Revenue Bonding
by the
State Building Ownership Authority
and the
State Board of Regents

September 14, 2004

Report to the Executive Appropriations Committee
Of the Utah State Legislature

Prepared by
The Office of the Legislative Fiscal Analyst

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Executive Summary

All revenue bonds must be approved by the Legislature. As the state grows there will continue to be a need to build space for higher education, state agencies and recreation activities. Revenue bonds are an appropriate financing mechanism so long as they are tied to a suitable funding source that represents a user fee. Legislative concern arises when agencies request conversion of lease obligations into bond payments, but recent history indicates that few projects of this type have been approved.

While revenue bonds may not generally be examined as closely as general obligation bonds, the expression of legislative concern—and the rejection of key projects—indicates that revenue bond projects receive legislative scrutiny. During the 2004 General Session the Legislature divided bond issues into a general obligation facilities bond, a transportation bond and a revenue/lease revenue bond. This seemed to allow more floor time to focus on each type of bond and the projects associated with each bill. Given that all revenue bonds must earn legislative approval, it seems that current levels of oversight ensure that future projects truly meet state needs and are appropriate for taxpayer funding.

Policy Recommendations

The Analyst recommends that the Legislature adopt the following policies in considering new capital facilities:

1. Require all appropriation subcommittees to more closely scrutinize agency leasing. This information can be included for subcommittees as the Legislative Fiscal Analyst prepares annual budget recommendations.

2. Require the Capital Facilities Committee to make a motion for approval of all revenue bonds with notification to be sent to committees overseeing operating budgets to ensure that this meets the mission of the requesting agency.

3. Continue the process of writing a separate bill for revenue bond authorizations. This allows more time for floor consideration of each project and should lead to a more informed decision by the full legislature.

Introduction

The State of Utah primarily issues three types of debt to finance capital facilities:

- **General obligation (G.O.) bonds** carry the "full faith and credit" of the state and are backed by a pledge to raise taxes to meet debt service needs in the unlikely event that the state budget falls short of needed funding levels.
- **Lease revenue bonds** are backed by lease payments from various state agencies to the State Building Ownership Authority (BOA). Agencies may fund lease payments from court fees, restricted accounts, federal funds, profits on sales, or from a transfer of embedded lease payments. The chief characteristic of a lease revenue bond is that the BOA is able to demonstrate debt service coverage by collecting lease payments.
- **Revenue bonds** are similar to lease revenue bonds in that a revenue stream is pledged for debt services. The distinction is that a revenue bond does not have a physical asset as security, but is funded from a dedicated income stream such as net income on student loan administration, hospital revenue, profits from retail operations (i.e., university bookstores) or payments from an auxiliary service (such as dormitories and parking).

During the 2004 General Session the Legislature expressed concern regarding the process by which lease revenue bonds are approved and focused specifically on the use of lease payments to leverage support for revenue bond financing. This report will address the following questions in response to legislative concerns:

1. How does the state use revenue bonds and lease revenue bonds?
2. How much revenue bond and lease revenue bond debt is carried by the state?
3. Is the approval process for revenue bond and lease revenue bond projects substantially different from the process for general obligation or cash projects?
4. Is the level of legislative oversight sufficient to ensure appropriate use of revenue bonds and lease revenue bonds?

How does the state use revenue bonds and lease revenue bonds?

The state uses revenue bonds for a variety of purposes. Examples include replacement stores for the Department of Alcohol Beverage Control (DABC), student centers on college and university campuses, capital for student loans and state office space.

The terms *revenue bond* and *lease revenue bond* are often used interchangeably in discussions regarding approval of new projects. Although the difference from a policy perspective is not great, there are subtle differences in what each term means.

Revenue bonds (used mostly by higher education) rely on revenue streams created by fees, tuition, or auxiliary (i.e., bookstore) profits. The state Building Ownership Authority[1] (BOA) issues *lease revenue bonds* for the facilities that it finances. The BOA issues bonds primarily for state office buildings (including regional centers) and DABC stores but also carries notes for courthouses, golf courses, and a hospital at the University of Utah. All of these bonds are technically *lease revenue bonds* in that the BOA collects rent from the user agency. In reality, though, most of the "lease" payments are funded from a revenue source: green fees, patient payments, court fines, or liquor sales. In effect, the BOA obtains financing, constructs or purchases a facility, then leases the facility to the user agency.

Lease Conversions are rare

Over the past few years the primary focus of legislative concern seems to focus not on the DABC, court or hospital bonds but rather on requests to fund regional centers and state office buildings using existing lease payments as the "funding source." Utah Code actually directs the BOA (and DFCM as its staff) to seek opportunities to convert leased space to owned space by declaring that

> *(3) the state is renting space for state bodies in privately owned buildings with funds which could more efficiently and economically be put to use toward the purchase and acquisition of facilities by the state;*
> *(4) in order to provide for a fully adequate supply of office space, related facilities, other governmental facilities, and property at the lowest possible cost, this Legislature should establish a State Building Ownership Authority for the purpose of financing, owning, leasing, operating, or encumbering such facilities to meet the needs of the state government and to serve the public welfare;*[2]

[1] UCA 63B-1-304
[2] UCA 63B-1-302

While the Legislature realizes that long term space is cheaper when owned, agencies pledging lease payments as a funding source for debt service may leave the impression that leases are revenue sources. This seems to have become more prevalent as interest rates dropped to historic lows, allowing agencies to leverage the cost of leases into requests for new owned space. However, perception that lease revenue projects are growing may come from a combination of denied requests (which attract attention), the Building Board's unprecedented request for three new regional centers (St. George, Ogden and Logan) in both the 2003 and 2004 general sessions, and a couple of high profile leases that required legislative attention over the past two years.

How much revenue bond and lease revenue bond debt is carried by the state?

As noted above, all BOA bonds are considered “lease revenue” bonds, even if proceeds come from rates, fees or profits.

Utah State Building Ownership Authority Lease Revenue Bonds

	Outstanding as of 6/30/1995	*Outstanding as of 6/30/2003*	*Original Issue*	*Principal Due After Refunding*
2003 LR and Refunding Bond (2005-2015) (FY04)			$22,725,000	
2001C LR Bond (2005-2021)		$30,300,000	$30,300,000	
2001B LR Bond (2002-2024)		$25,750,000	$25,780,000	
2001A LR Bond (2005-2021)		$69,850,000	$69,850,000	
1999A LR Bond (2001-2021)		$8,835,000	$9,455,000	
1998C LR Refunding Bond (2000-2019)		$104,910,000	$105,100,000	
1998B LR Bond (2005)		$28,978,000	$23,091,000	
1998A LR Bond (1999-2020)		$16,565,000	$25,710,000	
1997A LR Bond (1999-2018)		$3,510,000	$4,150,000	
1996B LR Bond (1999-2013)		$12,550,000	$16,875,000	
1996A LR Bond (1999-2007)		$7,455,000	$44,725,000	$14,375,000
1995A LR Bond (1996-2005)		$15,435,000	$93,000,000	$31,075,000
1994A LR Bond (1995-2005)	$30,615,000	$3,700,000	$30,915,000	$11,440,000
1993B LR Bond (1995-2014)	$7,910,000	$5,430,000	$8,160,000	
1993A LR Bond (1995-2013)	$6,020,000	$3,965,000	$6,230,000	
1992B LR Bond (1994-2011)	$1,330,000	$860,000	$1,380,000	
1992A LR Refunding (1993-2011)	$24,535,000	$15,785,000	$26,200,000	
Total Outstanding CAFR 6/30/95	$70,410,000			
Total Outstanding CAFR 6/30/03		$353,878,000		

Source: Utah Division of Finance

BOA debt is at an all time high, but this is due in large part to the convergence of several unique issues that have driven bond balances higher. The table above shows outstanding debt in FY 2003 at more than $353 million. However, approximately $200 million of that amount is from issues related to the Olympics, the University of Utah Hospital and the Matheson Courthouse. A full list of projects and outstanding balances can be found in Appendix A following this report.

Utah State Building Ownership Authority Lease Revenue Bonds
Selected Projects

	Outstanding as of 6/30/2003	*Original Issue*
UofU Clinical Research Hospital Project	$30,300,000	$30,300,000
UofU Clinical Research Hospital Project	$69,850,000	$69,850,000
UofU Student Housing for Athletes 2003 Olympics	$28,978,000	$23,091,000
UofU Huntsman Cancer Inst.	$12,550,000	$16,875,000
SL Courts	$58,777,428	$70,840,000
	$200,455,428	$210,956,000

Source: Utah Division of Finance

The entities with the largest amount of debt have no relationship to state facilities. The Utah Housing Corporation carries $1.2 billion in bonds used to assist with home purchases.[3] The State Board of Regents carries $1.3 billion in bonds to finance student loans under the auspices of the Utah Higher Education Assistance Authority.[4] Both of these programs borrow money and lend it to users at a slightly higher rate, using the difference to fund operations and ensure that obligations can be met.

In addition, colleges and universities fund auxiliary facilities, hospitals and student centers through revenue bonds that are backed by student fees or enterprise revenue. These bonds often pledge facilities and revenue streams as collateral. The following table shows higher education's outstanding revenue bond debt as of June 30, 2003:

USHE Outstanding Revenue Bond Debt

	Maturity Date	*Original Issue*	*Outstanding June 30, 2003*
University of Utah	2006-2027	$307,640,000	$241,036,000
Utah State University	2003-2020	72,935,000	44,565,000
Weber State University	2003-2031	20,995,000	17,525,000
Southern Utah University	2014-2023	20,545,000	15,745,000
Utah Valley State College	2011-2014	19,565,000	17,830,000
Dixie State College of Utah	2010-2023	10,790,000	9,065,000
College of Eastern Utah	2022	1,250,000	1,070,000
Salt Lake Community College	2004-2016	23,205,000	15,085,000
Total - USHE		$476,925,000	$361,921,000

Source: Utah Division of Finance CAFR

[3] Utah Division of Finance *Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2003*; p. 181-182.
[4] Ibid, p. 182-183.

Revenue Bonds are not general obligations

Whether the bonds are for low income housing assistance, new liquor stores or central court facilities, most state revenue bonds are not general obligations on the state:

> *In the opinion of the bond counsel, the revenue bonds are not a debt, liability, or general obligation of the State of Utah and, therefore, do not impair the legal borrowing capacity of the State.*
>
> *The enabling legislation for bonds issued by the State Board of Regents (with respect to the Student Assistance Programs), the Utah State Building Ownership Authority, and the Utah Housing Corporation requires or permits these entities to establish debt service reserve funds as reserves for those bonds. The State Financing Consolidation Act also permits the State to establish debt service reserve funds as reserves for obligations issued under that Act. Such reserve funds should be funded to the maximum amount allowed by Federal or statutory law. Should those reserve funds ever fall below their required levels, an appropriation may be sought from the Legislature to cover the deficit. The Legislature may, but is not required to, make such an appropriation. Bonds issued with these types of reserve funds supported by the State are referred to herein as "State Reserve Fund Moral Obligation Bonds."*
>
> *As of June 30, 2003, the Utah Housing Corporation, the State Board of Regents, and the Utah State Building Ownership Authority have never failed to pay when due the principal of and interest on any State Reserve Fund Moral Obligation Bonds. The reserve funds for the various State Reserve Fund Moral Obligation Bonds have never been below their respective debt service reserve fund requirements. Therefore, to date no appropriation has ever been requested from the Legislature.*[5]

[5] Ibid, p. 179.

Is the approval process for revenue bond and lease revenue bond projects substantially different from the process for general obligation or cash projects?

There is no doubt that the approval process is different for projects seeking funding from a revenue bond when compared to funding for projects from state funds. Whether funded through cash or general obligation debt, the Legislature is limited by statute, policy and budget for state funded projects.[6] Funding for revenue bonds assumes debt service from a source of funding that is already embedded in an agency budget or will be outside the typical appropriation process as a dedicated credit or restricted fund. However, funding sources embedded in a budget or from restricted funds impact overall budget policy. For example, the Department of Alcoholic Beverage Control (DABC) returns profits to the General Fund, so debt service obligations drain funds available for general appropriation. Projects funded through restricted funds or by college funds limit flexibility in agencies and institutions, potentially creating a need for additional appropriations from the General Fund.

Over the past three legislative sessions, Legislators and the members of the Capital Facilities committee expressed increasing concern over the level of revenue bonds, especially those pledging lease obligations as a "funding source." Much of this focus was on state agencies, largely due to the issues involving the request for regional centers in St. George, Ogden and Logan. These centers would have consolidated various state agencies into a single location. In the 2003 General Session Legislators expressed concern over the issue of moving agencies from leased space that was built-to-suit and privately owned, contributing property tax money to the county. At that time, none of the three projects were approved and the St. George project was ultimately abandoned. In 2004 the Legislature approved the Ogden facility as part of a solution to inadequate space that would save state taxpayers over the long run. The Logan project did not gain approval due to concerns that the new facility would not only lead to a loss of property tax from removal of private ownership, but also because the proposed project required an increase in funding to maintain the buildings.

The Analyst believes recent concerns that state agency office space is growing through the revenue bond process is largely unfounded. The Legislature appears to be more aware of the process than ever before and has approved only four lease revenue bond projects since 1996 (see "LR Bond" column in the table on the following page). The Public Safety project is funded from a restricted fund, and two of the projects were approved in the 2004 General Session (funding the Ogden Regional Center and the purchase option on a facility in Moab).

[6] State funded projects generally refers to those projects funded with General Fund, Uniform School Fund or Income Tax.

State Office Buildings Funded Since 1988

Project	Year	LR Bond	GO Bond
Public Safety - West Valley Driver License Office	2003	$1,242,000	
Corrections and Pardons Office Building	1999	6,518,000	
Murray Highway Patrol Office	1998		$2,300,000
Clearfield Office Building Addition (DWS)	1998		2,780,000
Human Services - Vernal Addition	1996	857,600	
St. Library/Visually Disabled	1996	14,299,700	
Human Services - Administration Bldg. Purchase	1996	7,400,000	
Natural Resources Building	1994	10,600,000	
Environmental Quality Office Buildings & Land	1994	8,300,000	
Two Human Services Field Offices	1994	9,000,000	
Corrections Office Building	1994	6,800,000	
Board of Education Office Building	1993	7,200,000	
DHS/DWS Office Bldg. 1385 S. State, SLC	1993	5,625,000	
Tax Commission Building	1992		14,224,000
DHS Clearfield Office Purchase	1991		960,000
Employment Security - Administration Office	1988	16,816,000	
Employment Security - Metro Office	1988	3,428,500	
Employment Security - Midvale Office	1988	3,350,900	

Source: Division of Facilities Construction and Management

In the 2003 General Session[7] and during the 2003 interim[8] the Analyst reported to the Legislature on leasing policy. Part of the reporting included a concern that appropriation subcommittees may not fully consider the impact of agency leases. Leasing is appropriate for dynamic agencies (i.e., DWS, UCAT, community colleges) that see regular mission changes or changing clientele over short periods of time. However, many stable agencies with growing missions (i.e., DNR, Highway Patrol) find it difficult to compete for needed space against colleges and universities for state funding or G.O. bonding. The answer in the past has been to leverage lease payments so that taxpayers will own the building in the future and save long-term costs. So long as there is sufficient oversight, this policy will remain sound and provide a balance between the need for space and the utility of owning versus leasing.

[7] Walthers, Kevin (2003). *FY 2004 Budget Recommendation: Capital Budget*. Salt Lake City, Utah: Office of the Legislative Fiscal Analyst

[8] Walthers Kevin (2003). *Report on Leasing*. Salt Lake City, Utah: Office of the Legislative Fiscal Analyst.

Is the level of legislative oversight sufficient to ensure appropriate use of revenue bonds and lease revenue bonds?

The fact that all revenue bonds must be approved by the Legislature is a strong deterrent to abuse of the system. As the state grows there will continue to be a need to build space for higher education, state agencies and recreation activities. The Analyst believes that revenue bonds are appropriate so long as they are tied to a funding source that represents a user fee. Agencies seeking to convert leases to purchases should receive higher scrutiny, but a blanket policy to prevent such conversions likely will result in unintended future consequences.

The expression of legislative concern – and the rejection of key projects – indicates that revenue bond projects receive legislative scrutiny. During the 2004 General Session the Legislature divided bond issues into a general obligation facilities bond, a transportation bond and a revenue/lease revenue bond. This seemed to allow more floor time to focus on each type of bond and the projects associated with each bill. Given that all revenue bonds must earn legislative approval, it seems that current levels of oversight ensure that future projects truly meet state needs and are appropriate for taxpayer funding.

Recommended Legislative Policy

The Analyst recommends that the Legislature adopt the following policies in considering new capital facilities:

1. Require all appropriation subcommittees to more closely scrutinize agency leasing. This information can be included for subcommittees as the Legislative Fiscal Analyst prepares annual budget recommendations.

2. Require the Capital Facilities Committee to make a motion for approval of all revenue bonds with notification to be sent to committees overseeing operating budgets to ensure that this meets the mission of the requesting agency.

3. Continue the process of writing a separate bill for revenue bond authorizations. This allows more time for floor consideration of each project and should lead to a more informed decision by the full legislature.

Appendix A: Excerpt from the LFA FY 2005 Budget Recommendation for Capital Facilities

Utah State Building Ownership Authority Lease Revenue Bonds (Table 1 of 2)

	Outstanding as of 6/30/1995	*Outstanding as of 6/30/2003*	
2003 LR and Refunding Bond (2005-2015) (FY04)			
DABC - Tooele		$1,905,000	
West Valley Drivers License		$1,305,000	
West Jordan Courts		$15,060,000	
Refund 1993 B (Education)		$4,455,000	
		$22,725,000	
2001C LR Bond (2005-2021)			
UofU Clinical Research Hospital Project	$30,300,000	$30,300,000	Original Issue
2001B LR Bond (2002-2024)			
Soldier Hollow (2005-2024)		$13,890,000	
DABC - Warehouse (2004-2023)		$8,870,000	
DABC - Magna Store (2004-2023)		$1,045,000	
DABC - So. Valley (2004-2023)		$1,625,000	
UDOCorrections Admin Project (2002-2021)		$350,000	
	$25,750,000	$25,780,000	
2001A LR Bond (2005-2021)			
UofU Clinical Research Hospital Project	$69,850,000	$69,850,000	Original Issue
1999A LR Bond (2001-2021)			
Correction Admin (2002-2021)		$6,960,000	
Correction Gunnison (2001-2020)		$1,295,000	
DABC - Various (2001-2020)		$1,200,000	
	$8,835,000	$9,455,000	
1998C LR Refunding Bond (2000-2019)			
Refunds 1994A		$15,655,000	
Refunds 1995A		$60,925,000	
Refunds 1996A		$29,035,000	
Difference between new bond issue and amount refunded		($515,000)	
	$104,910,000	$105,100,000	Original Issue
1998B LR Bond (2005)			
UofU Student Housing for Athletes 2003 Olympics	$28,978,000	$23,091,000	Original Issue
1998A LR Bond (1999-2020)			
Surplus Property (2000-2020)		$1,155,000	
UDOT (2000-2005)		$10,400,000	
SL County Youth Corrections (1999-2017)		$13,330,000	
DABC Project (1999-2020		$825,000	
	$16,565,000	$25,710,000	Original Issue
1997A LR Bond (1999-2018)			
DABC Project-Various Counties	$3,510,000	$4,150,000	Original Issue

Utah State Building Ownership Authority Lease Revenue Bonds (Table 2 of 2)

1996B LR Bond (1999-2013)					
UofU Huntsman Cancer Inst.		$12,550,000	$16,875,000	Original Issue	
					Principal Due After Refunding with 1998C LR Bond
1996A LR Bond (1999-2007)			Original Issue		
Provo Refunding			$5,540,000		$3,125,000
SVATC			$600,000		$205,000
CEU			$1,875,000		$600,000
Washington Courts			$4,375,000		$1,250,000
DCED State Library			$15,825,000		$4,355,000
Davis Courts			$12,110,000		$3,370,000
DHS Vernal			$935,000		$300,000
DABC North Temple			$925,000		$315,000
Wasatch DPR			$1,635,000		$550,000
DABC Synderville			$905,000		$305,000
		$7,455,000	$44,725,000		$14,375,000
					Principal Due After Refunding with 1998C LR Bond
1995A LR Bond (1996-2005)			Original Issue		
SL Courts			$70,840,000		$23,265,000
DHS Field			$10,010,000		$3,445,000
DHS Office			$8,055,000		$2,915,000
DPR			$2,810,000		$960,000
DABC			$740,000		$280,000
SOEducation			$545,000		$210,000
		$15,435,000	$93,000,000		$31,075,000
					Principal Due After Refunding with 1998C LR Bond
1994A LR Bond (1995-2005)			Original Issue		
DNR			$11,935,000		$2,635,000
DEQ			$8,420,000		$2,465,000
DABC			$3,450,000		$1,005,000
DOCorrections			$7,110,000		$5,335,000
	$30,615,000	$3,700,000	$30,915,000		$11,440,000
1993B LR Bond (1995-2014)			Original Issue		
Education Building Project	$7,910,000	$5,430,000	$8,160,000	-	
1993A LR Bond (1995-2013)					
DHS Building Acquisition Project	$6,020,000	$3,965,000	$6,230,000	Original Issue	
1992B LR Bond (1994-2011)					
DYC Washington County	$1,330,000	$860,000	$1,380,000	Original Issue	
1992A LR Refunding (1993-2011)					
Employment Security Project	$24,535,000	$15,785,000	$26,200,000	Original Issue	
Total Outstanding CAFR 6/30/95	$70,410,000				
Total Outstanding CAFR 6/30/03		$353,878,000			

Source: Utah Division of Finance

Appendix B: Updated Excerpt from the LFA FY 2005 Budget Recommendation for Capital Facilities

Capital Facility Financing

The State employs several methods of financing to meet state needs.

General Obligation Bonds - G.O. debt is secured by the full faith and credit of the State and its ability to tax its citizens. General Obligation debt is counted against the state's constitutional and statutory debt limits (certain highway bonds are exempt from the statutory limit). In recent years the State of Utah issued General Obligation Bonds for facilities that mature in six years. Other states and government entities typically issue General Obligation Bonds with terms of 10 to 20 years. Debt service interest begins to accrue when the bonds are issued.

Revenue Bonds – The State Board of Regents issues bonds when a revenue stream can be identified and legally restricted for repayment of the bonds. Revenue Bonds for higher education facilities pledge student fees, auxiliary services revenues, or reimbursed overhead. In order for the bonds to be marketable, the pledged revenue stream must be substantially larger than the debt service requirements. This type of debt is not secured by the full faith and credit of the state nor its taxing power and is exempted from calculations of the state's constitutional and statutory debt limits.

Lease Revenue Bonds - The State Building Ownership Authority, the official owner of state facilities, issues Lease Revenue Bonds. The occupying agency pays rent to the Authority which is used to pay debt service. A pledge of future rental payments (subject to legislative appropriation) and a mortgage on the financed project secure debt.

Since neither the full faith and credit of the state nor its taxing power secure lease Revenue Bonds, they are not counted against debt limits. However, subsection 63b-1-306 states the debt issued by the Building Ownership Authority plus other debt issued by the State (less exempted highway debt) cannot exceed 1.5 percent of the value of the taxable property of the state. A statutory change would be required for BOA bonds if G.O. bonds were authorized up to the constitutional limit. Unlike General Obligation Bonds, Revenue Bonds are typically issued with a repayment period of 20 years. An additional amount is borrowed to cover interest payments during construction.

Certificates of Participation (COP) - COP are very similar to lease Revenue Bonds with one major difference: instead of being a bond issued directly by a governmental entity, COP's represent an undivided interest in a lease agreement. This lease agreement may be entered into by any entity that has the ability to lease space. Although either the state or a private entity may initially hold title to the facility, title must pass to the state by the end of the lease term in order for the interest on the COP to be exempt from federal income tax.

Summary - All of the above are accounted for as debt on the state's accounting records and are considered to be debt by national rating agencies. In addition, the State Auditor issued an opinion in December of 1995 that any General Fund, Uniform School Fund, or Transportation Fund used to retire lease purchase and revenue bond obligations should be counted in the spending limitation formula.

Relative Costs

The total cost associated with various options for financing projects are listed below, ranked from least expensive to most expensive. Specific projects may have circumstances that would affect this ranking. The order for Revenue Bonds and certificates of participation depends on the nature of the project and the source of funding for the debt service.

1. Cash (state funds)
2. General Obligation Bonds
3. Lease Revenue Bonds
4. Revenue Bonds
5. Certificates of Participation
6. Leasing (long-term)

The true cost of bond financing may be much less than commonly assumed because most of the state's payments to investors are made in future years using dollars that may be cheaper due to inflation. However, savings from inflated dollars are difficult to achieve with short-term bonds. The Analyst believes that the differential in interest costs and inflation savings should be considered when the state issues general obligation debt.

The relative cost of different types and terms of debt fluctuates with the financial market. As a general rule, a 20 year general obligation bond carries an interest cost which is about two thirds of one percentage point higher than a 6 year General Obligation Bond. A twenty year lease revenue bond carries an interest cost which is about one third of one percentage point higher than a 20 year general obligation bond. Interest rates for certificates of participation are generally higher than lease Revenue Bonds. By far the largest costs occurs when the state enters into a long term lease instead of purchasing a building that an agency will need for fifteen or twenty years.

Suggested Policy Issues

During the 1996 General Session, the Legislature adopted general guidelines for issuance of state debt. The Analyst recommends the adoption of those guidelines again for the 2004 General Session.

General Obligation bonding should be the preferred method for critical facilities whose costs exceed the availability of current funding. It is assumed that the need for the facility has received full analysis for justification. Short term bonds (6 to 10 years) should be used when a facility has no present funding base to service debt and when the building fulfills a critical need that can not be funded within the base budget for capital facilities. Long term bonds should be used (15 to 20 years) when there are current facility occupancy costs within the agency base budget that could be used to assist the funding of debt service.

Current market conditions should also be considered when bonding is discussed. For example, if current rates are lower than what the Treasurer is earning on the state investment pool, it may be a favorable time to bond. This is especially true with short term bonds that will not recover interest costs through inflation.

Revenue Bonds should be considered when a dedicated source of revenue is available to cover underwriting requirements. Generally, a coverage ratio is required that is in excess of actual debt service. Examples would include higher education facilities such as dormitories and parking lots where the funding source for debt service is derived from rents or fees.

Lease Revenue Bonds or *Certificates of Participation* should be used if the Legislature is willing to fund a lease for a long term facility. This type of funding could be considered when an agency has an outside source of revenue in addition to any existing costs in the budget base. An example would be the State Library where Federal funds are available as lease costs but federal regulation may not allow the funds to be used for debt retirement. Of course, it would be wiser still to issue a long-term General Obligation bond instead and shift the operating funds to debt service. Caution should be exercised by the Legislature to avoid excessive lease purchase obligations since they are treated like debt once funds have been committed. If funds were not appropriated in a given year the state would enter into a default position. Lease Revenue Bonds should be issued with a repayment period not to exceed 20 years.

Leasing provides the least expensive option for space only for short term needs. Some programs are temporary in nature or provide a function that needs to be able to change locations frequently. The Analyst recommends that DFCM continue to provide funding alternatives for the Legislature when agency high cost leases are requested. High cost leases are defined in statute as real property leases that have an initial term of ten years or more or will require lease payments of more than $1,000,000 over the term of the lease, including any renewal options.