OREGON STATE TREASURY

Local Government

News Report

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INSIDE THIS ISSUE

BANK HOLIDAY

No holidays or bank closures remaining in July

A CAUTIONARY TALE FOR MUNICIPAL BORROWERS

This article is intended as an important heads-up to Oregon jurisdictions that have sold bonds through the Build America Bonds, Qualified School Construction Bond, Qualified Academy Zone, New Clean Renewable Energy Bonds, and Qualified Energy Conservation Bonds programs.

In the aftermath of the Lehman Brothers bankruptcy filing in the fall of 2008, the municipal bond market experienced a huge sell off. For a time this made it nearly impossible for state and local governments to find investors willing to buy new municipal bond issues at "normal" interest rates. In 2009, the U.S. Congress passed a large stimulus package called the American Recovery and Reinvestment Act (ARRA). The ARRA package included a new program offering attractive federal interest subsidies on bonds sold by state and local governments for certain types of public works projects. Most programs were for bond sales for the following two years, with a few programs having longer time frames for issuance.

Because ARRA bonds were structured in a taxable mode, there was a much wider range of buyers than would be typically available to municipal borrowers. This approach played a significant role in helping state and local governments regain access to the credit markets. Our records indicate that since 2009, 47 Oregon local government transactions and three State transactions were structured and sold through one of the ARRA bond programs listed above.

An important feature of these bonds was the federal subsidy on interest payments. Following bond-issuance, issuers (or fiscal agents on behalf of issuers) periodically submit and receive a pre-determined amount of federal payment on a portion of the interest paid on these taxable bonds. Initially, those who issued Build America Bonds (BABs) received a federal subsidy offsetting 35 percent of the interest cost, while other targeted ARRA program bonds received even larger interest subsidy payments.

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INTEREST RATES

The average annualized yield for June was
0.875 percent

The rate for June was as follows:

June 1–30
0.875 percent

A CAUTIONARY TALE FOR MUNICIPAL BORROWERS

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These interest subsidies where reduced, however, as part of the Deficit Reduction Act of 2013, whereby Congress provided all ARRA bond issuers an annual 8.7 percent "discount" on their subsidy payment.

It recently came to our attention, however, that four school districts who sold Qualified School District General Obligation Bonds through the ARRA program did not receive their federal interest subsidy in a timely fashion despite having submitted the 8038-CP reimbursement paperwork in a timely fashion. Unfortunately, the district's paying agent had billed the four school districts for the net amount of debt service after taking into account the federal subsidy rather than the gross amount actually due on the bonds. The school districts, in turn, paid that net amount to the paying agent in advance of the actual payment date on their bonds. Of further regret, the paying agent did not alert the school districts about the delay in the IRS subsidy payment until the day that debt service was actually due -- June 15, 2016. While one of the districts was able to scramble fast enough to get the balance of funds owed to the paying agent that day, the other three school districts were, not surprisingly, unable to accomplish this quick payment turnaround – resulting in an actual debt service payment default on their bonds.

Fortunately, all three districts were able to cure this payment default within one to five business days after being alerted to the problem. Based on the obligations each district entered into in their secondary market disclosure agreements, even this type of communication mishap is nevertheless considered a "**material event"** that must be disclosed publically via the Electronic Municipal Market Access system (EMMA) within ten business days of the event. While all three districts filed their material event notices on EMMA in a timely fashion, going forward, they will also have to disclose this material event in their future bond offering documents, which is not likely to be a credit positive factor to cautious investors.

Sadly, if Treasury had been made aware of the situation in advance, none of this would have occurred. All three district's general obligation bonds were guaranteed for timely repayment by the State through the Oregon School Bond Guaranty (OSBG) program. Because the paying agent did not contact Treasury about the matter until June 23rd, we were unaware of the issues and thus unable to step in and help resolve the matter prior to payment default – which would also have avoided the subsequent EMMA material event disclosure filings by these districts. It is important to understand that under the terms of the OSBG program, the paying agent is legally required to contact Treasury about potential payment shortages a full 10 days in advance of the actual payment date, which did not occur in this case.

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A Cautionary Tale for Municipal Borrowers

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So here's the bottom line on this "series of unfortunate events"… if your jurisdiction has issued direct-pay interest subsidy bonds through the ARRA program, please be aware that even if a paying agent or trustee bills you for the net amount owed on these bonds, your jurisdiction remains responsible for the full amount of each debt service payment. Given the federal government's after-the-fact "discount" on the initially promised interest rate subsidy, as well as this recent IRS payment processing delay, it is important for all of us to keep a close eye on all aspects of these ARRA bonds to make sure that this type of payment default doesn't ever happen again.

Oregon Local Government Intermediate Fund

Treasury recently launched the Oregon Local Government Intermediate Fund (OLGIF) as a new option for local governments to invest public funds. The OLGIF is constructed and diversified to potentially yield higher returns, depending on market conditions. That said, Treasury is underscoring an important caveat for the fund: Unlike the existing Oregon Short Term Fund, invested principal will be at risk. With that in mind, local governments interested in participating in the fund must first meet requirements established by Treasury to be considered eligible. Information about the fund and underlying requirements for participation is available at:
www.oregon.gov/treasury/Divisions/Investment/Pages/OLGIF.aspx. A full press release can be found at:
http://www.oregon.gov/treasury/Newsroom/Pages/ViewArticle.aspx?pressReleaseID=145.

CMIRP Corner

The Cash Management Improvement & Renewal Program (CMIRP) is a continuous improvement program focused on the renewal, replacement, and refinement of processes and technology supporting Treasury cash management services.

Treasury released a Request for Proposal (RFP) to select a service vendor for the LGIP Business Systems Renewal (BSR) project. Initial responses were due July 11, and finalist presentations are now scheduled for the week of July 25. Two local government representatives from the LGIP BSR Stakeholder Workgroup will participate in the presentation phase and contribute to selection evaluation. If you have questions or comments about the LGIP BSR effort, please contact project staff at cmirp@ost.state.or.us.

New Employee

We are pleased to welcome Ryan Auclair to Treasury as our new Cash Management Project Manager. Ryan joins Treasury as a member of our newly formed Project Management Office PMO, where he will directly support our cash management project efforts. Ryan comes to us from Florida where he worked as a Senior Project Manager for the Pinellas County Business Technology Services. He also held a Senior Project Manager position for Honeywell Technology Solutions, and has experience in the U.S. Army. Ryan graduated with his Bachelor's Degree from Providence College in Rhode Island, and is a Certified Project Management Professional through the Project Management Institute. We are fortunate to have Ryan as a member of Treasury's team to help lead our diverse project management needs.

CREDIT MARKET REVIEW

What a difference a month can make.

The conversation about future Fed rate hikes, which had been widely seen as a certainty, made a transition from "when" to "if" in June. A poor May jobs report, as noted in last month's newsletter, combined with the surprise result of the UK "Brexit" referendum vote on June 23 introduced a fresh dose of volatility into the markets. Uncertainty in economics and politics -- combined with low global growth, tepid inflation and negative interest rates across much of the world -- is giving markets some pause.

The risk-off tone and search for safe assets immediately following the UK referendum vote had large impacts on the British Pound and global sovereign bond markets. The British Pound, the currency for the United Kingdom, reached a 31-year low of 1.29 US Dollar per Pound on July 7. US Treasury yields hit record lows with the 10-year Treasury yield closing at 1.367 percent on July 5, and the German 10-year Bund dropped to a new low on July 8 with a negative yield of 0.189 percent. Despite the headwinds, US stocks managed to print new all-time highs with the Standard and Poor's 500 Stock Index closing above 2,152 on July 13.

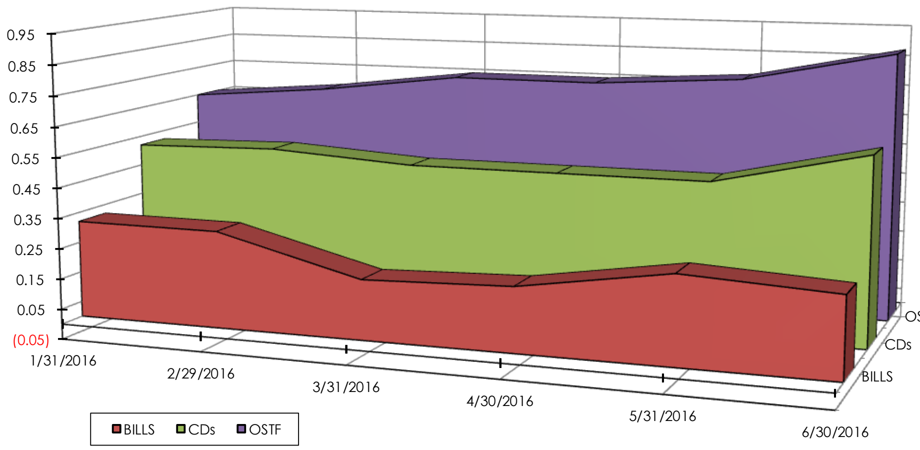
The June U.S. jobs report was released on July 8. The report reversed the May disappointment as figures came in much stronger than expected with headline jobs increasing 287,000. The median economist projection, according to Bloomberg, was for job growth of 180,000. Wage growth ticked higher showing a 2.6 percent annualized increase in wages. The headline unemployment rate moved higher from 4.7 percent to 4.9 percent due to new entrants into the labor force and some decimal rounding. The market reaction was one of mild relief which sent risk assets higher and Treasury rates slightly higher.

Money market rates and front-end Treasury yields fell to near term lows after the UK referendum vote results were digested by the market. Credit spreads remained largely unchanged on the month as investors appeared to favor the relatively higher-yielding US markets.

MARKET DATA TABLE

	6/30/2016	1 Month	3 Months	12 Months		6/30/2016	1 Month	3 Months	12 Months
7-Day Agency Discount Note**	0.23	0.23	0.16	0.01	Barclays 1-3 Year Corporate YTW*	1.41	1.68	1.79	1.51
30-Day Agy Nt Disc**	0.25	0.31	0.20	0.02	Barclays 1-3 Year Corporate OAS*	0.78	0.76	0.90	0.78
90-Day Agy Nt Disc**	0.28	0.38	0.29	0.06	Barclays 1-3 Year Corporate Modified Duration*	1.96	1.96	1.96	2.00
180-Day Agy Nt Disc**	0.34	0.44	0.38	0.12					
360-Day Agy Nt Disc**	0.46	0.65	0.56	0.27	7-Day Muni VRDN Yield**	0.41	0.40	0.40	0.07
					O/N GGC Repo Yield**	1.03	0.48	0.24	0.44
30-Day Treasury Bill**	0.18	0.23	0.12	0.00					
60-Day Treasury Bill**	0.21	0.26	0.14	(0.00)	US 1 Year Inflation Break-Even**	1.17	1.43	2.12	0.73
90-Day Treasury Bill**	0.22	0.32	0.21	0.00	US 2 Year Inflation Break-Even**	1.32	1.44	1.68	1.19
6-Month Treasury Yield**	0.35	0.45	0.39	0.11	US 3 Year Inflation Break-Even**	1.34	1.42	1.52	1.37
1-Year Treasury Yield**	0.44	0.68	0.61	0.27					
2-Year Treasury Yield**	0.584	0.88	0.76	0.65	1-Day CP (A1/P1)**	0.48	0.38	0.46	0.13
3-Year Treasury Yield**	0.69	1.03	0.90	1.01	7-Day CP (A1/P1)**	0.49	0.40	0.47	0.14
					30-Day CP (A1/P1)**	0.54	0.48	0.51	0.15
1-Month LIBOR**	0.47	0.47	0.43	0.19					
3-Month LIBOR**	0.65	0.69	0.63	0.28	30-Day CD (A1/P1)**	0.45	0.44	0.44	0.18
6-Month LIBOR**	0.92	0.99	0.90	0.44	90-Day CD (A1/P1)**	0.62	0.62	0.61	0.25
12-Month LIBOR**	1.23	1.34	1.21	0.77	6-Month CD (A1/P1)**	0.89	0.89	0.86	0.38
Sources: *Barclays, **Bloomberg, ***JP Morgan					1-Year CD (A1/P1)**	1.16	1.21	1.14	0.65

OREGON SHORT TERM FUND ANALYSIS AS OF 6-30-16



	1/31/2016	2/29/2016	3/31/2016	4/30/2016	5/31/2016	6/30/2016
LGIP AV DOLLARS INVESTED (MM)	7,419	7,409	7,225	7,124	6,986	6,241
STATE AGENCY AV DOLLARS INVESTED (MM)	8,316	7,852	7,649	7,783	8,183	8,236
TOTAL OSTF AV DOLLARS INVESTED (MM)	15,735	15,261	14,873	14,907	15,169	14,477
OST ANNUAL YIELD (ACT/ACT)	0.65	0.69	0.75	0.75	0.78	0.88
3-MO UST BILLS (BOND EQ YLD)	0.32	0.32	0.20	0.21	0.29	0.26
3-MO US CD (ACT/360)*	0.52	0.53	0.50	0.50	0.50	0.61

NOTE: The OST ANNUAL YIELD represents the average annualized yield paid to account holders during the month. Since interest accrues to accounts on a daily basis and the rate paid changes during the month, this average rate is not the exact rate earned by each account.

3-MO UST BILLS yield is the yield for the Treasury Bill Issue maturing closest to 3 months from month end. 3-MO US CD rates are obtained from Bloomberg and represent a composite of broker dealer quotes on highly rated (A1+/P1/F1+ from Standard & Poor's Ratings Services, Moody's Investors Service and Fitch Ratings respectivley) bank certificates of deposit and are quoted on a CD equivalent yield basis.

This material is available in alternative format and media upon request.

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