LFA LEGISLATIVE FISCAL ANALYST

Budget Brief: Debt Service

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.

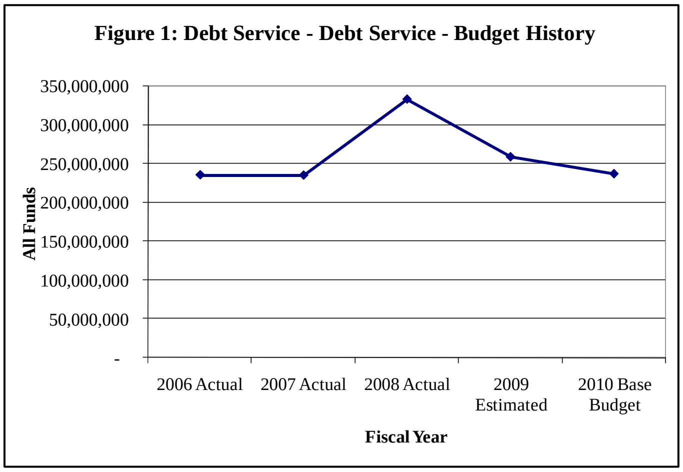
ISSUES AND RECOMMENDATIONS

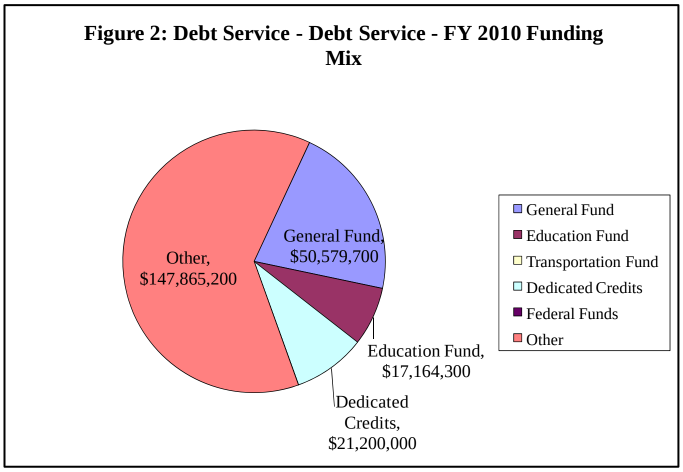
Outstanding General Obligation (G.O.) Bonds

Outstanding GO Bond Indebtedness

Series	Purpose	Original Amount	Final Maturity Date	Outstanding as of Jan. 1, 2009
2001B*	Highways	$348,000,000	July 1, 2009	$37,650,000
2002A*	Various	$281,200,000	July 1, 2011	$18,075,000
2002B	Refunding	$253,100,000	July 1, 2012	$221,125,000
2003A*	Various	$407,405,000	July 1, 2013	$234,125,000
2004A	Refunding	$314,775,000	July 1, 2016	$314,775,000
2004B	Various	$140,635,000	July 1, 2019	$101,660,000
2007A	Various	$75,000,000	July 1, 2014	$66,400,000
Subtotal Prinicipal Amount of GO Debt				$993,810,000
Plus Unamortized Original Issue Bond Premiums				$42,632,400
Less Deferred Amount on Refunding				($11,061,900)
Total GO Debt				$1,025,380,500

*Portions refunded in subsequent bond issues





This schedule does not include bonds authorized by the Legislature but not yet issued, such as $1.06 billion for highways, $26.3 million for Salt Lake County highways, $110 million for USTAR, and other miscellaneous projects.

Can bonds be paid off early?

Under our current schedule, Utah will pay off one bond (series 1998A) on July 1, 2008 and another (2001B) on July 1, 2009. 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. 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. See Issue Brief *Debt Defeasance* for more information.

FY 2010 Adjustments to Debt Service

General Fund and Education Funds are typically used to pay the debt service on the building portions of the General Obligation bonds. Centennial Highway Funds and County of the First Class funds are used to pay the debt service on the highway portions of the bonds.

The FY 2010 the debt service on buildings will require $500,000 less General Fund; however, the 2009 Legislature is recommending an additional $6.4 million in General Fund for new debt service on GO bonds for buildings to help balance the FY 2009 budget. The Analyst recommends making these adjustments to the debt service base budget.

Furthermore, in FY 2010 the debt service requirements for highway General Obligation bonds will increase by approximately $7.2 million. The Analyst recommends an appropriation of $3,195,700 from the Centennial Highway Fund and $3,955,000 from the County of the First Class Highway fund to pay the increased debt service on highways bonds.

Any additional bonding in FY 2010 will require additions to the debt service line item from the appropriate funding source.

Non-lapsing Balance

The Debt Service line item finished FY 2008 with a $26.6 million non-lapsing balance. Of that amount, $5.8 million is committed to pay future lease revenue bonds. The Legislature decreased the nonlapsing balance by $12 million in FY 2009 and replaced $7 million of ongoing General Fund with one time nonlapsing balances of $7 million. The 2009 Legislature further reduced the balance by $1 million in FY 2009. The chart at right shows the five year history of the non-lapsing balance.

Non-lapsing Balance	
FY 2005	12,635,900
FY 2006	20,722,200
FY 2007	23,534,200
FY 2008	26,569,300
FY 2009 Est.	8,116,900

Utah's "Triple A" Rating

The three national rating agencies (Moody's Investor Service, Fitch Ratings, and Standard and Poor's) provide ratings of credit worthiness of all states. At this time only seven states merit a "Triple A" rating from all three agencies: Delaware, Georgia, Maryland, Missouri, North Carolina, 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 of showing a willingness to manage its debt seems to be as important as its ability to pay its debt.

ACCOUNTABILITY DETAIL

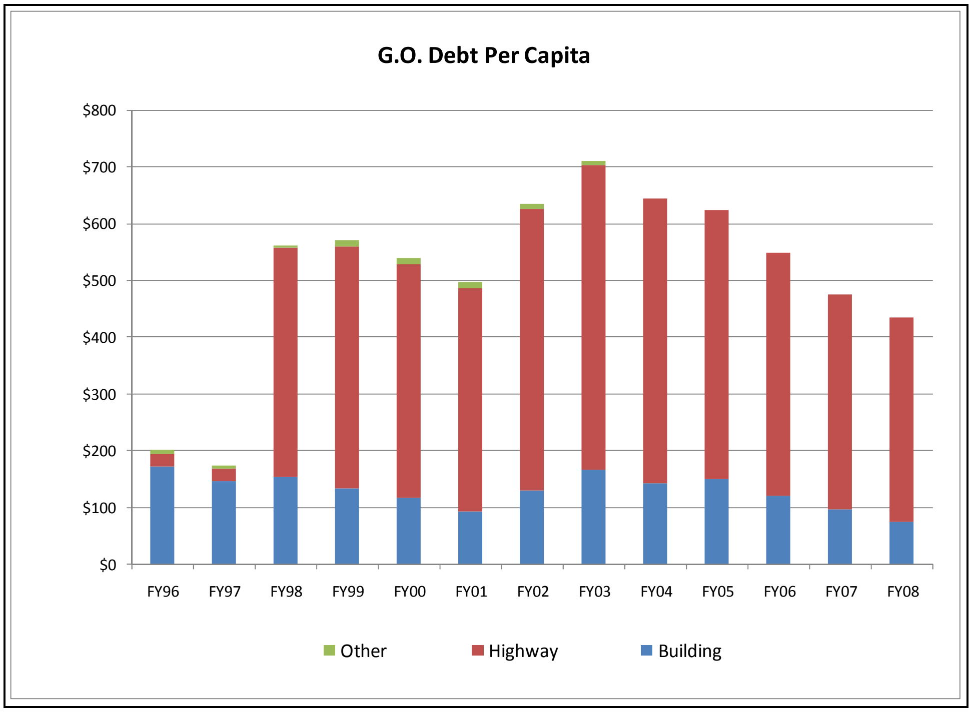
Constitutional and Statutory Bonding Capacity

Remaining General Obligation Debt Capacity				
	FY 2005	FY 2006	FY 2007	FY 2008
Constitutional	$1,196,499,000	$1,547,896,900	$2,211,169,800	$3,034,469,600
Statutory	$249,751,600	$385,958,100	$531,055,800	$680,343,500

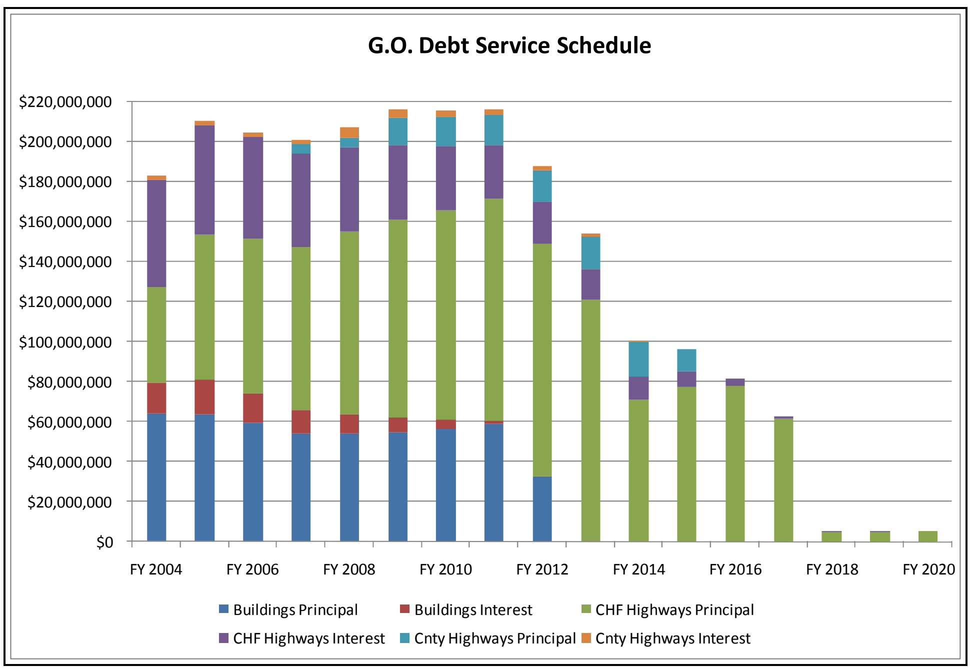
The state's constitutional debt limit caps total general obligation debt at 1.5 percent of the value of the state's taxable property. The state's statutory debt limit further caps general obligation debt to 45 percent of the allowable appropriations limit unless approved by more than two-thirds of the 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 25.8 percent in the last ten years (since FY 1998), the state's per capita general obligation debt has decreased 23.9 percent. In FY 1999 the state's general obligation debt peaked at $570.7 million as a result of the I-15 reconstruction project in Salt Lake County.



Debt Service Schedule of Outstanding G.O. Bonds



In FY 2009 the state will pay off $167.7 million of general obligation bond principal ($54.8 million for buildings plus $112.9 million for highways), and will pay $48.9 million in interest on general obligation bond debt. In FY 2010 the state will pay off $175.5 million of general obligation bonds ($56.4 million for buildings plus $119.1M for highways), and will pay $40.6 million in interest on general obligation bond debt. This chart does not reflect bonds authorized by the Legislature, but not yet issued.

BUDGET DETAIL

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.

LEGISLATIVE ACTION

The Analyst recommends the Legislature consider adopting:

1. A total FY 2010 base appropriation of $236,809,200 for the Debt Service line item.
2. An ongoing FY 2010 appropriation of $3,195,700 from the Centennial Highway Fund and $3,955,000 from the County of the First Class Highway fund to pay the increased debt service on highways bonds.

BUDGET DETAIL TABLE

Debt Service

Sources of Finance	FY 2008 Actual	FY 2009 Appropriated	Changes	FY 2009 Revised	Changes	FY 2010* Base Budget
General Fund	51,679,700	44,679,700	5,900,000	50,579,700	0	50,579,700
General Fund, One-time	0	(12,000,000)	(6,900,000)	(6,400,000)	18,900,000	0
Education Fund	17,164,300	17,164,300	0	17,164,300	0	17,164,300
Centennial Highway Fund	127,976,800	133,826,800	0	133,826,800	0	133,826,800
Centennial Highway Fund, One-time	3,650,000	0	0	0	0	0
Dedicated Credits Revenue	125,527,800	29,820,000	0	29,820,000	(8,620,000)	21,200,000
Dedicated Credits - GO Bonds	3,261,900	0	0	0	0	0
TFR - County of First Class State Higl	6,950,000	14,100,000	0	14,100,000	0	14,100,000
Beginning Nonlapsing	23,534,200	27,231,400	11,337,900	26,569,300	(31,114,400)	6,954,900
Closing Nonlapsing	(26,569,300)	(8,116,900)	662,000	(6,954,900)	(61,600)	(7,016,500)
Total	$333,175,400	$246,705,300	$10,999,900	$258,705,200	($20,896,000)	$236,809,200
Programs						
Debt Service	333,175,400	246,705,300	10,999,900	258,705,200	(20,896,000)	236,809,200
Total	$333,175,400	$246,705,300	$10,999,900	$258,705,200	($20,896,000)	$236,809,200
Categories of Expenditure						
Current Expense	333,175,400	246,705,300	10,999,900	258,705,200	(20,896,000)	236,809,200
Total	$333,175,400	$246,705,300	$10,999,900	$258,705,200	($20,896,000)	$236,809,200

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

LFA
LEGISLATIVE FISCAL ANALYST

Issue Brief: State Budgets and Credit Ratings

SUMMARY

States across the nation have seen a drastic reduction of revenues flowing into state coffers. As of December 2008 forty-two of the fifty states are facing budget deficits.

DISCUSSION AND ANALYSIS

The following table, compiled by Standard and Poor's rating agency, details the budget deficit positions of the 50 states.

State	General Fund FY2009 Deficit	% of General Fund Budget	Available Reserves
Alabama	$ 128,000,000	6.2%	$ 200,000,000
Alaska	$ -	0.0%	$ 10,350,000,000
Arizona	$ 1,200,000,000	12.0%	$ -
Arkansas	$ -	0.0%	$ 310,000,000
California	$ 14,800,000,000	14.6%	$ -
Colorado	$ -	0.0%	$ 302,000,000
Connecticut	$ 285,000,000	1.7%	$ 1,382,000,000
Delaware	$ 180,000,000	6.5%	$ 186,000,000
Florida	$ 2,142,000,000	8.3%	$ 1,672,000,000
Georgia	$ 1,400,000,000	8.0%	$ 1,010,000,000
Hawaii	$ 295,000,000	5.7%	$ 102,000,000
Idaho	$ 174,000,000	5.9%	$ 325,000,000
Illinois	$ 2,011,000,000	6.4%	$ 100,000,000
Indiana	$ 763,000,000	5.7%	$ 1,400,000,000
Iowa	$ 137,000,000	2.2%	$ 620,000,000
Kansas	$ 211,000,000	3.7%	$ 110,000,000
Kentucky	$ 456,000,000	5.1%	$ 226,000,000
Louisiana	$ -	0.0%	$ 775,000,000
Maine	$ 140,000,000	0.5%	$ 170,000,000
Maryland	$ 432,000,000	3.0%	$ 976,000,000
Massachussets	$ 1,400,000,000	5.0%	$ 1,700,000,000
Michigan	$ 540,000,000	2.3%	$ 2,000,000
Minnesota	$ 426,000,000	1.2%	$ 505,000,000
Mississippi	$ 1,700,000,000	1.0%	$ 213,000,000
Missouri	$ 342,000,000	4.0%	$ 335,000,000
Montana	$ 65,000,000	3.5%	$ 368,000,000
Nebraska	$ 56,000,000	1.5%	$ 574,000,000
Nevada	$ 751,000,000	20.0%	$ 456,000,000
New Hampshire	$ 100,000,000	4.2%	$ 89,000,000
New Jersey	$ 1,200,000,000	3.6%	$ 600,000,000
New Mexico	$ 384,000,000	6.4%	$ 218,000,000
New York	$ 1,700,000,000	3.1%	$ 1,200,000,000
North Carolina	$ 1,200,000,000	5.6%	$ 800,000,000
North Dakota	$ -	0.0%	$ 1,150,000,000
Ohio	$ 1,180,000,000	6.1%	$ 1,082,000,000
Oklahoma	$ -	0.0%	$ 572,000,000
Oregon	$ 166,000,000	2.3%	$ 734,000,000
Pennsylvania	$ 658,000,000	2.3%	$ 756,000,000
Rhode Island	$ 358,000,000	11.5%	$ 70,000,000
South Carolina	$ 103,000,000	10.0%	$ 108,000,000
South Dakota	$ 15,000,000	1.0%	$ 107,000,000
Tennessee	$ 884,000,000	7.0%	$ 1,600,000,000
Texas	$ -	0.0%	$ 11,700,000,000
Utah	$ 350,000,000	6.9%	$ 395,000,000
Vermont	$ 66,000,000	5.8%	$ 112,000,000
Virginia	$ 1,138,000,000	6.9%	$ 1,014,000,000
Washington	$ 413,000,000	2.7%	$ 23,000,000
West Virginia	$ -	0.0%	$ 581,000,000

Source: Standard and Poor's RatingsDirect December 19, 2008 *U.S. State Brace for Difficult Budget Environment In 2009*

General Fund deficits in the forty-two states range from less than 1% (Mississippi) to 20% (Nevada). Utah falls in the middle of that range with a General Fund deficit of approximately 7% in FY 2009 (not including the September Special Session). California has the largest deficit at $14.8 billion, which is almost 15% of their state's total General Fund budget.

Of the forty-two states with General Fund budget deficits, all but two have reserve funds like Utah's Rainy Day Fund to use to offset some of the deficits. These reserves may be helpful to states to offset some budget deficits; however, rating agencies will be closely monitoring how states use these funds. Standard and Poor's stresses the importance of fiscal prudence and structural balance including adjustments to expenditures. States that rely solely on budget reserves to weather the current economic storm could see potential rating impacts to their state bond ratings if the economy continues to decline and/or remain stagnant. Currently the state has $186 million in the General Fund Budget Reserve Account, $227 million in the Education Budget Reserve Account, and $19 million in the Disaster Recovery Restricted Account.

CONCLUSION

Utah is not alone in facing revenue shortfalls in the current fiscal year. All but eight other states, mainly energy producing states, are in a similar situation. The three credit rating agencies will be watching Utah and the other states to see how we adapt to the changing economic situation. The State currently maintains an AAA bond rating. Fiscal prudence and a balanced budget have contributed to that achievement.

LFA LEGISLATIVE FISCAL ANALYST

Issue Brief: Debt Defeasance

SUMMARY

The State issues two main types of debt instruments: General Obligation (GO) bonds and State Building Ownership Authority (SBOA) revenue bonds. These bonds may be refunded at a lower interest rate or defeased with cash through an escrow account. Defeasance refers to the method of rendering outstanding bonds null and void. While in the strict sense, defeasance also refers to bond refunding, typically defeasance refers to using cash to set up an escrow account which will pay off the entire principal and interest on the bonds. When properly defeased, the State removes the bond from its books and has no further obligation towards that bond. In addition, some bonds have a call provision which allows the issuer (the State) to pay off the principal amounts before the maturity date.

This Brief also discusses another method of paying off bonds in which cash is set aside in an account that can earn higher interest rates than an escrow account. Caution should be used if such a method were employed so that the State is not required to comply with federal arbitrage regulations that limit the amount of earned interest. This method does not "defease" the bonds in the sense that the State would continue to carry the bonds on its accounting books.

Before pursuing defeasance options the State should consider the market environment and other State priorities for cash funding. If the Legislature determines to defease some of the State's debt, the 2004B and 2002A series of General Obligation Bonds are the best options based on call provisions and coupon rates.

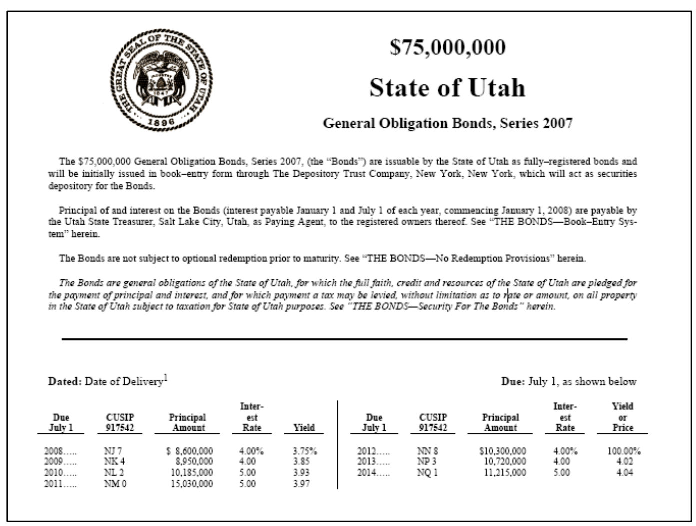
DISCUSSION AND ANALYSIS

Types of debt

The State issues two main types of debt instruments: General Obligation (GO) bonds and State Building Ownership Authority (SBOA) revenue bonds. General Obligation bonds are secured by the full "faith and credit" of the State and its ability to collect taxes. SBOA revenue bonds, used to construct buildings, are secured by: (1) a revenue stream of annually appropriated lease payments from agencies occupying those buildings and (2) a lien placed against the building cross-collateralized with other State owned buildings. GO bond debt is limited by the State Constitution and by statute whereas SBOA bond debt is limited only by statute.

Bond Structure

Unlike standard loans individuals may use, bonds are issued in numbered series by year. Whereas a typical loan is often a lump sum amount that an individual borrows that can be repaid at any time, each bond series has multiple principle amounts that mature in various years. The figure at right comes from the State's most recent bond offering statement for the 2007A Series of GO bonds. The table at the bottom of the figure illustrates how the $75 million of GO bonds is really seven different bonds whose principal amounts mature in different years.



$75,000,000

State of Utah

General Obligation Bonds, Series 2007

The $75,000,000 General Obligation Bonds, Series 2007, (the "Bonds") are issuable by the State of Utah as fully–registered bonds and will be initially issued in book–entry form through The Depository Trust Company, New York, New York, which will act as securities depository for the Bonds.

Principal of and interest on the Bonds (interest payable January 1 and July 1 of each year, commencing January 1, 2008) are payable by the Utah State Treasurer, Salt Lake City, Utah, as Paying Agent, to the registered owners thereof. See "THE BONDS—Book–Entry System" herein.

The Bonds are not subject to optional redemption prior to maturity. See "THE BONDS—No Redemption Provisions" herein.

The Bonds are general obligations of the State of Utah, for which the full faith, credit and resources of the State of Utah are pledged for the payment of principal and interest, and for which payment a tax may be levied, without limitation as to rate or amount, on all property in the State of Utah subject to taxation for State of Utah purposes. See "THE BONDS—Security For The Bonds" herein.

Dated: Date of Delivery[1] **Due:** July 1, as shown below

Due July 1	CUSIP 917542	Principal Amount	Interest Rate	Yield	Due July 1	CUSIP 917542	Principal Amount	Interest Rate	Yield or Price
2008.....	NJ 7	$ 8,600,000	4.00%	3.75%	2012.....	NN 8	$10,300,000	4.00%	100.00%
2009.....	NK 4	8,950,000	4.00	3.85	2013.....	NP 3	10,720,000	4.00	4.02
2010.....	NL 2	10,185,000	5.00	3.93	2014.....	NQ 1	11,215,000	5.00	4.04
2011.....	NM 0	15,030,000	5.00	3.97					

Call Provisions

Certain bonds are issued with a call provision which allows the issuer (the State) to redeem the bonds prior to maturity. While bonds without a call provision require the payment of all principal and interest until maturity, bonds with a call provision allow the issuer to pay off the remaining principal on the bonds at the call date. If bonds are redeemed at the call date, no additional interest payments are required of the issuer. The 2004B Series is the only GO bond debt with a call provision, though about half of the SBOA revenue bonds have a call provision. In most cases the call date (the date in which the State can pay off the bonds) is set about ten years from the date of issuance.

Defeasance

Defeasance refers to the method of rendering outstanding bonds null and void. Typically bond defeasance is both legal and financial - meaning that the debts are taken off of the accounting books and the State is no longer legally obligated to the debts. Unlike typical loans, bonds cannot simply be paid off at any time. As mentioned above, each bond series has multiple bond maturities and each of those maturities can be owned by many different entities which are guaranteed payment. Although bonds may be defeased, they remain outstanding to the bond holders. The bond indenture protects bond holder interests and requires the issuer to pay the principal and interest as outlined in the bond offering documents through the call date or maturity. Bond holders are entitled to *all* the principal *and* interest guaranteed by the bond offering through the call date or maturity as stipulated in the legal documents. Thus, the State cannot simply pay off the principal amounts of the bonds and be debt free – the State must pay both the principal and interest through the respective call date or maturity.

Outstanding Debt

Outstanding GO Bond Indebtedness

Series	Purpose	Original Amount	Final Maturity Date	Outstanding as of Jan. 1, 2009
2001B*	Highways	$348,000,000	July 1, 2009	$37,650,000
2002A*	Various	$281,200,000	July 1, 2011	$18,075,000
2002B	Refunding	$253,100,000	July 1, 2012	$221,125,000
2003A*	Various	$407,405,000	July 1, 2013	$234,125,000
2004A	Refunding	$314,775,000	July 1, 2016	$314,775,000
2004B	Various	$140,635,000	July 1, 2019	$101,660,000
2007A	Various	$75,000,000	July 1, 2014	$66,400,000
Subtotal		$1,820,115,000		$993,810,000
Plus Unamortized Original Issue Bond Premiums				$42,632,400
Less Deferred Amount on Refunding				($11,061,900)
Total GO Debt				$1,025,380,500

*Portions refunded in subsequent bond issues

Outstanding Revenue Bond Indebtedness

Series	Original Amount	Final Maturity Date	Outstanding as of Jan 1, 2009
1992AB Series	$27,580,000	August 15, 2011	$6,525,000
1993A Series	6,230,000	January 1, 2013	1,835,000
1998C Series	105,100,000	May 15, 2019	87,950,000
1999A Series	9,455,000	May 15, 2009	405,000
2001A Series	69,850,000	May 15, 2021	5,350,000
2001B Series	25,780,000	May 15, 2024	21,695,000
2003 Series	22,725,000	May 15, 2025	19,095,000
2004A Series	45,805,000	May 15, 2027	43,215,000
2006A Series	8,355,000	May 15, 2027	8,075,000
2007A Series	15,380,000	May 15, 2028	15,380,000
Subtotal	$336,260,000		$209,525,000
Plus Unamortized Premiums			$2,509,000
Less Deferred Amount on Refunding			($1,116,100)
Total SBOA Debt			$210,917,900

Bond Refunding

Bond refunding refers to the practice of using the proceeds from the issuance of new, lower interest rate bonds to set up an escrow account to pay the principal and interest on old, higher interest rate bonds until maturity. If done properly, the State is able to take the old bonds off of its accounting books and can consider the old bonds legally defeased (though the new bonds take the place of the old bonds on the accounting books). Bond refunding typically occurs when current interest rates are low and the fixed interest rates on outstanding bonds are high. When this is the case, the issuer (the State) is able to refinance its debt at a lower rate and recoup the savings through lower annual debt service payments. As shown in the Outstanding GO Bond Indebtedness table above, the State has refunded several General Obligation bonds.

Cash Defeasance by Escrow Account

Whereas refunding simply refinances bonds at a lower rate, there is an option to actually take the debt completely off of the books. That option is to set up an escrow account with cash that will be sufficient to pay all of the principal and interest on the bonds until they are callable or mature. Federal law limits the types of investment options for such an escrow account to US Treasury Obligations or State and Local Government Series (SLGS) investments which have low interest rates, but are very secure. The escrow account is allowed to accrue interest off of those investments to offset the some of the principal and interest payments, though federal arbitrage regulations limit the amount of interest that may be earned.

The benefit to using an escrow account to defease bonds is that the State can completely take the debt off its books and not have any future obligations toward the bonds. The cost to the State of using this option is the higher interest earnings the State could otherwise receive by investing the cash in securities other than SLGS or Treasury Obligations and the opportunity cost of using the cash to fund other State priorities.

Arbitrage Calculations

Arbitrage is the profit the State earns by investing the proceeds of its tax-free bonds in securities that have higher yields. State (and local) bonds have low interest rates compared to the private sector because they are exempt from state and federal tax. Due to this benefit, the federal government limits the amount of arbitrage that states and local governments can receive on their bonds to a certain percent (yield) unique to each bond issuance. Any amount the State earns above this arbitrage yield rate is required to be remitted to the Federal Government.

When using an escrow account to defease bonds, the State may earn up to the arbitrage yield rate on the interest it receives from the investment earnings. If it earns more (positive arbitrage) the State must rebate that amount to the federal government. If the State earns less (negative arbitrage) the State has failed to take advantage of potential earnings allowed by federal law.

In the current market environment, SLGS and Treasury Obligation interest rates are lower than the arbitrage yield rates on the State's bonds. Therefore, if the State elects to use an escrow account to defease its bonds, the State will have negative arbitrage on its earnings – meaning the State will still collect interest earnings, but not as much as it could otherwise have collected under federal law.

Cash Defeasance without an Escrow

Another option exists that would allow the State to financially pay off the bonds, though legally the bonds would stay on the books until they mature. This option is for the state to put aside sufficient cash to be invested at rates higher than the federally restricted arbitrage yield. As long as the State avoids mentioning that these funds will be used specifically for debt service, the State may earn higher than arbitrage rates on the money and may use those earnings to pay off the bonds. Any mention of the intent of these funds, however, to pay debt service on bonds may be construed by the federal government as requiring the State to abide by arbitrage regulations. The risk of this option is that the market rates will decline to a level below the arbitrage yield and that interest earnings will not be sufficient to cover all of the principal and interest payments.

Other Considerations

When considering bond defeasance there are two considerations that the state should also take into account – the current market environment and inflationary costs of construction.

The current uncertainty in the market has resulted in lower interest rates on investments. The Public Treasure's Investment Fund (PTIF) is a good indication of the return on secure investment options the State currently invests in. In 2007 the PTIF had an average investment return of 5.3%, but has now dropped to an average of 3.3% for 2008. Therefore, the State is likely to receive low interest rates on any cash defeasance investments. The best time to cash defease bonds would be at a time when interest rates are high.

The second consideration is the cost of construction. The State typically bonds for buildings and highways, both of which have seen double-digit inflation costs over the last several years. The costs of steel and concrete, which are the primary components of buildings and highways, have increased dramatically over the last several years due to demand from China and other global economic conditions. Oil, which is used in asphalt for highways, has also seen significant price inflation over the last several years. The cost of using cash to defease bonds includes the opportunity cost of using those funds to build roads and/or buildings that have inflation rates of double or triple the interest rates on the bonds.

Which Bonds Should be Paid Off First?

- *High Coupon Bonds.* Typically, bonds with the highest interest rates are the most likely candidates for defeasance. The higher the coupon rate on the bonds, the more the State will pay in interest costs over the life of the bonds.
- *Bonds with Call Provisions.* As noted above, call provisions enable the State to pay off bonds early without having to pay the associated interest payments to maturity (as you would in an escrow). Assuming the coupon rates on the bonds with a call provision are not substantially lower than other bonds, the callable bonds would probably be defeased at a lower cost.

GO Bond Defeasance Candidates by Coupon Rate and Maturity

Bond Series	Maturity Date	Principal	Coupon Rate	Call Provision	Project Type
2004B	7/1/2019	$5,025,000	5.000%	7/1/2014	Hwy
2004B	7/1/2018	$4,800,000	5.000%	7/1/2014	Hwy
2004B	7/1/2017	$4,550,000	5.000%	7/1/2014	Hwy
2004B	7/1/2016	$4,350,000	5.000%	7/1/2014	Hwy
2004B	7/1/2015	$4,125,000	5.000%	7/1/2014	Hwy
2002B	7/1/2012	$59,915,000	5.375%	Cash Defeasance	Hwy
2002B	7/1/2011	$56,705,000	5.375%	Cash Defeasance	Hwy
2002B	7/1/2010	$53,670,000	5.375%	Cash Defeasance	Hwy
2002B	7/1/2009	$30,835,000	5.375%	Cash Defeasance	Hwy
2002A	7/1/2011	$6,325,000	5.250%	Cash Defeasance	Hwy

- *General Obligation Bonds.* Of the two types of debt instruments the State currently uses, General Obligation Bonds are the more likely candidates for defeasance. SBOA revenue bonds, for the most part, are paid for through dedicated revenue streams whereas GO bonds are paid with appropriations of state funds. GO bonds also count against the State's constitutional debt limit whereas SBOA bond do not.

CONCLUSION

Any bond may be defeased with cash whether or not it has a call provision. Cash may also be placed in a separate account to earn higher interest which helps pay the debt service on the bonds. This option, however, does not legally defease the bonds and bears some market risk. Before pursuing any defeasance option, the State should consider the market environment and other State priorities for cash funding. If the Legislature determines to defease some of the State's debt, the 2004B and 2002A series of General Obligation bonds are the best options based on call provisions and coupon rates. The 1998C series of SBOA revenue bonds is the best defeasance option for the revenue bonds, though the Analyst recommends that General Obligation bonds be defeased first.