Review of Commonwealth Debt and Debt Capacity

A Briefing for the Senate Finance Capital Outlay & General Government Subcommittee

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Overview

- Commonwealth Debt
  - Issuers
  - Constitutional Framework
  - 9(c) vs. 9(d) Debt
  - Amounts Outstanding, Authorized and Issued

- Debt Capacity
  - Background
  - Model
  - December 2017 Recommendation

Commonwealth Debt Management Goal

- To issue the debt of the Commonwealth in the most prudent, efficient and cost effective manner

- To administer the debt of the Commonwealth in compliance with federal and state laws, rules and regulations

Debt Overview - Issuers

- The following are the primary tax-supported debt issuing boards and authorities:
  - Treasury Board – General Obligation (GO)
  - Virginia College Building Authority (VCBA)
  - Virginia Public Building Authority (VPBA)
  - Commonwealth Transportation Board (CTB)
  - Virginia Port Authority (VPA)

- The following authorities currently issue moral obligation or sum-sufficient appropriation bonds:
  - Virginia Public School Authority (VPSA)
  - Virginia Resources Authority (VRA)

Debt Overview – Framework of Article X of Constitution

Type	Purpose	G.A. Action	Referendum	Security	Issuer
9(a)	Emergencies, Deficits, Redeem Prior Obligations	General Authorization	No	GO	Treasury Board
9(b)	Capital Projects	Project Authorization	Yes	GO	Treasury Board
9(c)	Revenue Producing Capital Projects	2/3 Majority Project Authorization	No	Revenues +GO	Treasury Board
9(d)	Anything Else	General Authorization	No	Revenues/ Appropriations	Agencies Authorities Institutions

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Debt Overview - 9(c) vs. 9(d) Debt

- 9(c) General Obligation Debt
  - Revenue producing projects (dorm and dining)
  - Paid by revenues from project, but backed by Commonwealth’s G.O. Pledge
  - “AAA” rating due to G.O. pledge provides lower interest rates
  - Tax-supported debt, but not included in debt capacity model, doesn’t impact debt capacity
  - Provides investors with diverse Virginia debt

- 9(d) Appropriation-Backed Debt (eg. VCBA 21st Century Program)
  - Educational & General projects
  - Slightly higher interest rates due to appropriation-backed security
  - Tax-supported debt included in debt capacity model, reduces debt capacity

- 9(d) Higher Education Debt
  - Eligible for all project types
  - May be issued by institution or through VCBA Pooled Bond Program
  - Not considered tax-supported debt

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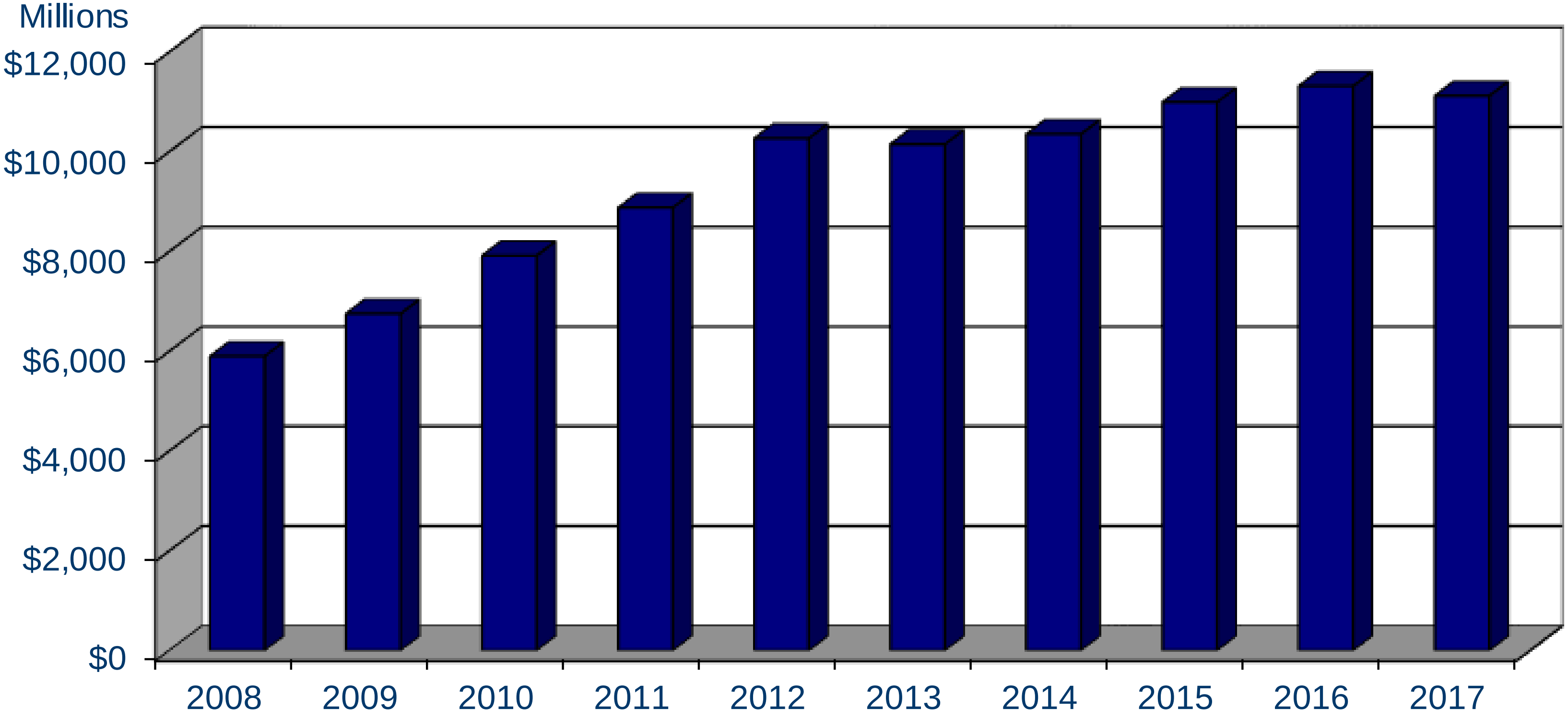
Debt Overview – Outstanding Tax-Supported Debt

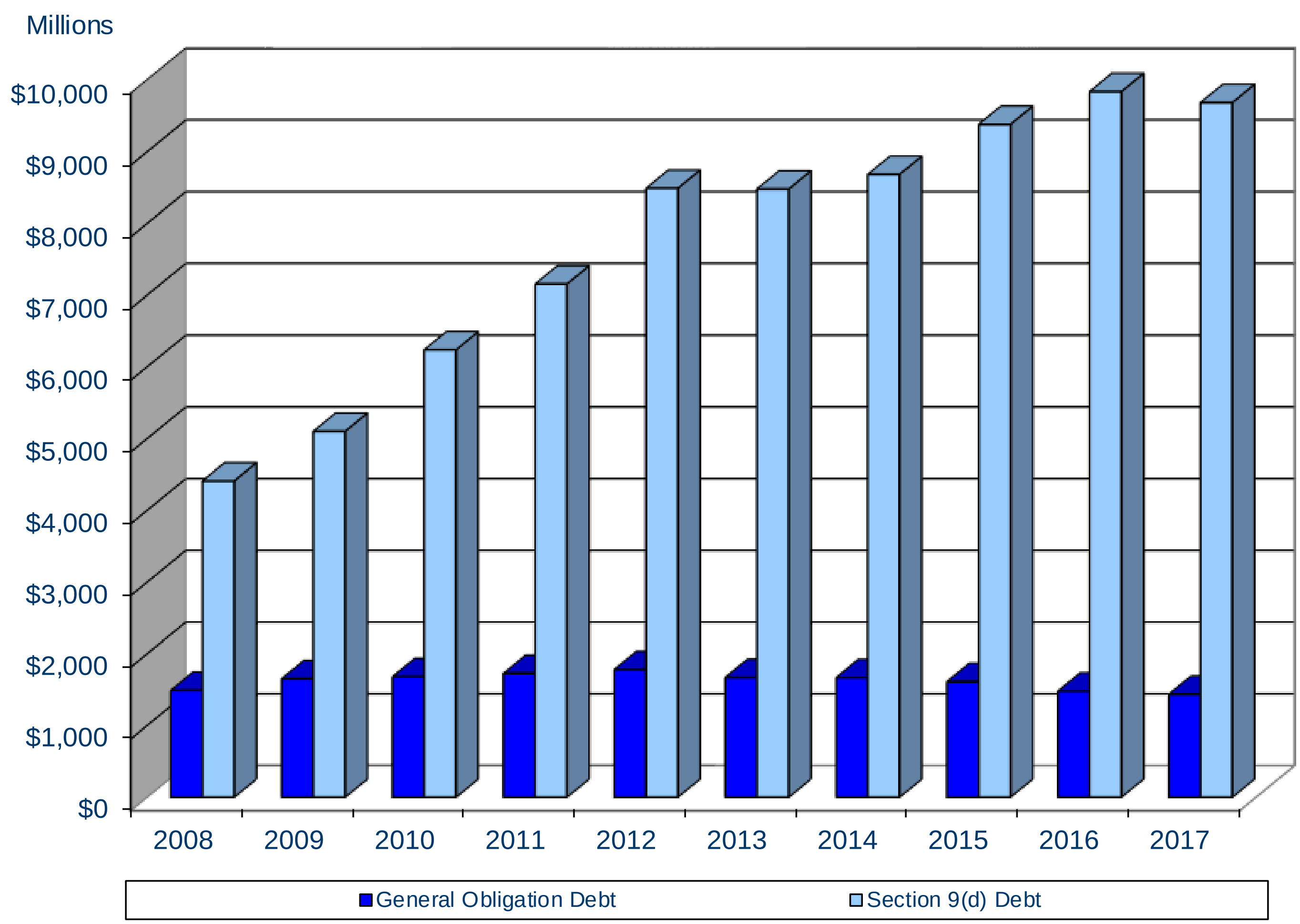
Fiscal Years 2008-2017[1]



(1) Excludes other long-term obligations such as pension liabilities, OPEBs and compensated absences.

Debt Overview – Outstanding Tax-Supported Debt by Category

Fiscal Years 2008-2017[1]



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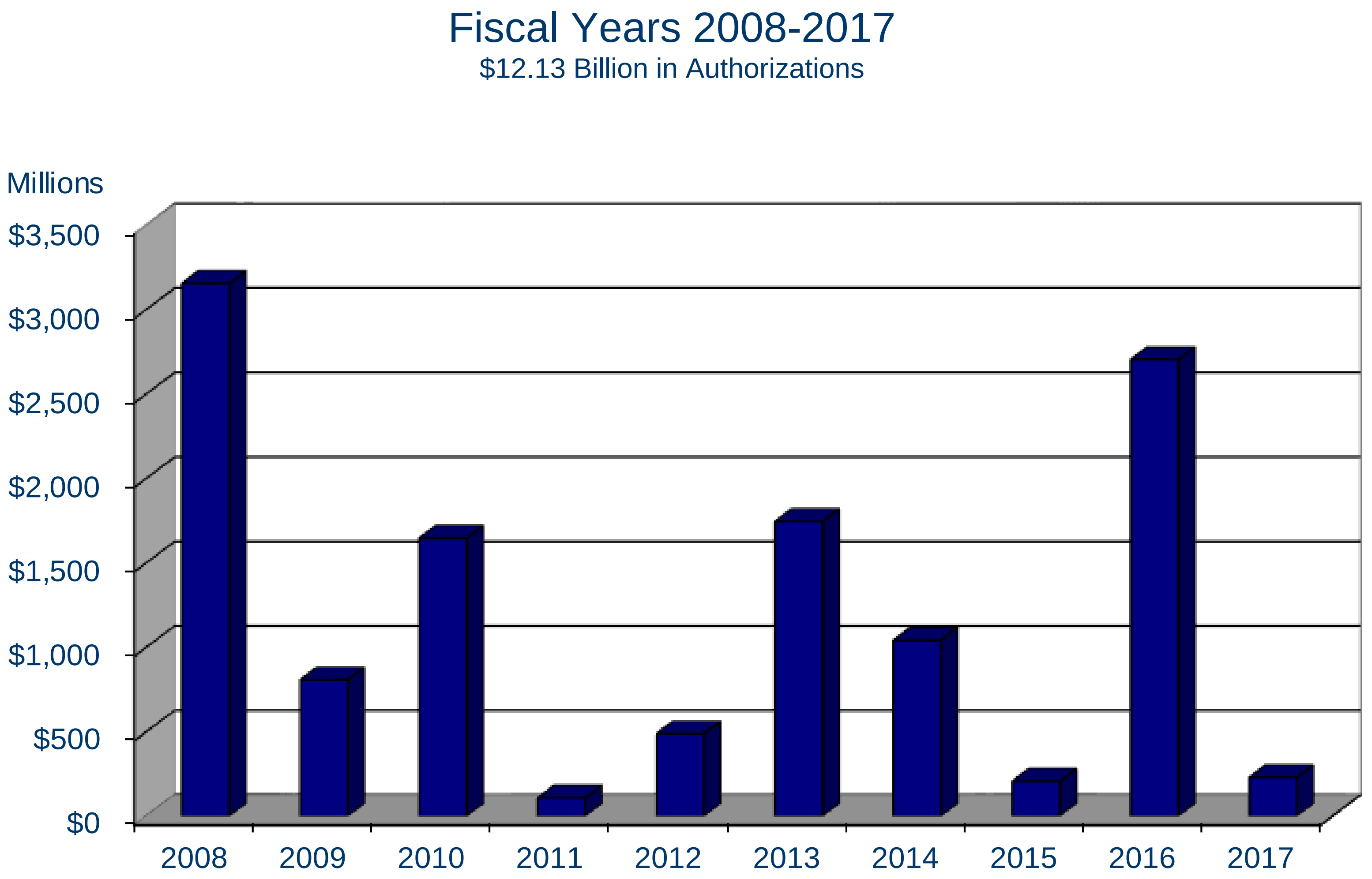
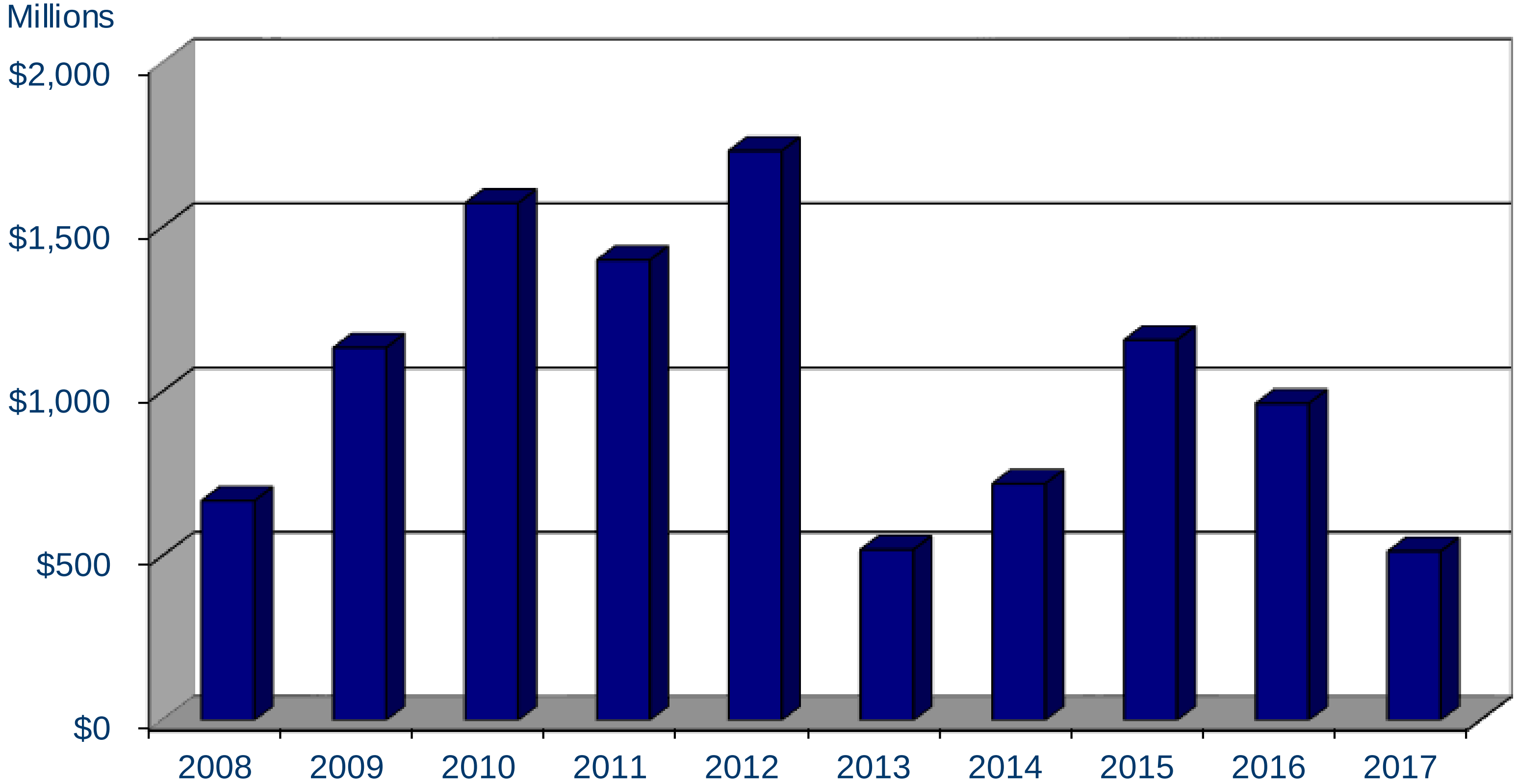
Debt Overview – Tax-Supported Debt Authorizations



Debt Overview – Tax-Supported Debt Issuances

Fiscal Years 2008-2017

$10.38 Billion in Issuances



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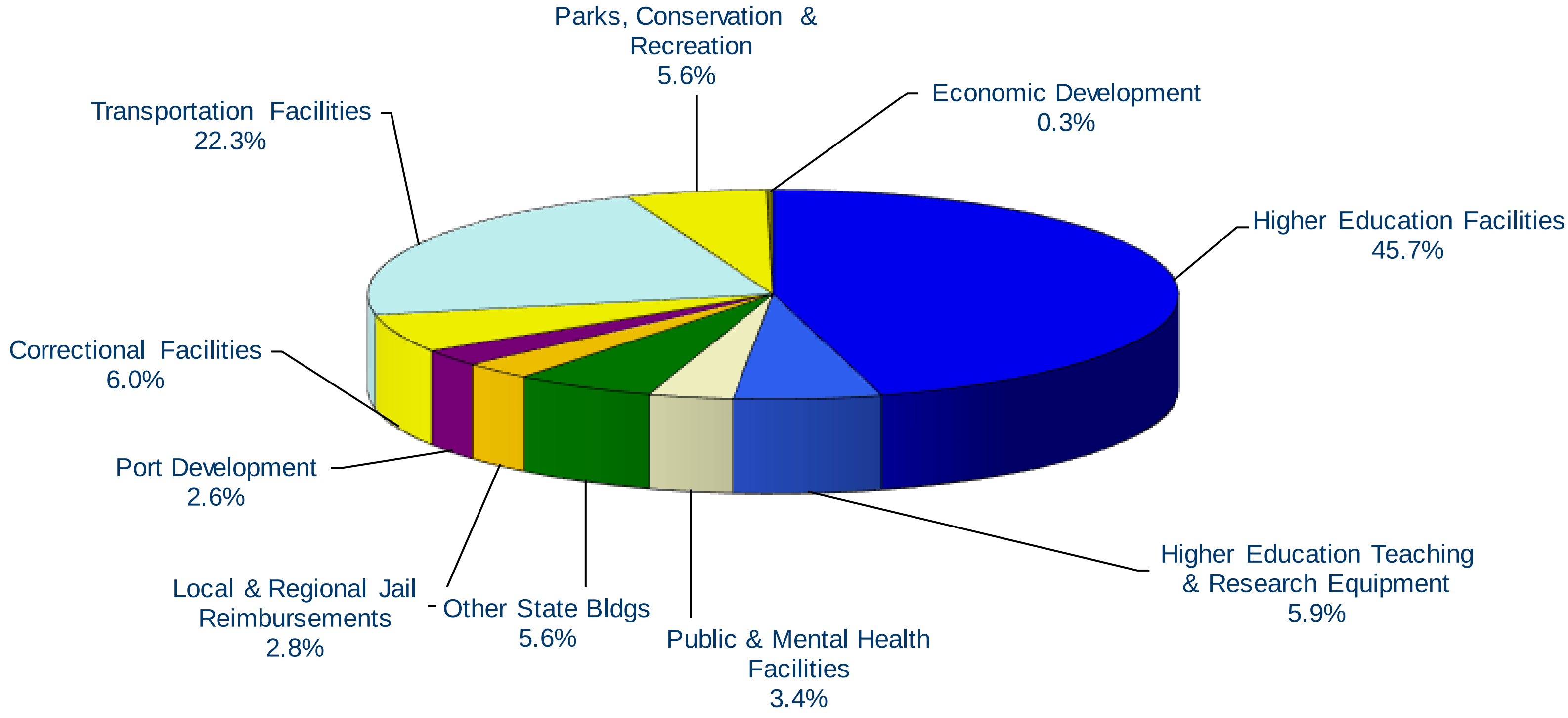
Debt Overview – Uses of Tax-Supported Debt

Fiscal Years 2008-2017

Ten-year Total = $10.4 Billion



Debt Capacity Advisory Committee (DCAC) Background

- Creation of the DCAC was recommended in *An Assessment of Debt Management in Virginia*, December 1990

- The Committee was originally created in September 1991 by Executive Order #38, and subsequently codified under Chapter 43 of the 1994 Virginia Acts of Assembly, as amended

- The Committee's general mandate is:
  - Annually review the size and condition of the Commonwealth's tax-supported debt; and
  - Submit to the Governor and the General Assembly before January 1, an estimate of the maximum amount of new tax-supported debt that prudently may be authorized for the next biennium (Section 2.2-2714 Code of Virginia)*

**This estimate is advisory and in no way binds the Governor or the General Assembly.*

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DCAC Background (Continued)

- The Committee is also required to:
  - Annually review the amount and condition of moral obligation debt and other debt for which the Commonwealth has a contingent or limited liability
    - Make recommendations to ensure the prudent use of such obligations
  - Review the amount and condition of Commonwealth obligations that are not general obligations or moral obligations
    - When appropriate, recommend limits on such additional obligations to the Governor and to the General Assembly

DCAC Background – Importance of Measuring Debt Affordability

- Debt affordability is a key factor assessed by rating agencies
- Attempts to correlate the borrowing for capital needs with the ability to repay
- Issuance above capacity can cause erosion in credit rating
- Most states perform a debt capacity calculation

DCAC Background – Importance of AAA Bond Rating

- Commonwealth has held a AAA general obligation bond rating from Moody's since 1938, Standard and Poor's since 1962 and Fitch since 1991

- Subject-to-appropriation bonds are rated one notch below the state's GO rating at AA+ (Includes: VCBA 21st Century, VPBA, CTB)

- Bond investors willing to accept lower rate of interest for high credit quality

- Demand for credit quality is high
  - 2008 financial melt-down and recent high profile defaults result in flight to quality
  - Reduced reliance on bond insurers make "natural" AAA's/AA's more valuable
  - Portfolio managers need highly-rated bonds to improve fund profile

Debt Capacity Model – Measure and Inputs

- In order to preserve the Commonwealth's ability to provide core government services, debt service should be limited to an appropriate level

- DCAC adopted the measure that debt service on tax-supported debt should not be greater than 5% of blended revenues
  - Committee has reaffirmed this measure each year
  - Recommendation is expressed in terms of a ten-year average

- Blended revenues include:
  - General Fund Revenues
  - General Fund Transfers – ABC, Sales Tax, Recurring Transfers
  - Virginia Health Care Fund
  - Transportation Trust Fund (TTF)

Debt Capacity Model – Measure and Inputs (Continued)

- Tax-supported debt includes:
  - Debt for which debt service payments are made or pledged to be made from funds derived from tax revenues
    - 9(b) General Obligation
    - 9(d) VCBA (21st Century and Equipment), VPBA, VPA, and CTB debt secured by the TTF
    - Capital leases, installment purchases and miscellaneous debt

- Tax-supported debt does not include:
  - 9(c) G.O. since payments are to be paid by project revenues
  - Debt/Notes of Institutions of Higher Education supported by General Revenues of the Institution
  - Moral Obligation issued by VRA
  - Sum-Sufficient Appropriation issued by VPSA
  - Grant Anticipation Revenue Vehicles ("GARVEES")

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Debt Capacity Model – Measure and Inputs (Continued)

- All scheduled debt service on outstanding tax-supported debt is included in the model
- Estimated debt service on authorized but unissued debt is included in model and is based on:
  - DPB draw schedules and information from agencies
  - Short-term interest rates
  - Long-term interest rates
- Debt service on <u>proposed</u> new debt is not included in the model

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Debt Capacity Model – Schedule of Issuance Assumptions for Currently Authorized & Unissued Debt

As of December 19, 2017

(Dollars in Millions)

	9(b)	VPBA	VCBA 21st Century Equipment	VCBA 21st Century Projects	CPR Transportation	NVTD Transportation	Route 58 Transportation	VPA	Total
Authorized & Unissued as of June 30, 2017	$ -	$ 1,381.2	$ 83.0	$ 2,068.4	$ 887.3	$ 24.7	$ 595.7	$ -	$ 5,040.3
Issued Jul 1 - Dec 31, 2017	$ -	$ -	$ -	$ 592.6	$ 260.7	$ -	$ -	$ -	$ 853.3
Assumed Issued:									
FY 2018	$ -	$ 395.1	$ 83.0	$ -	$ 122.9	$ -	$ -	$ -	$ 601.0
FY 2019	$ -	$ 403.2	$ -	$ 282.2	$ -	$ -	$ -	$ -	$ 685.4
FY 2020	$ -	$ 71.2	$ -	$ 291.5	$ 355.0	$ -	$ 150.9	$ -	$ 868.6
FY 2021	$ -	$ 164.7	$ -	$ 291.5	$ 125.3	$ -	$ 249.1	$ -	$ 830.6
FY 2022	$ -	$ 97.9	$ -	$ 225.3	$ -	$ -	$ -	$ -	$ 323.2
FY 2023	$ -	$ 249.1	$ -	$ 225.3	$ -	$ -	$ 195.7	$ -	$ 670.1
FY 2024	$ -	$ -	$ -	$ 102.6	$ -	$ -	$ -	$ -	$ 102.6
FY 2025	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
FY 2026	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
FY 2027	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Planned	$ -	$ 1,381.2	$ 83.0	$ 1,418.4	$ 603.2	$ -	$ 595.7	$ -	$ 4,081.5
Subtotal Issued & Planned	$ -	$ 1,381.2	$ 83.0	$ 2,011.0	$ 863.9	$ -	$ 595.7	$ -	$ 4,934.8
Authorized Debt Assumed Unissued[(1)]	$ -	$ -	$ -	$ 57.4	$ 23.4	$ 24.7	$ -	$ -	$ 105.5

[(1)] Assumed funded from premium from bonds sold and for NVTD authorized debt is assumed not to be issued.

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Debt Capacity Model – Factors Affecting Debt Capacity

- Revisions to revenue estimates
  - Driven by economy
  - Policy changes

- Authorization of additional tax-supported debt

- Changes to issuance assumptions
  - Actual financing dates/terms vs. estimated
  - Revisions to project spending schedules
  - Changes in interest rates

How Does the DCAC Recommendation Impact Authorizations?

- Recommendation is non-binding, but is taken into consideration by the Governor and the General Assembly when developing the budget
- Available debt capacity may constrain the ability to finance capital needs
- Previously authorized projects can be delayed, rescinded, or adjusted to impact the timing and amount of debt service

December 2017 Model – Base Solution

(Dollars in Millions)

Debt Capacity Maximum Ratio

Debt Service as a % of Revenue = 5.0%

December 19, 2017

Base Model Solution

Fiscal Year	[1] Blended Revenues	[2] Base Capacity to Pay Debt Service	[3] Annual Payments for Debt Service on Debt Issued	[4] Actual Outstanding Debt Service as a % of Revenues	[5] Annual Payments for Debt Service on All Planned Debt Issuances	[6] Actual & Projected Debt Service as a % of Revenues	[7] Net Capacity to Pay Debt Service	[8] Amount of Additional Debt that may Be Issued	[9] Debt Service on Amount of Additional Debt that may Be Issued	[10] Remaining Capacity to Pay Debt Service	[11] Total Debt Service as a % of Revenues
2008	17,528.90	876.45	532.95	3.04%	N/A	3.04%	343.50	**N/A**	N/A	343.50	3.04%
2009	15,680.90	784.05	587.33	3.75%	N/A	3.75%	196.72	**N/A**	N/A	196.72	3.75%
2010	16,085.70	804.29	633.45	3.94%	N/A	3.94%	170.83	**N/A**	N/A	170.83	3.94%
2011	16,751.10	837.56	693.64	4.14%	N/A	4.14%	143.92	**N/A**	N/A	143.92	4.14%
2012	17,787.10	889.36	747.02	4.20%	N/A	4.20%	142.34	**N/A**	N/A	142.34	4.20%
2013	18,626.30	931.32	820.77	4.41%	N/A	4.41%	110.55	**N/A**	N/A	110.55	4.41%
2014	18,502.80	925.14	835.53	4.52%	N/A	4.52%	89.61	**N/A**	N/A	89.61	4.52%
2015	20,041.00	1,002.05	897.38	4.48%	N/A	4.48%	104.67	**N/A**	N/A	104.67	4.48%
2016	20,380.50	1,019.03	904.30	4.44%	N/A	4.44%	114.72	**N/A**	N/A	114.72	4.44%
2017	21,137.30	1,056.87	988.33	4.68%	N/A	4.68%	68.54	**N/A**	N/A	68.54	4.68%
2018	21,775.70	1,088.79	957.97	4.40%	103.77	4.88%	27.05	**396.08**	27.049	0.00	5.00%
2019	22,653.10	1,132.66	923.88	4.08%	162.67	4.80%	46.10	**279.00**	46.102	0.00	5.00%
2020	23,628.40	1,181.42	874.64	3.70%	239.83	4.72%	66.95	**305.32**	66.953	0.00	5.00%
2021	24,471.50	1,223.58	851.99	3.48%	286.59	4.65%	85.00	**264.20**	84.996	0.00	5.00%
2022	25,259.40	1,262.97	806.61	3.19%	313.22	4.43%	143.14	**851.37**	143.137	0.00	5.00%
2023	26,037.50	1,301.88	776.65	2.98%	346.78	4.31%	178.44	**516.96**	178.441	0.00	5.00%
2024	26,836.00	1,341.80	750.48	2.80%	370.80	4.18%	220.52	**616.18**	220.520	0.00	5.00%
2025	27,653.32	1,382.67	697.84	2.52%	370.80	3.86%	314.02	**1,369.10**	314.018	0.00	5.00%
2026	28,496.15	1,424.81	674.91	2.37%	358.15	3.63%	391.75	**1,138.11**	391.741	0.00	5.00%
2027	29,365.28	1,468.26	634.87	2.16%	358.15	3.38%	475.25	**62.96**	396.041	79.21	4.73%

10 Year Average:	$579.93	2 Yrs Excess Avg Capacity:	$1,159.85

December 2017 Model – Average Solution

(Dollars in Millions)

Debt Capacity Maximum Ratio

Debt Service as a % of Revenue = **5.0%**

December 19, 2017

Base Model Average Solution

	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]	[10]	[11]
Fiscal Year	**Blended Revenues**	**Base Capacity to Pay Debt Service**	**Annual Payments for Debt Service on Debt Issued**	**Actual Outstanding Debt Service as a % of Revenues**	**Annual Payments for Debt Service on All Planned Debt Issuances**	**Actual & Projected Debt Service as a % of Revenues**	**Net Capacity to Pay Debt Service**	**Amount of Additional Debt that may Be Issued**	**Debt Service on Amount of Additional Debt that may Be Issued**	**Remaining Capacity to Pay Debt Service**	**Total Debt Service as a % of Revenues**
2008	17,528.90	876.45	532.95	3.04%	N/A	3.04%	343.50	**N/A**	N/A	343.50	3.04%
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2018	21,775.70	1,088.79	957.97	4.40%	103.77	4.88%	27.05	**0.00**	0.000	27.05	4.88%
2019	22,653.10	1,132.66	923.88	4.08%	162.67	4.80%	46.10	**579.93**	39.604	6.50	4.97%
2020	23,628.40	1,181.42	874.64	3.70%	239.83	4.72%	66.95	**579.93**	79.208	(12.25)	5.05%
2021	24,471.50	1,223.58	851.99	3.48%	286.59	4.65%	85.00	**579.93**	118.812	(33.82)	5.14%
2022	25,259.40	1,262.97	806.61	3.19%	313.22	4.43%	143.14	**579.93**	158.416	(15.28)	5.06%
2023	26,037.50	1,301.88	776.65	2.98%	346.78	4.31%	178.44	**579.93**	198.021	(19.58)	5.08%
2024	26,836.00	1,341.80	750.48	2.80%	370.80	4.18%	220.52	**579.93**	237.625	(17.10)	5.06%
2025	27,653.32	1,382.67	697.84	2.52%	370.80	3.86%	314.02	**579.93**	277.229	36.79	4.87%
2026	28,496.15	1,424.81	674.91	2.37%	358.15	3.63%	391.75	**579.93**	316.833	74.91	4.74%
2027	29,365.28	1,468.26	634.87	2.16%	358.15	3.38%	475.25	**579.93**	356.437	118.81	4.60%
							10 Year Average:	$579.93			

What was the Committee’s December 2017 Recommendation?

- Up to an additional $580 million could prudently be <u>authorized and issued</u> during each of fiscal years 2018 and 2019
  - Committee noted that the underlying forecast includes proposed provider assessments which are tied to Medicaid expansion and should that policy not be adopted, debt capacity would drop to $558 million annually

- Committee urged the Governor and the General Assembly to consider the implications of rising interest rates when authorizing new tax-supported debt during the 2018 Session of the General Assembly
  - 100 basis points increase to model interest rate would result in a decline in capacity to $509 million annually

- Committee expressed support of the Governor and General Assembly’s work to establish and fund the Revenue Cash Reserve Fund and recommended the continued prioritization of rebuilding reserves in an effort to maintain AAA bond ratings

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Introduced Budget – Impact on DCAC Model

- Approximately $719 million of proposed new tax-supported bond projects for 2018 Session

- If the additional debt service related to the proposed new debt in the budget is included in the DCAC model, the debt capacity would decline by $60 million annually to $520 million

- While not factored into the DCAC Model, an additional $21 million is proposed for self-supporting 9(c) G.O. Higher Education Bonds

Appendix
Description of Types of Debt

	Types of State Bonded Debt	Primary Security	Rating (Moody's, S&P, and Fitch)	Typical Purpose	Authorization Required	Debt Capacity	Typical term
General Obligation Bonds							
GO - 9(b)	Voter-approved GO's	GF	Aaa/AAA/AAA	Capital	GA + voters	Yes	20
GO - 9(c)	Project revenues + GO pledge	NGF/Auxiliary, Tolls + GO backstop	Aaa/AAA/AAA	Revenue-producing capital (dorm, dining, parking)	GA + Feasibility	No (1)	20-30
Subject to Appropriation/Revenue Bonds							
VCBA	21st Century Program	GF	Aa1/AA+/AA+	Capital - E&G, Maint Reserve	GA	Yes	20
VCBA	Equipment Trust Fund	GF	Aa1/AA+/AA+	Educational/Research Equipment	GA	Yes	7
VPBA		GF	Aa1/AA+/AA+	Capital - Maint Reserve, regional jails, water quality/ stormwater grants	GA	Yes	20
Other 9(d) Debt							
VCBA	Higher Ed Projects	NGF-General Revenue Pledge + State aid intercept	Aa1/AA/AA+	Capital - Rec/sports facilities, Athletic, Convocation, etc.	GA	No	20-30
College/ University	Higher Ed Projects	NGF-General or specific revenue pledge	Varies	Capital - Rec/sports facilities, dormitories, athletic, Convocation, etc.	GA (except Level 3's)	No	20-30
Capital leases, support agreements	Foundations, conduit issuers	NGF-General or specific revenue pledge	Varies	Capital - dormitory, multi-use facilities	GA (except Level 3's)	No	20-30

(1) So long as net revenues provide for debt service

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