DEBT AND DEBT SERVICE OVERVIEW

EXECUTIVE APPROPRIATIONS COMMITTEE
STAFF: BRIAN WIKLE

ISSUE BRIEF

OVERVIEW

In January 2019 the State issued General Obligation Bonds, Series 2019, at a par amount of $127.7 million. The sale generated proceeds of $150.4 million for transportation projects. The bonds sold at a true interest rate of 2.5 percent and the final debt payment will occur on July 1, 2033. Under current statute the State is authorized to issue bonds for another $567.7 million for transportation projects and $350.0 million for prison construction. As of January 15, 2019, the State planned issuances of $300.0 million in January/February 2020 and $265.0 million in January/February 2021 for transportation projects, and the State did not plan to issue additional bonds to finance prison construction.[1,2]

Over the past ten years the State's general obligation (G.O.) bond debt has ranged from a low of $2.2 billion in FY 2017 to a high of $3.7 billion in FY 2012, and the debt was $2.4 billion as of January 15, 2019 including debt incurred with issuance of Series 2019. During the ten-year period debt service for G.O. and lease revenue (L.R.) bonds—the amount required to make principal and interest payments—has ranged from a low of $302.9 million in FY 2010 to a high of $478.3 million in FY 2014.[1,3,4]

RECOMMENDATION

Background. In the past we have recommended that the Legislature rescind bond authorization when the State does not plan to issue the debt for the originally intended purpose. For example, in the July 2015 meeting of the Executive Appropriations Committee we recommended that the Legislature rescind approximately $63.7 million of authorized but unused general obligation debt for the Department of Transportation that the department did not intend to use, and the committee voted unanimously to open a bill file to rescind the authorization. The Senate subsequently passed S.B. 95, "General Obligation Bond Amendments," 2016 General Session, which rescinded the authorization; however, the bill did not pass in the House. In the 2019 General Session the Legislature redirected the use of that same authorization to fund certain projects as specified in S.B. 268, "Transportation Infrastructure Bond Amendments." While due to S.B. 268 the State will issue debt that it otherwise would not have issued, the Legislature reduced the need to issue bonds for prison construction by appropriating $113.0 million in FY 2019 and $168.0 million in FY 2020 for prison construction (in addition to $80.0 million it appropriated in FY 2016).[a]

Recommendation. We recommend that the Legislature consider rescinding authorized but unused general obligation debt for prison construction in the amount of $350,015,161 and that the Legislature appropriate cash to finance the rest of the construction.

[a] As part of the FY 2020 amount the Legislature originally appropriated $110.0 million ongoing from the General Fund (see S.B. 3001, Item 2, 2018 Third Special Session), but subsequently changed the appropriation to one-time (see S.B. 2, Item 340, 2019 G.S.). In connection with the change from ongoing to one-time, the Legislature directed the Legislative Fiscal Analyst to recommend "FY 2020 one-time appropriations that might be included as ongoing in FY 2021 base budgets" contingent on progress toward addressing General Fund revenue growth sustainability (see S.B. 2, Item 306, 2019 G.S.), and under this directive the Fiscal Analyst may recommend restoring the appropriation (or a portion of the appropriation) to ongoing.

DEBT SERVICE BUDGET

Debt service constitutes payment of interest and principal on the State's bond debt. General obligation bonds are backed by the full faith and credit of the State and lease revenue bonds are secured by dedicated revenue streams such as enterprise fund revenue and lease payments. The debt service line item in the State's budget combines service for G.O. and L.R. bonds. As shown in Table 1 the State paid $360.8 million in FY 2018 and the Legislature appropriated $393.2 million in FY 2019 and $386.9 million in FY 2020 for debt service.[4]

Table 1: Debt Service Sources of Finance and Uses of Funds

Source of Finance	FY 18 Actual	FY 19 Rev. App.	FY 20 Appropriated
General Fund	8,535,800	71,757,600	71,534,600
Gen. Fund, One-time	49,716,500	(35,910,500)	(33,274,000)
Education Fund	17,221,800		
Edu. Fund, One-time	(3,942,100)		
TIF of 2005	275,181,800	288,711,200	308,658,100
TIF of 2005, One-time	3,139,300	5,854,400	
Federal Funds	15,877,900	15,812,700	1,578,300
Federal Funds, One-time		72,300	12,987,000
Ded. Credits Revenue	27,694,800	18,781,900	26,131,900
County of 1st Class	9,537,000	13,540,200	12,263,200
Transfers	(14,200,000)	(14,306,700)	(12,987,000)
Beginning Nonlapsing	15,878,100	43,875,600	15,019,300
Closing Nonlapsing	(43,813,400)	(15,019,300)	(15,019,300)
Total	*360,827,500*	*393,169,400*	*386,892,100*
Use of Funds			
G.O. – Higher Education	36,866,500		
G.O. – State Government	24,539,600	21,317,400	25,273,600
G.O. – Transportation	301,744,200	322,412,500	333,908,300
Revenue Bonds	(2,322,800)	49,439,500	27,710,200
Total	*360,827,500*	*393,169,400*	*386,892,100*

GENERAL OBLIGATION BONDS

Outstanding G.O. Bonds. The State's G.O. bond debt as of February 5, 2019 was $2.4 billion. In addition to previously issued bonds and the Series 2019 bonds the debt included $111.3 million in total unamortized bond premium. It did not include long-term contract liabilities consisting of unused vacation leave for State employees of $97.1 million which in the opinion of the State Auditor may be considered as general obligation debt of the State, and it did not include approximately $917.7 million in bonds authorized by the Legislature but not yet issued for transportation projects and prison construction. The State paid $269.7 million toward G.O. principal on July 1, 2019. Table 2 provides detail on outstanding G.O. bonds.[1,5,6]

Table 2: General Obligation Bonds Principal Outstanding

	Series	Original Principal Amount	Final Maturity Date July 1	Principal Outstanding as of February 5, 2019	Principal Payments Made on July 1, 2019
Prison	2017	100,810,000	2027	95,455,000	8,625,000
	2018	88,605,000	2026	81,820,000	8,545,000
Highway	2009D	491,760,000	2024	491,760,000	74,145,000
	2010B	621,980,000	2025	621,980,000	29,470,000
	2010C*	172,055,000	2019	44,475,000	44,475,000
	2011A**	563,060,000	2021	131,970,000	43,990,000
	2013	226,175,000	2022	58,375,000	13,525,000
	2015*	220,980,000	2026	220,980,000	24,765,000
	2017	41,260,000	2032	40,100,000	2,075,000
	2017*	118,700,000	2028	117,600,000	1,300,000
	2018	254,550,000	2032	241,045,000	12,310,000
	2019	127,715,000	2033	127,715,000	6,425,000
			Total Unamortized Premium	111,342,484	
			Total	2,384,617,484	269,650,000

* refunding
** the series included funds for highways (shown in the table) and for buildings (paid off)

Bond Defeasance. Any bond can be legally defeased earlier than its final maturity date. Although a defeasance is generally accomplished by a refunding (refinancing) transaction, a defeasance can also occur with cash. Doing so involves setting aside sufficient cash or U.S. government obligations in an escrow account to meet all principal and interest payments on the outstanding bonds as they become due until their call date, at which point the escrow retires the remainder of the debt. However, there are limits to the degree which interest rates in escrow can exceed interest rates on the bonds (creating "arbitrage"), such that the bonds could lose their federally tax-exempt status. The last defeasance occurred in December 2017 and saved the State an estimated $5.3 million (net present value) when portions of Series 2013 were refinanced.[7]

Build America Bonds Subsidy. Utah issued five bond series using the federal Build America Bonds (BABs) program (two G.O. issues and three revenue bond issues) which used taxable bonds with a 35 percent direct cash subsidy paid by the U.S. Treasury to the issuer, in lieu of the traditional federally tax-exempt bond structure. The BABs program was originally projected to save the State approximately $55 million (net present value) over 15 years on approximately $1.1 billion of G.O. bonds. However, the United States Congress has reduced subsidies and the actual savings realized will be less than the amount originally projected. The State budgets for debt service gross of federal subsidies to ensure sufficient funds to make payments regardless of federal actions – the State appropriated an additional $14.3 million from the General Fund to the Debt Service budget for FY 2019 and $13.0 million for FY 2020, and the funds will be transferred back to the General Fund upon receipt of the federal subsidy.[4]

Constitutional and Statutory Bonding Capacity. The State's constitution caps total general obligation debt at 1.5 percent of the value of the taxable property in the State. The data that follow in this section are estimated as of February 5, 2019.[1,8]

Fair market value of ad valorem taxable property.. $364,682,337,447
Fees in lieu of ad valorem taxable property.. $12,577,859,417
Total fair market value of taxable property.. $377,260,196,864
Constitutional debt limit (1.5%).. $5,658,902,953
Less: currently outstanding general obligation debt (net).. ($2,384,617,484)
Less: long-term contract liabilities*.. ($97,096,202)
Estimated additional constitutional debt incurring capacity of the State.. $3,177,189,267

The State's outstanding G.O. debt and long-term liabilities as a percent of the constitutional debt limit is about 43.9 percent.

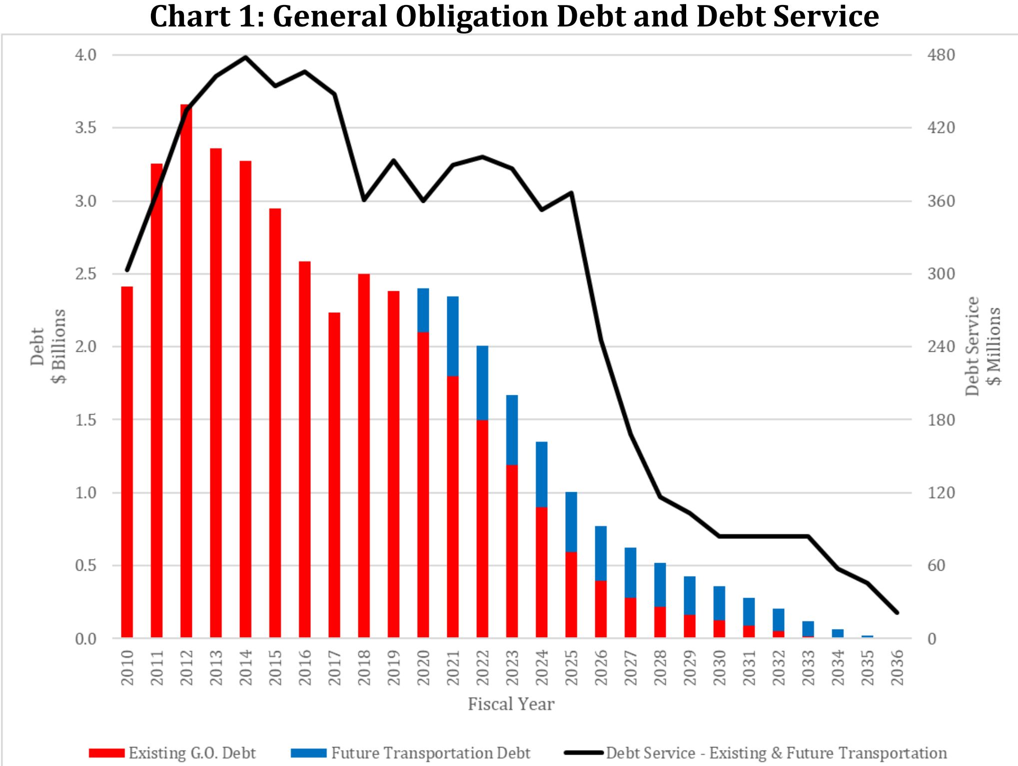
The State's statutory debt limit caps general obligation debt at 45 percent of the maximum allowable appropriations limit unless approved by more than two-thirds of the Legislature. However, statute excludes most highway bonds from being subject to the statutory debt limitation. Based on the State Appropriations and Tax Limitation Act, additional general obligation debt incurring capacity of the State under that act is estimated as of February 5, 2019 as follows:

Statutory general obligation debt limit	$1,753,870,500
Less: statutorily applicable general obligation debt (net)	($201,188,919)
Less: long-term contract liabilities*	($97,096,202)
Remaining statutory general obligation debt incurring capacity	$1,455,585,379

* In the opinion of the State Auditor, the State has long–term contract liabilities consisting of unused vacation leave for employees of approximately $97.1 million which financial obligations may be considered as general obligation debt of the State. No final legal determination has been made on this opinion.

G.O. Debt Issuance and Payoff Schedule. Chart 1 depicts the ten-year history of G.O. bond debt and shows existing commitments along with modeled future issuances of authorized but not yet issued transportation debt as follows: $300.0 million issued in January/February 2020 and $265.0 million in January/February 2021 with 15-year maturities for each issuance. Under this scenario, the State's G.O. bond debt would peak at $2.4 billion in FY 2020 and then would decline steadily until final payoff on July 1, 2035. The State's annual debt service would peak at $396.2 million in FY 2022, remain above $350.0 million from FY 2023 through FY 2025, and decline thereafter with the aforementioned final payment accruing to FY 2036.[9]

Chart 1: General Obligation Debt and Debt Service



LEASE REVENUE (L.R.) BONDS

As shown in Table 3, the State Building Ownership Authority's outstanding principal for L.R. bonds was $315.1 million as of February 5, 2019. This amount did not include approximately $14.6 million in bonds authorized by the Legislature but not yet issued for Department of Alcoholic Beverage Control liquor stores (the authority anticipated it would issue these bonds in FY 2020). Under the current schedule (assuming no additional bonds issued), the State will make a final L.R. bond debt payment on May 15, 2039.[1]

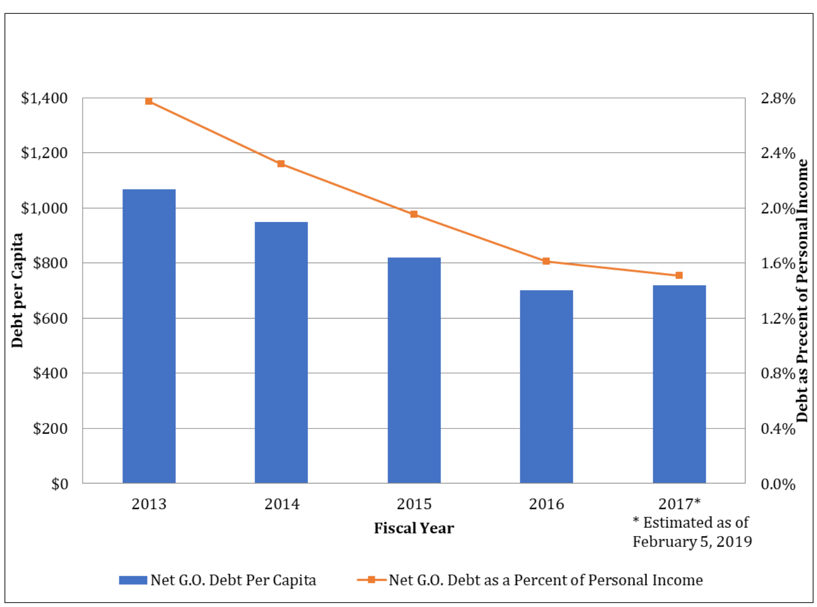
Table 3: Lease Revenue Bonds Principal Outstanding

Series	Original Amount	Final Maturity Date May 15	Principal Outstanding as of February 5, 2019
1998C	105,100,000	2019	2,110,000
2009A	25,505,000	2019	1,125,000
2009B	8,445,000	2019	1,240,000
2009C	16,715,000	2029	16,715,000
2009E	89,470,000	2030	85,460,000
2010	36,735,000	2024	19,075,000
2011	5,250,000	2031	2,780,000
2012A	15,610,000	2027	13,615,000
2012B	11,700,000	2022	2,870,000
2015	30,015,000	2030	27,765,000
2016	98,150,000	2038	98,000,000
2017	25,910,000	2024	25,910,000
2018	18,465,000	2039	18,465,000
		Total	315,130,000

CREDIT RATING AND DEBT RATIOS

The three primary nationally recognized bond rating agencies, Moody's, Standard and Poor's, and Fitch, rate the general obligation debt of all states. Utah is one of twelve states that currently receives the highest actual or implied "Triple A" rating from all three agencies. When evaluating a state's debt, rating agencies and investors focus in particular on "debt affordability" measures, such as a state's outstanding debt relative to population and personal income. Chart 2 shows Utah's G.O. debt affordability as measured by these two ratios for the past five fiscal years.[1,10]

Chart 2: G.O. Debt Per Capita and as a Percent of Personal Income



Utah's FY 2018 G.O. debt per capita was $719 and its debt as a percent of personal income was 1.51 percent (estimated as of February 5, 2019). Both measures have declined from their peaks in FY 2012, which resulted from increased bonding for highway projects including the reconstruction of I-15 in Utah County and the Critical Highway Needs program. However, both measures will rise as the State issues additional debt that has already been authorized for transportation projects.

As shown in Charts 3 and 4 – as reported by Moody's Investor Service on April 28, 2018 – Utah ranked near the middle among the twelve current consensus Triple-A states on the following measures of debt affordability: Chart 3 - net tax-supported debt (NTSD) per capita and NTSD as a percent of personal income; and Chart 4 – NTSD as a percent of state gross domestic product (GDP) and debt service as a ratio of state revenue. (Note: consensus Triple-A states are labeled and represented by red dots; other states are unlabeled and represented by black dots.)[11]

Chart 3: NTSD Per Capita and NTSD as a Percent of Personal Income

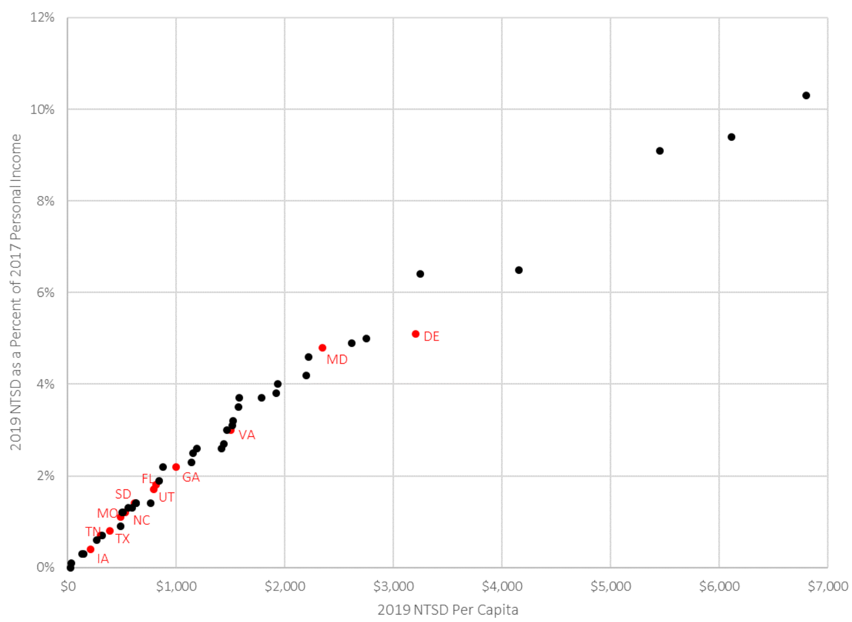
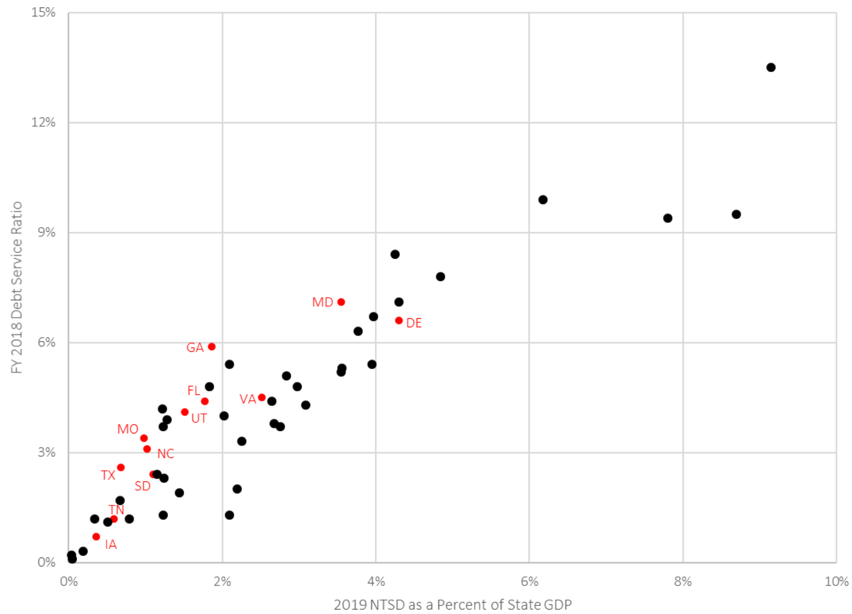


Chart 4: NTSD as a Percent of State GDP and Debt Service Ratio



---

1 State of Utah General Obligation Bonds, Series 2019 - Official Statement.
2 State of Utah General Obligation Bonds, Series 2019 - Issue Summary prepared by Zions Public Finance, Inc.
3 State of Utah Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2018.
4 Compendium of Budget Information prepared by the Office of the Legislative Fiscal Analyst.
5 State of Utah General Obligation Bonds, Series 2017 - Issue Summary prepared by Zions Public Finance, Inc.
6 State of Utah General Obligation Bonds, Series 2018 - Issue Summary prepared by Zions Public Finance, Inc.
7 State of Utah General Obligation Refunding Bonds, Series 2017 - Issue Summary prepared by Zions Public Finance, Inc.
8 Utah Constitution, Article XIV, Section 1.
9 General obligation debt issuance and payoff scheduled modeled by the Office of the Legislative Fiscal Analyst.
10 Email to the Office of the Legislative Fiscal Analyst from Zions Public Finance, Inc.
11 Medians – State Debt published by Moody's Investors Service on April 24, 2018.