House Appropriations Committee Retreat

Debt Capacity Update

Tony Maggio

November 13, 2012

Presentation Outline

- Basis of Commonwealth's Debt Capacity
- Current Status of Commonwealth Debt Capacity
- Comparative Data

Presentation Outline

- ✓ **Basis of Commonwealth's Debt Capacity**
- ☐ Current Status of Commonwealth Debt Capacity
- ☐ Comparative Data

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)
- 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
- In 2010, the DCAC retained the 5% limit but presents capacity using the ten-year average capacity ("smoothing" method)
- All three rating agencies mention the DCAC as a positive debt management practice

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
  - State Comptroller
  - Staff Directors for House Appropriations and Senate Finance Committees
- 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 using the following assumptions over a ten-year planning horizon:
  - Actual debt service on all issued tax-supported debt including capital leases and regional jails
  - Currently authorized but not yet issued tax-supported debt
  - 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

Commonwealth Debt Capacity

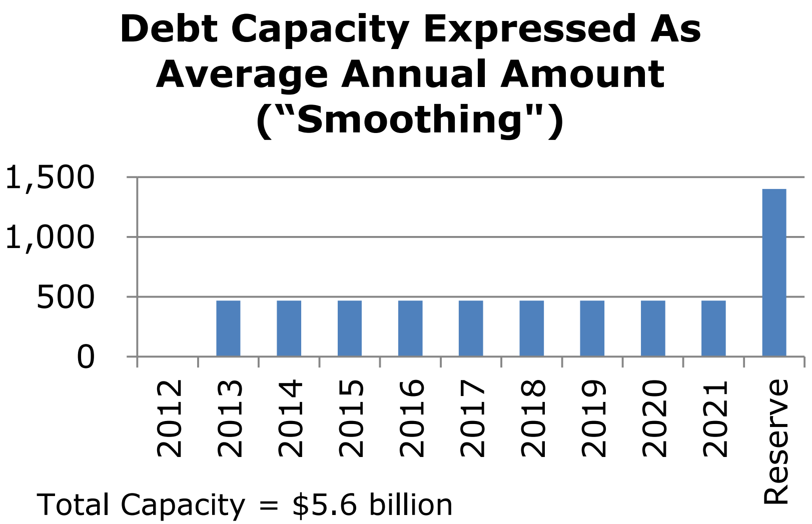
DCAC Model

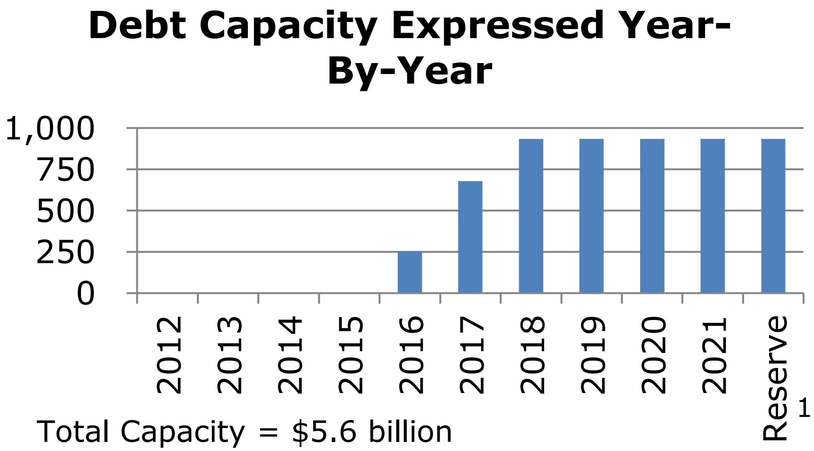
- Prior to 2010, the debt model calculated the debt capacity for a ten-year period with the requirement that debt service on tax-supported debt could not exceed 5 percent in any one year
  - This resulted in capacity solutions which would show several years of zero capacity followed by several years of significant capacity
- The "smoothing" model complements the capital planning approach outlined in Del Putney's HB 5001 (2008 Special Session I)
  - Several other AAA states utilize a similar approach most notably Georgia

DCAC Model Results

December 2011

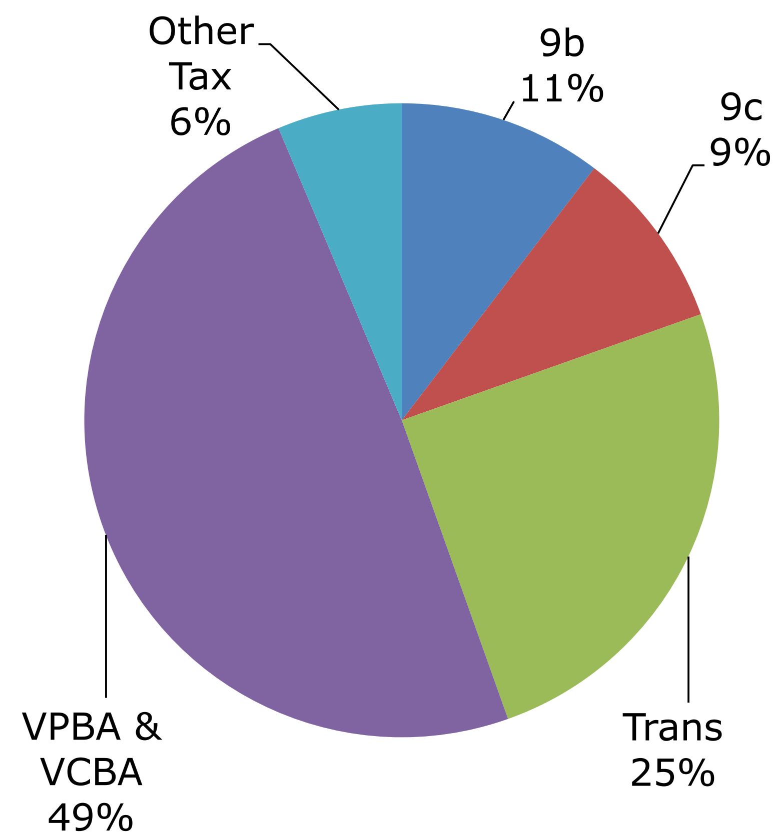
- The charts on the right show the expression of the ten-year debt capacity under the "smoothing" approach adopted by the DCAC and under the year-by-year approach used in previous years
- While both result in a total debt capacity of $5.6 billion over the ten-year period, the Year-By-Year Expression has most of its capacity in the last five years of the planning period. The "Smoothing" has a level approach over the ten-year period & holds a greater amount of the total capacity in reserve
- The "smoothing" model complements the capital planning approach outlined in Del Putney's HB 5001 (2008 Special Session I)
  - Allows State to manage its 6-year capital plan
  - Several other AAA states utilize a similar approach most notably Georgia





Current Outstanding Tax-Supported Debt as of June 30, 2011

- Total outstanding tax-supported debt is about $8.8 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: Debt Capacity Advisory Committee

Debt Authorized but Not Issued

as of December 2011

- As of December 2011, there was approximately $5.0 billion in all forms of tax-supported debt authorized but not yet issued
  - About 45% of the debt in pipeline is transportation related
    - $2.1 billion in 9(d) transportation bonds authorized under HB 3202
    - $125.0 million in Virginia Port Authority bonds
    - $24.7 million No. Va. Transportation District Program
  - $2.8 billion in Virginia Public Building Authority (VPBA) & Virginia College Building Authority (VCBA) debt
    - This primarily represents the projects authorized in the 2008 bond program as well as the planning projects that were later financed in 2011
    - $141.3 million of HEETF equipment allocations and project equipment
    - About $159 million for maintenance reserve & energy projects

DCAC Model Results

December 2011

- After factoring in the revenue forecast at that time and assumed interest rates of about 4.0 – 4.5 percent on new debt, the DCAC model resulted in an average annual debt capacity of about $467 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 about $5.6 million per year
  - Interest rate changes of 100 basis points can impact the debt capacity by about $50 million
- Debt capacity is updated annually by DCAC
  - Next official update is December 2012

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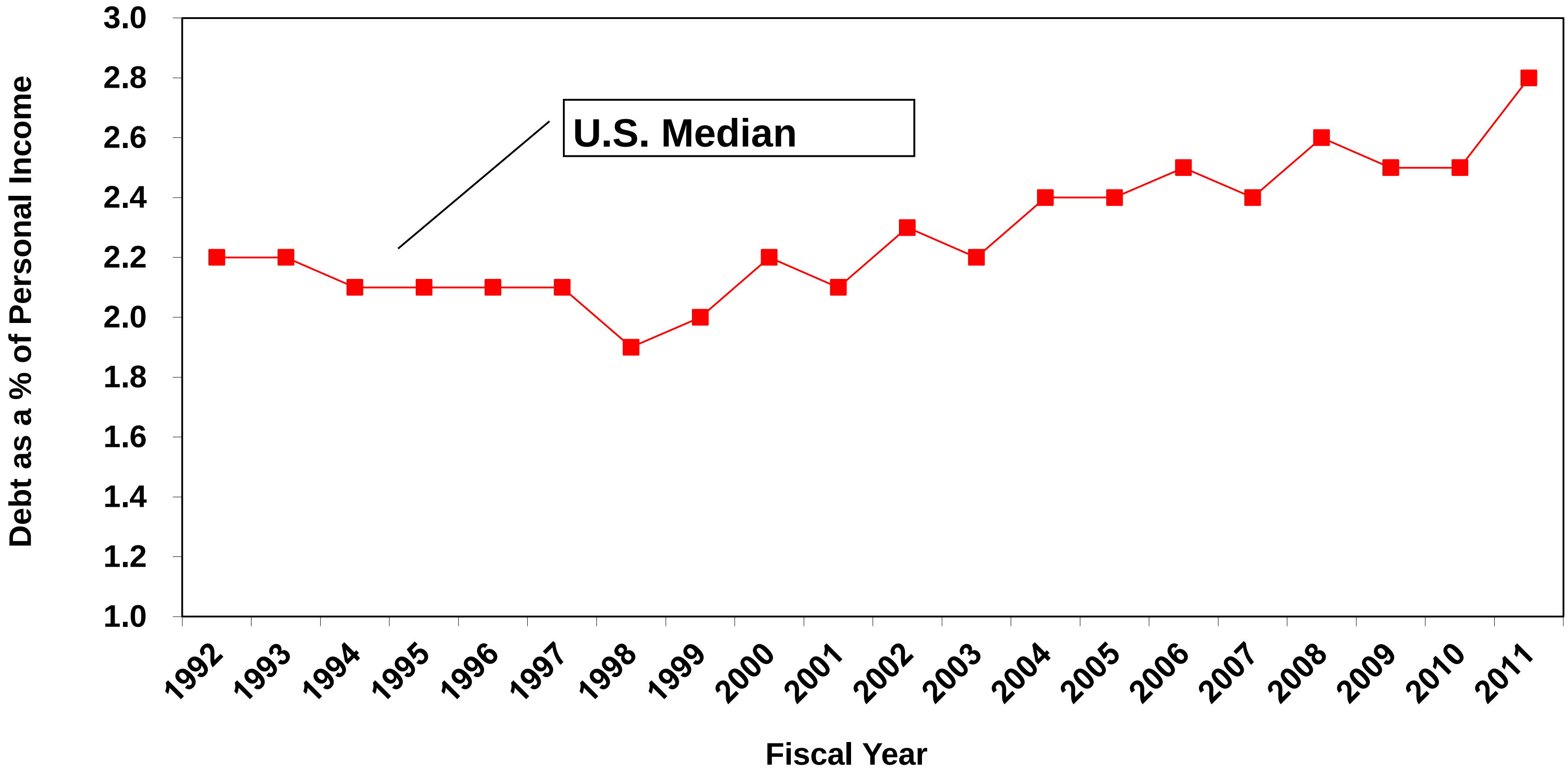
Net Tax-Supported Debt as a Percentage of Personal Income

Virginia Compared to National State Medians



Moody's State Debt Medians Report

Net Tax-Supported Debt as a Percentage of Personal Income

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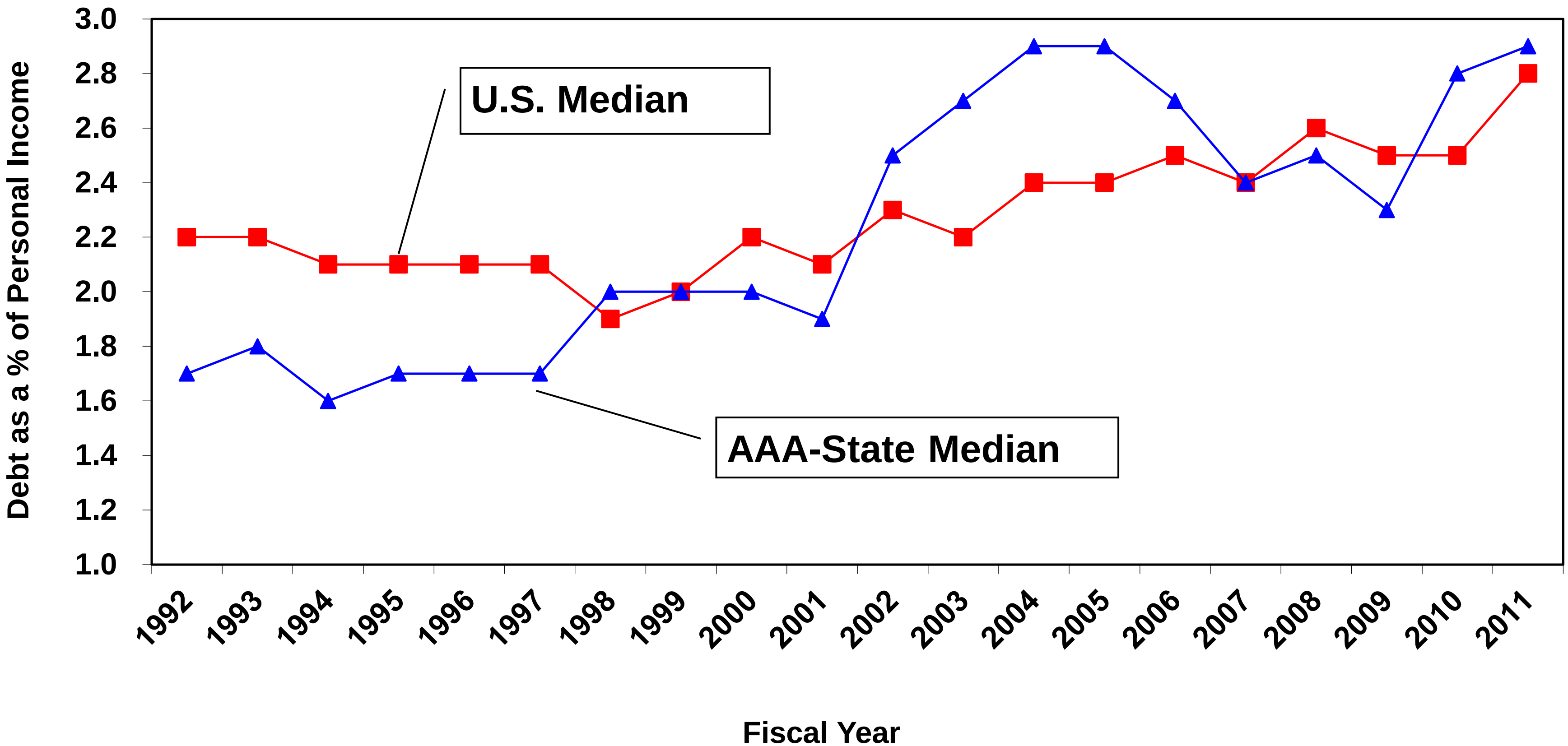

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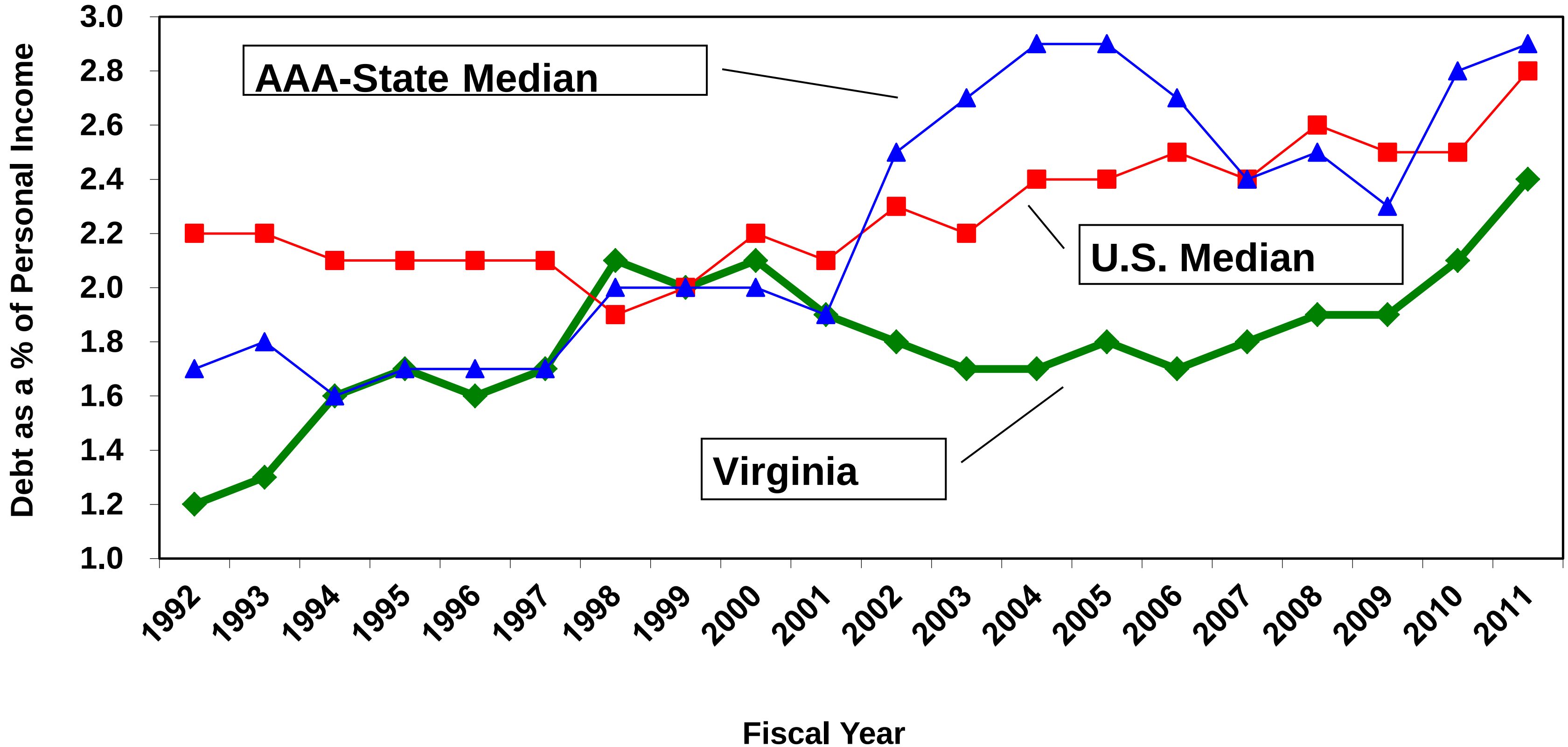
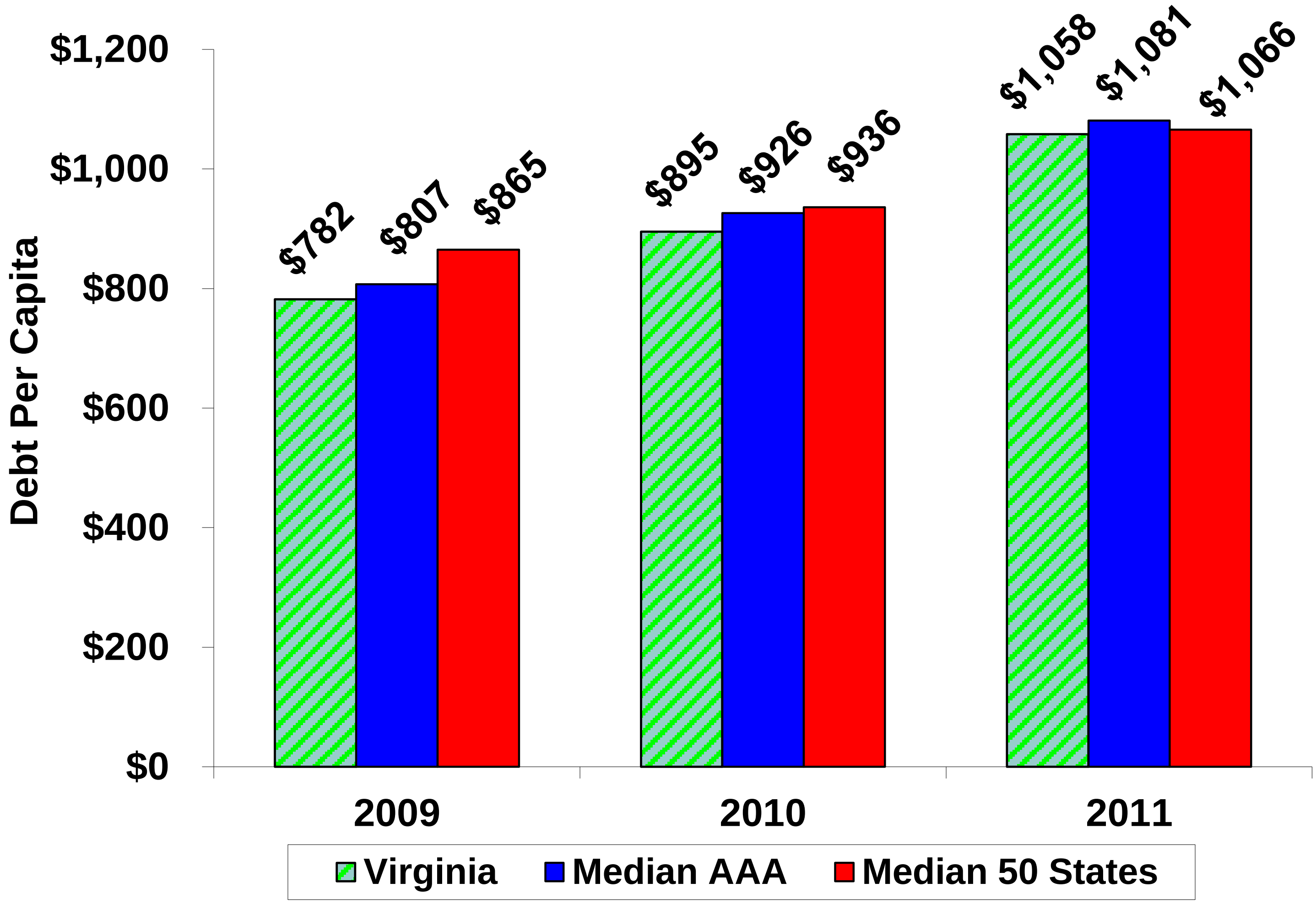


Moody's State Debt Medians Report

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 (Chapter 1)

Questions