STATE AND LOCAL INFRASTRUCTURE FINANCING OPTIONS

TOPIC AGENDA / ASSOCIATED FISCAL DIVISION REPORTS

Prepared for the
Legislative Finance Committee

By
Cathy Duncan

September 6, 2018

MONTANA LEGISLATIVE FISCAL DIVISION

INFRASTRUCTURE TOPICS AGENDA

Afternoon of 9/6/2018

1:00 – Introduction – Cathy Duncan, LFD Senior Analyst
    Introduction Report – Attachment 1

1:15 – Topic 1: State Government Infrastructure, State Buildings
    Review of June Report / Items of LFC interest – Attachment 2
    LRBP Revolving Fund – initial funding – Attachment 3
    Financial Concepts Matrix (state and local concepts) – Attachment 4

1:30 – Financial Concepts Panel
    Participants:
        David Ewer, Executive Director, Board of Investments
        Adam Gill, Executive Director, Facility Finance Authority
        Jonathan Heroux, Managing Director, and Marc Ragan, Asst. Vice President, Public Finance - Piper Jaffray & Co. (State Financial Advisor)

2:15 – Legal analysis of financial concepts
    Julie Johnson, Attorney, Legislative Legal Services Office – Memo

2:45 – Topic 2: State Bonding Comparison
    General fund general obligation bonds – Cathy Duncan – Attachment 5
    Debt comparisons – Jonathan Heroux, Managing Director, and Marc Ragan, Asst. Vice President, Public Finance, Piper Jaffray & Co. (State Financial Advisor)

3:15 – Topic 3: Local Government Infrastructure Funding
    Existing local infrastructure funding programs – Attachment 6

3:30 – Local Infrastructure Funding Panel
    Participants:
        Eric Bryson, Executive Director, Montana Association of Counties (MACo)
        Tim Burton, Executive Director, MT League of Cities and Towns
        Daryl James, Executive Director, MT Infrastructure Coalition

4:00 – Coal Severance Tax Trust – Sam Schaffer, Senior Fiscal Analyst – Handout

4:30 – Next Steps

ATTACHMENT 1 – INTRODUCTION

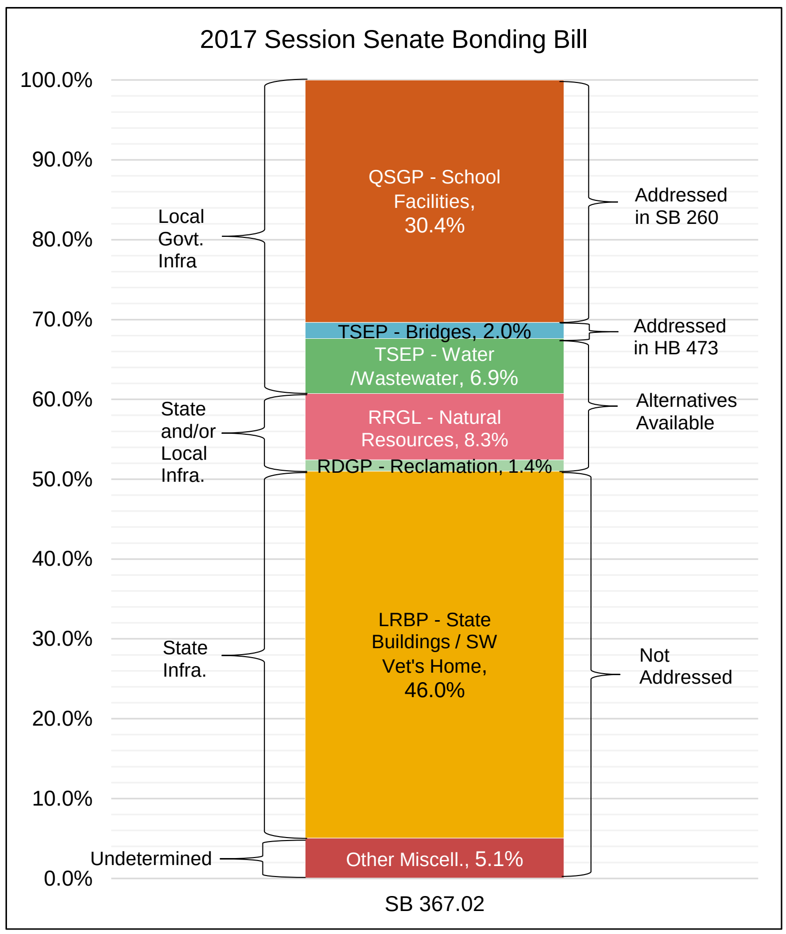
In the 2017 session, the executive and legislature introduced several pieces of legislation that would have funded the construction of state buildings and other local government infrastructure projects with the proceeds of bond issues. None of the bills were passed during the session.

Combining funding of state and local projects with bond proceeds has marked a recent change in practice, as the legislature considered assuming debt to finance local government infrastructure. In each of the pieces of legislation the focus was on increasing funding for Long-Range Planning (LRP) programs, a set of programs developed over time to fund the maintenance and construction of state buildings along with local government water, wastewater, bridges, land reclamation projects, and school facilities shown in the figures as:

- LRBP – Long-Range Building Program
- RDGP – Reclamation and Development Grant Program
- RRGL – Renewable Resource Grant and Loan Program
- TSEP – Treasure State Endowment Program
- QSGP – Quality School Facilities Grant Program

This combination of bond proceed use has been unsuccessfully attempted in the last two sessions.

The adjacent figure shows the funding, as a percentage of the total bonding, in the Senate version of SB 367 from the 2017 Session. Additionally, on the right-hand side the chart shows those areas where new funding was provided in other legislation, where there are alternatives available to meet the funding needs[1], and the funding that was ultimately unmet in any other way.



Aside from the traditional dedicated funding for LRP programs, the 2017 Legislature enacted funding increases for two types of infrastructure that included:

- SB 260 - created a new trust to fund the construction and maintenance of school buildings
- HB 473 - increased gas and diesel taxes, much of which will flow to local governments (repairs, maintenance, replacement, or construction of bridges)

[1] Available funding alternatives include low interest loans and grants from state and federal infrastructure (water and wastewater) programs. The RRGL program frequently includes funding for natural resource (including irrigation) projects that would not qualify for loans from the water and wastewater loan programs. Typically, these types of projects can access loans that are provided in HB 8, the Renewable Resource Loan Program funding legislation. In the 2017 biennium HB 8 was not passed. The information is not easily disaggregated, but many of the projects that were not funded through the bonding legislation were for water and wastewater infrastructure projects.

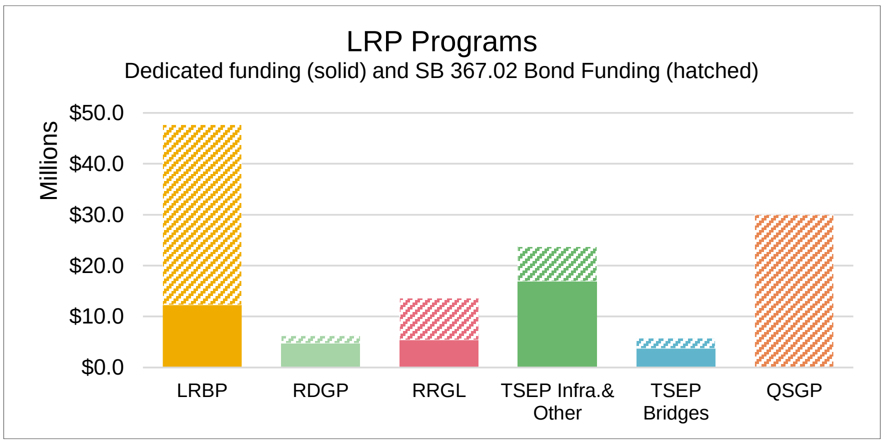
Alternative Funding is available for water, wastewater, natural resource, and remediation projects:

- Numerous grant and loan programs (see the Financial Assistance Programs for Water, Wastewater, and Solid Waste Projects in Montana attachment to this report)

Not addressed (51% of SB 367.02) in other legislation or from other sources of funding were:

- State Buildings
- Other Miscellaneous funding (there were no specific projects related to the funding)

While the bonding bill failed, most of the LRP programs were provided with appropriations from their dedicated revenue streams in the 2019 biennium. Consequently, while many of the projects in SB 367 were not funded with state dollars, there were similar projects that did receive funding. The figure below demonstrates the funding that was available for these programs, as shown in the solid portion of the bars, along with the additional funding that would have been provided in SB 367.02, as shown in the hatched portion of the bars.



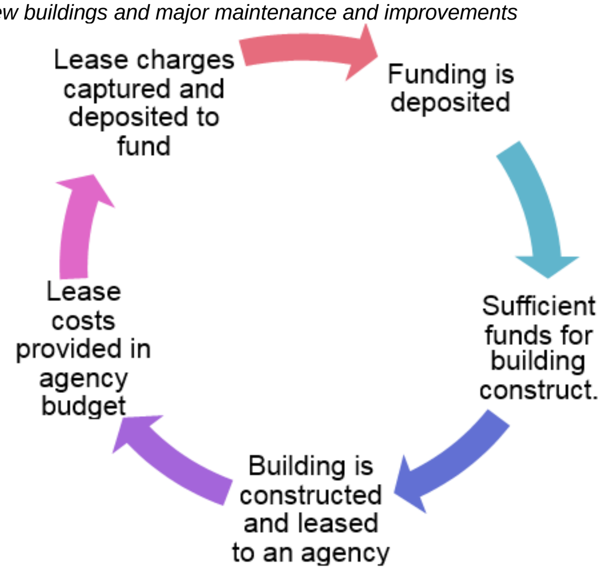
Notable in the figure above is the contribution of bond proceeds to the LRBP and the QSGP. The LRBP has funds that are generally used for major capital maintenance projects in existing state buildings[2]. However, the program revenues are generally not sufficient to provide for new construction, significant repair projects, or additions. The bond proceeds would have provided for those larger projects. The funding for the QSGP was not sufficient to support all of the account obligations. As a result, K-12 facility projects would only have been funded in the 2019 biennium with bond proceeds. In future years, such projects will be funded through a new Education Trust, as developed in SB 260.

[2] The LRBP fund typically supports the major maintenance on state buildings for those agencies with budgets that are funded primarily with general fund dollars.

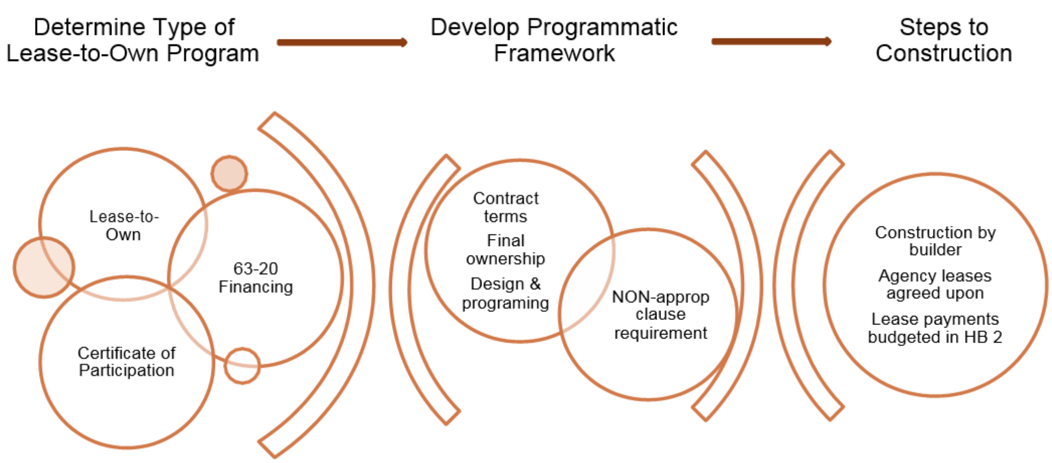
ATTACHMENT 2 – CONCEPTS OF COMMITTEE INTEREST

Below are the state building funding concepts of continued interest to the LFC following the June meeting. Further information is found in the matrix of Attachment 4.

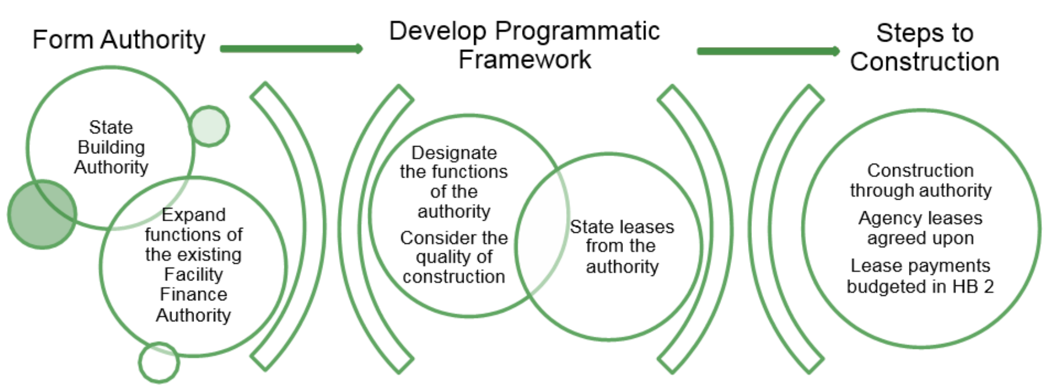
1. Revolving Capital Projects Fund (Pay-as-You-Go and Lease Concepts):
Program applicable for new buildings and major maintenance and improvements



2. Lease-to-Own Concepts:



3. Public Authority Bonding:



ATTACHMENT 3 – LRBP REVOLVING CASH PROGRAM CONCEPT

The state uses revolving funds for several state programs, including the State Revolving Fund (SRF) drinking and wastewater programs and the State Building Energy Conservation Program (SBECP). This concept may be more applicable to lower cost projects such as additions and renovations of buildings, which has/will become a greater need as the state's building inventory ages. The major consideration for such a program is the determination of an initial revenue stream to begin the revolving function. Later in the program, leases for the buildings would be recaptured and the lease payments recirculated into new projects. This concept could take a substantial amount of time to collect sufficient funds for projects (dependent on the revenue source). Furthermore, it would take time to collect sufficient lease funds to be able to finance new projects. However, once the program is fully functional the need for new funding would decline.

Some of the initial revenues discussed in the June meeting included:

- Increase existing/create new revenue source - This source could include but is not limited to increasing the percentage distribution from traditional revenue sources flowing into the LRBP fund, creating a new flow into the fund from other existing revenue sources, or tapping into a new revenue source. Recent examples of this in Montana include funding the state share of the Butte Veterans' Home through temporary redirection of cigarette tax revenues, and the proposal to fund construction of the Montana Heritage Center through a temporary redirection of increases in accommodation tax revenues.
- Capture overflows and reversions – This source could include redistribution of funds from programs that sunset, capturing general fund reversions, and overflows from reserve funds once the required fund balances are reached and directing those to the capital projects fund. Examples of legislation in Montana that have captured these types of revenue streams include the Fire Suppression Fund (HB 354, 2013 Session) and Budget Stabilization Reserve Fund (SB 261, 2017 Session).
- Redirect general fund no longer needed for debt service – GO bond payments for LRBP debt issues are declining as bond issues authorized in the past are paid off. This concept maintains the total amount of general fund payments at current levels and as bond issues are paid off, redirects the funding designated to retire the bond issues to the capital projects fund. The general fund is projected to be obligated to the payment of an average of $10.8 million/year of GO bonded debt in the 2019 biennium when considering only the currently issued debt. Currently issued general fund debt service is projected to decline and then be fully paid by FY 2032.

Initial revenues for a revolving program could also be obtained should the 2019 Legislature find that there is a sufficient amount of unappropriated general fund that could be devoted to state building construction.

ATTACHMENT 4 – MATRIX OF FINANCING CONCEPTS

The following matrix summarizes the benefits, concerns, methods of control, and required statutory amendments to develop new financing methods for the construction and major maintenance of state buildings and local infrastructure.

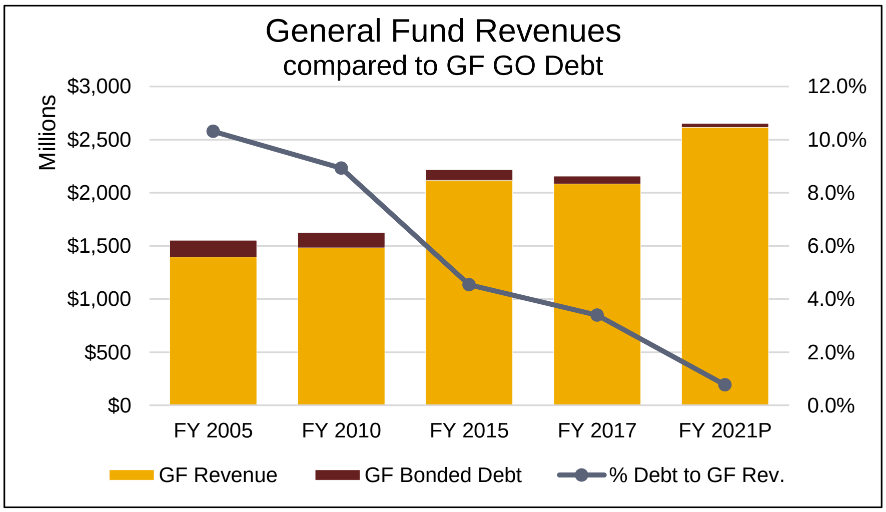
State Buildings and Local Infrastructure Financing Concepts					
#	Concept / Fi-Tool	Benefits	Concerns	Methods of Control	Statutory Work / Considerations
State Buildings Revolving Cash (C) Concept					
C-1.	**Cash Program Concept-revolving**	1) No state debt 2) Many program parameters already in place 3) Allows leveraging of federal funds for the lease reimbursement costs (for agencies with federal functions)	1) Determination of funding source 2) Time required to accumulate sufficient funding 3) Time required to revolve funds 4) Increased long-term costs in HB 2	1) Executive - budget request 2) Legislature - project appropriation 3) Agency - funding distribution and (DOA) contracting	1) Potential revisions of Title 17, Chapter 7, part 2, MCA 2) Develop program rules in the same title/chapter (above) 3) Amend 17-7-205, MCA to include a new revolving account
Lease-to-Own (LO) Concepts					
LO-1.	**Lease-to-Own Financing Tools**	1) Provision of new space for state agencies without acquiring state debt 2) Allows leveraging of federal funds for the lease reimbursement costs (for agencies with federal functions)	1) Higher state costs than using cash or issuing general obligation bonds 2) Approval of lease-to-own without a 2/3rd vote of the legislature could be tested in the courts 3) Increased long-term costs in HB 2	1) Executive - budget request 2) Legislature - project appropriation 3) Agency - (DOA) contracting	1) Amend 18-3-101, MCA - Authority to lease with option to purchase 2) Develop program rules in Title 2, Chapter 17, part 1, MCA
Public Authority (PA) Bonding					
PA-1.	**Public Authority**	1) Authority could assume debt without the state being obligated to the costs 2) Allows leveraging of federal funds for lease reimbursement costs (for agencies with federal functions)	1) Higher state costs than using cash or issuing general obligation bonds 2) Perpetual lease costs in HB 2 3) State may never directly own the buildings	1) Executive - budget request 2) Legislature - project appropriation 3) Agency - (DOA) contracting	1) Develop state buildings authority similar to facility finance authority (FFA) or expand the current FFA to construct, own, and operate state agency buildings 2) Codes included in Title 2 and Title 90, MCA
State and Local Infrastructure Trust (IT) Concepts					
IT-1.	**Redirect permanent trust interest for local and state infrastructure projects**	1) Consistant form of funding 2) Could be used to finance either state or local government projects 3) Could develop a **revolving loan program** for either state or local projects (state projects would reimburse costs through lease payments) 4) Would allow the state to leverage federal funds through the lease (reimbursement) mechanism	1) Reduction in GF revenues	1) Executive - budget request 2) Legislature - project appropriation 3) Agency - funding distribution and (DOA) contracting	1) Revise: 17-5-703(1)(a), MCA - Coal Tax Trust Funds 2) Determine administrating agency 3) Develop program rules: Title 90, MCA - Planning, Research, and Development - New Chapter
IT-2.	**Excess general fund or unexpected windfall dollars deposited in a trust**	Same as IT-1.	1) Reduced ability to use funding for other purposes	Same as IT-1.	1) Create new trust in appropriate section of law 2) Determine administrating agency 3) Develop program rules: Title 90, MCA - Planning, Research, and Development - New Chapter

ATTACHMENT 5 – GENERAL FUND GENERAL OBLIGATION DEBT

Montana has often relied on debt financing, or the use of general obligation bonds (GO), for the construction and major maintenance of state buildings. Historically, the debt associated with state building construction and maintenance projects has made up most of the general fund supported GO debt. Over time, this debt obligation and the general fund costs have declined. Assuming no new GO issues for building construction and maintenance, the last debt service payment will occur in FY 2028.

Outstanding Debt

The figure below shows the outstanding general fund GO debt[3] compared to general fund revenues at specific points in time. The data used shows only state debt that is paid (directly and indirectly) with general fund compared to total general fund revenues.



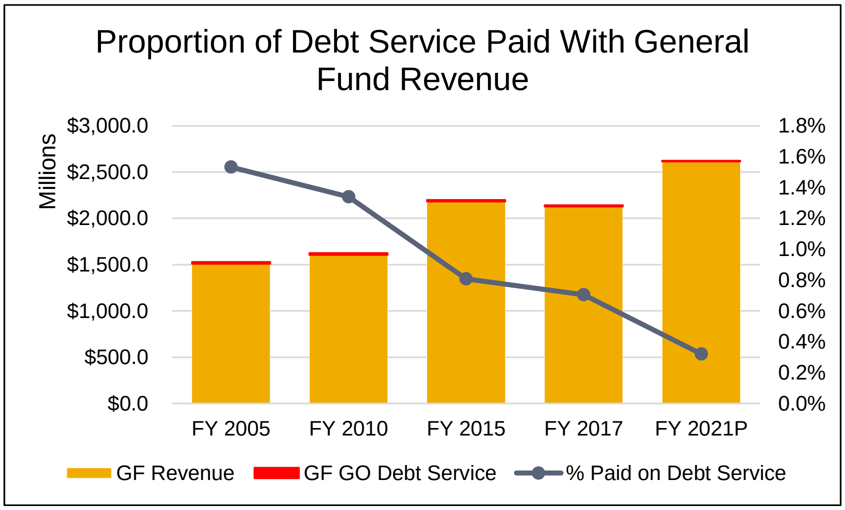
As demonstrated in the figure above, over time the revenues of the general fund have increased while the debt balances have declined. In FY 2005, the general fund GO bond balances were equal to 10.3% of general fund revenue and in FY 2017 (the latest year of actual debt data) the percentage of debt to revenue had declined to 3.4%. In FY 2021, the debt balance to general fund revenue is projected to be 0.8%, assuming no new issues.

The proceeds from general fund GO debt has primarily supported state building construction and maintenance. In FY 2005, 85.4% of the outstanding debt was associated with bonds issued for state building purposes and state building debt in relation to all general fund debt has varied over time but declined to 77.9% in FY 2017. As projected in FY 2021, the proportion of the general fund state building debt will decline to 38.9% as bond issues reach maturity.

Debt Service

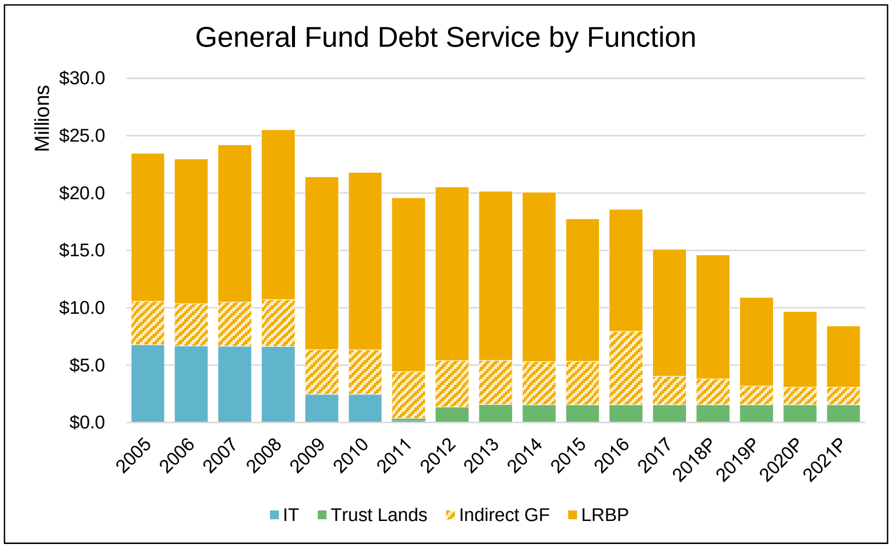
The figure on the following page shows the proportion of general fund revenue that pays for the debt service on GO bonded debt.

[3] GO bonds are always pledged with the full and credit of the state government, indicating the general fund. However, not all the debt service of GO bonds is the responsibility of the general fund and are instead paid through an independent revenue streams. Nevertheless, should any of the revenue sources dedicated to the payment of the debt service be unable to meet the debt service obligation, the general fund would become responsible for the payments. This has not happened in the history of the state.



While visually similar to the previous chart, this figure shows the decline in general fund debt service costs in comparison to general fund revenues. Unlike the bond balances, the general fund debt service tends to decline in chunks, as debt service costs are substantially constant over the life of a bond. In FY 2017, $15.1 million was expended from the general fund on debt service (0.8%) and by FY 2021, the state is projected to spend $6.9 million, or 0.3% of the general fund revenue, assuming no new issues.

The figure below shows the general fund GO bond debt service by its bond proceed use (with state building project funding shown in the gold and gold hatched segments of the bars).

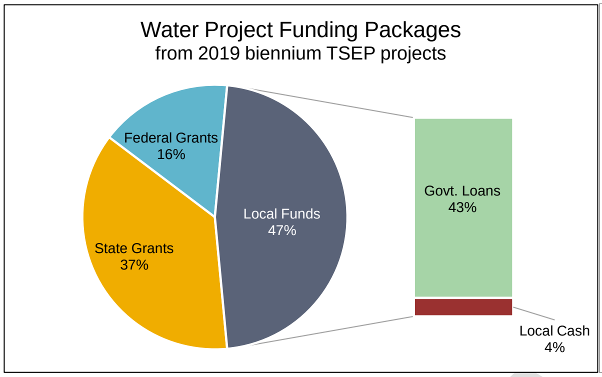


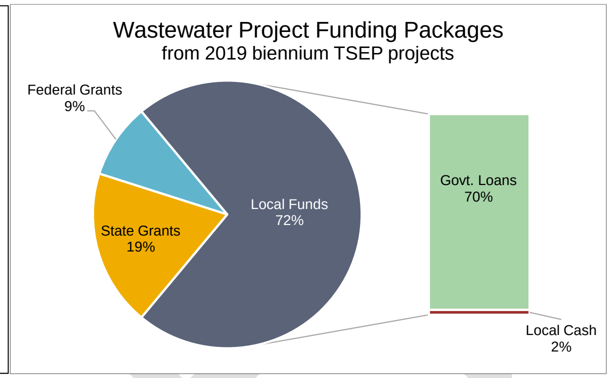
Between FY 2005 and FY 2017, 84.8% of the debt service paid with general fund revenues was related to state building construction and maintenance. In the same period, the general fund devoted an annual average of $17.7 million to this purpose. By FY 2021, it is expected that the general fund debt service cost of building construction and maintenance will be $6.9 million, a reduction of $10.8 million or 61.0%. FY 2028 is projected to be the final year of general fund debt service payments ($1.1 million) on state building construction and maintenance bonds, assuming no new issues.

ATTACHMENT 6 – LOCAL GOVERNMENT INFRASTRUCTURE

Water and Wastewater

For water, wastewater, storm water, and solid waste projects, both the state and federal governments offer a wide range of financial assistance to local governments. If grants are not available for projects, local governments can access a variety of state and federal low interest loan programs, which are repaid through user fees. The following charts show the funding mix[4] used by local governments when applying for TSEP water and wastewater projects from the list of projects authorized by the 2017 Legislature[5].





Water and wastewater projects are costly propositions for local governments. For projects authorized in the 2019 biennium, project costs ranged between $16.0 million for major water treatment plant upgrades and equipment and $588,000 for a water well and transmission lines. The assistance provided through state and federal grant and loan programs benefits the public by reducing the fees charged for the provision of water and wastewater services.

Attached to this report is a funding source matrix compiled by the Water, Wastewater, and Solid Waste Action Coordinating Team (W_2ASACT), a group of state, federal, and non-profit organizations that finance, regulate, and/or provide technical assistance to communities in planning and constructing water and wastewater systems projects. Most, if not all, of the funding illustrated in the figures above come through these programs[6].

Other Infrastructure

Funding for other types of local government infrastructure is also available through grant programs, as well as various local government taxing provisions. Most of these local government financing tools require a vote of the electorate. Examples include:

- Tax Increment Financing Districts – for a variety of local government infrastructure projects
- Local option motor fuel excise tax (7-14-301, MCA) – for local road projects
- The resort tax (Title 7, Chapter 6, part 15, MCA) – for a variety of local government infrastructure projects
- Imposition of K-12 education mills (20-9-403, MCA) – for school facilities[7]
- School major maintenance aid[8]

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[4] The funding mix may not be the final financial package, but is intended to show the variety of funding sources used for projects.

[5] The data in these figures was not adjusted for funding reductions that may have occurred in actions of the November special session.

[6] Information available at (Ctrl + click): http://dnrc.mt.gov/divisions/cardd/docs/resource-development/w2asact-docs/WASACTFundingProgramTableMar2017.pdf

[7] The state participates in the debt service costs on bonds issued for the construction and maintenance of K-12 facilities

[8] A new program that will distribute interest earnings from a new coal severance trust fund to K-12 districts for maintenance and construction of school facilities (2017 Legislature - SB 307)