of time, and some will never return, leaving many Rhode Islanders in a state of severe economic hardship.

The state can play a valuable role in spurring economic activity and assisting those who are experiencing financial stress. Unemployed Rhode Islanders can be offered temporary jobs to assist in the Covid-19 response, as well as job training to allow them to gain long-term employment in higher wage jobs. Others can be put to work on shovel-ready construction projects. Assistance can be offered to the hardest hit communities to ensure that Rhode Islanders experiencing Covid-19 related hardships remain housed and secure. Support can be provided to small businesses to assist with the re-opening process and adaption to social distancing guidelines.

Due to the leadership of Rhode Island's Congressional Delegation, our state received $1.25 billion of aid through the federal CARES Act, and there is hope that additional federal aid could be forthcoming. However, the extent of the economic and health crisis is so great, that even increased federal aid may not be sufficient to meet the urgent needs face by Rhode Islanders. Other financing tools must also be considered.

Long-term borrowing is typically employed by states and municipalities to smooth the cost of large capital projects such as schools, roads, and affordable housing, over multiple budget years. There is no shortage of shovel ready capital projects of public importance that the state could invest in now to employ workers and prime the economy.

Additionally, while bonding for non-capital costs is less common, it can be allowable and appropriate if the programs being supported are likely temporary in nature. Precedents include Rhode Island bonding during the credit union crisis to make depositors whole[1], the state of Missouri bonding to train workers for new job openings[2], and the state of Ohio bonding to provide bonuses to war veterans[3].

Given current conditions, the state can consider bonding for non-capital expenses, on a tax-exempt or taxable basis, as permitted by law, for temporary expenses related to the health or economic response to the Covid-19 crisis. Such initiatives could include, but not be limited to, temporary employment and workforce training for Rhode Islanders unemployed due to Covid-19, temporary assistance to help Rhode Islanders with a Covid-19 hardship remain housed, and targeted support to help small businesses adapt to Covid-19 guidelines. Bonding for non-capital expenses related to these purposes is permissible, but only to the extent those expenses are temporary in nature.

**Affordability Guidelines**

While bonding can be a useful economic tool for Rhode Island, particularly during times of recession, it is important that the state not borrow beyond its means.

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[1] https://www.nytimes.com/1992/05/28/business/rhode-island-plans-payout-in-deposit-insurance-crisis.html

[2] "Strategies for Financing Workforce Intermediaries", the National Fud for Workforce Solutions, Edited by heath Prince, July 2007

[3] https://ballotpedia.org/Ohio_Bonds_for_Veterans,_Amendment_1_(2009)

The Public Finance Management Board (PFMB) adopted a series of guidelines to determine affordable levels of state borrowing in 2017, updated in 2019. Under PFMB guidelines, there are four recommended limits to state borrowing:

- Annual debt service costs should be limited to 7% of general revenue,
- Total debt should not exceed 4% of state personal income,
- Combined annual debt service, pension costs and OPEB costs should not exceed 18% of general revenue, and
- Combined debt, pension and OPEB liability should not exceed 12% of state personal income

Importantly, the PFMB guidelines also state that these limits may be temporarily exceeded in times of recession: "the recommended liability limits, may be exceeded from time to time due to unforeseen events such as recession, natural disaster or other emergency."[4]

**Projections:**

As previously noted, our office deems $200 million of bonding in addition to the Governor's original proposed $387.6 million, to be affordable and reasonable under state guidelines. Enclosed you will find a debt affordability projection for this amount of new borrowing relative to the PFMB's affordability guidelines.

In this projection we assume a 3.5% interest rate, a conservative assumption that is higher than the current market rates for AA rated tax-exempt and taxable bonds.

| Type of Bond (20 Year) | 7/1/2020 Estimated Total Interest Cost |
|---|---|
| AA General Obligation Tax-Exempt | 1.68% |
| AA General Obligation Taxable | 2.86% |
| AA- Appropriation Tax-Exempt | 1.78% |
| AA- Appropriation Taxable | 2.96% |

The projection shows that under this level of new borrowing, three of the four PFMB affordability thresholds are never exceeded. The fourth affordability threshold, Debt Service as a percent of Revenue, is exceeded only slightly, by just 0.12%, for one year. Given that the PFMB guidelines state that limits may be temporarily exceeded in times of recession, this amount of new borrowing is clearly reasonable and acceptable.

Importantly, the projection also shows significant capacity for additional bonding to be proposed in the FY23 budget and beyond without breaching any affordability guidelines, with more than $2 billion of additional borrowing capacity projected to remain over the next decade.

**Recommendation:**

Given the severity of the current health and economic crisis, the Office of the General Treasurer recommends that the General Assembly consider an additional $200 million of bonding in addition to the Governor's original request, provided that all borrowing be for projects and initiatives deemed most impactful for combating the spread of Covid-19, catalyzing economic recovery, and supporting those Rhode Islanders facing hardships as a result of the epidemic.

[4] 2019 PFMB Debt Affordability Study, p. 28