



House Bill 2199 Expanding Debt Financing Options

As part of its efforts to increase both efficiencies and cost savings for capital projects financed with long-term debt, the Oregon University System (System) is seeking statutory authority to expand its debt financing options in order to reduce borrowing costs. Specifically, for long term debt issued to finance “self-supporting” capital projects relating to its activities – also called auxiliary enterprise projects – the System desires to expand its ability to enter into variable rate debt instruments and to obtain the ability to pay interest rate swap agreements from the revenues of its self-supporting activities.

Background

Historically, the System has utilized fixed rate debt instruments to finance the construction and improvement of its auxiliary enterprise facilities (housing, food services, parking, and intercollegiate athletics). Many governmental entities across the country, including other Oregon state agencies such as the Housing and Community Services Department, have been successful in lowering their borrowing costs by issuing variable rate debt and entering into interest rate swap agreements to effectively fix the interest rate and the required debt service payments.

Cost Savings

Utilizing a mix of variable and fixed rate financing is generally considered the most cost-effective manner in which to finance capital projects. The proper mix of variable and fixed rate debt, coupled with the ability to earn interest on all operating resources, can yield substantial cost savings without adding undue budgetary risk. Historical analysis shows potentially significant savings when issuing variable rate debt over fixed rate. Variable rate debt can be conservatively priced approximately 1% below fixed rate debt. Thus, a 30-year fixed rate tax-exempt bond with an interest rate of 5% requires a \$70,000 annual payment (for principal and interest) for every \$1 million borrowed. That same bond, sold as variable rate debt, would carry an interest rate of 4% and would require \$60,000 (principal and interest) debt service for every \$1 million borrowed, lowering the annual payment by nearly 15% or \$10,000 per million borrowed.

HB 2198: Interest Earnings

Prudent financial practice requires that variable rate borrowings be matched to variable rate assets. Companion legislation, HB 2198 – Interest Earnings, will authorize the System to retain the interest earned on all of its revenues, such as tuition. The variable rate of interest that the System will earn on these resources will provide the asset that could be matched to variable rate financing, allowing the System to benefit from substantial cost savings.

The types of funds that would be affected by HB 2198 are predominately tuition and fee revenues paid by students to attend OUS institutions; general funds transferred to OUS; housing, food service and parking revenues collected by campuses; indirect cost revenues earned on grants and contracts, and other miscellaneous funds. This bill, if passed, would allow OUS to retain interest earnings on these types of funds and provide enhanced services to students. The rationale for keeping these funds, which are predominately paid by students, at the institutions is that they be used to support the programs and services which positively and directly affect students.

