

Commission on State Debt

September 9, 2011

Overview of SSB 5181

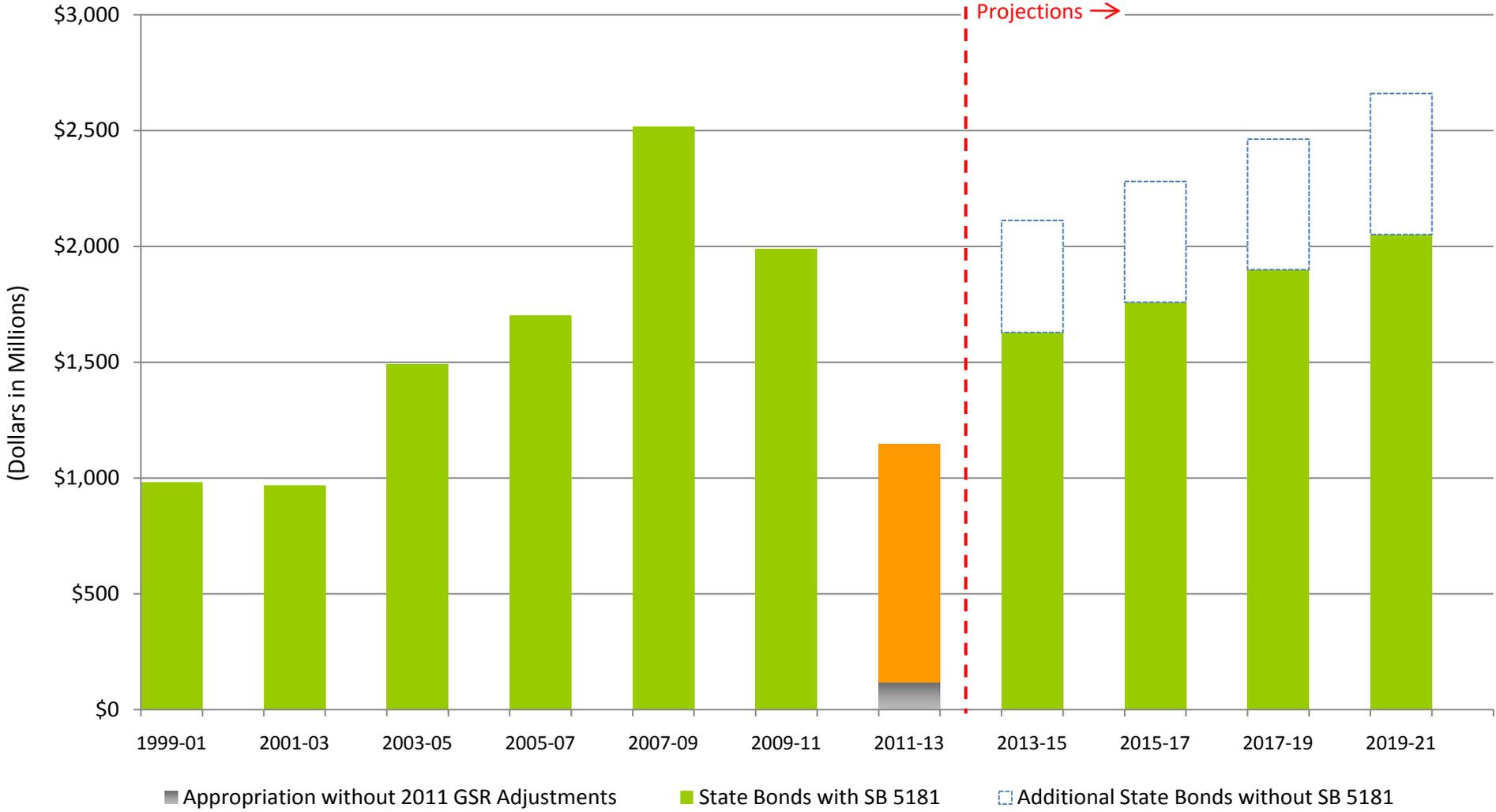
- 2011 Session Context
- Commission must examine the following:
 - Trends in the use of debt and other long term liabilities and the resulting impact on operating budget expenditures
 - Existing debt limits and policies compared to other states
- Commission must recommend improvements in debt limits and policies to:
 - Stabilize capacity
 - Reduce growth in debt service payments
 - Maintain and enhance credit rating
- Establishes a “working debt limit” in statute

Policy Questions

1. Why does the state use debt financing?
2. When and what kinds of debt are appropriate outside the debt limit?
3. What are the timing considerations with regard to capital planning and economic and revenue trends?
4. What limits should apply when issuing, appropriating, or using debt, and what circumstances should be included in issuing debt under the limit? What is the objective of a working debt limit, and what is an appropriate debt limit?
5. At what point does the cost of state and local debt outweigh the public policy benefit of investing in capital assets? To what extent does debt stimulate the economy?
6. What is the appropriate division between state and local government debt?

Capital Budgets – Bonds with and without SSB 5181

2011-13 bond capacity would have been \$118M.
(Dollars in Millions)



Bond projections based on working debt limits (8.5% FY16-17; 8.25% FY18-19; 8% FY20-21; 7.75% FY22 ongoing) required in SSB 5181.

State Debt Obligations

Subject to the Constitutional Debt Limit		
Types of Debt Obligations	Cost *	Examples
Various Purpose State General Obligation (GO) Bonds \$10.8 billion outstanding (6-30-11)	4.0% to 5.0%	Renovation of K-12 school facilities. Prison construction. Higher Ed building preservation.
Other Debt Obligations Not Subject to the Constitutional Debt Limit		
MVFT/GO Bonds \$6.0 billion outstanding (6-30-11)	4.0% to 5.0%	Highway projects.
State Revenue Bonds \$0 outstanding (6-30-11)	25-100 bp higher than GO	Potential future authorization for SR 520, Alaskan Way Viaduct.
Certificates of Participation (COP) - State \$394 million real estate outstanding \$116.5 million equipment outstanding (6-30-11)	25-50 basis points (bp) higher than GO	Student services building. Parking garage construction.
63-20 Financing (legislatively authorized) \$360.7 million outstanding (6-30-11)	25-100 bp higher than GO	Tumwater Office Building and Wheeler Block.

* See Appendix for more detail on cost, structure, and ratings.

Other Financial Obligations

- Long-term operation leases

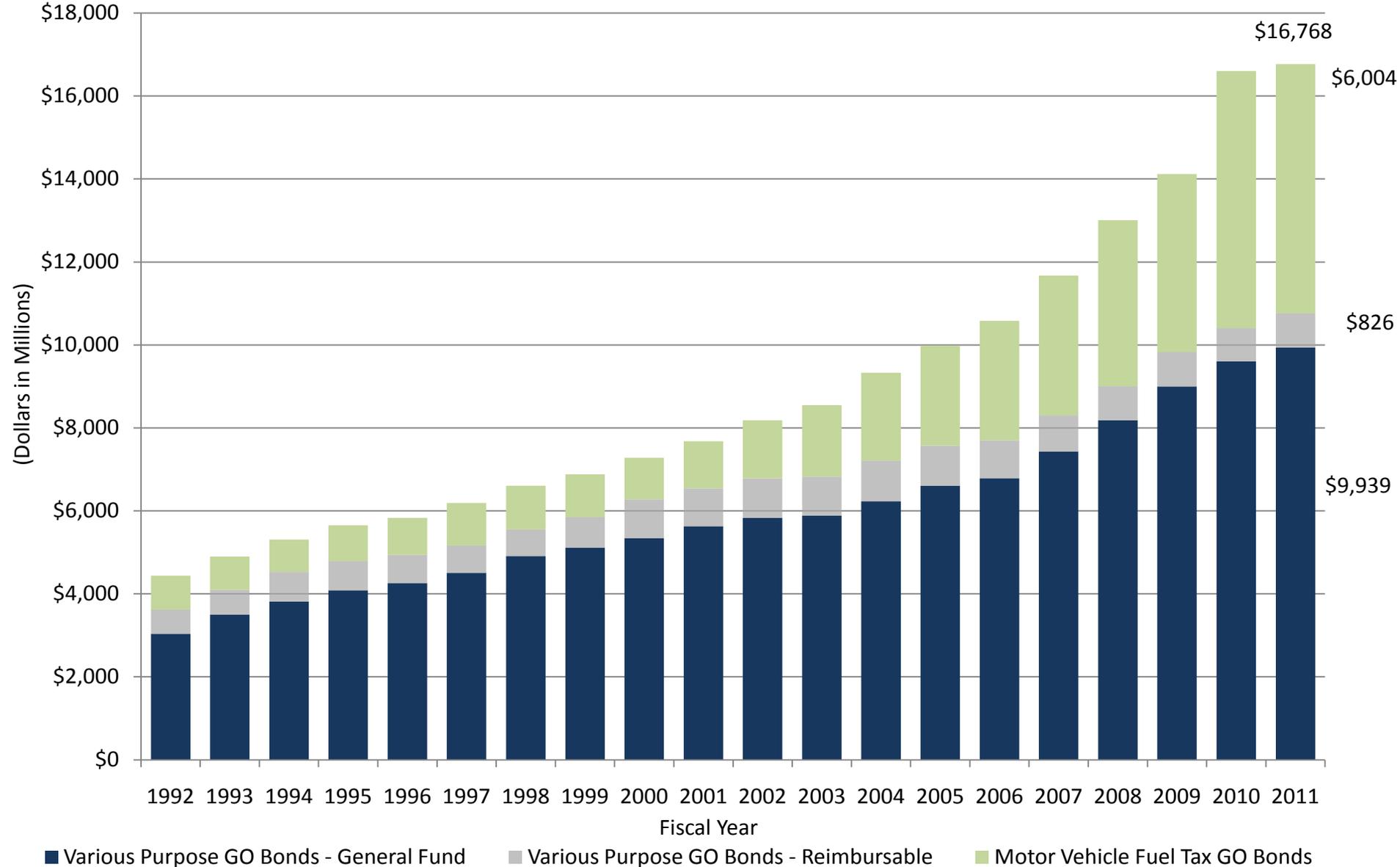
Real Estate Authority	Annual Rent	Total Square Feet
General Administration	\$171,429,518	9,961,196
Higher Education	45,522,123	1,894,164
Other State Agencies	22,049,577	2,041,522
Total	\$239,001,217	13,896,882

Source: Office of Financial Management, 2010 Facility Inventory Summary. Figures do not include other occupancy costs (such as utilities, janitorial, etc).

- Higher Education Revenue Bonds
- School District Bond Guarantee Program
- Pensions
- Guaranteed Education Tuition (GET) Program

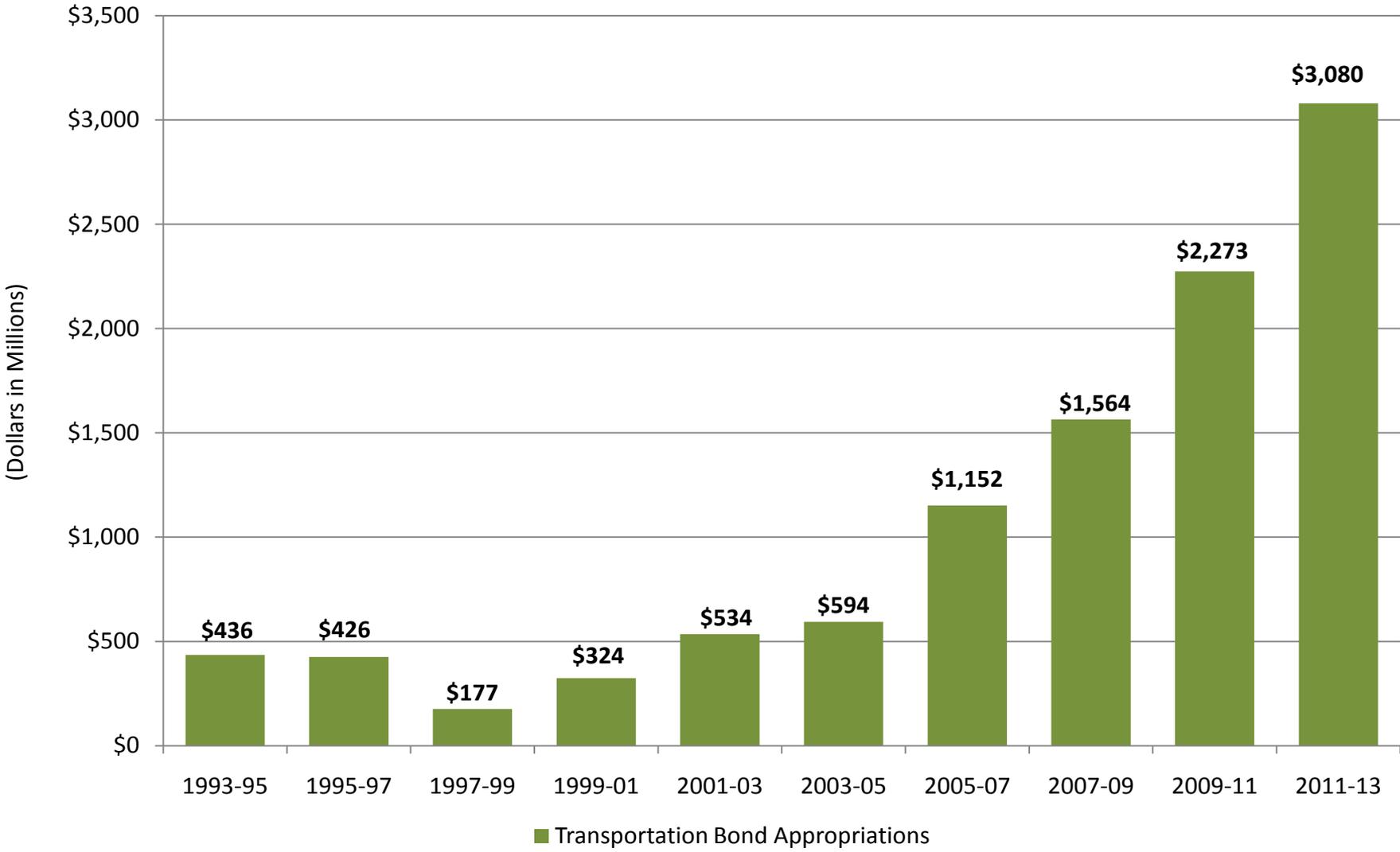
Washington State Debt

Outstanding Bonds by Fiscal Year – As of 6/30/2011

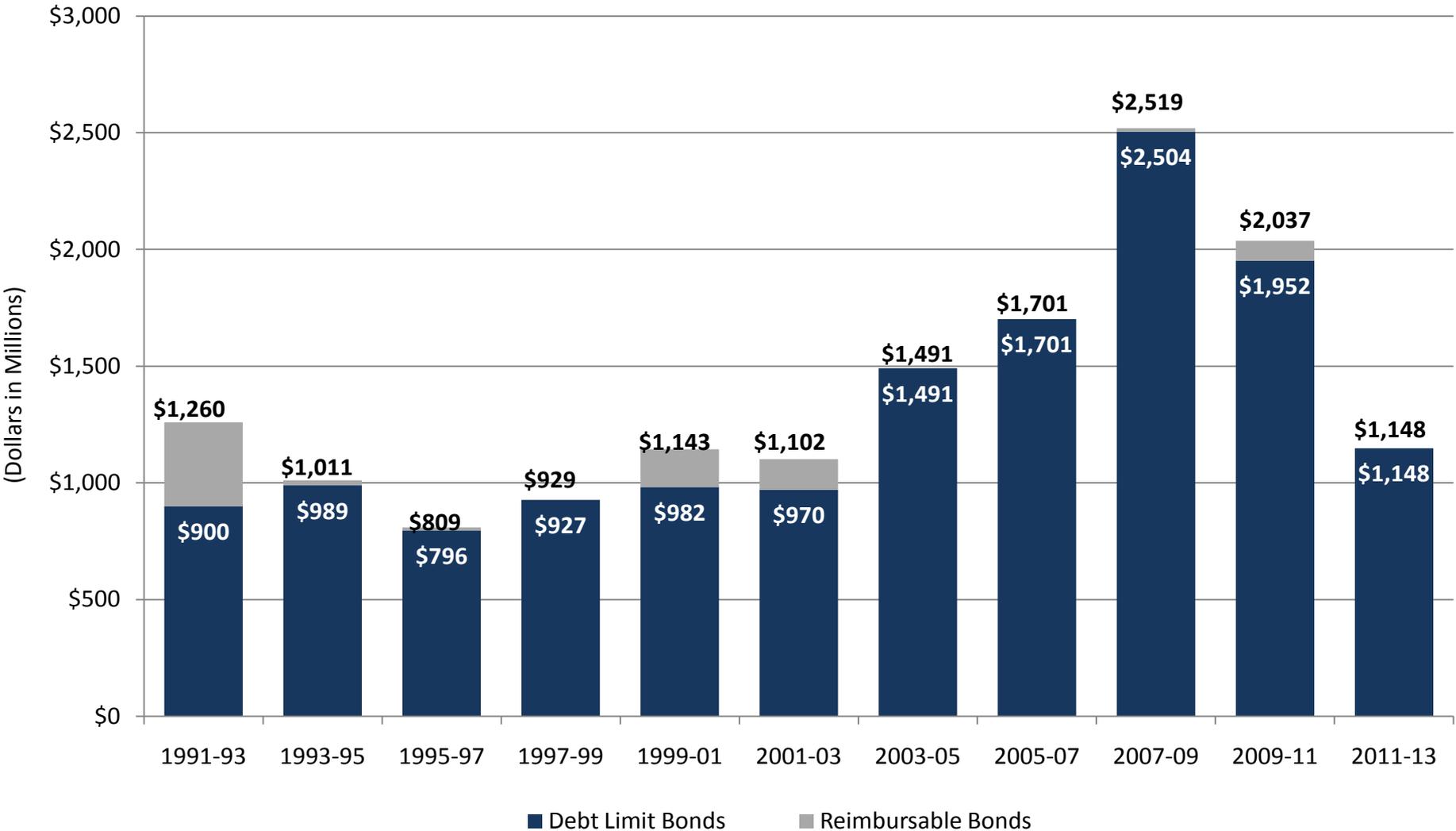


Source: Office of the State Treasurer, August 30, 2011.

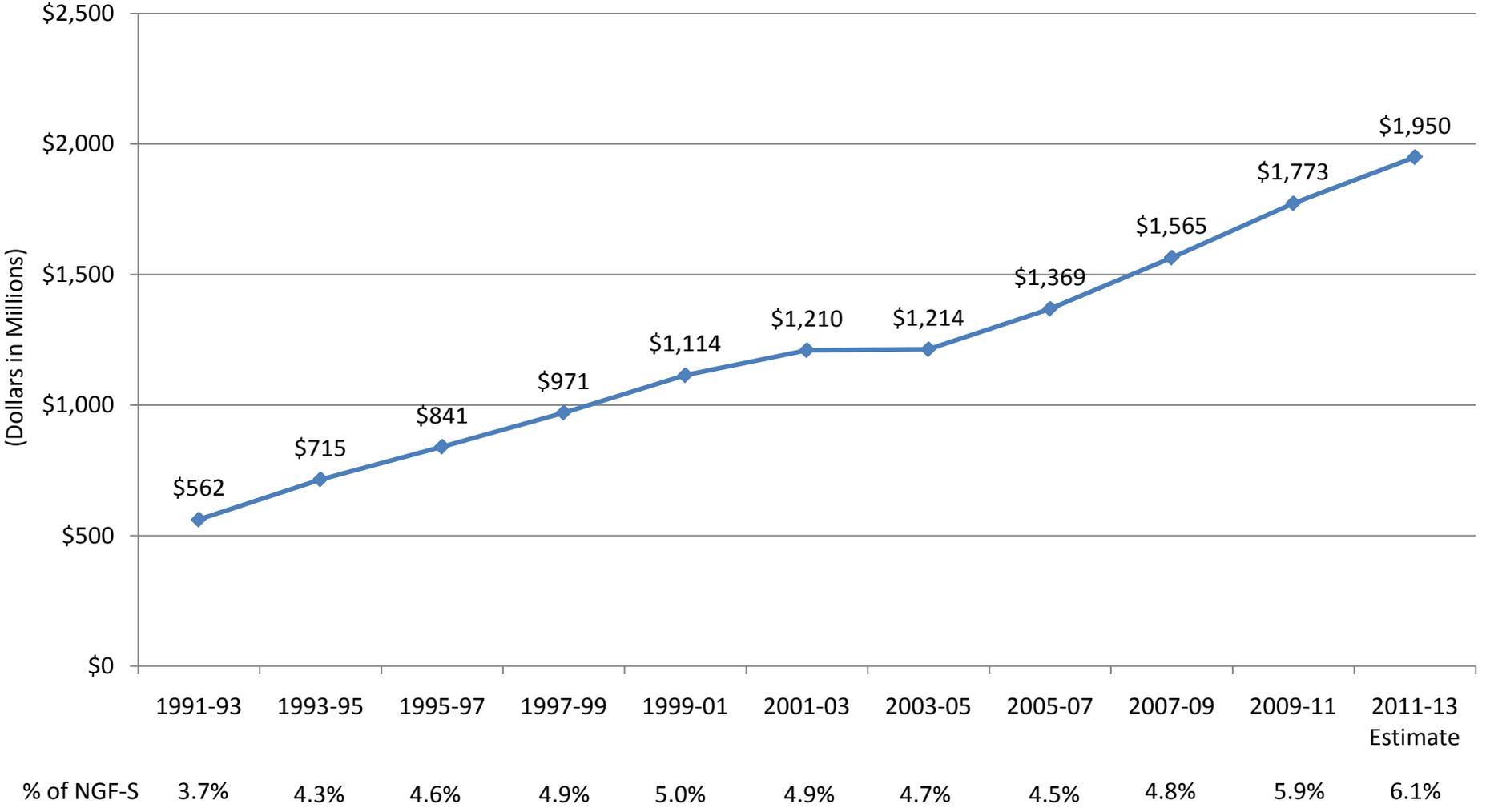
Transportation Appropriation History



State General Obligation Bonds Capital Budget Appropriation History



General fund debt service payments for the 2011-13 biennium are budgeted at \$1.95 billion, or 6.1% of Near General Fund.



Source: Legislative Evaluation & Accountability Program (LEAP) Committee.

Constitutional Debt Limit

- 9% debt limit (Article 8, Section 1) adopted by voters in 1972 replaced a fixed debt limit of \$400,000.
- The state debt limit expands and contracts with state general revenues, and consequently, with the growth or contraction of Washington's economy.
- Principal and interest payments in any year may NOT exceed 9% of average of prior three years general state revenues.
- An unofficial working debt limit has been used to maintain a cushion below the 9% constitutional limit since the 2003-05 biennium.
- SSB 5181 established a working debt limit in statute.

Constitutional Debt Limit

(Continued)

Article 8 of the Washington State Constitution excludes some types of debt from the debt limit calculation, most notably:

- Bonds payable from the gas tax and motor vehicle license fees;
- Voter-approved bonds;
- Bonds payable from income received from the investment of the Permanent Common School Fund;
- Debt issued to meet temporary deficiencies in the State Treasury;
- Debt payable solely from revenues of particular public improvement (Revenue debt); and
- State guarantee of voter-approved GO debt of school districts.

Debt Model

- Decision support system
 - “What-if” modeling.
 - Long-term planning/early warning.
- Assumptions
 - Future capital appropriations and growth rates.
 - Future revenue and growth rates.
 - Interest rates.
 - Other variables (debt issuance structure and frequency).
- Projections
 - Issuance and debt service for more than 20 years.
 - Debt limit and comparison to debt service.

What are “General State Revenues” used to calculate the debt limit?

Generally speaking, “General State Revenues” include all undedicated state money received in the Treasury.

Does not include (examples):

- State Property Tax (in General Fund)
- Public Works Assistance Account (non-General Fund)
- State and Local Toxics Accounts (non-General Fund)

Legislative Changes to Expand General State Revenues

2000 (Initiative 728)	Added lottery revenue to the statutory definition of general state revenues.
2002 (SB 6818)	Add the Real Estate Excise Tax to the statutory definition of general state revenues.
2003 (HB 2242)	Add the State Property Tax to the statutory definition of general state revenues. This allowed the Legislature to authorize \$750 million in GO bonds for higher education (ESSB 5908 – Gardner Evans Bonds – WA Future’s Act).
2005 (HB 2170)	Removed the statutory dedication of the Real Estate Excise Tax - “for the purpose of common schools”. This increased the amount of general state revenues used to calculate the constitutional debt limit.

Legislative Changes to Expand General State Revenues

<p>2009 (ESSB 5073)</p>	<p>Eliminated the Health Services Account, Water Quality Account, Public Safety & Education Account, and the Violence Reduction & Drug Enforcement Account. Transferred balances in the accounts to the state general fund. This increased the amount of general state revenues used to calculate the constitutional debt limit.</p>
<p>2009 (SSB 5537)</p>	<p>Repealed the 7% statutory debt limit. This created a single debt limit for the state.</p>
<p>2011 (HB 2019)</p>	<p>Undedicated the Cigarette Tax (permanent). This increases the amount of general state revenues used to calculate the constitutional debt limit.</p>
<p>2011 (ESHB 1497)</p>	<p>Temporarily undedicated the Public Works Assistance Account revenue that was transferred to the state general fund in FY 2011. This increases the amount of general state revenues used to calculate the constitutional debt limit.</p>

Factors influencing demand for the capital budget

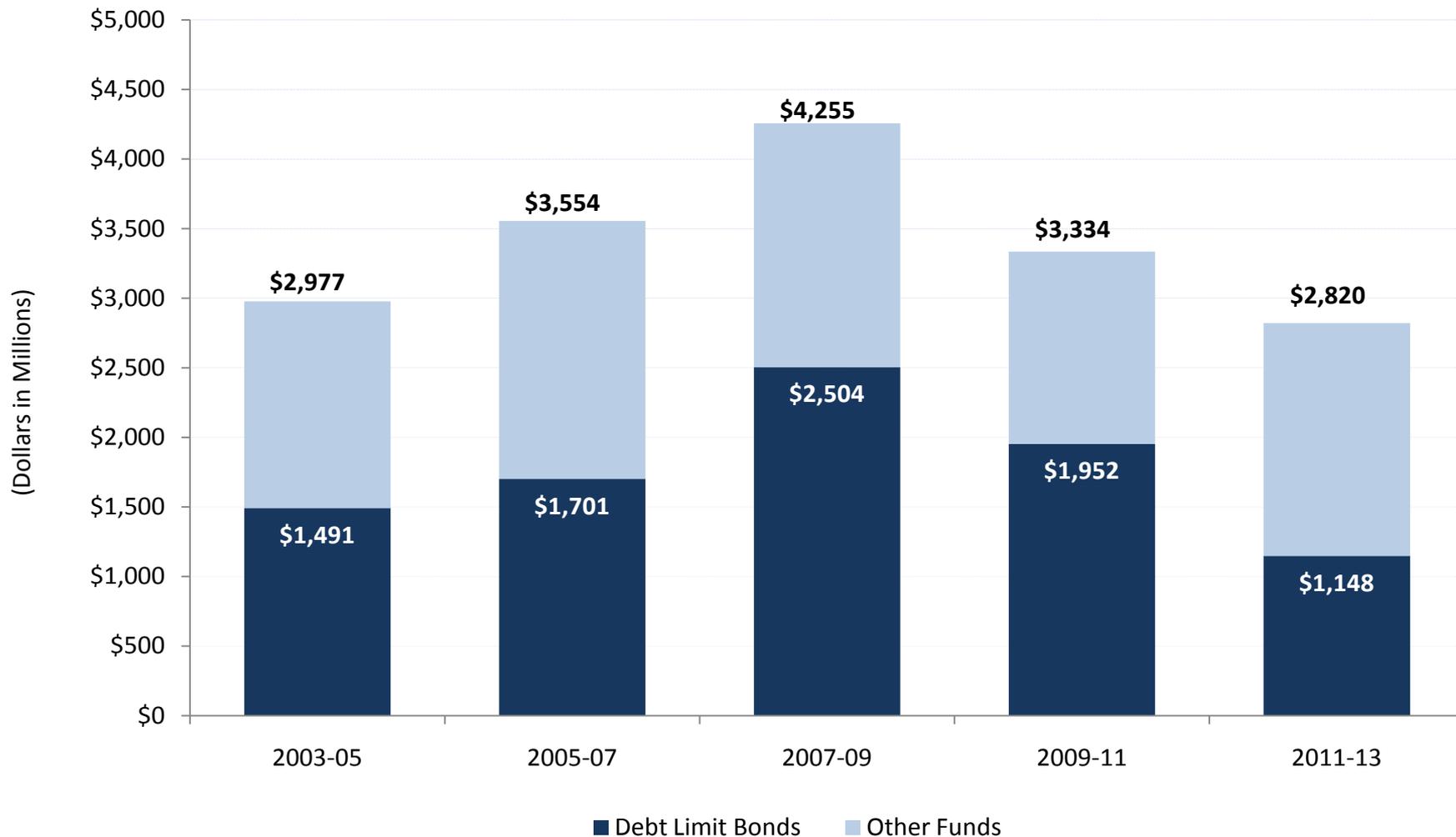
- Caseload and population growth
- Maintenance and repair backlogs
- Programmatic needs
- Statewide policy initiatives
- Local infrastructure
- Quality and quantity
- Cost of construction
- Changes in state revenues

The Capital Budget appropriates money for the construction and renovation of:

- Public school buildings
- College and university buildings
- Prison facilities and juvenile rehabilitation facilities
- Other state institutions
- State office buildings
- Parks and recreation facilities
- Low-income housing
- State and local museums and cultural facilities
- Local government infrastructure improvements
- Wastewater and toxic waste cleanup facilities
- Wildlife habitat conservation and open space projects
- State land purchases

Total New Appropriations in the Capital Budget

10-Year History



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Appendix

General Obligation Bonds

- **Definition:** A municipal security secured by the full faith, credit, and taxing power of the issuer; an unconditional promise to repay.
- **Typical use:** To finance the capital portion of tax-supported general public purpose governmental activities, such as public buildings and roads.
- **Rating:** Aa1, AA+, AA+.
- **Cost:** Lowest interest cost. Lowest cost of issuance; Recent interest rates in the 4.0% to 5.0% range.
- **Structure:** Various Purpose GO bonds or MVFT/GO bonds. Typically 25 to 30-year maximum term with level debt service. Most VPGO bonds subject to the Constitutional debt limit; MVFT/GO bonds not.
- **Recent examples:** a) Various purpose capital projects, and b) highway projects.

Certificates of Participation

- **Definition:** A municipal security whose payments represent an interest in payments that an issuer has promised to make.
- **Typical use:** State agency acquisition of real estate or equipment. Financing program also available to local governments.
- **Rating:** Aa2.
- **Cost:** Approximately 25-50 bp higher interest cost than General Obligation Bonds. Relatively low cost of issuance.
- **Structure:** Maximum term depends on useful life of property; can be sized and structured to fit unique project requirements and revenue stream(s). Not subject to the Constitutional debt limit.
- **Recent examples:** a) Equipment for state and local agencies, and b) energy efficiency equipment.

Revenue Bonds

- **Definition:** A municipal security which is payable from specific non-general fund source of revenue. No full faith and credit pledge. Revenue bonds are payable from identified sources of revenue, such as tolls and grants.
- **Typical use:** Capital project(s).
- **Rating:** Depends on the structure and the relative strength of the revenue source.
- **Cost:** 25 - 100 bp higher than General Obligation Bonds, depending on the structure and the relative strength of the revenue source. Low to moderate cost of issuance.
- **Structure:** Maximum term 40 years. Not subject to the Constitutional debt limit.
- **Recent examples:** At present, Washington State has no outstanding revenue bonds.

63-20 Financing

- **Definition:** Bond issued by non-profit entity "on-behalf of" a governmental entity. The non-profit corporation causes the project to be designed and built, typically through a fixed-price contract with a private real estate development company. Security for the bonds is rent payments from the State to the non-profit under a lease agreement.
- **Common types:** Generally real estate.
- **Mechanics:** The debt is issued by the non-profit entity, which builds or buys the asset in question for lease to the State. Title to the project is held by the non-profit for the life of the bonds and transferred to the State when the debt is repaid. Market views 63-20 bonds as a form of appropriation-backed state obligation.
- **Cost:** 25 - 100 bp higher interest rates than General Obligation Bonds. Significantly higher cost of issuance.
- **Structure:** Can be sized and structured to fit unique project requirements and revenue stream(s). Not subject to the Constitutional debt limit.
- **Recent examples:** Tumwater Office Building, Wheeler block.

Types of Debt Obligations	Laws and Policies
<p>Various Purpose State General Obligation (GO) Bonds</p>	<p>Washington State Constitution, Article VIII – Limits debt service to 9% of the average of the previous three years</p> <p>RCW 39.42 – Authorizes the State Finance Committee (SFC) to issue and refund bonds, allows the SFC to delegate responsibilities to the State Treasurer., requires the State Treasurer to compute general state revenues at the close of each fiscal year.</p> <p>State Treasurer Policies – Identifies guidelines for the method and manner of sale of state debt.</p>
<p>Other Debt Obligations Not Subject to the Constitutional Debt Limit</p>	
<p>Motor Vehicle Fuel Tax/GO Bonds</p>	<p>Washington State Constitution, Amendment 18 – Requires motor vehicle fuel taxes to be “placed in a special fund to be used exclusively for highway purposes” and defines highway purposes.</p> <p>RCW 39.42 (same as GO Bonds above) – Authorizes the State Finance Committee (SFC) to issue and refund bonds, allows the SFC to delegate responsibilities to the State Treasurer., requires the State Treasurer to compute general state revenues at the close of each fiscal year.</p> <p>RCW 47.10 – Authorizes issuance of bonds for specific transportation projects.</p> <p>State Treasurer Policies –(same as GO bonds above) – Identifies guidelines for the method and manner of sale of state debt.</p>

Types of Debt Obligations	Laws and Policies
<p>State Revenue Bonds</p>	<p>RCW 39.42 (same as GO Bonds above) – Authorizes the State Finance Committee (SFC) to issue and refund bonds, allows the SFC to delegate responsibilities to the State Treasurer. Requires the State Treasurer to compute general state revenues at the close of each fiscal year.</p> <p>State Treasurer Policies (same as GO bonds above) – Identifies guidelines for the method and manner of sale of state debt.</p>
<p>Higher Education Revenue Bonds</p>	<p>RCW 28B – Authorizes the higher education institutions to issue bonds, and use building fees to pay debt service when authorized by the Legislature. Authorizes the Community and Technical Colleges to issue bonds when authorized by the Legislature.</p>
<p>Certificates of Participation (COP)</p>	<p>RCW 39.94 – Allows the state to enter into financing contracts and requires prior approval by the SFC.</p> <p>State Treasurer Policies – Provides basic legal, federal tax and policy guidelines for determining if state agency projects appropriately can be undertaken with financing contracts.</p>
<p>63-20 Financing</p>	<p>RCW 39.94 (same as COPs above) – Allows the state to enter into financing contracts and requires prior approval by the SFC.</p> <p>State Treasurer Policies – Identifies guidelines for entering into financing contracts for 60-20 financed projects.</p>

History of State Debt

1853 – Territory’s Organic Act, was passed by Congress. It did not permit any debt.

1889 – The delegates of the Constitutional Convention of 1889 imposed a flat \$400,000 cap on state debt without voter approval, except when borrowing was necessary *“to repel invasion, suppress insurrection, or to defend the state in war.”*

1924 – Motor Vehicle Fuel Tax was instated. (2 cent/gallon)

1937 – The Motor Vehicle Excise Tax was instituted to replace the property tax on cars.

1939 – The State issued some Revenue Bonds, particularly toll revenue bonds, for projects such as the Lacey Murrow Lake Washington floating bridge, built in 1940. (Tolls were removed in 1946.)

1944 – 18th Amendment requires the motor vehicle fuel taxes to be *“placed in a special fund to be used exclusively for highway purposes.”*

1955 – The State Building Finance Authority was established to purchase or lease property from State agencies, build facilities on the property and then lease back those buildings to the agencies. The idea was that the Authority would finance facilities by issuing revenue bonds payable from agency rent, and the debt would not be included in the \$400,000 debt limit.

A court ruled (1955) that the technique was not a leasing arrangement between landlord and tenant, but was the installment purchase by the State of certain buildings and facilities with state moneys raised by taxation, far in excess of the Constitutional limitation.

History of State Debt, Continued

1968 – Voters approved Amendment 51 (Article VII, Section 9), which allowed a State Building Authority to issue bonds outside the debt limit and to lease financed facilities to State agencies. This mechanism has not been used.

1972 – Constitutional Amendment 60 (HJR 52) replaced the \$400,000 debt limit with a new limit that expands and contracts with State general revenues, and, consequently, with the growth or contraction of the State's economy.

The amendment authorized three ways the State may incur general obligation debt:

1. Affirmative vote of 60 percent of both houses of the Legislature.
2. Affirmative vote of 50 percent of both houses of the Legislature and a majority of the citizen voters.
3. State Finance Committee to meet temporary deficiencies (must be discharged within 12 months of the date of incurrence).

Amendment 60 permitted bonds backed by motor vehicle taxes and gas taxes to be outside the debt limit.

1989 – Statutory allowance for the State Finance Committee to approve financing contacts.

2000 – The Motor Vehicle Excise Tax was repealed in response to a voter initiative.

1991 – The State Supreme Court issued a three-way split decision to the effect that financing contract arrangements under the statute were not debt and do not count against the state debt limit.

2003 – Motor Vehicle Fuel Tax increased by 5 cents/gallon.

2005 – Motor Vehicle Fuel Tax increased by 9.5 cents/gallon (phased in).

Other State Issuers — Not State Obligations

- Washington Housing Finance Commission
- Washington Higher Education Facilities Authority
- Washington Health Care Facilities Authority
- Washington Economic Development Finance Authority

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Website link to the Commission on State Debt:

<http://www.tre.wa.gov/news/debtCommission.shtml>