STATE POLITICS

Idaho's treasurer spent at least $5 million too much borrowing money. Now he's refusing a review

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Cameron Arial, who serves on the state investment advisory board, is pressing officials to look at how much it costs Idaho to borrow $500 million a year and why it needs so much. BY BILL DENTZER

A Statesman review of how Idaho borrows to cover periodic multimillion-dollar dips in cash flow shows that state Treasurer Ron Crane has routinely overpaid to finance those borrowings and could have saved the state millions through competitive bidding.

Idaho has borrowed billions of dollars over the last decade to cover those dips, paying millions in interest and fees to underwriters, a part-time financial adviser and outside agencies that grade the state's debt for investors. The Statesman's review, together with a state investment adviser's analysis of the costs, shows that for many of the years in question, Idaho did not need to borrow as much, and possibly any, outside funds to cover short-term shortfalls.

Members of an advisory panel on the state's creditworthiness, whose members include Lt. Gov. Brad Little and two legislators, state finance officials, and the heads of agencies such as the state building authority and the Idaho Housing and Finance Association, are now pushing for their own review of the half-billion-dollar yearly transactions. At least three members have refused to sign off on the committee's annual report to the governor without such a review. The report goes to the governor each August.

The $5 billion worth of tax anticipation notes, or TANs, are routine debt-financing instruments issued by governments to shore up accounts pending receipt of tax revenues. The notes are repaid from tax collections, with interest, at the end of a year.

The premiums and fees Idaho paid to issue the debt over a 10-year period, from 2007 to 2016, total approximately $45 million. Idaho could have saved $5 million off the top if it had simply matched the more favorable yields and underwriting costs paid by other states and eliminated unnecessary expenses on ratings and travel. It could have saved substantially more just by borrowing less, as Treasurer Office staffers recommended.

The costs and potential savings appear small measured against the $3.5 billion state general fund budget, or the $4.5 billion in assets overseen by the state Treasurer's Office, which issues the debt. But it is money sorely needed in a state that struggles year after year to find money to repair its sagging transportation infrastructure or boost public education funding while lawmakers clamor for cutting taxes on income and food sales.

"I see this as my fiduciary responsibility, as a member of the (advisory) board appointed by the governor and confirmed by the Senate, to analyze these things, and I'm doing just that," said Cameron Arial, a former investment banker who has asked two state oversight boards to review the borrowings.

NO COMPREHENSIVE REVIEW

As much as the dollars spent, what critics take issue with is the appearance that the annual debt financing has been on virtual auto-pilot. Crane has authorized the same amount of borrowing with the same players with no comprehensive review of costs or need, and against the recommendations of his internal investment division staff.

Crane, who has held the elected post since 1998, is thus once again under scrutiny for how he handles routine state financial business. Prior critical assessments by legislative auditors, lawmakers and former employees have questioned spending and investment decisions and found a lack of best practices, such as competitive bidding.

Crane declined to be interviewed for this story. Responding to written questions submitted by the Statesman, he said state officials and their outside advisers review the borrowing every year and reach agreement that the state "will be able to meet its cash flow needs using this financial tool."

The appointed panel that monitors Idaho's creditworthiness, the Credit Review Enhancement Committee, which has not met formally in years, is now pushing him to convene a meeting to discuss members' concerns with the borrowings. Crane chairs the committee and has resisted a meeting on grounds that the panel does not have oversight on the TAN borrowings.

The CREC's role "is to enhance and protect the credit rating of the state. It has nothing to do with overseeing the TAN issue," he said in May.

He's also pushed back against outside criticism as uninformed and off-base.

Members of the review committee disagree with Crane's hands-off assessment and have met informally with him and among themselves to press for a review.

"As I understand the mission of the CREC, it's to help the state increase its ratings and present the best possible financial face to the financial world," said John Sager, a committee member and chief financial officer of the Idaho Housing and Finance Association. "I think some of the things here probably need to be questioned and discussed."

The two lawmakers on the panel, Rep. Rick Youngblood, R-Nampa, and Sen. Chuck Winder, R-Boise, concur. Crane has not called a CREC meeting "in the five years I've been on the committee," said Youngblood, a banker. "We're not trying to shoot arrows. We're just trying to say. . .why don't we sit down as business professionals and legislators and talk about it?"

Winder said: "The issues have been raised to a level where the treasurer needs to address them."

The Statesman began to review Crane's management of the tax notes after a former employee filed a notice of claim against him for wrongful dismissal. The employee, who worked in the office's investment division, alleged he was fired in 2015 for trying to stop waste and mismanagement. The claim, which has not moved forward, included criticism of how the tax note transactions were conducted.

Arial, who sits on the five-member Treasurer's Investment Advisory Board, questioned costs on the state's 2016 tax note financing in a May letter to that board. The board meets quarterly; its next meeting is Thursday and Arial has asked that his concerns be added to the agenda.

Crane also chairs the investment board and maintains that the matter is outside the board's purview. He denied Arial's request to discuss it Thursday.

COMPARING IDAHO TO OTHER STATES

Two states that issue tax notes comparable to Idaho are Colorado and Oregon. Colorado chooses underwriters via competitive bid, which typically costs less. Oregon, like Idaho, does a negotiated bid; it works with a pre-approved group of underwriters. Idaho uses just one underwriter — since 2009 the same one, until a switch this year.

From 2007 to 2016, Idaho paid higher interest on its debt than the other states. For most of the decade, yields — the amount of interest paid to investors — on investment-grade debt were driven down by recession to below 1 percent.

Idaho paid about $38 million on $4.975 billion in debt issued. It would have paid $1.4 million less over the decade at the yields Oregon obtained, and $2.2 million less if it matched Colorado's.

Yields fluctuate over time, sometimes rapidly. The Treasurer's Office has previously cited that as a reason Idaho paid higher yields, and why it has always opted for a negotiated sale of its tax notes with a single underwriter, which allows more control on when to go to market.

But Sager, of the IHFA, which financed $1.2 billion in home loans last year, said market volatility isn't a factor with short-term debt such as Idaho's tax notes, which he described as a "plain vanilla" investment.

To Sager's point, all three states issued debt within the same three-month time frame, often in the same month, or even same week. Rates were historically low and stable for seven years from late 2008 and into the post-recession environment, beginning to climb again only at the end of 2015.

In several years between 2007 and 2016, Idaho obtained yields at or below the best benchmark market rates for municipal borrowers. The other states simply obtained better rates, in eight out of 10 years and on average for the decade.

The differences were just hundredths of a percent. But with such large sums involved, the dollar amounts are big enough to raise the question of why Idaho is borrowing so much, or at all, if there is a cheaper way to cover cash-flow needs.

DO WE NEED TO BORROW SO MUCH?

In 2006, Idaho issued just $100 million in tax notes. That number jumped to $400 million in 2007 and has stayed at or above $500 million since, with the exception of $475 million in 2014.

Governments typically are no more keen on indebtedness than the average household: In 2016, Texas's state comptroller praised prudent fiscal management for eliminating his state's need to borrow for a second straight year.

Critics of Idaho's borrowing think the state should do the same, given its healthy cash reserves. In November 2011, the state's idle funds account, which it uses to balance daily cash flows, reached a low market value of $304 million. It rebounded and has been above $1 billion, and as high as $1.8 billion, since mid-2012. Additional cash reserves against which Idaho can borrow total nearly $4 billion.

The state already borrows internally, against its own accounts, to cover short periods when the state's general fund dips below zero, on paper, such as when the state makes large payments to public schools. The largest of these periodic payments occurs in August.

The tax notes, Crane said in a written response to the Statesman, "provide additional liquidity to the general fund" given the inflows and outflows over the fiscal year. They remain "the best option for Idaho."

Crane contends that borrowing via tax notes reduces the need for more frequent internal borrowing, which requires interest payments. But when money is borrowed internally, the state is on "both sides" of the transaction, with interest paid back to itself, not outside investors.

"It is much cheaper to borrow internally than it is externally which is generally the case in any corporation," a member of the Treasurer's investment division wrote in 2011, arguing that the state should borrow less.

UNDERWRITING

Idaho's underwriting fees from 2007-2016, as a percentage of the total debt issued, were nearly equal to Oregon's but substantially more than Colorado's, which selects underwriters via competitive bid. Idaho paid nearly $3.2 million in underwriting fees over the 10 years. At Colorado's fee rate, it would have paid $2.2 million less.

Treasurer's Office records show the investment division team pressed Crane on ways to reduce costs, including seeking competitive bids for the underwriting work. Crane finally did so at the end of 2014. Seven financial firms made bids, which were reviewed by the state's long-time financial adviser on the tax notes, Cheryl Cook.

Cook recommended the same underwriter with whom she and the state had worked since 2009, even though that firm, Piper Jaffray, submitted the second-highest price for the work.

Crane declined to answer any questions about the bidding, including why he did not also seek bids on Cook's financial adviser work, or why he did not have a third party, or his own investment division, grade the underwriter's responses. Cook has not responded to Statesman questions.

FINANCIAL ADVICE

Cook, of Salt Lake City, served as the financial adviser on the deal since 1987, working for firms such as KeyBank and other underwriters in the 1990s and early 2000s before starting her own one-person firm, C2 Financial. Data that registered municipal advisers must submit to the SEC show she had one client, the Idaho state treasurer, whom she advised on one transaction a year. A one-time Salt Lake City treasurer, she retired from her Idaho role in December.

From 2007 to 2016, Cook was paid $1.2 million for the advisory work, including being reimbursed for $166,500 for deal-related travel by state officials to New York City. Prior to 2009, her fee was open-ended based on the amount borrowed, with a minimum set at $70,000.

In 2008, when Idaho issued $600 million in tax notes, she earned $150,000 plus expenses. The following year her fee was capped at $100,000, which she would earn if the sale were $400 million or more. The last time Idaho borrowed less than $400 million was 2006, when it issued $100 million in tax notes.

The Government Finance Officers Association, which promotes best practices in financial management for state and local governments, recommends that municipal advisers be paid on an hourly or retainer basis, not contingent on borrowing size, to avoid conflicts.

The financial adviser for this year's tax notes — Piper Jaffray, formerly the underwriter — was paid on the same contingency basis as Cook and earned $102,500, plus $2,400 in expenses.

Crane declined to answer questions about Cook's work, citing the possible litigation from the employee he fired.

Arial's analyses criticized the larger costs Idaho paid for its debt compared to Colorado. He has questioned both Cook's advice and the state's failure to follow best practices.

"If you're paying a large fee for a service but you're getting a comparatively worse deal than your peers, then you have to wonder how good is that advice and how good is the process that you're using," Arial said.

RATINGS AGENCY FEES

Idaho seeks investment ratings on its tax notes from all three major agencies, Standard & Poor's, Moody's and Fitch Ratings. So does Oregon. The agencies charge up to $60,000 to assign a rating, which investors rely on to gauge the value and risk of an investment.

Sager and other municipal finance executives told the Statesman there was no need for three ratings on a simple one-year tax note. Colorado, for example, seeks only two, and arguably one is enough. From 2007 to 2016, Idaho spent $1.3 million on the triple ratings. That's not counting the $165,000 in travel expenses it incurred for trips state officials made to New York annually to meet with the agencies – meetings that other states, like Colorado, handle over the phone. Crane has faced criticism previously for the cost and need of those trips.

Idaho could have saved $320,000 by dropping the least expensive agency's rating, and $550,000 if it cut out the highest agency fee.

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HOW MUCH TO BORROW? HOW TO INVEST THE UNUSED MONEY?

The Treasurer's investment division, which handles day-to-day management of $4.5 billion in invested assets, pressed hard in 2011 for the state to borrow less with tax notes. That year, Cook and others were recommending a half-billion dollar issue.

The investment team said the state could make do with $400 million to $450 million, making up the difference by borrowing from internal reserves. An investment officer's analysis showed that the state could save as much as $400,000 in interest by borrowing the lower amount. Cook, in emails to Crane, disputed the numbers but underestimated borrowing costs.

"I would hope that you have grown to trust me in all of the years I have acted as (adviser) for the TAN and know that I have always sized the issue based on what is in the best interest of the State," she wrote to Crane.

When Idaho sells one-year tax notes, it invests the proceeds in short-term holdings to earn interest on the borrowed money until it's paid out, a tactic known as arbitrage. Crane sided with Cook on the borrowing size and, as emails between them show, she wrote him a note to send explaining his decision. The increased cost of the higher borrowing, Cook and Crane said, would be "more than made up for when you consider the positive arbitrage earnings on the additional $25 to $50 million (to be borrowed)."

That was in May 2011. Given the near-zero interest rate levels at the time, the assertion about "positive arbitrage" was exceedingly optimistic, as the investment team noted.

"The current market environment is far from the good old days," wrote the investment officer. With rates low and potential spreads between investments compressed, "it has become harder and harder to earn positive arbitrage" – that is, invest the money at rates higher than what the state was paying out.

Making interest on the "parked" money before it is needed allows the state to recoup some of the costs of borrowing, such as premium, interest, underwriter's discount and fees paid to the financial adviser, ratings agencies and lawyers. The borrowing costs between 2009 and 2016 ranged roughly from $2 million and $4 million annually.

In 2009, the most recent year for which the Treasurer's office had complete data on how the tax note proceeds were invested, the state earned back slightly more in interest than it paid to borrow the money. But as the Great Recession deepened, returns dwindled.

A Statesman review shows that in 2011 the state managed to recoup about two-thirds of its borrowing expenses. As interest rates dropped through 2014, however, the state recouped less than one-tenth of its costs. Rates and returns improved in 2015, when the state made back about a quarter of its costs. Overall from 2009 to 2016, Idaho made back in interest about half its borrowing costs.

Crane said the Statesman's analysis did not include further gains the state made from twice reinvesting the borrowed funds before repaying investors with interest. If the state could thus reinvest the money, that contradicts the stated reason for borrowing the money in the first place — to keep it liquid to cover cash-flow shortfalls.

But "arbitrage opportunity," Crane said in a written response, has never been a motive for issuing the tax notes.

"The opinion of the Treasurer's Office continues to be that issuing an external TAN is the more conservative approach to cash flow management," he wrote.

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