Financial Services Update

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Successful $400 million OTIA Bond Issue

Greetings from Financial Services:

On June 14th, Financial Services closed the sale of the Series 2006 Bonds and received $400 million in bond proceeds to fund OTIA programs. This sale was the culmination of more than a year of planning the OTIA bonding program and six months of work on this bond issue.

This update focuses on two aspects of OTIA bonding: the successful completion of the June sale, and program features we have introduced to position ODOT to complete the program and achieve the lowest possible cost.

We welcome your comments and suggestions on these and other financial issues of importance to the Department. Please email at:

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Dennis Strachota,
Chief Financial Officer

Oregon Department of Transportation

The Series 2006 Bonds provided $300 million for the OTIA III program and $100 million for the OTIA I & II program.

These were the first bonds issued for the OTIA III State Bridge program. The bonds also included the first variable rate debt ODOT has issued – $100 million of the OTIA 3 bonds is variable rate debt.

The bonds were sold with an average rate of 4.55% on the 25- year fixed-rate bonds and an initial 3.90% on variable-rate bonds.

Expenditure of Bond Proceeds

Program managers often ask about expenditure requirements for bond proceeds. If proceeds are not spent quickly, ODOT may be required to pay IRS penalties.

The 2006 Bonds were sold primarily on a "reimbursement basis" – ODOT has spent existing Highway Fund balances for OTIA, then reimbursed the Highway Fund with bond proceeds. As of May 31st, only $48 million remains to be spent from this issue, and full expenditure should be complete within only a few months.

Savings from Lower Cost Variable Rate Debt

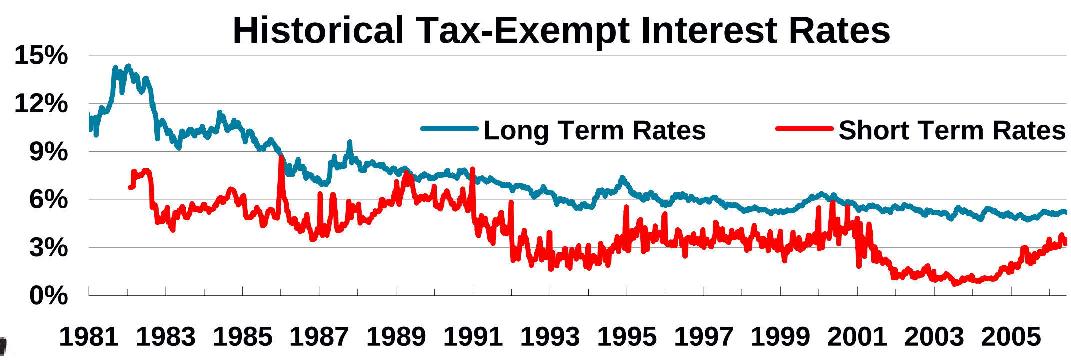
Variable rate bonds are long term bonds with short term rates. For example, a bond may be due in 20 years, but the interest rate is reset every 7 days.

Based on historically lower short-term rates, as shown in the graph below, this would potentially save ODOT about $14.5 million per year in interest costs relative to long term debt.

Program Completion

The OTIA laws identified specific revenues to pay debt service. These revenues have typically grown about 2% per year. With rising interest rates, higher debt service could jeopardize completion of the total OTIA bonding program.

To address this concern, variable rate bonds are sold as "junior" debt, which requires a lower level of revenues. This conserves ODOT's debt capacity – the ability to complete the entire bonding program, even if interest rates rise.



✓ Short term rates have averaged 3 percentage points below long term rates over 25 years.

Highest Oregon Bond Ratings

ODOT received very high ratings on the Series 2006 Bonds – AA+ by Standard & Poor's, Aa-2 by Moody's, and AA by Fitch. These ratings are just a "notch" below the highest possible rating, AAA.

In April, Director Matt Garrett, CFO Dennis Strachota, and Debt Manager Diane Hopper visited the agencies. This was an opportunity to introduce the new ODOT Director, the variable rate debt program, the bonding program plan, and the OTIA 3 state bridge program. The visit resulted in the highest ratings of any Oregon State bonds.

Financial Services is a branch of ODOT's Central Services Division. Financial Services provides centralized accounting, financial reporting, payroll and benefits, budget development, economic and financial analysis, business planning, debt administration, cash management, the Oregon Transportation Infrastructure Bank, tax collection and auditing, revenue forecasting, tax policy analysis and cost allocation services.

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Development of an OTIA Bonding Plan

When the first OTIA bonds were sold in 2002, the bonds represented almost half of the total OTIA I & II authorization. It appeared that there would be no need for an overall plan, because one more issue would have completed the program. The passage of OTIA III legislation changed that. With a total of $2.4 billion in bonds and about $178 million per year in projected debt service, a plan was needed. This would allow the Department to consider all issues and build a structure to target the lowest cost of borrowing.

Financial Services, in consultation with professional advisors and State Treasury, developed an overall program plan during 2005. This plan was approved by the Director and presented to the OTC.

The plan addresses the type of debt, structure of bond issues, and when and how much to issue.

Future bond issues are expected to be issued on a reimbursement basis. This means that ODOT spends Highway Fund balances first, then later reimburses the Highway Fund with bond proceeds. This allows ODOT to retain interest earnings on bond proceeds and avoid IRS penalties. The OTIA bonding program is expected to be completed about 2011.

Key Plan Features

- ✓ Annual spring bond issue ahead of construction season
- ✓ Amount based on forecast spending over the next year
- ✓ A gradual increase to about 20% variable rate debt – about $480 million of the total $2.4 billion
- ✓ "Junior" variable rate debt to preserve debt capacity
- ✓ Bonds to be sold primarily on a reimbursement basis allowing ODOT to retain most interest earnings

How Does ODOT Sell Bonds?

A sale date is determined months in advance through State Treasury. Each bond issue takes 3-4 months of intensely focused effort by at least 25 people. All sales must be approved by the OTC.

Team members include ODOT Financial Services, State Treasury, the Department of Justice, bond counsel (a law firm specializing in bond issues), a professional financial advisor and major investment banking firms.

As documents are developed, numerous decisions are made to secure the highest possible ratings and make the bonds attractive to investors.

A major investment bank purchases the entire bond issue. Then a group of 6 to 10 major firms sells the bonds to investors. Investors may purchase blocks of many millions or as small as a single $5,000 bond.

On the closing date, ODOT receives the full amount of bond proceeds, and the underwriting bank receives the bonds to deliver to investors.