VIRGINIA HOUSE
APPROPRIATIONS
COMMITTEE
CHAIRMAN BARRY D. KNIGHT

Debt Capacity Update

House Appropriations Committee Retreat

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Debt Capacity Update

- Basis of Commonwealth's Debt Capacity
- Status of Commonwealth Debt Capacity as of December 2021
- Impact of Current Conditions

Debt Capacity Update

- **Basis of Commonwealth's Debt Capacity**
- Status of Commonwealth Debt Capacity as of December 2021
- Impact of Current Conditions

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 structured with level principal
- 9(c) debt also is limited to the 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)
  - Debt capacity was linked with the new six-year capital outlay planning process
  - All three rating agencies viewed the changes 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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- **Status of Commonwealth Debt Capacity as of December 2021**

- Impact of Current Conditions

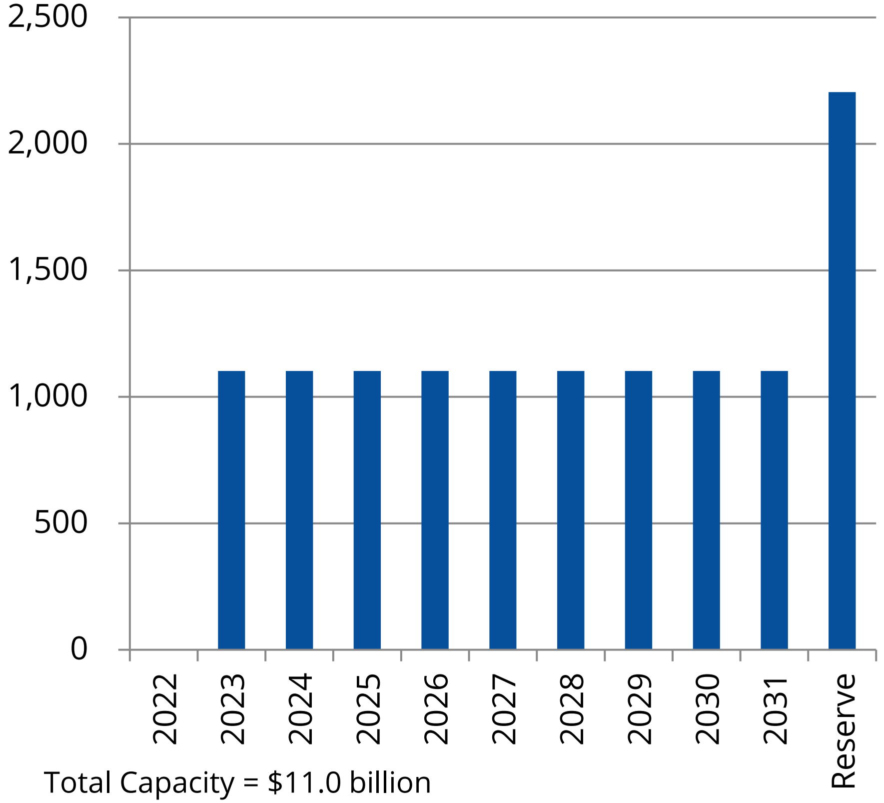
Commonwealth Debt Capacity
DCAC Model as December 2021

- DCAC Model uses 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 **Bond Buyer 11 Bond Index**
    - 9(d) debt was assumed at 25 basis points higher, or about 2.50% in December 2021

DCAC Model Results *December 2021*

- The chart on the right shows the ten-year debt capacity under the "smoothing" approach adopted by the DCAC
- Annual debt capacity was about $1.1 billion per year
- Total debt capacity was $12.1 billion over the ten-year period which includes holding $2.2 billion the total capacity in reserve
- This assumes all previously authorized debt as part of the calculation
- Debt capacity is impacted by changes in revenue and interest rates

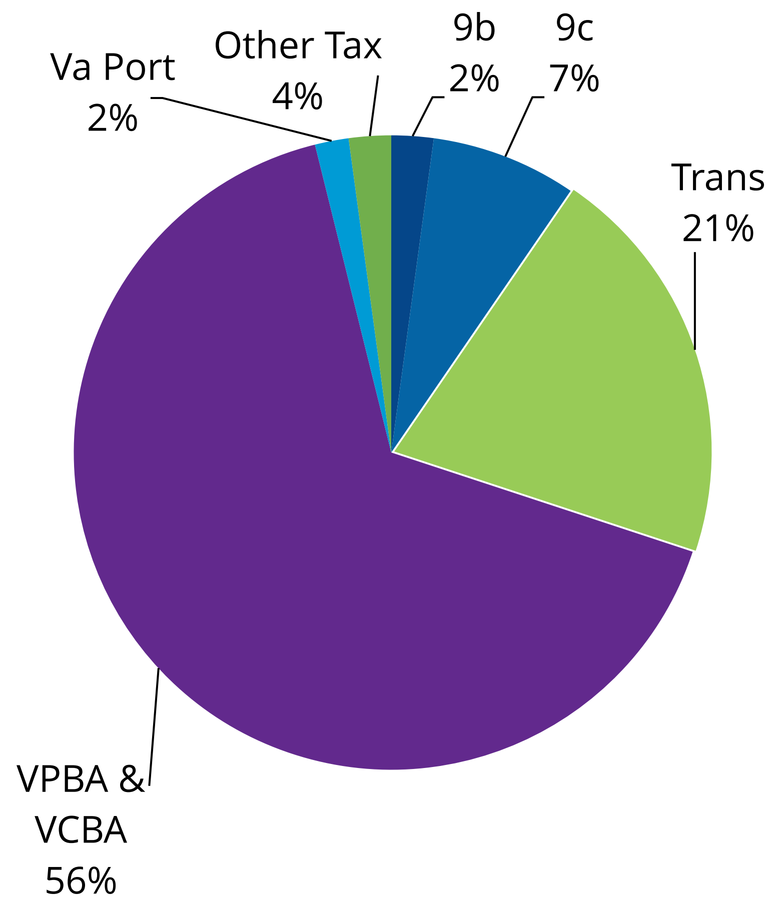
Debt Capacity Expressed As Average Annual Amount ("Smoothing")



Total Capacity = $11.0 billion

Current Outstanding Tax-Supported Debt as of June 30, 2021

- Total outstanding tax-supported debt was about $13.0 billion
- Tax-supported debt is when the debt service payment is made, or ultimately pledged to be made, from general government funds -- corresponds to the rating agency definitions
- Only state funds – excludes federally backed debt like transportation



Source: Debt Capacity Advisory Committee

Debt Authorized but Not Issued
as of December 2021

- As of December 2021, there was approximately $5.1 billion in all forms of tax-supported debt authorized but not yet issued
  - $4.2 billion in Virginia Public Building Authority (VPBA) & Virginia College Building Authority (VCBA) debt
    - This reflects the significant investments made in the 2018 through 2021 Sessions
    - Includes about $88.2 million of HEETF equipment allocations and project equipment
  - About 17% of the debt in pipeline is transportation-related
    - $243.2 million in 9(d) transportation bonds
    - $595.7 million for Route 58
    - $24.7 million No. Va. Transportation District Program

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- **Impact of Current Conditions**

Impact of Current Conditions

- Based on US Labor Department data as of November 2022, the annual inflation rate is 7.7%
- As a result of the Federal Reserve has raised interest rates aggressively
  - Six rates hikes since March 2022 have brought the federal funds rate up to a range of 3.75%-4.00%
  - The Fed projects the federal funds rates will continue to increase to at least the 4.50%-4.75% range
- The rate hikes has a two-fold impact
  - Policy impact – reduction in available debt capacity
  - Budget impact – increase in general fund required for debt service for previously authorized but unissued bonds
- Assuming interest rates of 4%-6%, the debt capacity reduction could range from $200 million to $425 million
- Budgetary impact could be $25 to $40 million in the near term and up to $65 to $80 million in future biennia

2022 Federal Interest Rate Hikes

	March 22	May 22	June 22	July 22	Sept 22	Nov 22
Basis Points	25	50	75	75	75	75
Range	0.25%-0.50%	0.75%-1.00%	1.50%-1.75%	2.25%-2.50%	3.00%-3.25%	3.75%-4.00%