House Appropriations Committee Retreat

State Debt Management Practices

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November 17, 2009

Presentation Outline

- Basis of Commonwealth’s Debt Capacity
- Current Status of Commonwealth Debt Capacity
- Debt Management Practices in Triple-”AAA” States and Virginia Localities
- Comparative Data

Presentation Outline

- ✓ **Basis of Commonwealth's Debt Capacity**
- Current Status of Commonwealth Debt Capacity
- Debt Management Practices in Triple-"AAA" States and Virginia Localities
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Virginia Constitution

- Article X, Section 9 provides for the issuance of debt
  - Sections 9(a), 9(b) & 9(c) provide the Full Faith and Credit of the Commonwealth
- 9 (a) debt is reserved to meet emergencies
- 9 (b) debt is often referred to as general obligation or GO debt and requires voter approval
- 9 (c) debt is for revenue-producing capital projects and is authorized by 2/3 vote of the General Assembly
  - Self-supporting in nature; the Governor is required to certify that pledged revenues are sufficient
  - For example, dorm and dining hall projects
- Because it has the Full Faith and Credit of the Commonwealth, this debt receives the highest (AAA) rating from the three rating agencies (Moodys, S & P and Fitch)

Virginia Constitution

- Section 9(d)
  - Authorized by the General Assembly
  - Does not provide Full Faith and Credit
    - Rated as AA debt but actual interest rate has been very close to AAA-rated debt in recent years
    - Repaid from both GF and NGF including auxiliary enterprises and local governments
  - Issued by Commonwealth agencies, institutions and authorities. For example,
    - Virginia College Building Authority (VCBA)
    - Virginia Public Building Authority (VPBA)
    - Commonwealth Transportation Board
    - Virginia Housing Development Authority

Debt Limitations

- Constitution sets limits for 9(a), 9(b) and 9(c) debt
- 9(b) GO debt limits:
  - Total 9(b) GO debt is limited to approximately 115% of average annual income tax and sales tax revenues of prior three fiscal years
  - General Assembly can only authorize up to 25% of the total 9(b) GO limit over a four-year period
  - Debt must mature at the lower of either 30 years or useful life of the project
  - Debt payments are structures with level principal
- 9(c) debt is limited to the same 115% of average annual income tax and sales tax revenues of prior three fiscal years
- 9(d) debt technically has no limitations placed on it by the Virginia Constitution

Commonwealth Policy on Debt Capacity

- In the early 1990s the Commonwealth developed its current debt policy
  - 1990: Appropriation Act required development of a plan for the coordination of the Commonwealth's borrowing
  - 1991: Executive Order 38 established the Debt Capacity Advisory Committee (DCAC)
  - 1994: DCAC statutorily established (Chapter 43, 1994 Acts of Assembly)
  - All three rating agencies mention the DCAC as a positive debt management practice
- DCAC established the policy of limiting tax-supported debt to 5% of revenues
  - Debt service payments are made or ultimately pledged to be made from general funds
  - Corresponds to rating agency definition

Debt Capacity Advisory Committee

- Comprised of:
  - Secretary of Finance
  - State Treasurer
  - DPB Director
  - Auditor of Public Accounts
  - JLARC Director
  - Two citizen members appointed by the Governor
- Committee annually reviews Commonwealth's tax-supported debt and submits to the Governor and to the General Assembly an <u>advisory, non-binding estimate</u> of the maximum amount of new tax-supported debt that prudently may be authorized for the next biennium

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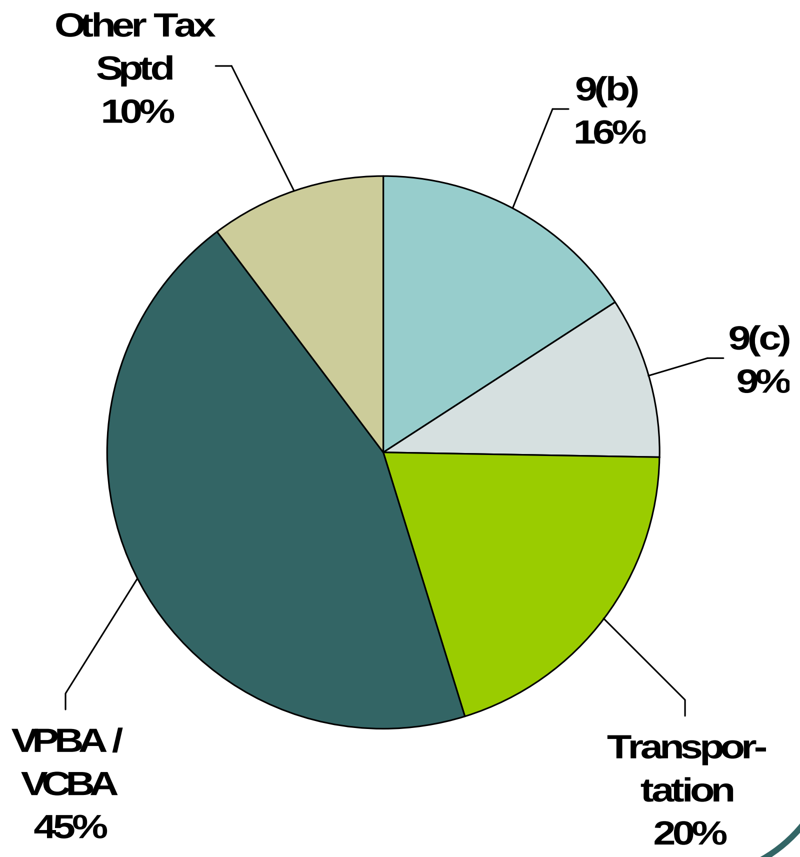
Commonwealth Debt Capacity
DCAC Model

- DCAC Model considers:
  - Actual debt service on all issued tax-supported debt including capital leases and regional jails
  - Currently authorized but not yet issued tax-supported debt over a ten-year planning horizon
  - 20-year bonds with level debt service payments except for 9(b) which assumes level principal
  - Blended revenues which include general fund, state revenues in the TTF, & ABC profit transfers
    - Official forecasts excluding Lottery funds
    - TTF revenues do not include Highway Maintenance & Operating Funds, Federal grants, or toll revenues
  - Interest rates for all GO debt is based on the **<u>Bond Buyer 11 Bond Index</u>**
    - 9(d) debt assumed at 50 basis points higher
  - Benchmark is total tax-supported debt service should be less than 5 percent of revenues

Current Outstanding Tax-Supported Debt as of June 30, 2008

- Total outstanding tax-supported debt used in the debt capacity model is about $5.9 billion
- Tax-supported debt is where the debt service payment is made or ultimately pledged to be made from general government funds & corresponds to the rating agency definitions



Source: Commonwealth of Virginia Comprehensive Annual Financial Report

Debt Authorized but Not Issued

As of December 2008

- As of December 2008, there was approximately $6.7 billion in all forms of tax-supported debt authorized but not yet issued
  - Over half of debt in pipeline is transportation related
    - $3.2 billion in 9(d) transportation bonds authorized under HB 3202
    - $155 million in Virginia Port Authority bonds
    - $97.1 million No. Va. Transportation District Program
  - $2.8 billion in Virginia Public Building Authority (VPBA) & Virginia College Building Authority (VCBA) debt
    - About half of this amount was authorized as part of the 2008 bond program
  - $145 million of 9(b) debt from the 2002 GO bond program
  - $116.9 million of HEETF equipment allocations
  - $197.8 million in 9(c) revenue bonds

DCAC Model Results
December 2008

- After factoring in the revenue forecast at that time and assumed interest rates of about 4.5 – 5.0 percent on new debt, the DCAC model resulted in an average annual debt capacity of about $406 million over the ten-year period
- Debt capacity is impacted by changes in revenue and interest rates
  - $100 million change in revenue per year impacts the debt capacity by $5.7 million per year
  - Interest rate changes of 100 basis points can impact the debt capacity by $50 to $60 million
- Since the last DCAC debt capacity report revenues have been adjusted downward in February 2009 and again in August 2009
- Estimated average annual debt capacity under these revised revenues is about $280 million over the ten-year period
- Debt capacity is updated annually by DCAC
  - Next official update is December 2009

Commonwealth Debt Capacity
Virginia Constitution

- Virginia Constitution limits yield a different result than the DCAC debt capacity model
- The computation of the legal debt limit is reported annually by the State Comptroller in the Comprehensive Annual Financial Report (CAFR)
- The June 2008 CAFR reports that new 9(b) General Obligation debt cannot exceed $14.9 billion in total
  - In addition, the Constitution places a limit on how much new 9(b) GO debt can be authorized by the General Assembly over a four-year period
  - That limitation is $3.96 billion which equates to about $1 billion per year
- The Commonwealth's current debt rating is not based on constitutional limits

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Debt Management Practices

- Examine states rated AAA by the three rating agencies
  - Delaware
  - Georgia
  - Maryland
  - Missouri
  - North Carolina
  - Utah
- The terminology used by individual states is not synonymous with Virginia definitions and procedures
- Examine two AAA Virginia localities
  - Chesterfield
  - Henrico

Delaware

- No Constitutional debt limit
- Delaware tax-supported debt is approved through legislative process and does not require voter approval
  - ¾ of elected members
- In 1991, they established three debt limit tests
  - The first test determines the total amount of tax-supported debt that may be **authorized** in any one fiscal year
    - 5% of estimated GF revenues in that year
  - The next two tests determine how much debt can be **issued** within the authorization
    - Annual debt service on tax-supported debt and debt supported by the TTF cannot exceed 15 percent of combined GF & TTF revenue
    - Annual debt service on existing tax-supported debt cannot exceed cash balances including all reserves

Georgia

- Constitutional debt limit of 10 percent of the previous year's revenues for debt service on tax-supported and guaranteed revenue bonds
  - Requires legislative approval
  - Debt service for each issuance is appropriated into a sinking fund
- State debt management plan
  - Utilized in conjunction with a capital budgeting plan over a five-year period
  - The debt plan is updated annually
  - No specific formula that determines maximum amount of debt in any particular year but they use 3 ratios to measure debt burden

Georgia
(continued)

- Georgia utilizes 3 ratios to measure debt burden
  - Debt Service as Percent of Prior Year Revenues
    - 7% target
  - Debt per Capita
    - $1,200 maximum level
    - Adjusted by $200 beginning in 2007 to meet infrastructure needs for continued economic growth & due to higher construction costs
  - Debt As Percent of Personal Income
    - 3.5% maximum level
- Georgia estimates issuing about $1.2 billion of tax-supported annually through 2014
  - Includes about $800 million for buildings & $300 million for transportation projects

Maryland

- Essentially no debt limit except what the legislature establishes
- Commission on State Debt created in 1980 as advisory group
  - Recommends state property tax rate to meet debt service requirements
- Tax-supported bonds have averaged about $800 million / year for last 8 years and projected to average about $980 million / year for next 5 years
  - Amortize over 15 years
  - Bonds used for grants to public schools, private institutions, local governments

Maryland
(Continued)

- Maryland has established two criteria for evaluating debt authorizations
  - Debt service as a percent of revenues at 8%
  - Debt as percent of personal income at 4%
    - In 2008, Maryland adjusted this criteria from 3.2% to 4.0% because it limited debt capacity in a declining economy
- Maryland excludes higher education debt issued by institutions in its debt affordability calculation
  - This includes both academic and auxiliary facilities
  - Colleges can pledge tuition and fees but not any other source unless expressly authorized by the Maryland legislature
- Maryland sets separate debt ceilings for transportation debt
  - About $2.6 billion
  - Continuous authorization

Missouri

- No formal debt guidelines
- GO debt limits are enumerated in the Missouri Constitution
  - All GO debt must approved by the voters
  - Amount of GO debt limited to the amount approved by the voters plus $1 million
    - State Building Funds (1956, 1987, 1994) - $925 million
    - Water Pollution Control Funds (1971,1979 & 1988) - $625 million
    - Rural Water and Sewer Grants (1998) - $100 million
    - Stormwater Control (2008) - $200 million
- Also utilizes the Board of Public Buildings to construct and then lease back to state agencies
  - $945 million cap
  - Legislature appropriates rent costs

North Carolina

- Very similar to Virginia
- Constitution requires voter approval of GO debt
  - NC also provides for other tax-supported debt (Special Indebtedness)
  - Prior to 2004, NC used GO almost exclusively
    - Special Indebtedness has been the preferred financing option since 2004
- In 2004 NC established a Debt Affordability Advisory Committee
- Three tests are used for tax-supported debt
  - Debt Service as % of Revenues: 4.00 – 4.75%
    - This test is the more controlling with the remaining two metrics used more for information purposes
  - Debt as % of Personal Income: 2.5 – 3.0%
  - Amount of debt to be retired over ten years: 55%
  - Debt is structured on a 20 year basis

North Carolina
(continued)

- Transportation debt capacity is calculated separately from general fund tax-supported debt
  - The debt capacity test used is of 6% of state transportation revenues (Highway Trust Funds & Highway Fund)
    - Includes motor fuels tax, highway use tax and motor vehicle revenues (title fees, license, inspection, registration)
    - Excludes federal revenues
- Debt is structured on 25-year basis
- Highway Construction GO Debt is excluded from the General Fund Debt Model

Utah

- Constitution caps total tax-supported debt to 1.5% of the value of all the taxable property in Utah including vehicles
  - The total debt cap is reduced by outstanding debt principal
- Statutory limits further cap tax-supported debt
  - State formula based on population and inflation determines maximum allowable appropriations
  - Debt is limited to 45% of the allowable appropriations less outstanding debt principal (excludes most highway bonds)
  - Limit can be waived by 2/3 of legislature
  - Limit was 20% until 2004 but changes in the formula led to changes in the limit

Utah
(continued)

- In addition, Utah utilizes the Utah State Building Authority (1979) which acquires / constructs state facilities and leases the facilities back to state agencies
  - Debt service is paid through the rents charged by the Authority
- Based on its latest reports, Utah has
  - $3.2 billion constitutional tax-supported debt authority
  - $820 million statutory tax-supported debt authority
  - In addition, the state could issue $3.6 billion in lease revenue bonds of the Utah State Building Authority

Local Government Debt

- Authority to issue debt is specified in Virginia Constitution & Virginia Public Finance Act (§ 15.2-2600 thru 2663)
  - City/Town: 10 percent of assessed value of taxable property
  - County: Debt is subject to voter approval
    - Does not apply to debt incurred via VPSA or for revenue producing projects
- Virginia has 5 counties that are rated AAA by all three rating agencies
  - Arlington, Chesterfield, Fairfax, Henrico, Loudoun
- Only 22 AAA counties nationwide
  - Generally clustered in AAA states

Chesterfield County

- Debt management policies work in conjunction with the Capital Improvement Plan (CIP)
- Utilize four measures to guide use of debt with debt service as % of expenditures the controlling factor

	Plan Cap	Ceiling	FY 08 Actual
Debt Svc as % of GF Exp	10.0%	11.0%	7.7%
Debt as % Assessed Property	3.0%	3.5%	1.47%
Debt Per Capita	$1,665	$1,873	$1,782
GF Balances as % of GF Exp	7.5%	5.0%	10.3%

Henrico County

- Debt management policies work in conjunction with the Capital Improvement Plan (CIP)
- Utilize three measures to guide use of debt with debt service as % of expenditures the controlling factor

	Guideline	FY 08 Actual
Debt Svc as % GF Exp	7.75%	6.63%
Debt as % Assessed Property	1.49%	1.00%
Debt Per Capita	$1,650	$1,310

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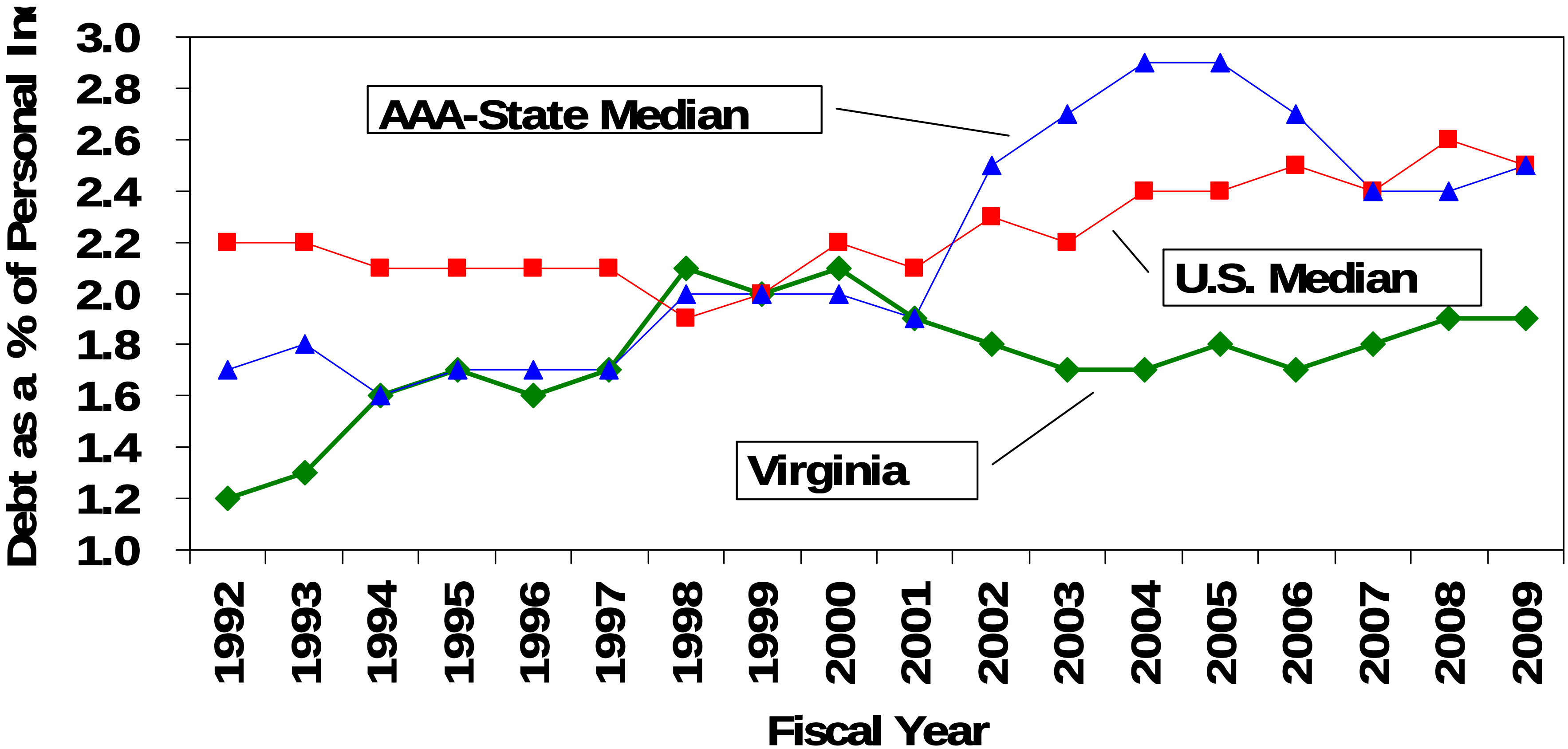
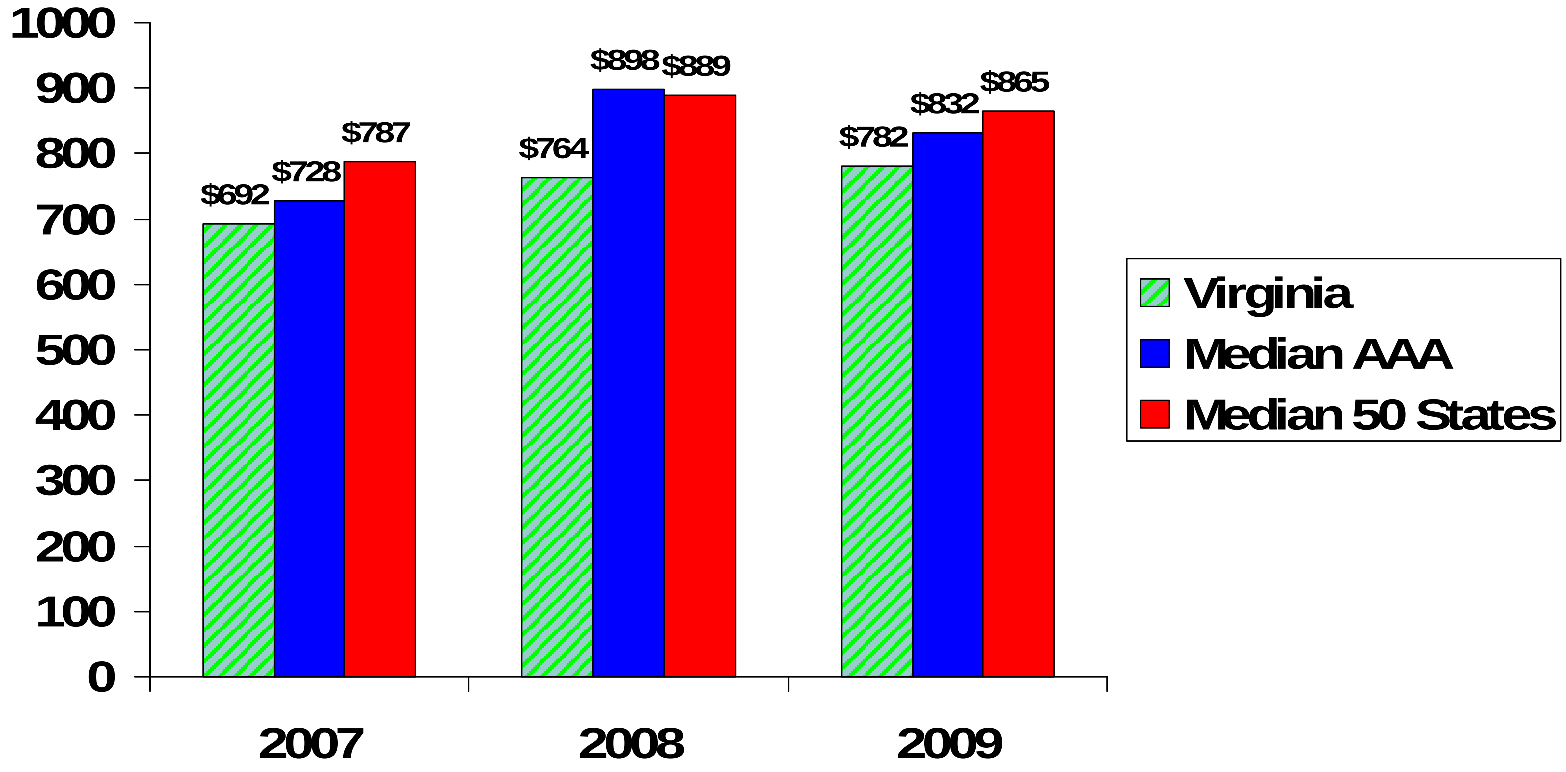
Net Tax-Supported Debt as a Percentage of Personal Income

Virginia Compared to National State Medians



Moody's State Debt Medians Report

Net Tax-Supported Debt Per Capita
Virginia Compared to State Medians



Moody's State Debt Medians Report

Virginia Debt is Well Managed

- Based on Moody's State Medians Report, Virginia has consistently low debt ratios both in terms of per capita and percent of personal income
- Our credit rating has been re-affirmed
- Long-range capital outlay process
  - House Bill 5001 (Putney), 2008 Special Session I

AAA State Debt Practices

- AAA States Use a Variety of Debt Management Practices
  - 5 States use Debt Service as a Percent of Revenues
    - Only practice used by Virginia
  - 2 States use Total Debt as a Percent of Revenues
  - 3 States use Debt as a Percent of Personal Income
  - 1 States uses Total Debt Per Capita
  - 1 State uses Assessed Property Value
  - 6 States use Differentiated Practices such as:
    - Transportation debt separated from other state debt
    - Use of separate state building authority & lease back practices
    - Debt determined by capital plan

AAA State Debt Practices

	Debt Svc % of Rev	Tot Debt % of Rev	Debt % of Pers Inc	Debt Per Capita	Assessed Property	Multiple Practices
Virginia	✓					
Delaware	✓	✓				✓
Georgia	✓		✓	✓		✓
Maryland	✓		✓			✓
Missouri						✓
No. Car.	✓		✓			✓
Utah		✓			✓	✓

Rating Agency Factors

- Control of tax-supported debt
  - Debt policy
  - Total debt
- Economic Vitality and Diversity
- Fiscal Performance
- Administrative Capabilities
  - Long-term financial and capital planning

Questions