Office of the
Legislative Fiscal Analyst

FY 2003 Budget Recommendations

Joint Appropriations Subcommittee for
Capital Facilities and Administrative Services

Utah Department of Administrative Services
Debt Service

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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 2003 Base	Analyst FY 2003 Changes	Analyst FY 2003 Total
General Fund	43,629,800		43,629,800
Uniform School Fund	24,670,600		24,670,600
Centennial Highway Fund	82,657,500		82,657,500
Dedicated Credits Revenue	29,342,000	2,213,400	31,555,400
Beginning Nonlapsing	5,512,600		5,512,600
Closing Nonlapsing	(5,175,600)		(5,175,600)
Total	$180,636,900	$2,213,400	$182,850,300
Programs			
Debt Service	180,636,900	2,213,400	182,850,300
Total	$180,636,900	$2,213,400	$182,850,300

2.0 Issues: Debt Service

2.1 General Obligation Bonds (Facilities)

Bonds issued for facility construction traditionally have been 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.

The Legislature's recent pursuit of a "pay as you go" plan for capital facilities will result in a third consecutive year of declining debt service for state facilities. However, there has been some talk of a large bond issuance. For such a large bond, the State will need to use more traditional financing instead of the normal six year amortization. If a large bond is approved, the Analyst recommends a term of ten to fifteen years with debt service proceeds to be paid from net savings in the Debt Service Program and funds previously transferred to the Capital Budget.

2.2 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. Funds expended on Revenue Bonds are considered Dedicated Credits paid to the Building Ownership Authority.

Dedicated Credits..$2,213,400

3.0 Programs: Debt Service

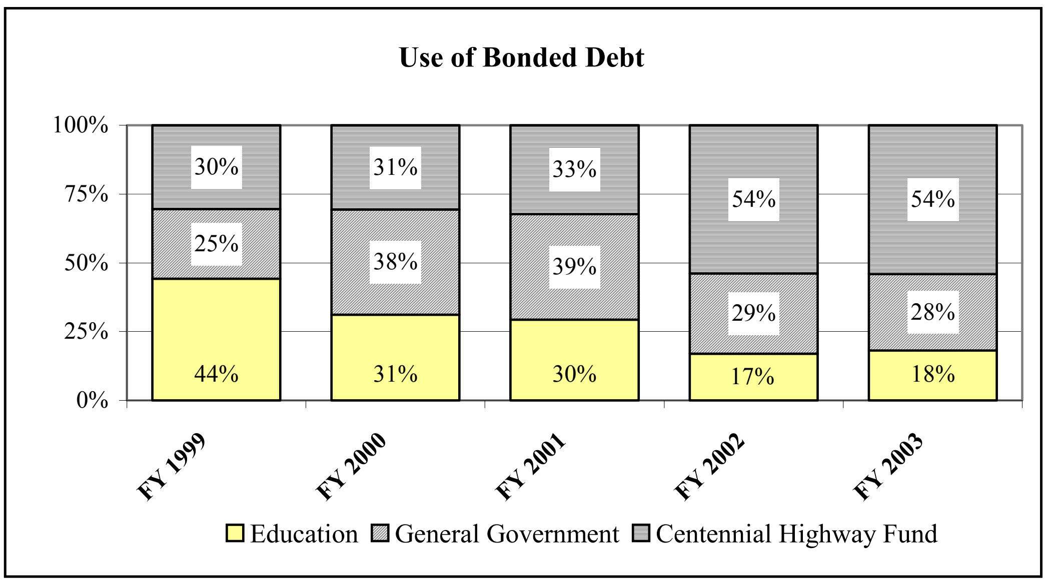
3.1 Recommendation

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

Financing	2001 Actual	2002 Estimated	2003 Analyst	Est/Analyst Difference
General Fund	73,223,900	43,629,800	43,629,800	
General Fund, One-time		(5,545,000)		5,545,000
Uniform School Fund	20,152,500	24,670,600	24,670,600	
Centennial Highway Fund	41,104,400	82,657,500	82,657,500	
Centennial Highway Fund, One-time	3,079,000			
Dedicated Credits Revenue	20,044,000	29,342,000	31,555,400	2,213,400
Transfers	3,999,800			
Beginning Nonlapsing	8,757,200	11,474,700	5,512,600	(5,962,100)
Closing Nonlapsing	(11,474,700)	(5,512,600)	(5,175,600)	337,000
Total	$158,886,100	$180,717,000	$182,850,300	$2,133,300
Expenditures				
Current Expense	158,886,100	180,717,000	182,850,300	2,133,300
Total	$158,886,100	$180,717,000	$182,850,300	$2,133,300
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 $1.09 billion after deducting outstanding debt totaling $1.19 billion.

Constitutional Limitations	**FY 2000**	**FY 2001**	**FY2002 (1)**	
Fair Market Value	$142,192,158,000	$152,352,902,000	$152,352,902,000	
Constitutional Bonding Limit	2,132,882,000	2,285,294,000	2,285,294,000	
Beginning G.O. Debt	1,251,525,000	1,212,325,000	1,146,000,000	
Principal Payment	(77,200,000)	(81,325,000)	(92,800,000)	
Bonds Sold	38,000,000	15,000,000	140,000,000	(2)
Outstanding Principal	1,212,325,000	1,146,000,000	1,193,200,000	
Additional Bonding Capacity	*$920,557,000*	*$1,139,294,000*	*$1,092,094,000*	

(1) The fair market value for FY2002, which is the 2001 calendar year end fair market value is unavailable at this time, so the calendar year end 2000 fair market value has been used.

(2) Series 2001B GO Bond issued July 2, 2001, $348 million less $208 million refunding portion.

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.

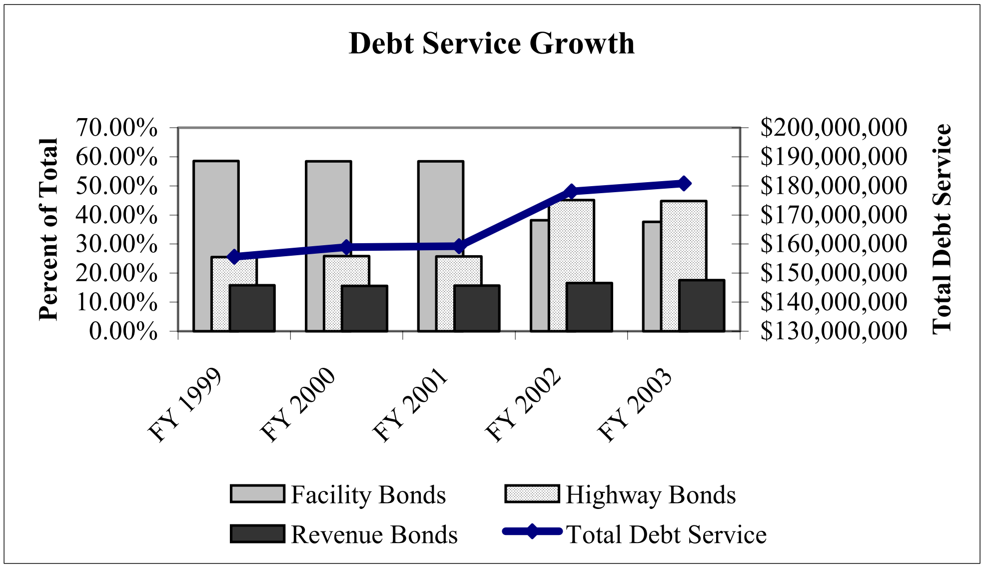
For FY 2002, the statutory general obligation debt limit is $811.6 million. Transportation bonds are exempted from the statutory limitation, leaving outstanding general obligation debt of $193 million to apply against the limit. The State has approximately $619 million in additional FY 2003 general obligation bonding capacity.

Statutory Limitations	**FY 2000**	**FY 2001**	**FY 2002**	
Appropriations Limitation	$3,673,543,000	$3,798,512,000	$4,058,096,000	
Statutory Bonding Limit	734,709,000	759,702,000	811,619,000	
Outstanding Principal	1,212,325,000	1,146,000,000	1,193,200,000	
Exempt Trans. Bonds	(908,000,000)	(908,000,000)	(1,000,450,000)	
Non-Exempt Bonds	304,325,000	238,000,000	192,750,000	(1)
Additional Bonding Capacity	*$430,384,000*	*$521,702,000*	*$618,869,000*	

(1) Includes $13.75 million of new building bonds associated with the 2001B GO Bond issued on July 2, 2001.

Debt Service Growth

Debt service for FY 2003 will total approximately $182.8 million, with approximately sixty-one percent of the expenditure going to principal payment. General Obligation facility bonds decreased by one-third over the last two years as the Legislature pursued a pay as you go plan.



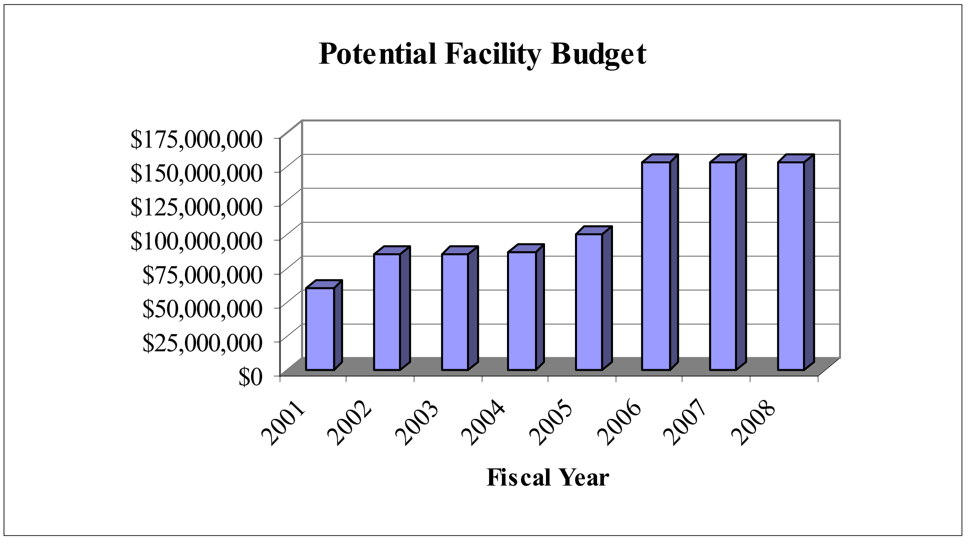
3.4 Capital Facility Financing

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 fifteen or twenty 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

Last year the Legislature adopted a plan that would fund all facilities without issuing new debt. If no further bonds are issued, debt service will decline by $94 million over the life of the program – thus raising the possibility of an annual capital budget of more than $150 million. The Analyst recommends that any new facility bonds issued this year should be funded from the existing capital base budget.



Since the Legislature traditionally funds increases in Capital Improvements with new revenue each fiscal year, this plan presents the potential to provide $100 million per year to address growth in higher education, facility maintenance backlogs and major remodeling projects. However, the financing plan was based on three years of one-time cash infusions in Fiscal Years 2001, 2002 and 2003. Given the revenue situation the State now faces, it seems unlikely that there will be sufficient revenue to fund critical state needs.

The Analyst believes that the pay as you go plan is a sound tool for ensuring that the most important projects are funded and that the pay as you go plan provides agencies and institutions with an unprecedented amount of planning information. Given current revenue estimates, this may be a good year to modify the pay as you go plan. This would take advantage of historically low interest rates and the state's AAA bond rating while costing approximately $13 million per year in debt service, **an amount that could be funded within existing budgets** if deducted from the cash anticipated by the pay as you go plan. As a one-time initiative, the infusion of construction funds could ensure that important projects move forward and, according to the State's Financial Advisor and other economists, could provide a multiplier effect throughout the state's economy.

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 neither the full faith and credit of the state nor its taxing power 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 $1.005 billion 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 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's 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 2002 General Session.

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 when the building fulfills a critical need that can not be funded within the base budget for capital facilities. Long term bonds should be used (15 to 20 years) when there are 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. 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.

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 such as dormitories and parking lots where the funding source for debt service is derived from rents or 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	1999 Actual	2000 Actual	2001 Actual	2002 Estimated	2003 Analyst
General Fund	79,951,300	71,206,700	73,223,900	43,629,800	43,629,800
General Fund, One-time				(5,545,000)	
Uniform School Fund	8,426,400	20,152,500	20,152,500	24,670,600	24,670,600
Centennial Highway Fund	38,097,300	45,628,600	41,104,400	82,657,500	82,657,500
Centennial Highway Fund, One-time			3,079,000		
Dedicated Credits Revenue	18,078,600	21,919,600	20,044,000	29,342,000	31,555,400
Dedicated Credits - GO Bonds	223,500				
Transfers			3,999,800		
Beginning Nonlapsing	380,100	8,123,600	8,757,200	11,474,700	5,512,600
Closing Nonlapsing	(8,123,600)	(8,757,200)	(11,474,700)	(5,512,600)	(5,175,600)
Total	$137,033,600	$158,273,800	$158,886,100	$180,717,000	$182,850,300
Programs					
Debt Service	137,033,600	158,273,800	158,886,100	180,717,000	182,850,300
Total	$137,033,600	$158,273,800	$158,886,100	$180,717,000	$182,850,300
Expenditures					
Current Expense	137,033,600	158,273,800	158,886,100	180,717,000	182,850,300
Total	$137,033,600	$158,273,800	$158,886,100	$180,717,000	$182,850,300