STEP 4: TYPES OF DEBT INSTRUMENTS

The following list briefly summarizes the types of debt and financial instruments authorized for Oregon local Issuers. For further definitions and information on varying types of bonds, see the MSRB Glossary.

General Obligation Bonds

General Obligation (GO) bonds typically benefit a community as a whole and are secured by the full-faith-and-credit and taxing power of the Issuer. The Issuer pledges unconditionally to pay the interest and principal on the debt as it matures. For Oregon local Issuers, a GO pledge means that the Issuer[1] pledges all of its unrestricted resources to meet debt service, including an *unlimited property tax* on all taxable property within the district. Local government GO bonds may only be issued if authorized by a ballot election of the issuing jurisdiction. Voter authorized General Obligation Bonds are supported by an unlimited tax levy outside of the limits imposed by the Oregon Constitution, Article XI, Section 11.

Under ORS 287A.001-287A.145 General Obligation debt can be incurred for capital costs, including costs associated with acquisition, construction, improvement, remodeling, furnishing, equipping, maintenance or repair, having an expected useful life of more than one year. This does not include maintenance and repair (the need for which could be reasonably anticipated), supplies, and equipment that are not intrinsic to a structure. General Obligation debt has been the traditional form of financing for capital projects such as land acquisition, schools, water facilities, sewerage facilities, and roads that are owned and operated by governments. GO bonds can also be issued to replace outstanding General Obligation Bonds. See Refunding Bonds for a discussion of such bonds.

There are several types of GO bonds, which place varying emphasis on the full-faith-and-credit security and the Issuers' taxing ability. These types of ULTGO bonds are categorized by source of repayment as follows:

Non Self-Supporting GO Bonds

Non-self-supporting GO bonds or tax-supported bonds are those which are paid for by property taxes or other tax sources. School district bonds in Oregon are traditionally supported by property taxes and are historically GO non-self-supporting bonds. Non-self-supporting and partially self-supporting GO bonds determine an Issuer's net bonded debt. Net bonded debt is a measure of the debt burden on property of the Issuer.

[1] The term "Issuer" is a general reference to issuing districts, municipalities, and local governments.

Self-Supporting GO Bonds

Self-supporting GO bonds are debt issues that carry the Issuer's ULTGO pledge and have a revenue stream separate from the Issuer's taxing authority to repay the bonds. The bond proceeds construct a revenue-generating enterprise or facility that provides the primary source of funds for bond repayment. These bonds may be fully self-supporting or only partially self-supporting. If fully self-supporting, the bonds are not included in the net bonded debt of the Issuer, but are included in its gross bonded debt. If only partially self-supporting, then 100% is included in the net bonded debt calculation. (See Computing Net Direct Debt). These are often referred to as double-barreled bonds.

Full Faith and Credit Obligations

Full Faith & Credit Obligations (FF&C) may be secured by a variety of pledges except as restricted by the Oregon Constitution or statutes or by local charter. FF&C obligations are also authorized under ORS 271.390. Limited Tax Revenue Bonds are authorized under ORS 287A.150. In such a case, the Issuer is still required to use all legally available resources to meet its obligations. FF&C obligations are backed by the general revenue and taxing power of the Issuer within the limits of the Oregon Constitution, Article XI, Section 11. FF&C obligations do not include a pledge of an unlimited property tax on all taxable property within the district, as is the case with GO bonds.

FF&C obligations are generally perceived by investors to have a higher risk than the unlimited-tax General Obligation Bond, but are still perceived to be a more secure investment than COPs since they are not subject to an annual appropriation process. The difference in interest rates will depend on numerous factors, including the financial condition and reputation of the Issuer, the revenue source used to repay the debt, the security pledge, the total amount of FF&C debt outstanding and the nature of the asset being financed.

Rating agencies may rate at the same level as the full unlimited-tax general obligation rating of the Issuer; however, in early 2017, Moody's Investors Service changed their rating methodology for FF&C obligations, resulting in rating upgrades for many Issuers to the same level as their outstanding ULTGOs. S&P historically has been rating FF&C and ULTGO's at the same level.

There are two types of FF&C obligations which place a varying emphasis on credit security and the Issuer's taxing ability. These types of obligations are categorized below.

Full Faith & Credit (non-self-supporting)

FF&C (non-self-supporting-N) obligations are paid by property taxes or other tax sources within the limits of the Oregon Constitution, Article XI, Section 11.

Full Faith & Credit (self-supporting)

FF&C (self-supporting-S) obligations are paid from a project's revenue stream. The proceeds are used to construct revenue generating enterprises or facilities, or there is an independent source of funds for repayment. The taxing authority behind the security pledge on the obligation is limited by the Oregon Constitution, Article XI, Section 11.

Revenue Obligations and Bonds

Revenue Bonds are usually payable from revenues generated by the project or enterprise. They may be issued under the authority of ORS 287A.150 and must adhere to applicable state and federal statutes and regulations. Alternatively, Revenue obligations may be issued under ORS 271.390. Both bonds and obligations have the same security structure and considerations with the caveat that Revenue Bonds are more widely recognized by investors outside of Oregon markets. No ad valorem property taxes are levied or pledged. Revenue bondholders do not have recourse against the full-faith and unlimited or limited taxing power of the government and these bonds are expected to be fully self-supporting. The bonds are generally repaid from user charges, system development charges or from enterprise earnings and do not rely on the ad valorem taxing powers of the government for their security. The following are advantages to issuing Revenue Bonds:

- Governments have the ability to finance traditional projects without pledging the power to tax, reserving this power for other services. Special districts have been created to promote projects as an alternative to general government action. Although they don't have the power to tax, they may have the power to float bonds and serve as conduits for financing non-governmental activities in the tax-exempt market.
- Those responsible for the payment are those who benefit reflecting a "user pays" philosophy.
- Revenue Bonds are usually not restricted by various debt limitation statutes. They generally also are not subject to the lending of credit prohibition in the Oregon Constitution, and so there may be more flexibility in the kinds of projects financed.
- Voter approval is usually not required. However, bonds issued pursuant to ORS 287A.150 may be subject to voter approval if sufficient petition signatures are gathered within the timeframe prescribed for non-emergency actions of the Issuer. A city's charter may have additional restrictions and could require voter approval.

Revenue Bonds often have other associated requirements and several distinctive disadvantages such as:

- Repayment revenue depends on the continuity of the revenue source and the Issuer's willingness to raise rates as necessary to repay the bonds. For certain Revenue Bonds, this may result in higher interest rates and issuance costs than ULTGO bonds because of their limited security, but not always. The strength of the system could put the rating at the same level as the ULTGO. Revenue Bonds issued for essential services, such as water and sewer, may carry ratings and borrowing costs comparable to an Issuer's ULTGO or potentially higher LTRB credit.

- Higher coverage requirements for issuing additional parity bonds (i.e. revenues compared to debt service).
- Depending on the financial health of the system, the Issuer may have to meet debt service coverage requirements.
- Requirement to maintain a debt service reserve fund, for certain types of Revenue Bonds.
- Generally require more complex financial arrangements.
- Bonds issued under ORS 287A.150 require that voters have the opportunity to refer the question of issuing the bonds to a public vote through a petition process. The timeframe and elector signature requirement necessary to refer the issuance to a public vote varies depending on how the proposed bonds were authorized (ordinance vs. resolution).

Revenue Bonds are often categorized by source of revenue. Some examples of different types of Revenue Bonds follow.

Enterprise Revenue Bonds

Enterprise Revenue Bonds finance projects (i.e., water and sewer) that are expected to generate revenues to repay the debt. The bonds are issued under the provisions of ORS 287A.150 or under other specific statutes.

Special Revenue Bonds

Special Revenue Bonds are secured by special revenues such as an assessment or gasoline tax. These funds are directed to a special fund established for the purpose of bond repayment. The contents of the fund form the bond's security and repayment source.

Double-Barreled Revenue Bonds

Some Revenue Bonds are dually secured with a dedicated revenue source and a jurisdiction's qualified or unqualified tax pledge. This enhancement generally results in a higher credit rating for the security which can result in lower interest rates for the bonds.

Industrial Development Revenue Bonds

Industrial/Economic Development Revenue Bonds (IDBs, IDRBs or EDRBs) are Revenue Bonds authorized to be issued in Oregon through the Oregon Business Development Department, port districts, and cities of over 300,000 in population. These bonds finance construction of facilities for eligible private enterprises to increase employment and to promote economic development and diversity. IDBs are private activity bonds and require an allocation of the State's private activity bond volume cap to qualify as tax-exempt.

Appropriation Bonds

Certificates of Participation (COPs), sometimes sold to investors through a Lease Purchase Agreement, may be an alternative to issuing bonds and are often used to finance real property or equipment, construction of public facilities, and facility maintenance and renovation. COPs are authorized under ORS 271.390. COP's principal and interest (debt service) payments are not secured by a particular revenue source nor does the government have the authority to levy extra taxes beyond constitutional limits to pay debt service. COPs are secured by an obligation of the government to make regular payments to meet debt service and, most commonly, a security pledge of the real property or equipment. In the typical COP, if the Issuer defaults, the structure or asset is "repossessed." The security of the instrument, in the eyes of the investors, lies in the expectation that the government will choose not to forego use of the structure or asset which may be a facility critical to the government's function. COPs differ from Full Faith and Credit Obligations in that COPs are subject to annual appropriation and therefore are not bonds and not subject to certain debt limits. Since they are subject to annual appropriation, collateral (if used) is generally viewed as one means to incent the Issuer to keep appropriating or lose access to an essential public asset. Since the real credit is the annual appropriation of the Issuer, highly rated Issuers sometimes issue COPs with little or even no collateral. In these cases, future access to the capital markets would be difficult should they fail to appropriate for the payment of the COP.

Some attributes of Certificates of Participations include:

- No voter approval is required, nor is adherence to the restrictions of the Uniform Revenue Bond Act (ORS 287A.150).
- General fund revenues, at the option of the governing body, may be used to pay the debt service.
- Interest rates are generally higher because the payments are subject to annual appropriation and lack a pledge of specific taxes.
- COPs are more complex than GO bonds. This may result in higher issuance costs and fees from service providers (Bond Counsel, MA, Underwriter).
- COPs are typically rated at least one notch below the Issuer's GO rating.

Urban Renewal Bonds

Tax Increment (Urban Renewal) Bonds, are authorized for cities, designated agencies of cities, and counties as authorized by the Oregon Constitution, Article XI, Section 11c and ORS Chapter 457 (Urban Renewal of Blighted Areas—Tax Increment Financing of Urban Renewal Financing). Urban Renewal Bonds are repaid by property taxes but the agency has no control over the amount of property tax revenue generated. They may be used for infrastructure improvements such as streets, sewers, property acquisition and housing development for the purpose of remedying "blighted" conditions within a specific community. The repayment source is limited primarily through taxes on any increase in assessed value above the previously established frozen base. This is referred to as “Divide the Taxes Revenues”. To use these bonds, an urban renewal area must be designated and property assessed valuations for this designated area are then “frozen” levels.

Divide-the-Tax Revenues are calculated by multiplying the incremental assessed value of an urban renewal area by the consolidated billing tax rate. The consolidated billing tax rate is the sum of certain tax rates of taxing districts that overlap the area. The incremental assessed value is the difference between the frozen base and the current assessed value of all taxable property in the area.

The security for the borrowing is the revenues generated from the future growth in property tax revenues resulting from the urban renewal improvements and from the growth in assessed values under Oregon property tax law. These bonds are riskier than General Obligation or most Revenue Bonds because there is no guarantee that resultant property values and tax revenues will increase sufficiently to repay the urban renewal. Unless the agency has special levy authority, they have no control over the amount of taxes received each year. Consequently, this usually results in lower bond ratings and higher interest rates paid on the bonds.

Local Improvement District Financing

Local Improvement District Bonds, known as Assessment Bonds are authorized in ORS Chapter 223. These bonds are secured by charges or assessments to property owners who benefit from the improvements. To collect the charges or assessments, municipalities may form Local Improvement Districts (LID) within which the improvements are to be made.

Special districts, such as county road districts, may use special assessment procedures and authority to issue bonds to finance various local improvements such as sewer, water and streets. Special Assessment Bonds are issued for the amount of the unpaid assessments and an amount necessary to establish a debt service fund and pay issuance costs. Properties that benefit from the improvements are proportionately assessed the actual cost of the improvement. The method of distributing the cost of the improvements among the benefitted properties may be determined in a number of different ways and is determined by the governing body. The assessment payments are used to meet debt service obligations. Since the timing of assessment pre-payments from benefitting property owners are unpredictable, the credit analysis of improvement bonds is more complex than certain other types of bonds. Assessment bonds are typically structured as a term bond with one maturity and a call provision which allows redemption from assessment payments at any time. Some assessment financings are issued as Full Faith and Credit Obligations (ORS 271.390) or Limited Tax Improvement Bonds (ORS 287A.150) with the assessments as the expected primary source of bond repayment, but pledging the Issuer’s full faith and credit as additional security for the obligations.

If the Issuer uses its full faith and credit to secure the obligations, it is important that the Issuer develop internal policies and procedures to minimize the risk that the Issuer's general revenues will be needed to repay the bonds. These policies and procedures should include a minimum property value to assessment ratio which considers all liens on the property. Some Issuers require additional collateral from property owners that own large portions of the LID, whose assessed value versus assessment ratio does not meet the guideline or may not meet the financial standards of the Issuer. Issuers must also determine the interest rate to be charged on assessment contract. Many Issuers "pass-through" the rate on any bonds issued to finance the assessment, plus an additional "bump rate" intended to offset the risk of payment delinquencies and other risks.

Private Activity Bonds

Private Activity Bonds (PABs) are government debt instruments issued for the direct benefit of private businesses. These bonds bear numerous restrictions imposed by federal and state regulations. Specifically, they are subject to the limitations and provisions of the Federal Tax Reform Act of 1986 of the Internal Revenue Code and ORS 286A.605 to 286A.625.

A frequent advantage of PABs is the private use of a municipality's tax-exempt name as a conduit to tax-exempt interest rates. Another advantage is that the government Issuer incurs no legal obligation to repay private activity conduit bonds; rather, the private business' credit quality provides the security for the debt financing and ultimately all repayment responsibilities.

If proposed Private Activity Bonds are to be sold in the public debt markets (as opposed to a private placement or bank loan), Issuers may wish to impose minimum credit rating standards, minimum bond denominations and other restrictions, in order to minimize the risk that lower rated bonds are purchased by investors that may not have the capability to fully understand the risks of the bonds.

The paramount consideration for the issuance of PABs in the State of Oregon is to maximize economic benefits to the citizens of the State by the promotion of appropriate economic development and other public purposes. PABs are issued to increase the number of family wage jobs, promote economic recovery in small cities heavily dependent on a single industry, emphasize development in underdeveloped rural areas, utilize educational resources available at public universities, support development of Oregon's small businesses, including businesses owned by women or minority groups, encourage use of Oregon's human and natural resources in endeavours that harness Oregon's economic comparative advantages, and assist lower income families to obtain housing.

Private Activity Bonds authorized for a variety of uses including: single family mortgage, small issue industrial development, student loans, water/sewer/solid waste, hazardous waste facilities, district heating and cooling, local gas and electric, and tax-increment financing bonds.

Private Activity Bonds are subject to a statewide bond volume cap limit. The amounts allocated for PABs, as provided in ORS 286A.615, are determined on a per capita basis using U.S. Federal government census data for Oregon's population. The Oregon Legislature determines PAB allocations each calendar year for the various state agencies such as the Oregon Economic Development Commission, Business Development Department, Housing and Community Services Department, Office of Energy, and the PAB Committee. The current volume cap and allocations are updated after each meeting.

The Oregon State PAB Committee is responsible for the allocation and reallocation of PABs among local governments, districts, and other public Issuers. Oregon Administrative Rule 170-71-0005, Allocation of Private Activity Bond Limit, provides PAB allocation guidance and procedures for Oregon local governments and municipalities. For additional information, contact the State Treasurer's Debt Management Division.

Short Term Debt

By convention, short-term debt is defined as debt with a stated final maturity at the time of sale of 13 months or less. General Obligation and Revenue Bonds are typically long-term debt, whereas short-term debt instruments are usually referred to as notes or warrants. Local governments, districts and agencies may, pursuant to ORS 287A.180, pledge anticipated taxes, grants, bond proceeds, or other revenues when entering into contracts with lending institutions for short-term financing. Obligations issued in anticipation of taxes or other revenues may not be issued in an amount greater than 80 percent of the amount budgeted to be received in the fiscal year in which the obligations are issued. Such obligations may be repaid according to the schedule determined by the governing body.

The Office of the State Treasurer, Debt Management Division does not track municipal debt of less than 13 months. Several types of short-term instruments are described below.

Tax Anticipation Notes and Warrants

Tax Anticipation Notes (TANs) are issued to provide interim financing for operations to which taxes are committed but not yet collected. In general, these instruments are used to alleviate a cash flow situation in which collections do not coincide with expenditure needs. Usually TANs are retired from tax collections, and only from proceeds of the tax levy whose collections they anticipate to be used for repayment.

Issuers of TANs may be able to access the public market if the amount to be issued is large enough and the credit quality is strong. Otherwise Issuers may look to a private placement with a bank. School districts, education service districts and community colleges also have access to the Oregon Education Districts Short-Term Borrowing Program which pools together Borrowers allowing them to gain access to the public market and save on costs of issuance.

Bond Anticipation Notes

Bond Anticipation Notes (BANs) are issued to provide immediate funds to begin a project prior to issuing approved bonds. Obligations issued to provide interim financing must mature not later than five years after the interim financing is issued. In periods of market instability and volatile interest rates, Bond Anticipation Notes may be used to delay the sale of a long-term debt issue until the market climate becomes more favorable to the Issuer. BANs may be sold in a fashion similar to bonds or more commonly they are sold as direct bank placements or as lines of credit. Other considerations related to the issuance of BANs include:

- Difference between long term rates or cost of capitalizing interest versus short term rates.
- Timing of ratings on long-term debt.
- Coverage requirements related to Revenue Bonds.
- Actual cost of the project.

It is important to note, however, that deferring long-term debt involves the risk that interest rates may rise from the time of the planning phase of the project to the actual issuance of the permanent financing. Care must be taken in financial projections to allow sufficient room in projections for some upward movement in interest rates.

Revenue Anticipation Notes

Revenue Anticipation Notes (RANs) are used as interim financing prior to collection of revenues that will be generated once a project is completed. RANs may also be used for operating purposes prior to collection of specific revenues.

Grant Anticipation Notes

Grant Anticipation Notes (GANs) may be used to finance a project for which a state or federal grant has been committed.

Refunding Bonds

Refunding Bonds are issued to replace or refinance previously issued debt with new debt. Refunding is typically used to restructure debt, to save borrowing costs through lower interest rates and revise legal restrictions or covenants. There are two principal types of Refunding Bonds as noted below.

Current Refunding

Oregon Law ORS 287A.360, allows the redemption of bonds up to 1 year in advance of their call date to be considered a current refunding and not fall under the state's advance refunding rules. Federal law defines a current refunding as the refunding of outstanding bonds within 3 months of their optional call date.

Advance Refunding

Advance Refunding occurs when outstanding bonds are refinanced 90 or more days before the refunded bond call date. Bond proceeds are invested in an irrevocable escrow structured so that the escrow generates sufficient revenues to pay the debt service on the refunded bonds up to and including the redemption date. Refunded Bonds defeased in accordance with their bond indenture are technically no longer considered outstanding until the call date and do not count against the Issuer's debt limitations, as long as they are legally defeased. To ensure the escrowed proceeds produce the expected payments, non-callable, Full Faith and Credit obligations of the US Government are required.

The federal government restricts yield on the investment of the proceeds of an Advance Refunding Bond. State regulations also limit the size of the Refunding Bond and the manner in which the proceeds can be invested. State regulations require that Advance Refunding Bonds be sold only to achieve a net dollar benefit to the Issuer or for debt reorganization purposes. An Advanced Refunding must comply with OAR 170-062-0000.

Advanced Refunding proceeds were most often invested in special State and Local Government Series (SLGS) Securities. SLGS are securities offered by the U.S. Treasury directly to state and local government entities as an investment alternative which assists Issuers of tax-exempt securities in complying with yield restrictions and arbitrage rebate provisions of the Internal Revenue Code. SLGS are subject to the federal debt limit and may be unavailable if the debt limit is reached. As a consequence, Issuers may have to procure securities on the open market through a bidding process. While this process is commonly used by Issuers when SLGS are not available, it can carry more risk and involve more complexity. Bond professionals will be of assistance in navigating this process should the need arise. Open Market Securities (OMS) may offer better yield than SLGS and could be used to fund an escrow even when SLGS are available.

When available, SLGS securities are purchased through the U.S. Treasury and additional information can be obtained at http://www.treasurydirect.gov.

Issuers of Advance Refunding bonds that are issued more than 1 year prior to a call must comply with ORS 287A.360-287A.380 and the State Treasurer's Administrative Rule detailing the Procedure for Submission, Review and Approval of an Advance Refunding Plan, OAR 170-62-0000). The December 2017 federal Tax Cuts and Jobs Act (TCJA) eliminated tax-exempt advance refundings.

Zero Coupon, Capital Appreciation, and Deferred Interest Bonds

Typical fixed rate bonds pay interest every six months until they mature. These are also referred to as Current Interest Bonds. Zero Coupon, Capital Appreciation (CABs), and Deferred Interest Bonds (DIBs) do not pay current interest, but rather delay all payment to the investor until maturity. These bonds are a tool used by Issuers to manage the amount of annual debt service due and, for GO bonds, the resulting levy rate. Interest accretes until the maturity date and is calculated every 6 months based on the accreted value. Since the accreted interest is not paid to the investor in the period it accretes, the debt service due or levy rate is lower than it otherwise would be with all current interest bonds. It is important to note that these types of bonds appeal to a different segment of the bond market and typically result in a higher borrowing cost than current interest bonds.

Variable Rate Bonds

Variable Rate Bonds do not have a fixed interest rate, rather the interest rate is allowed to fluctuate in response to particular market rates. The rate is periodically reset based on a period that is generally set by a remarketing agent, who is hired by the Issuer and remarkets the bonds each period at the lowest rate that the remarketing agent believes is necessary to remarket all of the outstanding bonds. This period can range from every day to several years. The bonds that are remarketed are called Variable Rate Demand bonds. Since it is possible that a remarketing may fail, Variable Rate Demand Bonds require a bank to provide liquidity to buy any un-remarketed bonds. This market is very large and trades occur quickly. It is also a market for only the highest rated securities so, if an Issuer is not at least AA rated, the bonds will probably need credit enhancement, most commonly provided by the same banks that provide the liquidity. These transactions bear significant risks related to interest rates, bank credits, and enhancement/liquidity renewals. Additionally, these transactions may be complicated and have higher issuance costs, and therefore may not be suitable for all issues. Since the interest rates vary on Variable Rate Bonds, the Issuer must be prepared to pay high interest rates at any point in time. However, the long-term average interest rate for this type of transaction is well below the long-term average rate on fixed rate debt.