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Representative Valerie Fraser
New Hampshire House of Representatives
Concord, New Hampshire
BY EMAIL

Dear Representative Fraser:

During 2015 and 2016, I served as Senior Policy Advisor to Rhode Island General Treasurer Seth Magaziner. One of the primary projects I took on was to help design and write legislation for the new Rhode Island Infrastructure Bank (RIIB). The legislation passed in 2015, and it has already become a vital institution and is poised to grow and do things we did not imagine. Its benefit to the state, in terms of roads (re)built and clean energy projects underway, is already substantial and in the future it will only grow.

You inquired about the feasibility and desirability of an institution like RIIB for New Hampshire, but with a funding structure borrowing certain aspects of a commercial bank, such as accepting short-term investments in the form of "deposits" or active participation in the state's management of its cash, in addition to the more standard bond finance. We also discussed the success of the Vermont Treasurer's "Ten Percent for Vermont" program. What follows is a brief discussion of lessons of the Vermont and Rhode Island programs, and their applicability to the state of New Hampshire.

New Hampshire manages considerably more cash than the state of Vermont, and a bit more than Rhode Island, too. As of the end of FY16, the state had almost $900 million in cash and cash equivalents on hand. The actual number will ebb and flow during the course of a fiscal year, and my unfamiliarity with New Hampshire's revenue structure does not provide me with intuition about whether the end of June is the high tide or the low. Assuming it to be the high water mark, you'd have to assume the average balance would be significantly lower. Still, allocating 10% of the average cash balance to investment in state housing and infrastructure agencies, as Vermont is doing now, could free up $40–50 million in loanable funds.

The Vermont program is essentially a first-draft of the kind of liquidity risk management a traditional bank would undertake. Ten percent represents a reasonable—and quite conservative guess—of what would be a sensible lending policy given the state treasury's constraints on liquidity and security. A bank would, over time, refine their original guess as they learn to quantify and predict the variability of their deposit base and the needs of their borrowers. Likely enough, the Vermont treasury will adjust their expectations, too. Perhaps 10% will seem high after some experience. More likely, given the experience of commercial banks, it will seem quite low. It would have been better for Vermont to start with an organizational structure that took into account the likelihood of policy reformulation. Instead, they named the program for the policy, and encoded the 10% number into state law, actions they will find overly constraining with time.

Part of the reason the Vermont policy was designed this way was so that the Treasurer would have direct contact with the borrowers, and could make it clear to them (the Vermont Housing Authority, the Vermont Economic Development Agency (VEDA), and a small number of other similar agancies)

that they were to guarantee the state's loans and the state's liquidity with their entire bottom line. This is, of course, exactly the kind of scrutiny the Treasury makes of new banks to manage its investment portfolio. Indeed, having a well-capitalized intermediary between Treasury and the borrowing agencies would make it much easier to maintain security and liquidity, but this was not considered. Such an intermediary would itself have demanded such security from its borrowers, but would also have the capacity to be a second line of defense. (In fact, the Vermont policy was enacted in part to *prevent* the creation of just such an institution through a 2014 bill from Senator Anthony Pollina that would have converted VEDA into a publicly-owned bank.)

In addition to the means in the possession of the state of New Hampshire, there are several places where significant borrowing needs are not met by current structures. Affordable housing finance, for example, is important to the future growth of New Hampshire, but it is underfinanced. Estimates I've seen imply that New Hampshire could easily use another $30 million in affordable housing finance. Apart from the obvious quantitative deficiencies, however, there are frequently also qualitative deficiencies, as there will be if a housing bond is used to solve this problem. For example, few public housing agencies are structured to be able to help non-profit developers with site acquisition, something that typically requires decisions to be made in a few days or less. Bridge finance is also often important to many housing projects, as slow funding catches up with projects already on the move. Bridge finance is available from private lenders, but is often quite expensive for non-profit developers.

In addition to housing, there are substantial infrastructure needs all over the state, that do not have readily apparent funding sources available. The ASCE rates New Hampshire's infrastructure as a C-, which is to say that dam and bridge closures are among the possibilities without imminent action. The Municipal Bond Bank exists to provide some of the financing for this work, but the need is far greater than it can provide under its current structure. Bond financing of these needs, works, but it is inflexible and clumsy.

In Rhode Island, we built RIIB from a small finance agency similar to the Bond Bank, but focused on water projects. Essentially the task was only to add some more flexible lending programs to an already-existing, well-run, agency. The old Clean Water Finance Agency was well used to doing bond finance, and bond finance was envisioned for the new programs. There was substantial demand from the state's municipalities for the new programs, for roads and bridges, and for energy finance. In fact, the demand was far greater than the capacity from the beginning.

Sole reliance on the bond market was problematic for a few reasons. The first is that trying to corral a dozen municipal projects into a bond issue is a long and tedious process. More than a few of the projects could have been completed months, possibly years, sooner but for financing delays caused by wrangling all the other municipalities into the same pool. Second, because we sought a rating for the bond, not the lending program or the institution, we were unable to concentrate the lending in the communities that need it the most. The logic of sharing risk as expressed in bond documents meant that our bonds would involve lending in rich communities, as well as poor ones. This is not a bad thing in some respects—rich communities have legitimate need for attention from the state, too—but the aid we can get this way is out of proportion to the needs.

The bond market is also inflexible. Programs must be envisioned completely enough to be thoroughly described in bond documents. A thorough airing of public policies is always a good thing, but it is not unknown for conditions to change. Once a bond is sold, the terms are immutable, and this can deprive the institution of adapting to unforeseen market developments and municipal needs.

In other words, Rhode Island would be much better served by an institution that was capitalized well enough to be able to direct funds to the needs of the state, not the needs of the bond market, and that can remain flexible as a community's needs evolve over time. The same is undoubtedly true of New Hampshire.

Beyond these issues, most states possess a tremendous amount of cash and equivalents, whose financial power is currently invested at the whim of the private banks and corporations that hold it. Last year, the cash management operation at the Rhode Island Treasury was contenting itself with investing in short-term CDs and notes at about 30–40 basis points of interest. Meanwhile RIIB was selling short-term bond-anticipation notes at 2–2.5%. Why, the RIIB CFO asked, can't we sell our notes to Treasury at 1%? Both of us would come out ahead. A quick analysis I completed showed there is easily enough cash on deposit or invested short like this around our state to safely double the capacity of the infrastructure bank, possibly more, and I expect the same is true of New Hampshire.

There are a couple of useful models to be found in other states that already incorporate some of these lessons. The state-owned bank in North Dakota is a good example of an institution with the flexibility and financial strength to do a tremendous amount of good on behalf of that state's economy. It manages the state's cash and thereby has the financial capacity to fulfill a lot of the state's borrowing needs, as well as the flexibility to create programs on the fly, such as providing emergency credit to rebuild ravaged communities after the disastrous floods of 2011 in Minot and Bismarck or 1997 in Grand Forks. And, of course, learning from the Vermont experience would be quite timely and productive. There is nothing about these states and yours that would make it infeasible to learn from their experience.

The state of New Hampshire has a significant store of wealth, and problems that can be addressed by redeploying that wealth to invest it for the good of its citizens. Models of public finance exist—in North Dakota and in Vermont—to do so in a way that maximizes efficiency and reduces wasted effort and wasted money at very low risk to the state. New Hampshire can build on its neighbors' experience to address these problems, and I would urge you and your colleagues to do exactly that.

I regret that I cannot attend your session on Tuesday, but I would be delighted to address any questions you or your colleagues have at another time.

Yours sincerely,

Tom Sgouros