MEMORANDUM

To: Chairman Wallace
From: John McPhetridge
Date: March 13, 2023
Re: Oklahoma State Advanced Financing Enablement (OSAFE) Fund

Oklahoma Capital and Infrastructure Budget:

Oklahoma's appropriated budget is primarily operational funding, providing little if any dedicated resources for capital, infrastructure, or maintenance needs. Agencies generally have been expected to internally save for maintenance and large capital projects, or more often than not, come to the Legislature for funding through bonding authorizations and subsequent debt service appropriations. Currently the State's appropriated budget finances debt service through OCIA debt service rents included in specific agency operational budgets. For FY-24 total rent payments financed through the state budget is estimated to cost $179,123,878, of that amount approximately $55 million constitutes interest and financing fees.

Oklahoma is currently in possession of a large amount of non-recurring revenue; which could prove problematic in future budgets if fully plowed into the operational budget of the state. In an effort to avoid increasing the operating budget of the state in an unsustainable manner, the State could instead isolate such funding into a revolving fund and implement a capital and infrastructure budget. By doing so the State could cash finance capital projects from the Fund, and reimburse the Fund for future use, with appropriations similar to those that would have been required for debt service, had the project been financed through traditional debt instead of cash.

Oklahoma State Advanced Financing Enablement (OSAFE) Fund:

The presence of a large amount of non-recurring cash provides the State a unique opportunity to capitalize a cash financing revolving fund; whereby, capital projects may be funded directly with cash up-front and avoid financing and interest costs. The Legislature would replenish the Fund through agency appropriations, similar to how the Legislature currently funds OCIA rent payments. The amount of agency appropriation that traditionally constituted debt service, will instead be directed to the Fund to replenish the Fund for future use. OCIA could be a good option to be the custodian and administrator of the Fund.

Once the Fund is created and funded, the Legislature can review capital projects for viability, but instead of enacting a bond authorization, the Legislature would pass a measure "authorizing the distribution of [*dollar amount*] from the Fund to [*state entity*] for [*project description*] compliant with [*specified terms and conditions*]. This allows for a more formal vetting of projects, as well as, allows for specific and unique terms and requirements for each project, breaking free from the streamlined language and structure the State must follow for bond authorizations. Also since this is not debt financing there are far fewer Constitutional issues; always worth avoiding when possible. Authorizing uses of the funds would require the enactment of legislation.

Advantages Flexibility

The Fund is designed to reduce financing costs, primarily interest costs, which are increasing in the current interest rate environment, but the Fund also provides liquidity options due to its flexibility. The Legislature through internal policy and appropriations controls the reimbursement schedule for the Fund. For this reason the Legislature can spread out reimbursements to the Fund, (the State reimbursing itself), over any time period, 5, 10, 30 years, etc. and vary reimbursement schedules as needed. Additionally, if the State experiences economic downturns in the future, the State can pause/suspend reimbursements to the fund and expenditures from the fund for a period of time, allowing for the more immediate use of such funds as operational budget resources, during such downturn.

Ultimately, the Legislature's attitude toward reimbursing the Fund will be dependent on the balance the Legislature wishes to maintain in the fund for immediate access. It would not be unreasonable to establish a balance target of 10% of initial corpus, and maintain such balance via reimbursements in-lieu of debt service payments. *Hypothetical:* a Fund initially funded with $1,000,000,000 and supported with an annual reimbursement base of 10% would require base appropriations of $100,000,000; which seems like a large amount until one takes into account that for FY-24 alone we are anticipating $55,000,000 in interest and financing fees in the base.

Maintaining a 10% cushion would provide access to approximately 20% of the corpus amount in a revenue downturn. In the previous hypothetical that 20% would constitute the 10% balance in the Fund, and the suspending of the 10% annual reimbursement appropriations, ($100M balance + $100M base reduction could close a $200M operational budget hole).

Conclusion:

The OSAFE fund achieves the following:
- limits increase to operational budget;
- avoids future financing and interest costs;
- provides upfront capital for immediate utilization for shovel-ready projects;
- encourages development of shovel-ready projects, less downstream uncertainty;
- makes available with no access penalty, significant budget resources for economic downturn;
- increases the state's general liquidity;
- program scalability, can implement expand corpus size; and
- represents the state ability to finance and invest in itself, sovereign autonomy.