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Debt Capacity Calculation

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Presentation Outline

- Review of Debt Capacity Calculation Methodology
- How the rating agencies view debt limitations
- How does Virginia compare to its “AAA” Peers
- Comments from Rating Agency Meetings
- Conclusion

Debt Capacity Calculation Methodology

- Debt Capacity Management Policy
  - Enhances executive/legislative control over debt authorization process
  - Limits debt service claim on tax revenues such that the State's ability to provide core services is not hindered

- Rating agencies factor "debt burden" in determining overall credit strength

- Current Policy:
  - Annual debt service on tax supported debt should not exceed 5% of forecast annual blended revenues
  - Blended Revenues: GF Revenues; state revenues in TTF; transfers of ABC profits

- Virginia's debt capacity calculation method compares favorably to other AAA-rated states.

DCAC Implements Changes to Debt Capacity Model

- **Key Technical Changes:**
  - Blended Revenues to include:
    - 0.25% sales tax ($200+ million/year)
    - Appropriation Act transfers from recurring sources ($90M/yr)
  - Debt Service total to exclude amount paid from non-GF sources
  - Estimating debt service on authorized/unissued debt:
    - Average of last 12 quarters of Bond Buyer 11 Index (previously 8 Qtrs)
    - Add 25 bps to average for appropriation-backed debt (previously 50 bps)

DCAC Implements Changes to Debt Capacity Model (cont.)

- **Key Policy Changes:**

  - Build America Bonds:
    - Debt service incorporated in model net of future federal subsidy
    - NOTE: BAB Program expired December 31, 2010

  - Smoothing the effect of revenue fluctuations
    - Averaging debt capacity results
    - Six-year capital planning process
    - Two-year excess capacity as reserve retained

Debt Capacity Calculation Comparison

Debt Capacity Model
($ in Millions)

		Base Calculation		Average Solution	
		[A]	[B]	[C]	[D]
Fiscal Year	Blended Revenues	Amount of Additional Debt that may Be Issued December 2010	Total Debt Service as a % of Revenues	Amount of Average Debt that may Be Issued December 2009	Total Debt Service as a % of Revenues
Actual 2008	17,076.40	N/A	3.12%	N/A	3.04%
Actual 2009	15,680.70	N/A	3.75%	N/A	3.75%
Actual 2010	15,871.20	N/A	3.99%	N/A	3.94%
2011	16,386.60	0.00	4.88%	0.00	4.88%
2012	17,192.53	0.00	4.69%	363.41	4.85%
2013	17,881.30	0.00	4.96%	363.41	5.27%
2014	18,693.10	0.00	5.00%	363.41	5.45%
2015	19,657.60	173.95	4.99%	363.41	5.49%
2016	20,565.90	459.72	4.99%	363.41	5.43%
2017	21,517.18	597.38	4.99%	363.41	5.33%
2018	22,451.66	813.59	4.99%	363.41	5.16%
2019	23,448.25	794.74	4.92%	363.41	4.94%
2020	24,490.00	794.74	4.77%	363.41	4.66%
	10-yr Average $	363.41			

[A] Represents the amount of additional principal that may be issued without violating the 5% annual parameter of the model.

[B] Debt service as a % of blended revenues, including outstanding debt service; debt service on currently authorized but unissued debt and debt service on available capacity reflected in Column A.

[C] Illustrates the capacity using the average annual solution computed in Column A.

[B] Debt service as a % of blended revenues, including outstanding debt service; debt service on currently authorized but unissued debt and debt service on available avg. capacity reflected in Column C.

Rating Agency Reaction to Increased Borrowing

- Increased bonding levels during periods of economic softening is not a new phenomenon for states
- Following the ‘01 Recession, nearly $30 billion of debt was issued by states to meet budget requirements
- Of the 5 states that experienced downgrades during the ‘01 downturn, increased debt burden was NOT cited as a contributing factor for any of the negative rating actions
- At its bi-annual infrastructure conference in September 2010, Moody’s stated it expects infrastructure funding needs to continue to grow for both new capacity and maintenance

Will Increasing the Debt Burden Affect Virginia's Bond Ratings?

- General obligation (GO) bond ratings are forward-looking assessments of an entity's relative credit strength
- Debt Burden plays a role in determining Ratings; one of five credit factors:
  - Government Framework
  - Financial Management
  - Economy
  - Budgetary Performance
  - Debt Profile (includes Debt Burden, Pension and OPEB)
- All factors are assessed to determine an entity's rating; historically, rating agencies have placed less "weight" on Debt Profile in the credit review process
- Peer comparisons help determine ultimate rating
- "AAA" ratings were affirmed in October, with rating agencies noting the State's below average debt burden

S&P Releases New State Ratings Methodology

- Published January 3, 2011

- Five key credit factors remain the same, with each factor – including Debt Profile – now having equal weighting

- In an effort to provide greater transparency, rating decisions to be based on quantitative factors (metric scoring)

- Three key debt metrics weighted equally: debt burden, pension liabilities and OPEB

- Ratios utilized to measure debt burden:
    - Debt per Capita
    - Debt/Personal Income
    - Debt/General Fund Spending
    - Debt Amortization

S&P State Ratings Methodology – Debt Burden Scoring

Debt per Capita	
1	Below $500 (Low)
2	$500-$2,000 (Moderate)
3	$2,000-$3,5000 (Moderately high)
4	Above $3,500 (High)

Debt/General Fund Spending	
1	Below 2.0% (Low)
2	2.0% - 6.0% (Moderate)
3	6.0% - 10.0% (Moderately high)
4	Above 10.0% (High)

Debt/Personal Income	
1	Below 2.0% (Low)
2	2.0% - 4.0% (Moderate)
3	4.0% - 7.0% (Moderately high)
4	Above 7.0% (High)

Debt Amortization (10 years)	
1	80% - 100% (Very Rapid)
2	60% - 80% (Rapid)
3	40% - 60% (Average)
4	Less than 40% (Slow)

Virginia stacks up well vs.“AAA” Peer Group

Moody's 2010 State Debt Medians

Aaa-rated States*

State		Net Tax Supported Debt		Debt per Capita	Rank	Debt as a % of Personal Income	Rank
Iowa	$	219,279	$	73.0	1	0.2%	1
Tennessee		2,003,673,000		318	2	0.9%	2
Indiana		3,156,986,000		492	3	1.5%	4
Texas		12,892,508,000		520	4	1.4%	3
North Carolina		7,174,650,000		765	5	2.3%	7
Missouri		4,672,127,000		780	6	2.2%	6
Virginia		**7,056,177,000**		**895**	**7**	**2.1%**	**5**
South Carolina		4,184,210,000		917	8	2.9%	8
Utah		2,665,545,000		957	9	3.2%	9
Georgia		11,011,066,000		1,120	10	3.3%	10
New Mexico		2,809,156,000		1,398	11	4.4%	12
Maryland		9,166,095,000		1,608	12	3.4%	11
Delaware		2,202,968,000		2,489	13	6.2%	13
50-State Median			***$***	***936***		***2.5%***	

*Listing includes states rated Aaa by Moody's

Virginia debt policy compares favorably to Peer Group

STATE DEBT POLICIES		
Comparable AAA-rated States Only		
State	**Ratings**	**Debt Limitation**
Virginia	**AAA/Aaa/AAA**	**5% of Blended Revenues - average over 10 years**
Delaware	AAA/Aaa/AAA	15% of prior year GF + Transportation Trust Fund revenues
Florida	AAA/Aa1/AAA	7% of General Revenues + tax revenues pledged to bond programs
Georgia	AAA/Aa1/AAA	7% of total revenues (Statutory); 10% of all Treasury receipts (Constitutional)
Indiana	AAA/Aaa	No GO Debt/Appropriation-backed debt permitted
Iowa	AAA/Aaa/AAA	No GO Debt/Appropriation-backed debt permitted
Maryland	AAA/Aaa/AAA	8% of Revenues
Minnesota	AAA/Aa1/AAA	Total principal less than 3.25% of personal income
Missouri	AAA/Aaa/AAA	NA
New Mexico	Aaa/AA+	Total debt less than 1% of statewide net taxable property value
North Carolina	AAA/Aaa/AAA	GF Debt Capacity: 4.75% of General Tax revenues; Transportation Debt Capacity: 6% of State Transportation revenues
South Carolina	AAA/Aaa/AA+	GO Debt Capacity (excl Highway Bonds): 5% of General Fund revenues; GO Highway Debt Capacity: 15% of highway-related taxes/licenses
Tennessee	AAA/Aaa/AA+	Special taxes (gas, MV fees, etc.) coverage requirement: 1.5x
Texas	AA+/Aaa/AAA	5% of General Fund Revenues
Utah	AAA/Aaa/AAA	GO Debt less than 1.5% of total taxable property

Rating Agency Views

Q: Is “Debt Burden” a ratings driver?

A: Yes and No

Formalizing Debt Capacity Calculations

- ***Would the Commonwealth benefit from formalizing such calculations either through statute or Constitutional Amendment?***
    - Virginia already has the highest rating
    - DCAC-adopted change is reasonable
    - Anything that reduces the Commonwealth's ability to respond to future challenges is not viewed as positive

How frequently should VA change its Debt Capacity Calculation?

- Frequent changes limit the effectiveness of the guideline, and the guideline may be viewed as arbitrary
- Once every 19 years is not too frequent
- Guidelines need to be able to change to reflect changing times

Will new guidelines enable Virginia to issue too much debt?

- Virginia has long history of conservative debt practices
- Debt is an important tool to enable the Commonwealth to finance essential capital investments
- Debt often enables projects to be started early, accelerating benefits
- Best control comes from conservative leadership from Governor and Legislature

Conclusion

- 2010 Debt Capacity recommendations allow VA to accelerate, but not increase, amount of debt to be issued over next 10 years
- Virginia's debt policies remain conservative
- Rating Agencies continue to regard Virginia as well managed