# Budget Brief – Debt Service

NUMBER CFGO-07-27

## SUMMARY

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 is combined in this line item.

## ISSUES AND RECOMMENDATIONS

### *Outstanding General Obligation Bonds*

Outstanding GO Bond Indebtedness

| Series | Purpose | Original Amount | Final Maturity Date | Outstanding as of July 1, 2006 |
|---|---|---|---|---|
| 1997E* | Highways | $135,000,000 | July 1, 2007 | $20,425,000 |
| 1997F* | Highways | $205,000,000 | July 1, 2007 | $33,850,000 |
| 1998A | Highways | $265,000,000 | July 1, 2008 | $53,250,000 |
| 2001B* | Highways | $348,000,000 | July 1, 2009 | $141,675,000 |
| 2002A* | Various | $281,200,000 | July 1, 2011 | $122,250,000 |
| 2002B | Refunding | $253,100,000 | July 1, 2012 | $250,860,000 |
| 2003A* | Various | $407,405,000 | July 1, 2013 | $314,025,000 |
| 2004A | Refunding | $314,775,000 | July 1, 2016 | $314,775,000 |
| 2004B | Various | $140,635,000 | July 1, 2019 | $126,280,000 |
| Subtotal Prinicipal Amount of GO Debt | | | | $1,377,390,000 |
| Plus Unamortized Original Issue Bond Premiums | | | | $79,299,700 |
| Less Deferred Amount on Refunding | | | | ($19,844,600) |
| Total GO Debt | | | | $1,436,845,100 |

*Portions refunded in subsequent bond issues

Figure 1: Debt Service - Debt Service - Budget History

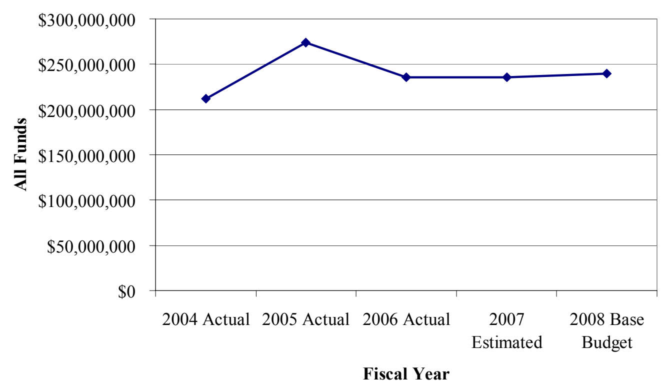
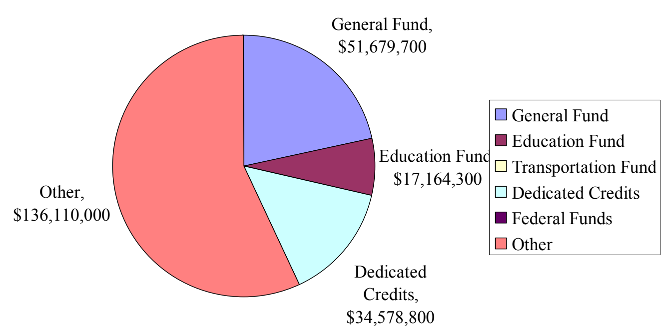



Figure 3: Debt Service - Debt Service - FY 2008 Funding Mix




This schedule does not include bonds authorized by the Legislature but not yet issued, such as $110 million for USTAR, $4.5 million for a veterans' nursing home, $6 million for a USU engineering building, and other miscellaneous projects.

### *Can bonds be paid off early?*

Under our current schedule, Utah will pay off two bonds (Series 1997E and 1997F) on July 1, 2007, and another on July 1, 2008. Any bond can be legally defeased earlier than its final maturity date. Although a defeasance is generally accomplished by a refunding transaction (which the state has already taken advantage of during times of low interest rates), a defeasance can also be accomplished with cash rather than the issuance of refunding bonds. Doing so would involve setting aside enough cash in an escrow account to meet all payments of principal and interest on the outstanding bonds as they become due, thereby instantly removing the debt from the balance sheet.

Because current short term interest rates are high relative to long term rates Utah is paying on its bonds, it would be easy for money in an escrow to yield the same rate Utah is paying on the bonds, so there would be no negative arbitrage. The state can't earn more than the bond yield, but right now the state can earn 100% of the bond yield on almost every bond outstanding. Removing the debt from Utah's balance sheet would also improve our debt profile for rating agencies. However, since Utah is paying low interest rates on its bonds, cash in the current environment may be more valuable elsewhere. For example, avoiding higher inflation rates on some building and road construction materials may be more desirable. Other examples may be investing the money in accounts with higher yields than the state's debt, or using the money for the many needs facing a growing state.

### *Reallocated Funds*

During the 2006 General Session the Legislature cut $5.5 million in ongoing General Funds from this line item and reallocated it to the Capital Development line item for FY 2007. The 2005 Legislature cut $7.2 million in General Funds and reallocated $2.7 million to the Capital Development line item for FY 2006. The Analyst does not recommend any further reallocations at this time. Although it is estimated that the line item will finish FY 2007 with $23 million in nonlapsing balances, these funds can be used to help pay upcoming increases for existing transportation bonds ($5 million increase in FY 2008, plus $1 million more in FY 2009-2010), as well as the USTAR, USU, Veteran's nursing home, and other bonds authorized by the Legislature but not yet issued. The one-time available nonlapsing funds may help postpone the need for an ongoing appropriation increase, depending on when future bonds are issued and how their repayment schedules are structured.

### *Reduce Appropriation for Salt Lake County Highways*

This line item includes debt service on certain highway projects in Salt Lake County, financed by the "quarter of a quarter" county sales tax. In FY 2008 the required debt service payment will drop from the base of $7,204,400 to $6,950,000, a net reduction of $254,400. The Analyst recommends reducing the appropriations accordingly.

### *Debt Service for State Highway Bonds*

In FY 2008 the required debt service for highway *principal* will increase by $10,110,000. However, the required amount for highway *interest* will decrease by $4,783,500, a net increase of $5,326,500. The Analyst recommends using nonlapsing balances to cover the increase rather than increasing the appropriation from Transportation Funds.

### *Utah's "Triple A" Rating*

National rating agencies such as Moody's Investor Service, Fitch Ratings, or Standard and Poor's provide ratings of credit worthiness of all states. At this time only six states merit a "Triple A" rating from all three agencies: Delaware, Georgia, Maryland, Missouri, Utah, and Virginia.

Utah maintains an "AAA" rating for many reasons, since ratings factors are complex, but in large part because of the commitment to good management shown by both the Executive and Legislative Branches. Utah's track record showing its willingness to manage its debt seems to be as important as its ability to pay its debt.

## ACCOUNTABILITY DETAIL

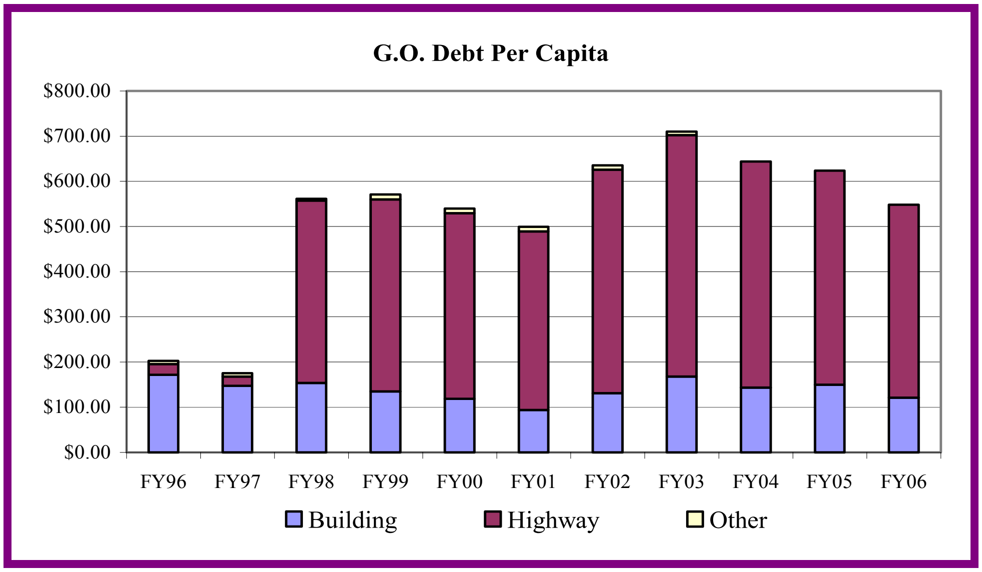
### *Constitutional and Statutory Bonding Capacity*

**Remaining General Obligation Debt Capacity**

| | FY 2003 | FY 2004 | FY 2005 | FY 2006 |
|---|---|---|---|---|
| Constitutional | $847,884,000 | $1,059,305,000 | $1,196,499,000 | $1,547,896,900 |
| Statutory | $136,431,000 | $227,293,000 | $249,751,600 | $385,958,100 |

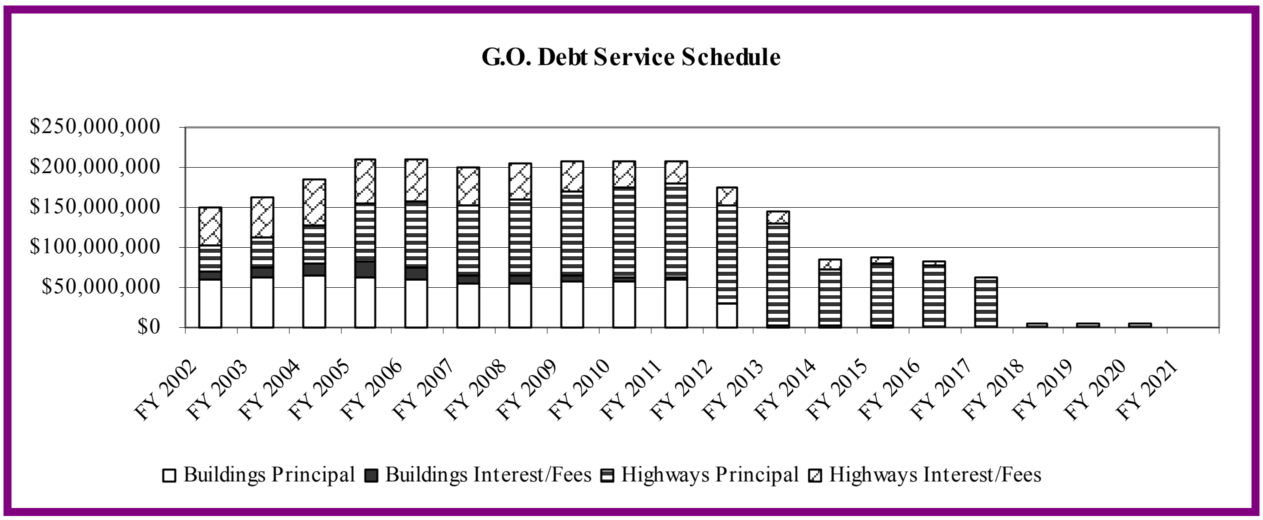
The state's constitutional debt limit caps total general obligation debt at 1.5 percent of the value of the state's taxable property. The state's statutory debt limit further caps general obligation debt to 45 percent of the allowable appropriations limit unless approved by more than two-thirds of the Legislature. However, statute excludes most highway bonds from being subject to the statutory debt limitation.

### *General Obligation Debt Per Capita*




While the state's population has grown by 28.3 percent since FY 1996, the state's per capita general obligation debt has grown by 171 percent (nearly tripled) in the same amount of time. However, since FY 2003 per capita general obligation debt has declined slightly each year. In fact, since FY 2000 the population has grown by 16.6 percent, but per capita general obligation debt has grown by 1.6 percent. As the chart shows, most of the per capita debt growth since FY 1998 is due to the I-15 reconstruction project.

### *Debt Service Schedule of Outstanding G.O. Bonds*




In FY 2007 the state will pay off $140.5 million of general obligation bonds ($54 million for buildings plus $86.5 million for highways), and will pay $60.7 million in general obligation interest/fees (down from $67.7 million in FY 2006). In FY 2008 the state will pay off $150.9 million of general obligation bonds ($54.3 million for buildings plus $96.6M for highways), and will pay approximately (depending on prior year authorizations not yet issued) $53.8 million in general obligation interest/fees.

## BUDGET DETAIL

This appropriation includes debt service on general obligation bonds and revenue bonds. Status quo debt service for general obligation bonds has leveled off at between $204 million to $207 million per year until FY 2011. However, future debt service payments will depend on future bond authorizations.

During the 2006 General Session the Legislature approved a technical change of appropriating from the Education Fund (mostly income taxes) rather than from the Uniform School Fund. The Uniform School Fund should be used solely for public education, while the Education Fund can be used for higher education.

***Budget Recommendation***

The Analyst recommends a total FY 2008 Debt Service base appropriation of $239,532,800. This represents the ongoing portion of the FY 2007 appropriation.

## LEGISLATIVE ACTION

The Analyst recommends the Legislature adopting:

1. A total FY 2008 base appropriation of $239,532,800 for the Debt Service line item, with $68,844,000 from state funds.
2. A reduction of $254,400 from the TFR – Public Transportation System Tax, making the new total $6,950,000. This action would reflect the necessary debt service on bonds for Salt Lake County. Doing so would reduce the estimated Closing Nonlapsing balance to ($22,177,500).

## BUDGET DETAIL TABLE

**Debt Service - Debt Service**

| Sources of Finance | FY 2006 Actual | FY 2007 Appropriated | Changes | FY 2007 Revised | Changes | FY 2008* Base Budget |
|---|---|---|---|---|---|---|
| General Fund | 57,181,700 | 51,679,700 | 0 | 51,679,700 | 0 | 51,679,700 |
| General Fund, One-time | 2,698,000 | 0 | 0 | 0 | 0 | 0 |
| Uniform School Fund | 17,164,300 | 0 | 0 | 0 | 0 | 0 |
| Education Fund | 0 | 17,164,300 | 0 | 17,164,300 | 0 | 17,164,300 |
| Centennial Highway Fund | 126,393,400 | 127,976,800 | 0 | 127,976,800 | 0 | 127,976,800 |
| Dedicated Credits Revenue | 25,252,700 | 34,368,900 | 0 | 34,368,900 | 209,900 | 34,578,800 |
| TFR - Public Transp. System Tax | 7,204,400 | 7,204,400 | 0 | 7,204,400 | 0 | 7,204,400 |
| Transfers | 7,628,300 | 0 | 0 | 0 | 0 | 0 |
| Beginning Nonlapsing | 12,635,900 | 7,340,700 | 13,381,500 | 20,722,200 | 2,638,500 | 23,360,700 |
| Closing Nonlapsing | (20,722,200) | (9,140,000) | (14,220,700) | (23,360,700) | 928,800 | (22,431,900) |
| **Total** | $235,436,500 | $236,594,800 | ($839,200) | $235,755,600 | $3,777,200 | $239,532,800 |
| **Programs** | | | | | | |
| Debt Service | 235,436,500 | 236,594,800 | (839,200) | 235,755,600 | 3,777,200 | 239,532,800 |
| **Total** | $235,436,500 | $236,594,800 | ($839,200) | $235,755,600 | $3,777,200 | $239,532,800 |
| **Categories of Expenditure** | | | | | | |
| Current Expense | 235,436,500 | 236,594,800 | (839,200) | 235,755,600 | 3,777,200 | 239,532,800 |
| **Total** | $235,436,500 | $236,594,800 | ($839,200) | $235,755,600 | $3,777,200 | $239,532,800 |
| **Other Data** | | | | | | |

*Does not include amounts in excess of subcommittee's state fund allocation that may be recommended by the Fiscal Analyst.