STATE DEBT – DECEMBER UPDATE

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ISSUE BRIEF

SUMMARY

Utah's current outstanding debt is at 87% of the Constitutional Debt Limit ($4.2 billion) and Utah's debt ratios are at an all-time high. Property values are expected to continue to decline and an additional $350 million will likely be needed in FY 2013 and FY 2014 to finish current infrastructure projects. The state will pay off $295 million of outstanding debt in FY 2013 and $315 million in FY 2014, allowing for additional bonding capacity; however, cash funding a portion of current infrastructure projects would accelerate the decline in outstanding debt. Should cash be available, we recommend using it to reduce future transportation bonds as they have the longest maturities and cost the most in interest payments. We recommend no new bond authorizations for FY 2013.

DISCUSSION AND ANALYSIS

Outstanding Debt and the Constitutional Debt Limit

The state's constitutional debt limit caps total general obligation debt at 1.5% of the value of the state's taxable property, which declined by 3.6% (to $280 billion) in the latest property tax report. After a July issuance of $610 million the state has approximately $3.7 billion of bonds outstanding or 87% of the limit.

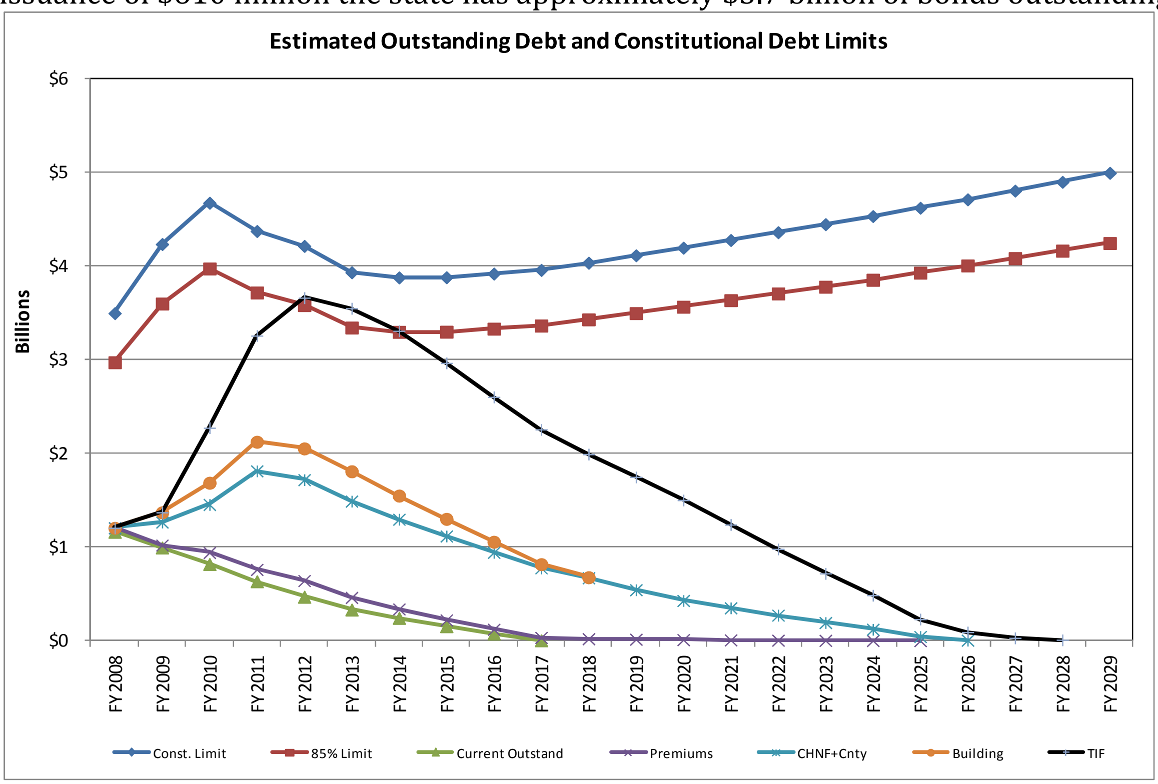

Figure 1

Figure 1 above shows projections of outstanding debt and the constitutional debt limit (lines are cumulative) and includes estimated bond issuances of $205 million in FY 2013 and $125 million in FY 2014 to finish road and building projects. Based on updated revenue estimates for state property values, the model assumes an additional 7% decline in 2011 property values and slight growth in property values thereafter. From those assumptions the state will be at 90% of the constitutional debt limit in FY 2013 and 85% in FY 2014.

Transportation Projects and Funding

Transportation projects have had the most influence on the constitutional debt limit in recent years. Figure 2, produced by an updated capital model, shows a five year actual history and a nine year projection of transportation capital outlays. Lines and bars in Figure 2 are cumulative. Debt funding transportation projects from FY 2009 through FY 2014 enabled the state to double and even triple capital expenditures during the recession, which bolstered Utah's fragile economy. Significant increases in debt service result from these bonds beginning in FY 2011. In fact, a majority of the revenue going into the transportation fund (blue line) is dedicated to paying off debt service (green bars) for the next several years.

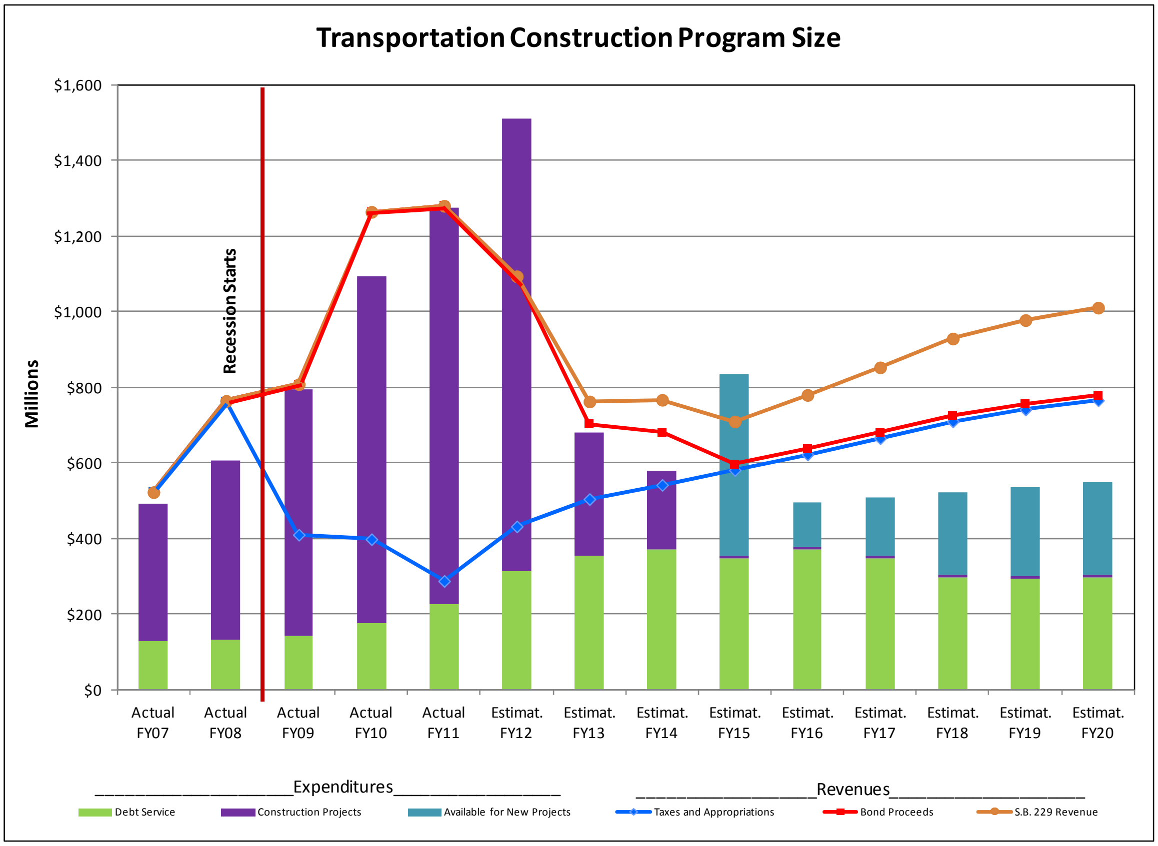

Figure 2

Transportation revenues are needed to finish currently authorized projects until fiscal year 2015 when some funding becomes available (teal bars in Figure 3) for cash funding new projects or debt service on new bonds. Revenue from S.B. 229 *Transportation Funding Revisions* (2011 G.S.) will begin accruing to transportation in FY 2013 (orange line).

Rating Agency Reviews

The three rating agencies (Moody's, Standard and Poor's, and Fitch) reaffirmed Utah's 'AAA' credit worthiness on the 2011A series of general obligation bonds issued in July, 2011. Standard and Poor's rating letter contained several interesting points on why and how Utah received an 'AAA' rating:

- Good financial management and proactive budget adjusting make Utah a best-managed state.
  - During good years Utah built up reserve funds.
  - During the recession Utah used reserve funds sparingly.
  - Utah reduced budgets to achieve structural balance by FY 2013.
  - Utah accommodated the loss of federal stimulus through budget reductions.

- Utah's debt burden, that while increasing, has historically been restrained.
    - 73% of debt retires in 10 years.
    - General obligations bond amortization schedules are no longer than 15 years.
- Pension and OPEB reform reduced the state's future liability significantly.

While not explicit nor necessarily recommendations, the Standard and Poor's letter also made several observations that could indicate areas for improvement:

- The state does not have a priority of payment to debt service in statute.
- The state does not have a debt management policy.
- General obligation debt is increasing and has doubled in recent years.

In August we formed a working group comprised of our office, the State Treasurer, the Division of Finance, the Tax Commission, the Governor's Office, and the state's financial advisor to discuss debt management issues. The working group proposed creating a state debt management policy, which is a best financial practice and addresses an area of concern mentioned above. The State Treasurer presented a draft of the policy to the Executive Appropriations Committee in November, 2011 and also recommended legislation to include a priority of payment for debt service in statute.

Utah Debt Ratios

Rating agencies, as well as investors, look at a state's outstanding debt relative to population and personal income. These indicators give insight into a state's indebtedness. Per capita debt is calculated by dividing the total outstanding debt by the current population estimate. Debt as a percent of personal income is calculated by dividing current outstanding debt by a state's total personal income. The chart at right shows a history of Utah's debt ratios.

The current estimates of the State's general obligation debt per capita ($1,262) and debt as a percentage of personal income (3.7%) are both at an all-time high. The previous peak of either debt ratio occurred in FY 2003 as a result of the I-15 reconstruction project in Salt Lake County. Rating agencies watch trends in debt ratios and generally are permissive of peaks in these numbers as long as "troughs" (restrained debt and quick debt amortization) follow.

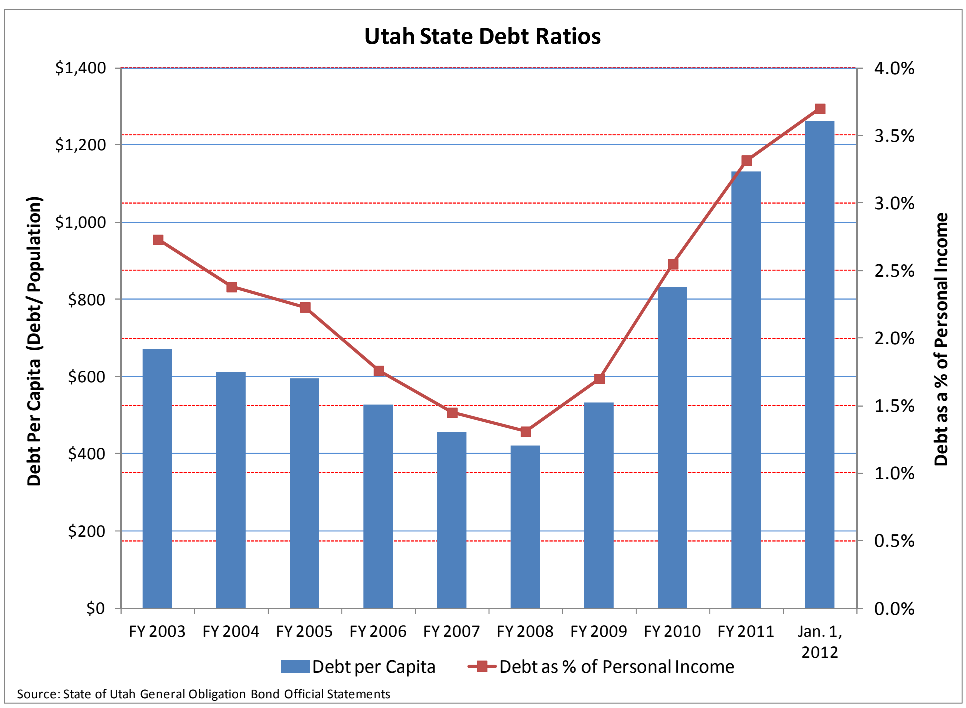

Figure 3

State Debt Obligations

While General Obligation debt is the most direct debt obligated by the state, there exist several other types of debt obligations that amount to an additional $4 billion of debt outstanding related to the state. These obligations include public school debt (from a constitutional guarantee), State Building Ownership Authority bonds, and higher education revenue bonds (see Table 1 next page).

Principal Outstanding (billions) as of June 30, 2011

	Direct State Obligations		Indirect State Obligations	
Legal Obligations	General Obligation Debt	$3.3	Public School Debt Guaranty	$2.5
Credit Obligations	State Building Ownership Auth.	$0.4	Higher Education revenue bonds	$1.2
	Total State Legal and Credit Obligations			**$7.4**

Non-State Obligations	Housing Authority	$1.2
	Student Loans	$0.6

Table 1

Capital Improvements

Capital improvement funding allows for critical repairs to state facilities and replacse worn equipment. Typical improvement projects include repairs to utility tunnels, HVAC systems, electrical systems, roofs, and parking lots. State statute requires the Legislature to fund capital improvements at a level equal to 1.1% of the replacement value of existing state buildings before the Legislature may approve new capital development projects. During budget deficits statute allows funding at 0.9% of the replacement value of existing state buildings, though for FY 2009 thru FY 2012 the Legislature amended the statue to allow funding below the 0.9% level. The FY 2013 beginning base for Capital Improvements is $41,989,100 which represents 0.49% of the replacement value of buildings in FY 2013 ($52.5 million below the 1.1% level).

Though capital improvements are not directly related to debt service, rating agencies watch how states take care of current infrastructure. Additionally, capital improvement funding in the "good years" provided a working rainy day fund that the Legislature used during the recession to balance the budget.

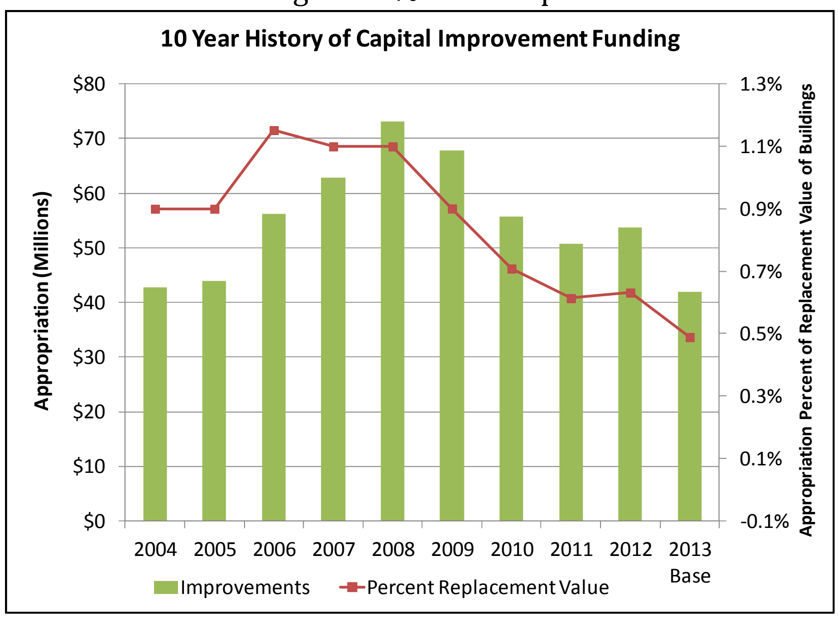

Figure 4

CONCLUSION AND RECOMMENDATION

With outstanding debt currently at 87% of the constitutional limit and the state paying off $295 million of bonds in FY 2013, the state has bonding capacity to complete authorized capital projects. Additionally, transportation revenues will be sufficient to pay debt service on existing and anticipated bonds. However, significant capacity to bond or cash-fund new transportation projects, beyond SB 229 revenue, will not likely exist until FY 2015. We recommend no new bond authorizations for FY 2013.

Should the Legislature have cash available for infrastructure, the following, listed in order of effectiveness, would reduce future indebtedness or improve the state's financial position:

1. Cash for UDOT projects – would replace up to $310 million bonds in FY13-14 and 15 years of interest
2. Cash for Building projects – would replace up to $40 million bonds in FY13 and 6 years of interest
3. Capital Improvement – working rainy day fund –$52.5 million needed for 1.1% replacement value