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SUBMITTED TO THE FINANCE, REVENUE & BONDING COMMITTEE
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Good afternoon Senator Fonfara, Representative Berger, and members of the Finance, Revenue & Bonding Committee. Thank you for the opportunity to provide testimony on Senate Bill 40, *An Act Concerning the Use of Bond Proceeds*. In summary, there is a provision of the bill that I would support with some refinement, as it relates to the use of bond premiums, and another provision that I oppose on grounds that passage would unduly restrain the Treasury's management of the State's cash and would, quite likely, increase our overall debt costs.

As drafted, the bill would affect two aspects of the Treasury's operations. First, with respect to the management of debt, the bill would seem to require the use of bond premiums to finance authorized projects. Second, with respect to our management of the State's cash flow, the bill would prohibit the use of temporary interfund transfers from bond fund investment accounts to cover fluctuations in the flow of disbursements and receipts in other funds.

<u>Use of Bond Proceeds.</u> Because total bond proceeds include bond premiums, Senate Bill 40 would seem to require these funds be expended on programs and projects approved by the State Bond Commission. If this is the intent, then the bill would need to also amend existing law, specifically section 3-20(f) of the general statutes regarding general obligation (GO) bonds. The State's other programs for transportation obligations, the University of Connecticut, and clean water obligations already provide that bond premiums be used to fund authorized projects, thereby reducing the amount of issuance.

It bears noting that this Committee has raised a concept on bond premiums that I support, which would make the use of GO bond premiums consistent with other capital programs – to apply the amount to finance authorized programs and projects to reduce the amount the state borrows. Bond premiums are an upfront payment by investors to the State in exchange for the State paying a higher stated interest rate on a given bond – in essence, extra cash to the State in addition to the bond's face value.

Bond premiums are a tax-exempt bond market phenomenon in a low interest rate environment that results from investors wanting to purchase bonds with higher interest rates to avoid certain consequential provisions in the federal tax code. Given the extended period of low interest rates in recent years, and the expectation of a rise in interest rates, investors continue to seek this bond structure. However, once interest rates rise, bond premiums are expected to become less of a factor in the market.

Currently, state law (section 3-20(f) of the general statutes) requires bond premiums on GO bonds to be deposited into the General Fund, and federal tax law requires that it be used to fund up to 18 months of interest on GO bonds. Because these funds are available to pay current debt service, they create lapses in the General Fund debt service budget. These lapses are available to cover deficiencies in other areas of the budget, or if not needed, contribute to a budget surplus. Passage of this bill would discontinue this practice.

<u>Temporary Interfund Transfers.</u> This bill would reduce our flexibility in using already available funds to cover the state's obligations, thereby increasing the likelihood that we would have to enter into, and use, standby lines of credit, or issue short-term tax or revenue anticipation notes, with their

attendant additional costs. **<u>Thus, this bill would have the practical effect of increasing borrowing costs and debt outstanding, rather than limiting them.</u>**

By way of background, when bonds are issued, proceeds are deposited into short-term investment accounts and become part of the state's total available cash. The Treasury will, on occasion, transfer monies to the common cash pool from the separate bond proceeds investment accounts to cover other authorized disbursements. Any amounts transferred are always returned to the bond fund investment accounts from the common cash pool when other cash balances improve. Conversely, the Treasury also, on occasion, uses balances of other funds to cover capital expenditures prior to the issuance of bonds for those purposes. In this case, the common cash pool is reimbursed when bonds are sold. The transfers from the bond funds do not negatively impact the bond funds because any interest earnings on the balances go to the General Fund in any event.

This transfer process is in conformance with the State's longstanding, and auditor-sanctioned practice. As the State Auditors of Public Accounts noted in 1994 "…inter-fund borrowing is the most efficient and economical method of meeting the State's obligations," and "[i]nter-fund borrowing within civil list funds is the most efficient and economical means for assuring that every check issued by the State of Connecticut is covered and that all capital projects can continue on a timely basis." In essence, we make use of all of the State's cash already on hand prior to going to external credit markets.

To allow our continued use of temporary interfund transfers, I recommend the substitution of the word "expend" in place of "use."

Thank you again for the opportunity to offer this testimony on Senate Bill 40. I support the provisions affecting the use of bond premiums, but recommend additional changes to 30(f) that my office has developed. I also request substitution of the word "expend" in place of "use" to allow the Treasury to use all available funds in meeting daily obligations previously approved by the legislature and the Governor.