

HOUSE BILL REPORT

E2SSB 5188

As Reported by House Committee On:
Consumer Protection & Business
Appropriations

Title: An act relating to the creation of the Washington state public financial cooperative.

Brief Description: Concerning creation of the Washington state public financial cooperative.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senators Kuderer, Nguyen, Conway, Darneille, Das, Dhingra, Hasegawa, Hunt, Lias, Lovelett, Stanford, Van De Wege, Wellman and Wilson, C.).

Brief History:

Committee Activity:

Consumer Protection & Business: 3/17/21, 3/25/21 [DPA];
Appropriations: 3/30/21, 3/31/21 [DPA(CPB)].

**Brief Summary of Engrossed Second Substitute Bill
(As Amended By Committee)**

- Authorizes a public financial cooperative as a membership organization to lend to local and tribal governmental entities.

HOUSE COMMITTEE ON CONSUMER PROTECTION & BUSINESS

Majority Report: Do pass as amended. Signed by 4 members: Representatives Kirby, Chair; Walen, Vice Chair; Ryu and Santos.

Minority Report: Do not pass. Signed by 3 members: Representatives Vick, Ranking Minority Member; Dufault, Assistant Ranking Minority Member; Corry.

Staff: Serena Dolly (786-7150).

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not part of the legislation nor does it constitute a statement of legislative intent.

Background:

Public Banking in the United States.

A public bank is a financial institution owned by one or more public entities. Currently, the Bank of North Dakota (the Bank) is the only state public bank in the United States. The Bank is the only legal depository for all state funds, and the state and its agencies are required to place their funds in the Bank. Local governments may, but are not required to, deposit funds in the Bank. The Bank's deposits are guaranteed by the full faith and credit of the state. The Bank is permitted to collateralize government deposits. The Bank also administers infrastructure loan programs, provides products and services to other financial institutions, and offers a limited number of services directly to the public. Profits from the Bank are deposited in North Dakota's general fund or are used to support economic development in the state.

State Lending Programs for Local Governments.

Washington has more than 80 programs and subprograms administered by 12 agencies that provide financial support to local governments in the state. Some of the larger examples are listed below:

- The Public Works Assistance Account provides planning, pre-construction, construction, and emergency loans for local infrastructure improvements.
- The Water Pollution Control Revolving Loan Fund provides low-interest loans for planning, design, acquisition and construction of water pollution control facilities and nonpoint source pollution control activities.
- The Drinking Water State Revolving Fund provides low-interest loans for public water systems to publicly owned and privately owned drinking water systems statewide.
- The Community Economic Revitalization Board provides loans and grants to finance public infrastructure improvements that encourage new business development and expansion in areas seeking economic growth.
- The Housing Trust Fund provides loans and grants for construction, acquisition, and rehabilitation of low-income multi-family and single-family housing.

The Office of the State Treasurer administers two programs that provide local governments with access to capital through the municipal bond market. The LOCAL Program allows Washington municipalities to finance essential real estate and equipment through a lease agreement, also known as a certificate of participation. While these certificates are issued by the state, the state's obligation is limited to the extent that the state is an obligor in the certificates; otherwise local governments participating in a specific contract are named as the obligor. The School Bond Guarantee Program provides a backup general obligation pledge to school districts' bonds, providing a lower interest rate to the borrowing district.

Washington State Bank Business Plan.

In the 2018 Supplemental Operating Budget, the Legislature provided funding for the Washington State Office of Financial Management (OFM) to contract with an entity or

entities with expertise in public finance and banking to evaluate the benefits and risks of establishing a state bank and to develop a business plan for its creation and launch. The OFM contracted with the University of Washington's Daniel J. Evans School of Public Policy and Governance to complete the evaluation. This report was submitted to the Legislature in May 2020.

State Debt and Nonrecourse Bonds.

There are a number of constitutional provisions related to public funds and public financing. For instance, state debt is authorized and a state debt limit is established. As a general rule, the state and local governments are prohibited from lending their credit, making gifts, loans, or acting as a guarantor to non-governmental entities; in some cases exceptions apply. When authorized by the Legislature, the State Finance Committee issues debt on behalf of state agencies. General obligation bonds are secured by the full faith and credit of the state or a pledge of general state revenues. The state debt limit restricts the amount of general obligation bonds the state can issue at any one time. An exception is nonrecourse bonds issued by a state agency or quasi-state agency, which under certain legal parameters are not considered a state obligation.

Characteristics allowing state bonds to be nonrecourse rather than general obligation bonds are illustrated by the Washington State Housing Finance Commission (WSHFC). The WSHFC issues non-recourse revenue bonds for an ongoing program related to housing. Among other things, state revenues were not used to capitalize the program and state revenues are not used for WSHFC staff and other program costs. The WSHFC is funded through bond proceeds and revenue generated by the program.

Summary of Amended Bill:

Establishment and Activation of the Public Financial Cooperative.

The Washington State Public Financial Cooperative (cooperative) is established as a public body and instrumentality of the state. The cooperative is activated when:

1. the State Treasurer completes a study that provides recommendations on staffing and operational needs for the cooperative to be administered by the WSHFC;
2. a state appropriation sufficient to allow the cooperative to issue debt with a competitive rating is provided; and
3. executed articles of activation are filed with the Secretary of State in a form approved by the State Finance Committee.

Local governments and federally recognized tribes are permitted to invest in the cooperative. Each local or tribal government member must approve the articles of activation and provide a contribution to the cooperative in an amount approved the State Finance Committee. Beginning five years after activation, the cooperative must have a goal of providing 35 percent of the amount it annually lends to support housing in low to moderate income areas.

Operating Board and Staffing.

The cooperative's operating board (board) consists of the following nine members:

- five elected local or tribal officials, to be selected by the members of the cooperative;
- three state residents appointed by the Governor; and
- the State Treasurer, or a designated employee, serving as an ex-officio member.

The Governor shall appoint the chair from one of the three public members of the board. Board members serve staggered four-year terms. Board members serve without compensation but are entitled to reimbursement for expenses from the funds of the cooperative. The board must approve the cooperative's annual budget and establish an internal audit committee.

The board has the authority to hire and fire an executive director, who is funded through the WSHFC budget. The executive director and employees of the WSHFC will administer and operate the cooperative. The cooperative may consult with other state agencies at its discretion and without the approval of the WSHFC.

Oversight of the Cooperative.

The State Finance Committee serves as the oversight board of the cooperative and may require independent audits of the cooperative. The cooperative also is subject to audit by the State Auditor, and the Department of Financial Institutions (DFI) may review the funds, accounts, and transactions of the cooperative.

Powers and Limitations on the Cooperative.

The cooperative may:

- sue and be sued in its own name;
- adopt and alter an official seal;
- establish rules to conduct its business;
- engage independent consultants, attorneys, and advisers;
- contract with federal, state, local, and tribal governmental entities for services;
- acquire, hold, use, and dispose of real and personal property, income, revenues, funds, and money;
- receive and invest funds from state, local, or tribal governments;
- open and maintain accounts in qualified public depositories;
- procure insurance;
- apply for and accept grants, loans, advances, and contributions;
- borrow money and issue bonds;
- develop and conduct a loan program for local and tribal governments to facilitate the financing of infrastructure and economic development projects;
- establish program guidelines, membership contributions, and other fees and charges;
- make expenditures for paying administrative costs;
- establish reserve funds;
- provide financial and other assistance to state, local, or tribal governments; and

- distribute surplus funds to members, when authorized by two-thirds of the board.

The cooperative may not:

- issue bonds that would create state debt;
- serve as a public depository;
- constitute a bank or trust company within the jurisdiction or under the control of the DFI, the comptroller of the currency of the United States, or the United States Department of the Treasury; or
- constitute a bank, broker, or dealer in securities.

Financing Powers of the Cooperative.

Bonds issued by the cooperative are not obligations of the state, may not create state debt, and are only obligations of the cooperative. Funds created for bond repayment are not public moneys or funds of the state and must be segregated and set apart from other funds.

Bonds of the cooperative are subject to terms, conditions, covenants, and protective provisions as are found necessary or desirable by the cooperative. Any bonds issued may be secured by a financing document between the cooperative and the purchasers or owners of the bonds. The cooperative may purchase its bonds with any of its funds available and purchase its bonds in the open market. Any issuance of bonds requires advance notice to the State Treasurer as chair of the State Finance Committee.

The cooperative and its members, directors, and employees are not personally liable on bonds or subject to any personal liability or accountability. Any owner of bonds issued by the cooperative may become a purchaser at any foreclosure sale if the person is the highest bidder.

Exemption from Disclosure.

The following are exempt from disclosure:

- financial and commercial information and records supplied by businesses or individuals during the application for loans or program services; and
- examination reports and information obtained by the DFI.

Amended Bill Compared to Engrossed Second Substitute Bill:

The amended bill requires, rather than allows, a financing document used to secure bonds issued by the cooperative to contain provisions for protecting and enforcing the rights, security, and remedy of bond owners.

Appropriation: None.

Fiscal Note: Preliminary fiscal note available.

Effective Date of Amended Bill: This bill takes effect 90 days after adjournment of the session in which the bill is passed, except for section 10, relating to public disclosure, which takes effect January 1, 2022.

Staff Summary of Public Testimony:

(In support) The bill is not a roadmap to replicating the Bank in this state. It is a proposal that has evolved over the last decade. The bill establishes a cooperative to be run by bankers for the benefit of the public. The cooperative is different than commercial banks as it would be accountable to the public. This is a good step toward public banking. The cooperative is designed so as not to create state debt or impact the state debt limit, similar to the way the WSHFC operates. Any profits from the cooperative will be reinvested back into the community.

It makes good business sense to reduce government costs. The cost of borrowing from the cooperative would be less than the cost of borrowing from a private, for-profit bank. The cooperative can help increase the state's housing inventory and assist small and rural communities with infrastructure, such as broadband access. This is a very important tool for local communities. Investments will have a larger impact in smaller jurisdictions who are foregoing infrastructure projects, and a portion of the capital should be reserved for smaller jurisdictions who have less access to capital. One or two of the operating board member seats also should be reserved for representatives from smaller jurisdictions. During the economic downturn, banks were not responsive to the needs of local governments. The Bank continued lending, which lessened the impact of the recession in that state.

European countries successfully use public banks, and the International Monetary Fund recently came out in support of public banks. People who use public banks, like the ones in North Dakota and Germany, are very happy with those banks. A public bank could help the state compete internationally.

(Opposed) There is a fine line between a public cooperative and a state bank. Much of the support for the bill reflects a fundamental misunderstanding of how banks work. Community banks and credit unions do not lend their own money. The cooperative would serve the same function. Making a below-market interest rate loan results in a subsidy from some local governments to other local governments. During an economic downturn, local governments need access to their funds. Deposits would not be insured by the Federal Deposit Insurance Corporation. Banks have lending requirements, and if an entity cannot access loans through current methods, there should be concern about making a public loan to that entity. Some special districts are already overextended, and this may tempt those overextended districts to try to borrow more money. Oversight of the cooperative would come solely from the elected officials on the State Finance Committee.

(Other) The WSHFC is supportive of the underlying concept of providing additional opportunities to access capital for local governments. Protections to ensure that the

cooperative does not interfere with current WSHFC programs and operations should remain in place. Some cities are interested and intrigued by this type of program designed to address unmet infrastructure funding needs. There are many questions about how the program would work and whether cities could benefit. Any new program should be additive and not replace successful infrastructure programs already in place. City reserves are not always very large, and these reserves typically are needed for cash flow and emergencies. Cities really need no or below-market interest rate loans, similar to those from the Public Works Assistance Account. Some cities also have a need for technical assistance.

Persons Testifying: (In support) Senator Kuderer, prime sponsor; Ruth Fruland; Dennis Ortblad; Stoney Bird; Satpal Sidhu, Whatcom County; and Cynthia Stewart, League of Women Voters of Washington.

(Opposed) Jeff Pack, Washington Citizens Against Unfair Taxes; Brad Tower, Community Bankers of Washington; and Tim Noonan, 5th Legislative District Democrats.

(Other) Steve Walker, Washington State Housing Finance Commission; and Candice Bock, Association of Washington Cities.

Persons Signed In To Testify But Not Testifying: None.

HOUSE COMMITTEE ON APPROPRIATIONS

Majority Report: Do pass as amended by Committee on Consumer Protection & Business. Signed by 19 members: Representatives Ormsby, Chair; Bergquist, Vice Chair; Gregerson, Vice Chair; Macri, Vice Chair; Chopp, Cody, Dolan, Fitzgibbon, Frame, Hansen, Johnson, J., Lekanoff, Pollet, Ryu, Senn, Springer, Stonier, Sullivan and Tharinger.

Minority Report: Do not pass. Signed by 14 members: Representatives Stokesbary, Ranking Minority Member; Chambers, Assistant Ranking Minority Member; Corry, Assistant Ranking Minority Member; MacEwen, Assistant Ranking Minority Member; Boehnke, Caldier, Chandler, Dye, Harris, Hoff, Jacobsen, Rude, Schmick and Steele.

Staff: Charlie Gavigan (786-7340).

Summary of Recommendation of Committee On Appropriations Compared to Recommendation of Committee On Consumer Protection & Business:

No new changes were recommended.

Appropriation: None.

Fiscal Note: Preliminary fiscal note available. New fiscal note requested on (DATE).

Effective Date of Amended Bill: This bill takes effect 90 days after adjournment of the session in which the bill is passed, except for section 10, relating to public disclosure, which takes effect January 1, 2022.

Staff Summary of Public Testimony:

(In support) The Washington State Public Financial Cooperative (cooperative) authorized in the bill can provide better interest rates for local government borrowing. The cooperative will help local governments pool their resources and lower operating costs. After five years, a portion of the cooperative's loans will be dedicated to housing. Local governments have significant infrastructure needs, and this program can help provide funding for that. This is a common-sense idea that supports housing, transportation, and schools. The House of Representatives should put money in its operating budget similar to what is assumed in the Senate operating budget: \$10.25 million from the State General Fund (GF-S) in 2021-23 and \$200 million GF-S in fiscal year 2024.

(Opposed) There is plenty of funding currently available in the financial markets at low rates for infrastructure. There must be a good reason someone cannot access funding. It is not a good long-term strategy to tie up local government reserves given the cyclical nature of the economy. How can a public bank expect to be competent after the recent problems at the Employment Security Department.

(Other) Cities need infrastructure financing. This program should be in addition to existing public infrastructure financing programs.

Persons Testifying: (In support) Cynthia Stewart, League of Women Voters of Washington; Todd Lagestee; Ruth Fruland; Mary Paterson; and Stoney Bird.

(Opposed) Jeff Pack, Washington Citizens Against Unfair Taxes; Brad Tower, Community Bankers of Washington; and Jean Amick.

(Other) Candice Bock, Association of Washington Cities.

Persons Signed In To Testify But Not Testifying: None.