SENATE BILL REPORT

SSB 5837

AS PASSED SENATE, MARCH 10, 1993

Brief Description: Financing state and local government.

SPONSORS: Senate Committee on Government Operations (originally sponsored by Senators Quigley, Moore, Pelz, A. Smith, Prentice, Bauer, Hargrove, Sheldon, Erwin, Niemi, Jesernig and Talmadge)

SENATE COMMITTEE ON GOVERNMENT OPERATIONS

Majority Report: That Substitute Senate Bill No. 5837 be substituted therefor, and the substitute bill do pass.
Signed by Senators Haugen, Chairman; Drew, Vice Chairman; Loveland, Oke, Owen, von Reichbauer, and Winsley.

Staff: Rod McAulay (786-7754)

Hearing Dates: March 2, 1993; March 3, 1993

HOUSE COMMITTEE ON LOCAL GOVERNMENT

HOUSE COMMITTEE ON CAPITAL BUDGET

BACKGROUND:

Much of the construction or acquisition of capital facilities by state and local governments is financed by long-term debt instruments including revenue bonds, general obligation bonds, lease-purchase agreements, notes and other contractual arrangements. All of these arrangements include obligations to make payments which include interest. The interest, which is generally at a fixed rate, is determined by the financial markets at the time the obligation is incurred.

Because market interest rates constantly fluctuate, the financial community has developed a mechanism for parties to swap their respective payment obligations when it is in their mutual interest. These are side contracts which do not alter or impair the basic obligations. One party agrees to make the payments owed by the other party and vice versa for a fixed period of time. For example, this may enable a party with a fixed-rate obligation to take advantage of lower interest rates available on a variable-rate obligation while the swapping party obtains the advantage of reducing their exposure to the risk of rising interest rates.

Many states permit public agencies to enter these payment agreements. It is believed that the state of Washington and larger units of local government in the state should be expressly authorized to take advantage of these opportunities.

SUMMARY:

Governmental entities are authorized to enter into a payment agreement in connection with specific obligations for the purpose of managing or reducing exposure to fluctuations or levels of interest rates.

The term "governmental entities" is defined to include the State Finance Committee, the Washington Health Care Facilities Authority, the Washington Higher Education Facilities Authority, the Washington State Housing Finance Commission and any city, county, port district or public utility district which has or will have at the time of entering a payment agreement $100 million in outstanding obligations.

Prior to entering a payment agreement, the governmental entity must, by ordinance or resolution, make a finding that the transaction will reduce the amount or duration of its exposure to interest rate changes, reduce the cost of borrowing, or increase the rate of return on investments made in connection with the obligation. The governmental entity must obtain a written certification from a qualified and disinterested financial advisor that its findings are reasonable.

A payment agreement may only be entered with a party that has a rating from at least two nationally recognized credit rating agencies that is within either (1) the two highest long-term investment grade rating categories, or (2) the three highest long-term investment grade rating categories if the obligation of the other party is collateralized by direct obligations of or obligations guaranteed by the United States of America.

The term and notional amount of the payment agreement may not exceed the term and principal amount of the obligation on which the agreement is based. If otherwise permissible, any rates or taxes tied to the underlying obligation may be adjusted to reflect the requirements of a payment agreement.

The authority to enter new payment agreements will expire on July 1, 1995, except to replace an existing payment agreement if based upon the same underlying obligation.

Appropriation: none

Revenue: none

Fiscal Note: none requested

TESTIMONY FOR:

This will give the state and larger local governments flexibility to obtain the benefits of interest payment swaps. Savings can be in the millions of dollars. There are adequate protections against the risks involved.

TESTIMONY AGAINST: None

TESTIFIED: Tim Kerr, Deputy State Treasurer (pro); Jerry Sailer, Snohomish County PUD (pro); Jim Boldt, Clark County PUD (pro)

HOUSE AMENDMENT(S):

The definition of local governments authorized to enter "swap" agreements is expanded to include those which had at least $100,000,000 in gross revenue in the preceding calendar year. The State Finance Committee is required to make reports in 1993 and 1994 to the "appropriate legislative committees" of the agreements entered pursuant to this act.