Office of the
Legislative Fiscal Analyst

FY 2002 Budget Recommendations

Joint Appropriations Subcommittee for
Capital Facilities and Administrative Services

Utah Department of Administrative Services
Debt Service

Contents:

1.0 Summary: Debt Service

Debt Service is made up of interest and principal due on the State's bonded indebtedness. The State uses long term debt to finance large capital expenditures, including new construction, major remodeling and highway projects. Dedicated revenue streams such as enterprise fund revenue or dedicated lease payments secure some bonds. Debt Service on Revenue Bonds and General Obligation Bonds are included in this appropriation.

Financing	Analyst FY 2002 Base	Analyst FY 2002 Changes	Analyst FY 2002 Total
General Fund	73,223,900	(29,594,100)	43,629,800
Uniform School Fund	20,152,500	4,518,100	24,670,600
Centennial Highway Fund	41,104,400	3,079,000	44,183,400
Dedicated Credits Revenue	23,565,500	161,800	23,727,300
Total	$158,046,300	($21,835,200)	$136,211,100
Programs			
Debt Service	158,046,300	(21,835,200)	136,211,100
Total	$158,046,300	($21,835,200)	$136,211,100
FTE/Other			

2.0 Issues: Debt Service

2.1 General Obligation Bonds (Facilities)

Bonds issued for facility construction are amortized over a six year period. The state pays interest for five years, then a lump sum principal payment in the final year. For a variety of reasons (i.e., structural delays from the legislative process, construction delays, procurement extensions) bonds issued by the state are actually amortized for less than six years – it is more realistic to assume that bonds will actually be issued and amortized over a period of 54 to 60 months.

Due to a large principal payment in the current year, debt service for state facilities is $25,076,000 million lower in Fiscal Year 2002 than it was in FY 2002. The Analyst recommends using these savings to augment capital purchases as part of a five year plan to eliminate general obligation debt for facility construction.

General Fund .... ($29,594,100)

Uniform School Fund $4,518,100

2.2 General Obligation Bonds (Centennial Highway Fund)

Bonds for highway construction are issued as part of the Centennial Highway fund. The bonds are General Obligation Bonds but are treated separately by the Legislature because of the unique nature of the program. Fiscal Year 2002 marks the state's initial principal payment of $33,800,000. Centennial Highway Fund bonds are exempt from the statutory limitation on bonding and are amortized over a 15 year period in which both principal and interest are paid. The Analyst's Supplemental Recommendation includes $3,079,000 for FY 2001 CHF Debt Service. The Analyst recommends this funding continue in the current year. At the time of printing, the Legislature was still examining options for the Centennial Highway Program that will increase FY 2002 CHF debt service significantly but will not be included as part of this document.

General Fund $3,079,000

2.3 Revenue Bonds

Revenue Bonds are issued through the state Building Ownership Authority. Agencies pledge a stream of revenue (either profits from sales or dedicated lease payments) to amortize bonds. The Department of Alcoholic Beverage Control applies profits from liquor sales to debt service on new stores, store remodeling and expansion of warehouse capacity. Other agencies, such as the Department of Corrections, pledge ongoing lease funding to debt service so that the state may own facilities rather than continue in long term leases. All funds expended on Revenue Bonds are considered General Fund paid to the Building Ownership Authority.

General Fund 161,800

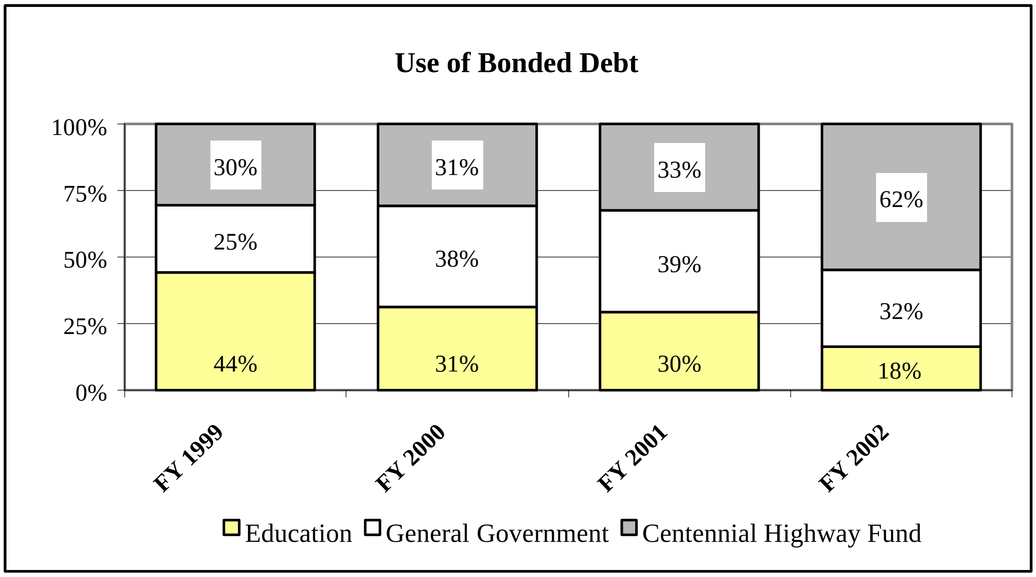
3.0 Programs: Debt Service

3.1 Recommendation The Analyst is recommending a base budget as requested by the Division of Finance.

Financing	2000 Actual	2001 Estimated	2002 Analyst	Est/Analyst Difference
General Fund	71,206,700	73,223,900	43,629,800	(29,594,100)
Uniform School Fund	20,152,500	20,152,500	24,670,600	4,518,100
Centennial Highway Fund	45,628,600	41,104,400	44,183,400	3,079,000
Dedicated Credits Revenue	21,919,600	23,565,500	23,727,300	161,800
Beginning Nonlapsing	8,123,600	8,757,200	5,051,200	(3,706,000)
Closing Nonlapsing	(8,757,200)	(5,051,200)	(5,051,200)	
Total	$158,273,800	$161,752,300	$136,211,100	($25,541,200)
Expenditures				
Current Expense	158,273,800	161,752,300	136,211,100	(25,541,200)
Total	$158,273,800	$161,752,300	$136,211,100	($25,541,200)
FTE/Other				

3.2 G. O. Debt Distribution

Higher Education and the Centennial Highway project account for nearly 70 percent of all General Obligation bonding over the last two years.



3.3 Board of Bonding Commissioners

General obligation debt is issued and managed under the authority of the Board of Bonding Commissioners, which consists of the Governor, the Treasurer, and a member of a political party different from that of the Governor (UCA 63B-1-201).

Constitutional debt limit

The State's constitutional debt limit caps total general obligation debt at 1.5 percent of total fair market value of taxable property. For FY 2002, the Division of Finance estimates additional capacity of $1.08 billion after deducting outstanding debt totaling $1.053 billion.

Constitutional Limitations	**FY 1999**	**FY 2000**	**FY 2001 (1)**	
Fair Market Value	$134,600,533,333	$142,192,133,333	$142,192,133,333	
Constitutional Bonding Limit	2,019,008,000	2,132,882,000	2,132,882,000	
Beginning G.O. Debt	1,202,310,000	1,251,525,000	1,212,325,000	
Principal Payment	(73,785,000)	(77,200,000)	(81,325,000)	
Bonds Sold (3)	123,000,000	38,000,000	15,000,000	(2)
Outstanding Principal	1,251,525,000	1,212,325,000	1,146,000,000	
Additional Bonding Capacity	*$767,483,000*	*$920,557,000*	*$986,882,000*	

(1) The fair market value for FY2001, which is the 2000 calendar year end fair market value is unavailable at this time, so the calendar year end 1999 fair market value has been used.

(2) Series 2001A GO Bond issued January 24, 2001.

(3) FY 1999 total is net of 623,000,000 sold and $500,000,000 refunded.

Statutory debt limit

The State Appropriations and Tax Limitation Act (UCA 63-38c-402) further limits general obligation debt to 20 percent of the allowable spending limit from the General Fund, Uniform School Fund, and Transportation Fund, less debt service. The limitation is established using a formula that includes population growth, inflation, and 1985 appropriations as a baseline.

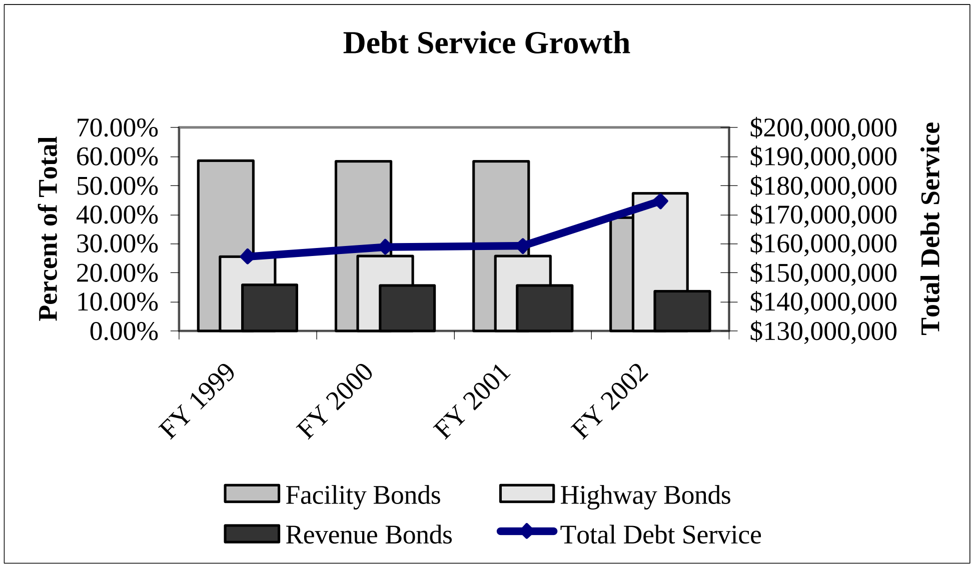
For FY 2002, the statutory general obligation debt limit is $801.3 million. Transportation bonds are exempted from the statutory limitation, leaving outstanding general obligation debt of $179 million to apply against the limit. The State has $622.3 million in additional FY 2002 general obligation bonding capacity.

Statutory Limitations	**FY 1999**	**FY 2000**	**FY 2001**	
Appropriations Limitation	$3,529,861,000	$3,673,543,000	$3,802,663,000	
Statutory Bonding Limit	705,972,000	734,709,000	760,533,000	
Outstanding Principal	1,251,525,000	1,212,325,000	1,146,000,000	
Exempt Trans. Bonds	(908,000,000)	(908,000,000)	(908,000,000)	
Non-Exempt Bonds	343,525,000	304,325,000	238,000,000	(1)
Additional Bonding Capacity	*$362,447,000*	*$430,384,000*	*$522,533,000*	

(1) Includes the Series 2001A GO Bonds, dated January 1, 2001, with final settlement anticipated to be January 24, 2001.

Debt Service Growth

Debt service for FY 2002 will total approximately $174 million, with approximately sixty percent of the expenditure going to principal payment. Debt service has remained relatively flat over the past three years with total expenditures increasing only three percent.



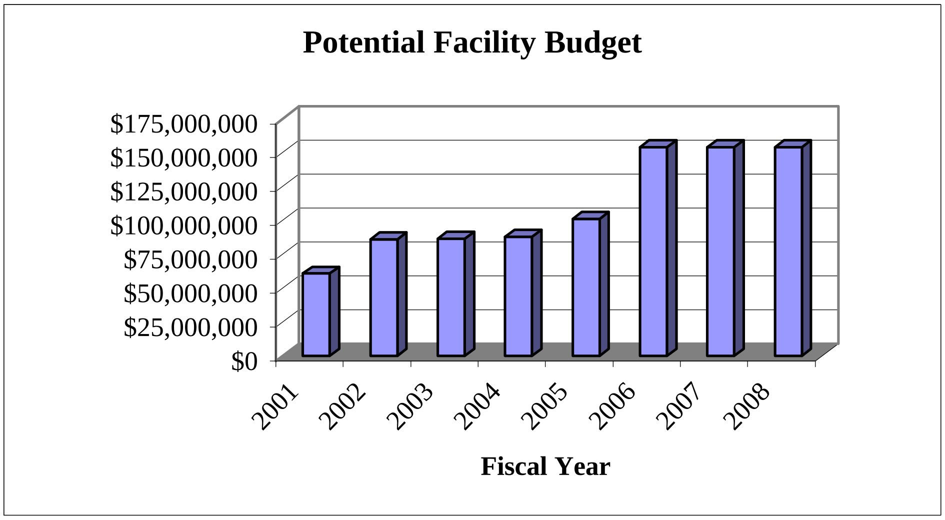
3.4 Capital Facility Financing

The Legislature uses several tools to finance new facilities. Bonds issued for facility construction are amortized over a six year period. The state pays interest for five years, then a lump sum principal payment in the final year. For a variety of reasons (i.e., structural delays from the legislative process, construction delays, procurement extensions) bonds issued by the state are actually amortized for less than six years – it is more realistic to assume that bonds will actually be issued and amortized over a period of 54 to 60 months.

One advantage of bonding is that the borrower pays back present value with future dollars. Modest annual inflation will result in long term savings when debt is extended over twenty or thirty years. Long term bonds may offer value in excess of present value, but if a state issues long term bonds every year it may ultimately find that debt service will become a driving force for all budget decisions. According to the United States Census Bureau, 15 states spend more than four percent of their total general expenditure on debt service and half of those are over six percent.

Debt Elimination Plan

The Analyst believes that the State has a unique opportunity to fund all facilities without issuing new debt. Current debt service will decline by $94 million over the next four years – thus raising the possibility of an annual capital budget of more than $150 million.



Since the Legislature traditionally funds increases in Capital Improvements with new revenue each fiscal year, this plan presents the potential to provide $110 million per year to address growth in higher education, facility maintenance backlogs and major remodeling projects. The Analyst believes that a financing plan with a dedicated amount of cash will encourage agencies and legislators to plan projects with an eye to the future rather than attempting to "fit in" as many projects as possible based on a perceived willingness to issue debt. The Analyst also sees future increases in general obligation debt to finance highways. By reducing debt on facilities, the State can fully implement highway plans to meet the needs of a growing state.

3.5 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 (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.

Lease Revenue Bonds - The State Building Ownership Authority, the official owner of state facilities, issues 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 the full faith and credit of the state nor its taxing power do not secure lease Revenue Bonds, it is not counted against statutory debt limits. However, subsection 63-9a-6(2) states the debt issued by the Building Ownership Authority plus other debt issued by the State (less $600 million in 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.

Revenue Bonds - This type of bond may be issued when a revenue stream can be identified and legally restricted for repayment of the bonds. The only state facilities which have been financed using Revenue Bonds have been for State Liquor Stores using sales revenue and higher education facilities where the revenues pledged have included 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.

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 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 are 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 2001 and 2002 General Session with two modifications as noted below with underlined text.

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 <u>when the building fulfills a **critical** need that can not be funded within the base budget for capital facilities</u>. Long term bonds should be used (15 to 20 years) when there is 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. <u>This is especially true with short tem bonds that will not recover interest costs through inflation. The Legislature should give strong scrutiny to any bond proposal in which amortization interest that exceeds future savings through inflation.</u>

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 where the funding source for debt service is not from state funds, Alcohol Beverage Control where revenues are generated from sales or golf courses that generate revenue from fees.

Lease Revenue Bonds or *Certificates of Participation* should be used if the Legislature is otherwise willing to fund a lease for a long term facility need and it would be wiser to use those operating funds instead for debt service on a lease revenue bond. Also, 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.

4.0 Tables: Board of Bonding Commissioners - Debt Service

Financing	1998 Actual	1999 Actual	2000 Actual	2001 Estimated	2002 Analyst
General Fund	79,316,100	79,951,300	71,206,700	73,223,900	43,629,800
Uniform School Fund	6,012,000	8,426,400	20,152,500	20,152,500	24,670,600
Centennial Highway Fund	12,000,000	38,097,300	45,628,600	41,104,400	44,183,400
Dedicated Credits Revenue	13,640,800	18,078,600	21,919,600	23,565,500	23,727,300
Dedicated Credits - GO Bonds	2,484,300	223,500			
Beginning Nonlapsing	436,900	380,100	8,123,600	8,757,200	5,051,200
Closing Nonlapsing			(8,757,200)	(5,051,200)	(5,051,200)
Total	$113,890,100	$145,157,200	$158,273,800	$161,752,300	$136,211,100
Programs					
Debt Service	113,890,100	145,157,200	158,273,800	161,752,300	136,211,100
Total	$113,890,100	$145,157,200	$158,273,800	$161,752,300	$136,211,100
Expenditures					
Current Expense	113,890,100	145,157,200	158,273,800	161,752,300	136,211,100
Total	$113,890,100	$145,157,200	$158,273,800	$161,752,300	$136,211,100
FTE/Other					