Commission on State Debt

November ~~22~~30, 2011

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Findings and Recommendations

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Introduction

Chapter 46, Laws of 2011 - Substitute Senate Bill 5181

Legislation adopted in the 2011 legislative session established a Commission on State Debt (Commission) to examine:

1. Trends in the use of all kinds of state obligations, including the impact of debt service payments on operating budget expenditures;
2. Major uses of state debt, the debt service expenditure associated with the major uses, and a comparison of debt service expenditures and other operating budget expenditures that address similar policy objectives as the major uses of debt; and
3. Existing limitations and policies on the use of various kinds of debt and how those policies and limitations compare with other states with similar or higher credit ratings.

The legislation requires the Commission to recommend improvements in state debt policies and limitations, including possible amendments to state constitutional debt limitations that will accomplish the following:

1. Stabilizes the capacity to incur new debt in support of sustainable and predictable capital budgets;
2. Reduces the growth in debt service payments to an appropriate level that no longer exceeds the long-term growth in the general fund expenditures; and
3. Maintains and enhances the state's credit rating.

The bill also requires the State Finance Committee to recommend working debt limits for budget development purposes. The State Finance Committee is composed of the Governor, Lieutenant Governor, and the State Treasurer. A working debt limit is a debt limit used for modeling and planning purposes. It is set below the constitutional debt limit to allow a cushion between the amount of debt service payments required and the constitutional debt limit in case financial conditions are less favorable than expected.

Substitute Senate Bill (SSB) 5181 phases the working debt limit down from 8.5 percent in Fiscal Year (FY) 2016 to 7.75 percent by FY 2022. The State Finance Committee may adjust the working debt limit under extraordinary economic conditions, and is authorized to delay or reduce bond issuance in order to not exceed the recommended working debt limit.

The Commission must report its findings and recommendations to the State Finance Committee and the appropriate committees of the Legislature by December 1, 2011.

The full text of SSB 5181 is included in Appendix A.

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Work of the Commission

The Commission on State Debt held five meetings from September 2011 through November 2011. The following topics were discussed:

1. Constitutional, Statutory, and Working Debt Limits
2. Laws and Policies
3. Various Purpose and Motor Vehicle Fuel Tax General Obligation Bonds
4. Other Debt Instruments
5. Debt Issuance History
6. State General Fund Debt Service
7. Capital Budget Overview and Capital Planning
8. Operating Budget Overview
9. State and Local Debt and Washington's Debt Relative to Other States
10. Debt Limits in Other States
11. Rating Agency Information and Perspectives
12. Economic Impact of Debt Financing
13. Modeling of Debt Limit Scenarios
14. Public Comment

Commission Presentations

The following individuals were invited to present information to the Commission on State Debt:

Marc Baldwin, Assistant Director of Forecasting, Office of Financial Management
Ellen Evans, Deputy Treasurer for Debt Management, Office of the State Treasurer
Ronald C. Fisher, Michigan State University
Susan Howson, Commission Staff, House Office of Program Research
Mark Matteson, House Office of Program Research
Jenny Poree, Montague DeRose and Associates (Financial Advisor to the State Treasurer)
Arun Raha, Executive Director and Chief Economist, Economic and Revenue Forecast Council
Brian Sims, Commission Staff, Senate Committee Services
Nona Snell, Commission Staff, Office of the State Treasurer
Sandi Triggs, Commission Staff, Office of Financial Management
David Ward, Senate Committee Services
Robert W. Wassmer, California State University Sacramento

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Background and Findings

Constitutional Debt Limit

Article 8, section 1 of the Washington State Constitution (Appendix B) limits the amount of debt service the state may pay for certain types of debt. The debt limit was adopted by voters in 1972 and replaced a fixed debt limit of $400,000. It expands and contracts with state general revenues collected by the state. The limit requires that principal and interest payments in any year may not exceed nine percent of the average of the prior three years of general state revenues (defined in the Constitution).

An unofficial working debt limit has been used to maintain a cushion below the nine percent constitutional limit since the 2003-05 biennium. The cushion is intended to prevent the state from reaching nine percent in a situation where the state's interest rates increase or revenues fall more than expected.

Some types of debt are excluded from the Constitutional debt limit, 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 general obligation debt of school districts.

Debt Model

A model administered by the State Treasurer's Office is used to calculate the available bond capacity or debt limit for the current budgeting period and for future biennia planning purposes. The model calculates the actual debt service on outstanding bonds and estimates future debt service based on certain assumptions. These assumptions include revenue growth, interest rates, rate of repayment, rate of bond issuance, and other factors.

The two primary considerations regarding bond capacity for any given year/biennium are: (1) maintaining the debt service, including the new bonds, below the debt limit in the future; and (2) maintaining a consistent bond capacity over time so that all the capacity is not used in one biennium, resulting in little capacity being available in following biennia. Typically, the Legislature and the Governor, in consultation with the State Treasurer, agree on the assumptions and bond capacity for the biennium so that decision makers can focus on policy and projects and not on bond capacity.

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Regardless of legislative authorization, the State Treasurer cannot issue bonds that would result in debt service exceeding the debt limit.

Findings

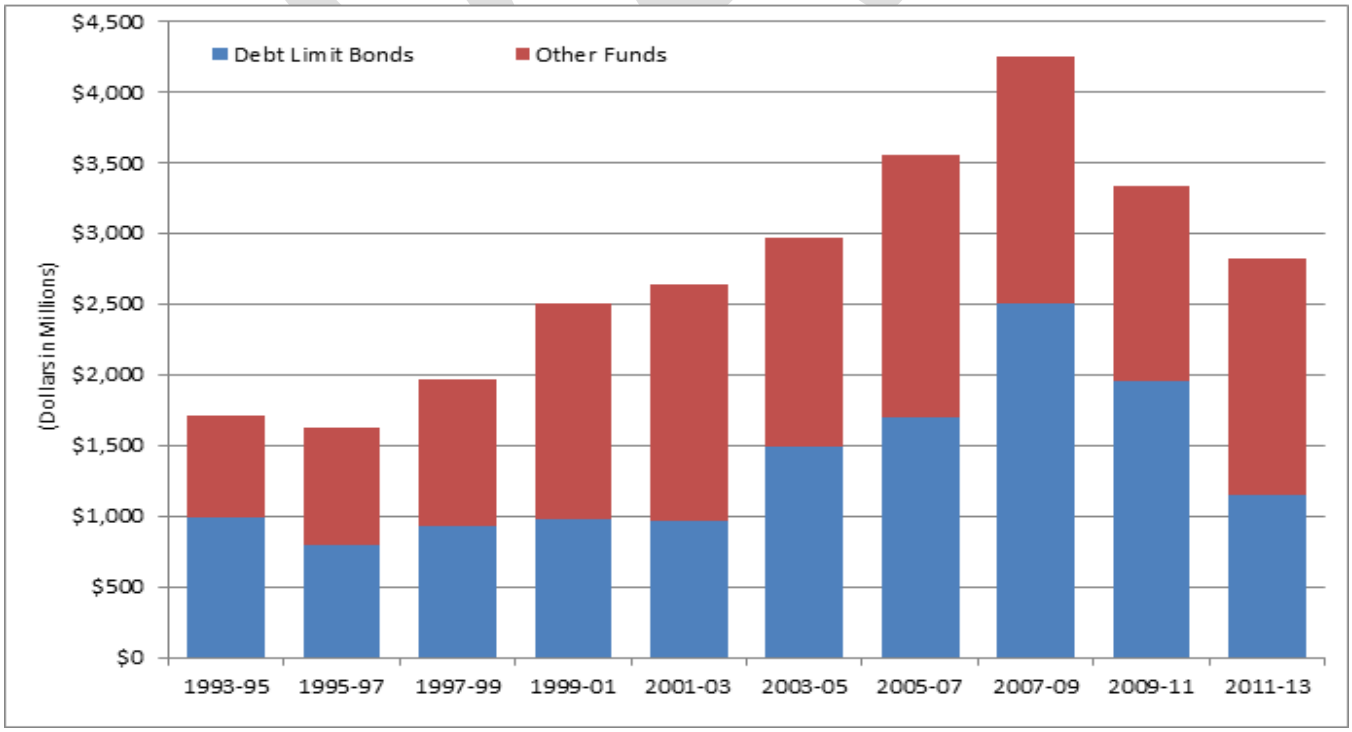
The Legislature has on various occasions expanded bond capacity under the constitutional debt limit by changing the base of general state revenues used to calculate the limit in order to meet increasing capital needs and policy objectives. (See Appendix C)

In any given biennium, the practice of the Legislature is to appropriate bonds in the capital budget up to the agreed upon working debt limit.

Various Purpose General Obligation Bonds in the Capital Budget

The State Finance Committee issues Various Purpose General Obligation (VP GO) bonds to support appropriations in the state capital budget.

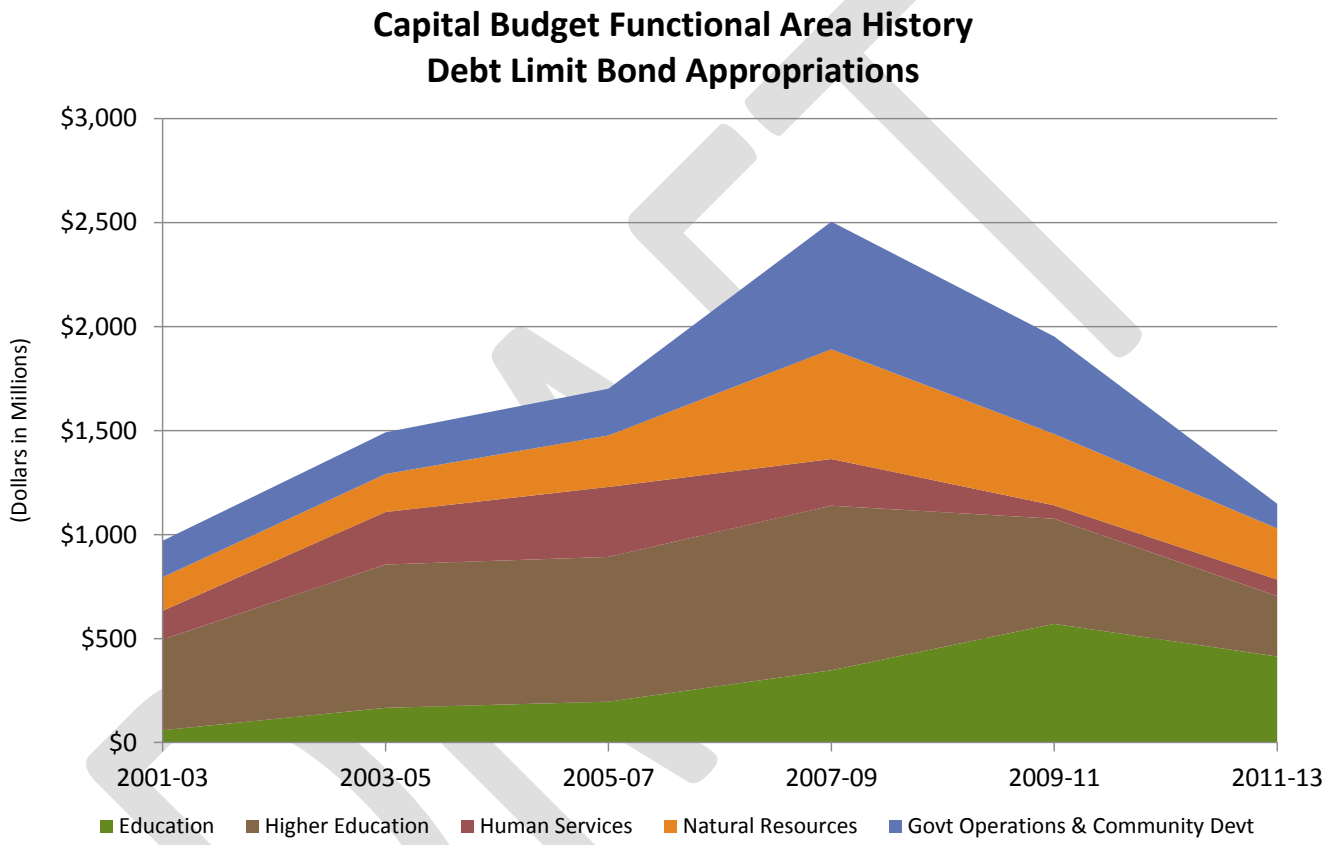
Capital Budget Appropriation History



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

State agencies have traditionally been categorized into functional areas for budgeting purposes. While appropriations are made to specific agencies rather than to functional areas, functional areas provide a useful tool for understanding the allocation of state resources and analyzing trends.

Functional areas in the capital budget include education, higher education, human services, natural resources, and governmental operations.



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

Ten-Year Capital Plan Requirements

The state Budgeting, Accounting and Reporting System Act (RCW 43.88) requires state agencies to submit a ten-year capital budget spending plan to the Governor and the Legislature each biennium. The purpose of the plan is to identify future needs and propose capital projects to address those needs. The ten-year planning process recognizes that major capital projects span several biennia. Major lease projects must also be included in the ten-year capital plan.

Transportation projects are subject to the same statutory capital plan requirements. However, at this time, long-term planning is done on a 16-year basis to align budgeting with the construction programs authorized by the 2003 and 2005 Legislatures.

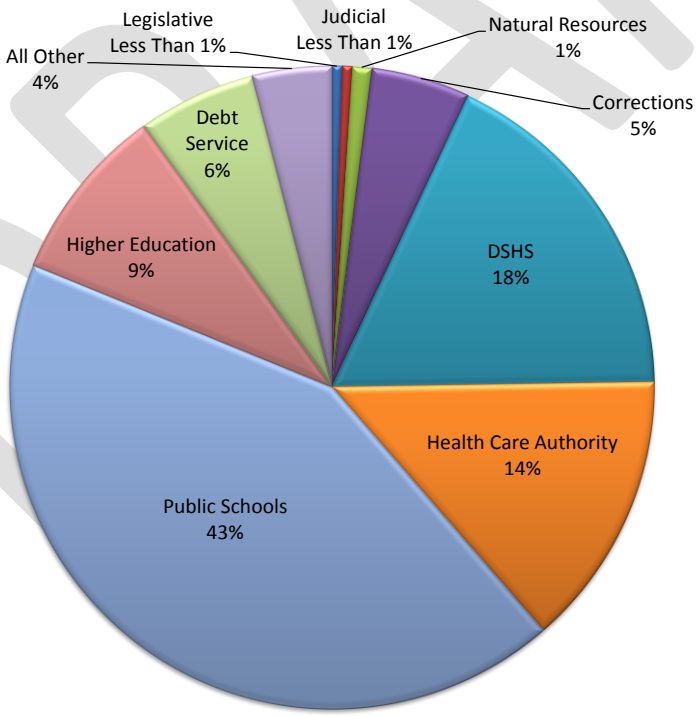
Debt Service for Various Purpose General Obligation Bonds

Funding for principal and interest (debt service) payments on VP GO bonds is paid from the state general fund in the operating budget. Debt service is projected several years into the future for planning purposes, based on expected revenues, interest rates, debt service payments, and future capital budget appropriation levels.

Bond appropriations today are restricted by these projected variables. Most recently, the various purpose (non-transportation) capital budget appropriation levels have met the perfect storm of projected debt service from past bond issuances, declining revenue, and the point at which debt service reaches the working debt limit (also known as the "pinch point"). These circumstances have caused the amount of bonds available for appropriation to decline dramatically from the last two biennia and from the amount anticipated.

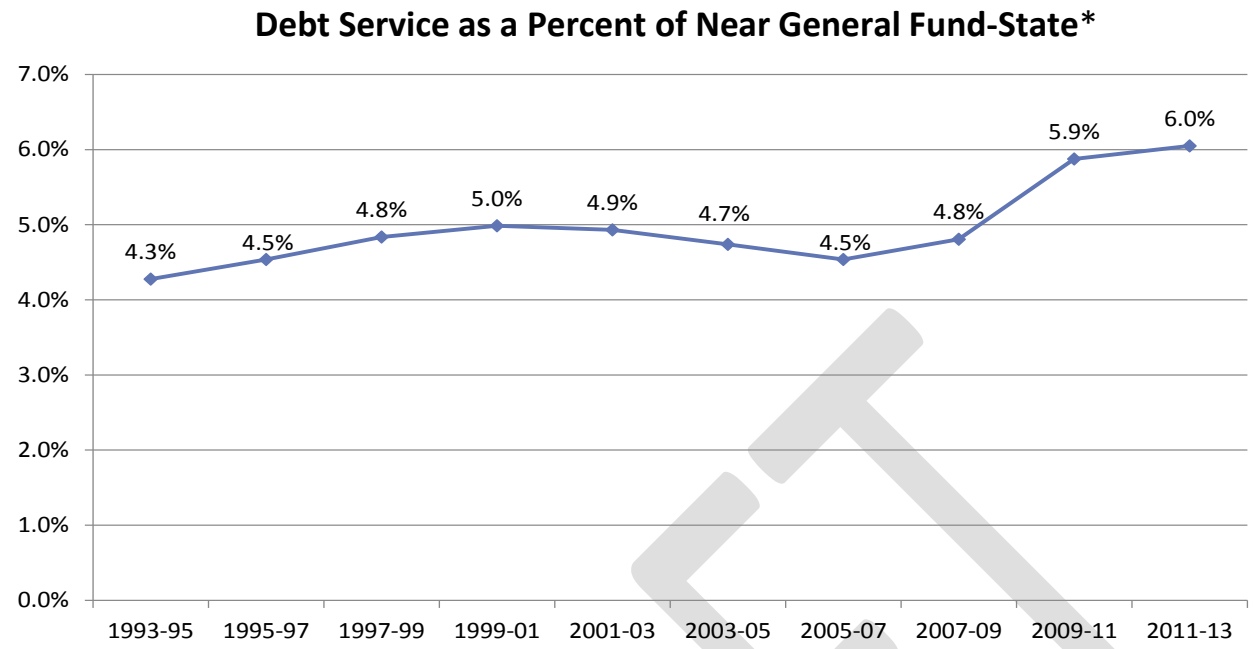
The payment of debt service is constitutionally protected and cannot be reduced during periods of economic decline. General fund debt service for the 2011-13 biennium is estimated at $1.9 billion or six percent of projected near general fund expenditures.

2011-13 Operating Budget - Near General Fund-State*



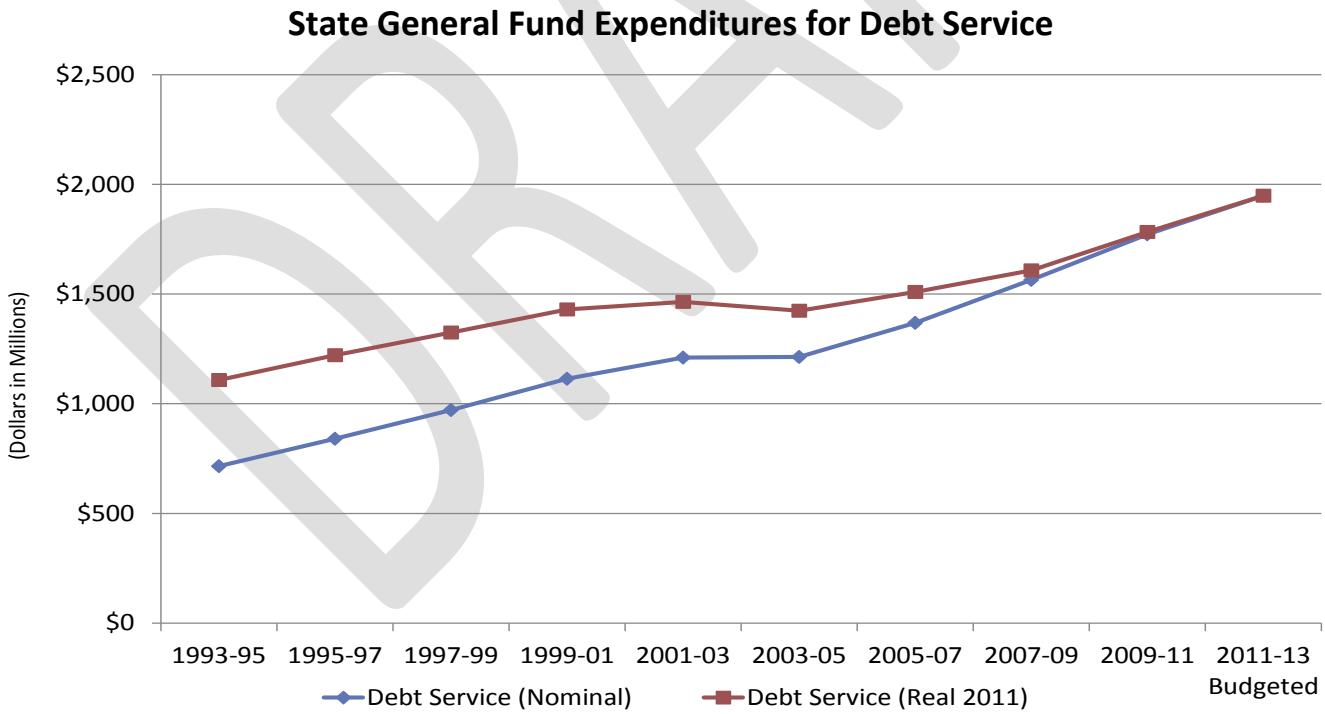
Source: Office of Program Research

**See Glossary.*



Source: Legislative Evaluation & Accountability Program (LEAP) Committee

** See Glossary.*



Source: Legislative Evaluation & Accountability Program (LEAP) Committee.
Debt Service (Nominal) is the dollar amount at the time of the expenditures, not adjusted for inflation.
Debt Service (Real 2011) is in dollars adjusted for inflation.

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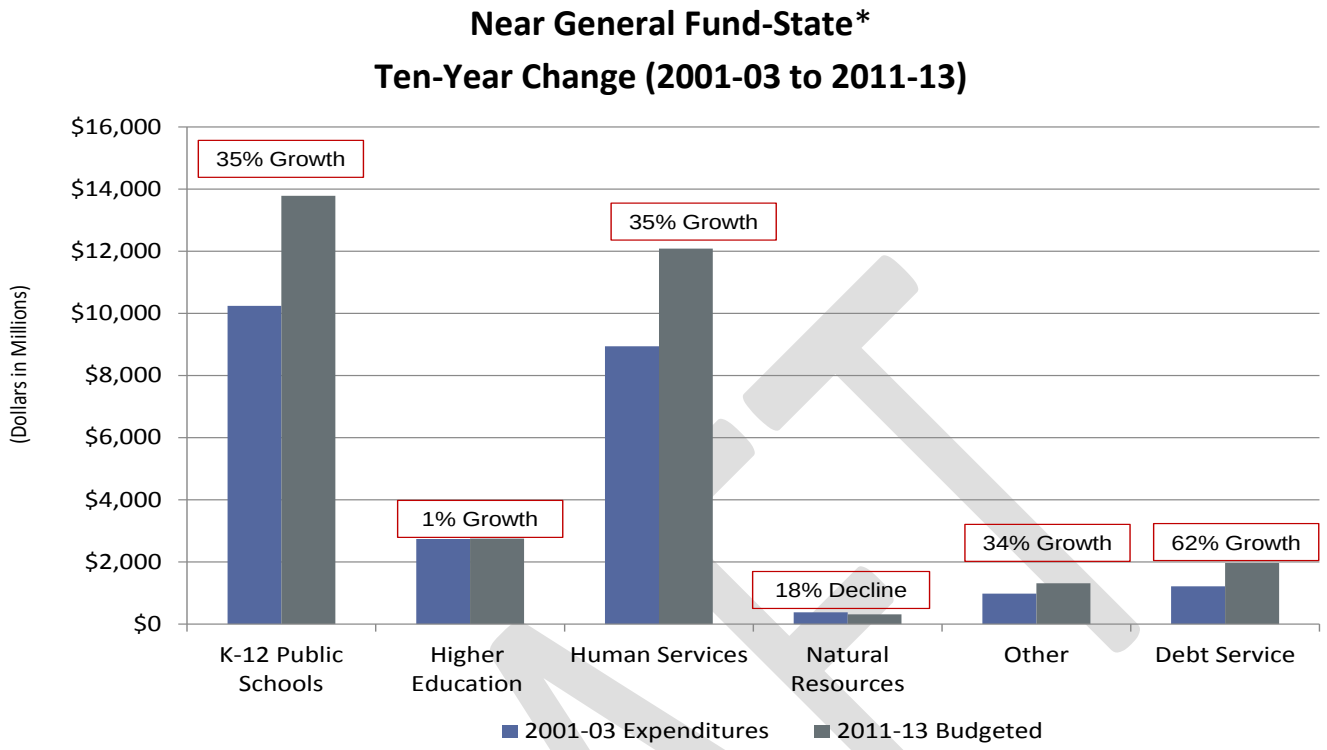
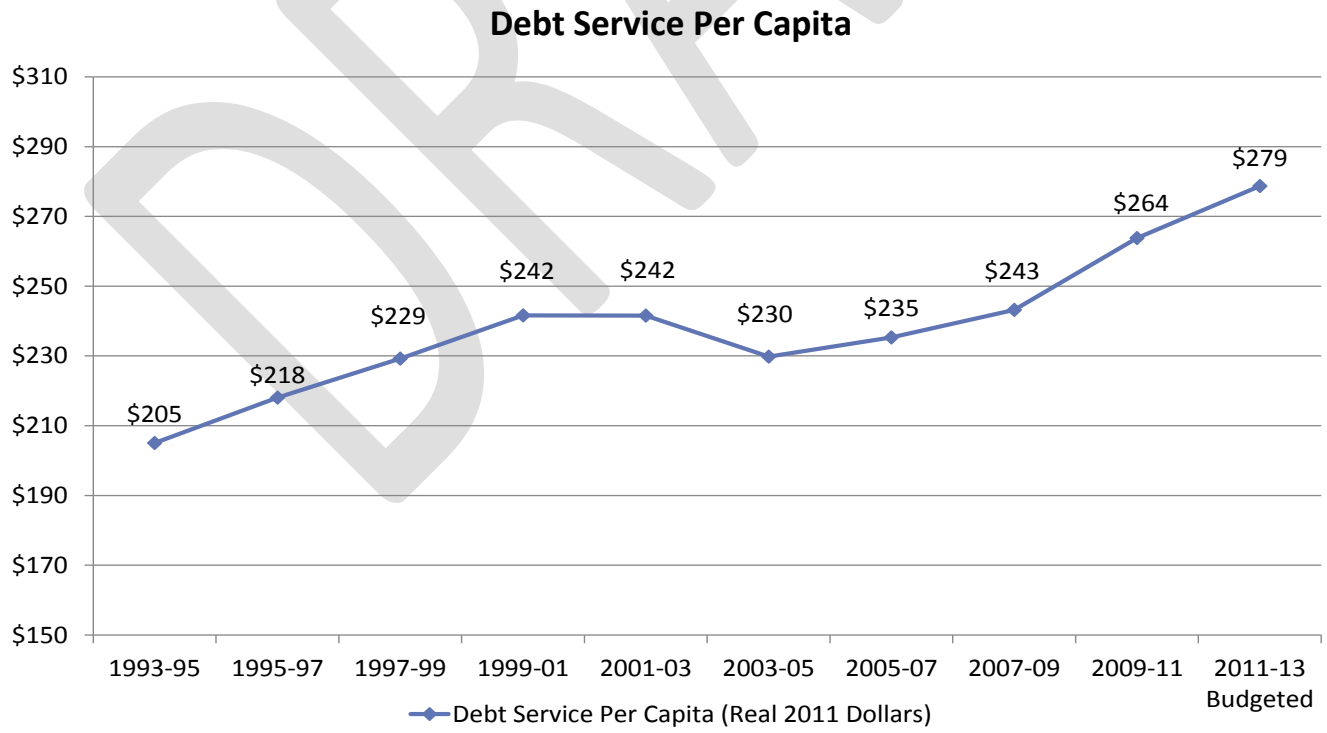


Source: Legislative Evaluation & Accountability Program (LEAP) Committee.
** See Glossary.*



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

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Between 1994 and 2013, after accounting for population growth (+1,586,000) and inflation, real debt service per capita is projected to increase by $74/person.

Findings

Debt service expenditures have represented an increasing share of the operating budget, particularly since the 2007-09 biennium. Debt service is projected at six percent of near general fund expenditures (and Opportunity Pathways Account) for the 2011-13 biennium.

The Legislature has made a number of changes to the base of general revenue used to calculate the debt limit, resulting in additional capacity available under the debt limit for capital investment and higher capital budget appropriations from the 2003-05 biennium through the 2009-11 biennium.

Declining general state revenues have resulted in significant operating budget reductions in many functional areas, while debt service has increased. Concern has been expressed about debt service crowding out other budgetary priorities and reducing financial flexibility since debt service cannot be cut in response to revenue downturns.

Advocates of capital budget projects argue that the debt-financed investments are valuable and worth the required debt service payments and that the percentage of the state general fund used for these payments may return to a somewhat lower level once state revenues recover.

Debt Service Estimates

Since 1991, existing statute (RCW 43.88.031) has required capital budget appropriation bills to include the estimated general fund debt service costs associated with new capital appropriations contained in the bill for the biennia in which the appropriations occur and for the succeeding two biennia.

Finding

Historically, the Governor and Legislature have not complied with this statutory requirement.

Is Washington a high debt state?

Whether Washington is considered a high debt state relative to other states is dependent on definitions and what debt is included in the debt calculation. Washington has made significant investment in public infrastructure through issuing tax supported debt and thus carries above-average debt ratios. Rating agencies rank Washington State's debt levels in the top ten among the 50 states based on the amount of outstanding tax-supported debt. Their definition of debt includes transportation debt that is paid with sources other than the state general fund, but does not include non-tax supported revenue debt.

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Moody's State Tax-Supported Debt Statistics for Fiscal Year 2010

	Total (mil. $)	Rank	Per Capita ($)	Rank	As % Personal Income	Rank	To GSP*	Rank
Washington	$17,712	8	$2,626	7	6.20%	7	4.60%	10
Mean	$9,984		$1,404		3.50%		2.78%	
Median	$4,308		$1,066		2.80%		2.17%	
Highest	$94,715		$5,236		10.10%		8.32%	
Lowest	$23		$13		0.00%		0.03%	

Source: Moody's Investors Service, 2011 State Debt Medians Report, May 25, 2011
**State GDP numbers have a one year lag*

The three major credit ratings agencies cite Washington's debt levels as a potential risk; however, each rating agency has recognized that fundamental strengths of the state partially mitigate the risks associated with the state's above-average debt burden. Moody's sees Washington's credit strengths as:

- Institutionalized conservative budgetary controls;
- Strong demographic trends;
- Satisfactory overall liquidity levels despite recessionary stresses; and
- Relatively healthy pension funding levels and modest retiree health insurance liability.

The rating agency sees Washington's credit challenges as:

- Economic weakness and steeper-than-forecast housing downturn that have driven large consecutive downward revenue revisions;
- Diminished financial flexibility given depletion of financial reserves, significant use of one-time actions to balance current biennial budget, and implementation of sizeable budget reductions over the past two years;
- Exposure to cyclical commercial aerospace industry;
- Debt ratios above average and likely to increase; and
- Voter initiative activity adds element of fiscal uncertainty.

Washington's bond issuances have been receiving the second highest rating from the credit rating agencies: Moody's – Aa1, Standard and Poor's – AA+, and Fitch – AA+. The investors in Washington bonds use other factors along with these ratings to determine the price (interest rates) that they are willing to pay for the bonds. The market conditions at the time of the sale and investors own comfort with the State's ability to repay the debt service also determine the interest rate they are willing to pay. The table below demonstrates the cost difference between the different rating levels.

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Cost of Borrowing of Different Ratings*

	AAA	AA	A
True Interest Cost	3.063%	3.368%	4.077%
Annual Principal and Interest	$57,835,822	$59,811,386	$64,453,077
Total Principal and Interest	**$1,445,843,611**	**$1,495,235,916**	**$1,613,570,267**
Present Value Difference			
Between AAA and AA	$34,363,959		
Between AA and A	$82,334,287		

**The amounts in the table are based on $1 billion 25 year bonds, level debt service payments, and the generic Municipal Market Index as of 11-4-11.*

Research conducted by Professors Ronald Fisher, Michigan State University, and Robert Wassmer, Sacramento State University, relies on census data to calculate the relative debt burden of the states. Census data includes not only general obligation bonds but also revenue bonds and certificates of participation, which is debt the rating agencies do not include in their calculations. By this measure, when local debt is excluded, Washington is 16th highest in per capita debt. (Including local debt, the Fisher and Wassmer calculations shows Washington ranking at the fifth highest.) During the same period the measure used by Moody's placed Washington as the eighth highest per capita debt.

Top Ten States, Alternative Measures of Outstanding Debt

2007 Per Capita State Government Only Long-term Debt Excluding Private Purpose	**2007 Per Capita State Government Only Long-term Net Tax-Supported Debt**
Census	***Moody's***
Massachusetts	Massachusetts
Hawaii	Connecticut
New Jersey	Hawaii
New York	New Jersey
Connecticut	New York
Rhode Island	Delaware
Alaska	Illinois
Delaware	**Washington (8)**
South Carolina	Rhode Island
Louisiana	California
Washington (16)	

Source: Responses to Questions from the Washington State Commission on State Debt, from the Meeting of October 21, 2011, page 3, Ronald C. Fisher, Michigan State University and Robert W. Wassmer, California State University, November 1, 2011.

Note: The 2007 data was collected pre-recession.

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The differences in the ranking of Washington's state debt burdens between Moody's analysis and the census data results from the different measures being used. The census data captures a number of bonds that are not financed with general revenues or gas taxes, but with project based revenues. These types of projects would include things like toll-financed transportation projects and tuition and fee-financed higher education buildings, which are widely used in some other states. Washington has used relatively few of these financing mechanisms to date. Because Washington finances nearly all of its transportation projects and most of its higher education buildings with gas taxes and/or general obligation bonds, they are included in both measures. Thus, from the perspective of an investor concerned about the capacity of general taxes to back state debt, Washington appears to have a higher debt load; reflected in the Moody's numbers. Alternatively, the overall state debt load for Washington taxpayers – including most forms of general and revenue specific debt – is about average; reflected in the census numbers.

The Wassmer and Fisher research indicates that the ratio of Washington's debt, relative to other states, has declined since 1992, based on the census data.

Ratio of Washington to U.S. All State Average

	Long-term Debt Per Capita	Long-term Debt Percentage of GDP	Long-term Debt Percentage of Annual Revenue
1992	1.47	1.38	1.28
1997	1.33	1.30	1.12
2002	1.32	1.24	1.19
2007	1.22	1.15	1.10

Source: Presentation to the Washington State Commission on State Debt, Ronald C. Fisher, Michigan State University and Robert W. Wassmer, California State University, September 9, 2011.

Findings

As measured by the rating agencies, Washington's debt burden is among the top 10 states in the nation as measured by: debt per capita, debt as a percentage of personal income, debt as a percentage of gross state product, and debt service as a percentage of governmental expenditures.

Despite citing the state's debt level as a potential risk, each rating agency has recognized that fundamental strengths of the state largely mitigate the above-average debt burden.

As measured by Professors Fisher and Wassmer using broader census data, Washington is a moderate debt state relative to other states.

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Economic Impact of Debt Financing

The Washington State Office of Financial Management's Input-Output Model of the economic/jobs impact by industry indicates that for every $1 million increase in construction spending, 10 jobs are either maintained or created. This is a combination of direct, indirect, and induced jobs that are one-time and last as long as the construction project that's funded.

Debt financing for construction projects that create or maintain jobs requires debt service paid from the operating budget. The operating funds, if not used for debt service, may also create or maintain jobs paid from the state's operating budget.

Construction expenditures are viewsed as ~~is~~ very important to Washington's general fund. For example, using the Office of Financial Management's Input-Output Model, an estimated $1 million spent on highway construction in FY 2012 will generate an estimated $88,000 in state tax revenues. Of this amount, $66,000 of the tax revenue is generated in the first year, with the remaining $22,000 in the following year.

Employment in non-residential construction is expected to recover slowly. Non-residential construction includes all construction activity that isn't single- or multi-family homes.

The following chart compares the actual and forecasted heavy and civil and non-residential employment data to general obligation debt that has been issued by the State Finance Committee to support State construction activity resulting from capital and transportation budget appropriations. The chart shows that non-residential construction employment declined precipitously during 2008-2010, despite the fact that the state's bond issuance for construction spending has been and is expected to remain at an elevated rate during the 2011-2013 period due to increases in issuances for transportation projects.

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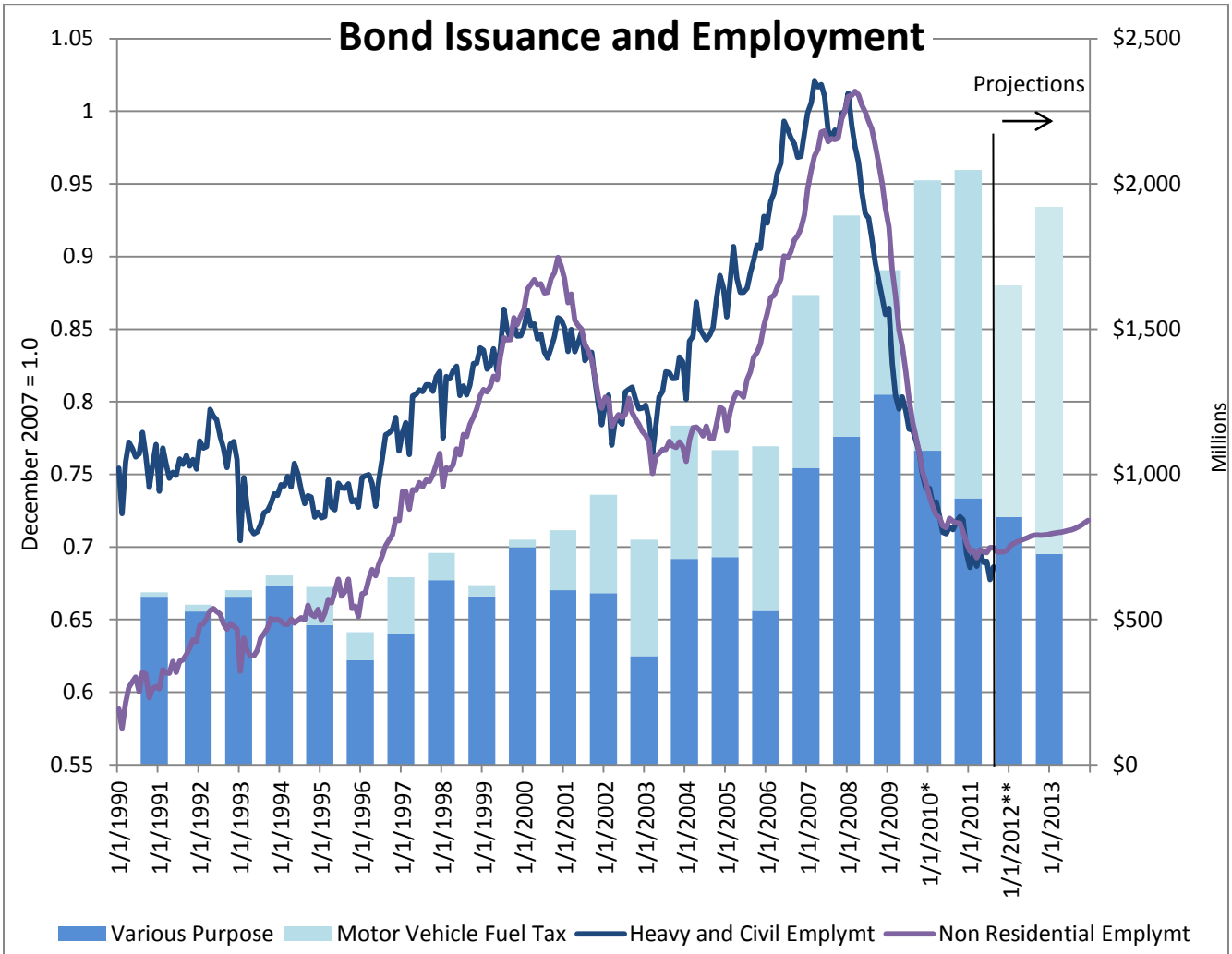

*The 2010 MVFT issuance was over $2 billion but $1.13 billion was moved to 2011 for demonstration purposes because those bonds would have been issued in 2011, but were issued in 2010 to take advantage of the low Build America Bonds interest rate.

**2012 issuance is year-to-date plus projected isuance amounts.

2012 and 2013 issuance amounts are estimated projects, subject to change.

Source: Office of the State Treasurer

Findings

The trade-off for job creation and the resulting tax revenues in the short run from debt financing is a long term reduction in other operating budget expenditures, including jobs supported in the operating budget, due to the required debt service payments for bond funded construction projects.

It is estimated that 28,400 jobs can move the employment rate by one percent.

Washington's debt limit follows the economic cycles too closely. Debt capacity falls in times of high unemployment when prices and interest rates are low. Debt capacity is high when unemployment is low and prices and interest rates are high. This "pro-cyclicality" increases the state's cost to acquire capital assets and constrains efforts to stimulate employment during recessionary periods.

The impact of spending state bond proceeds for construction projects on non-residential construction employment may depend on broader economic conditions in the economy.

Motor Vehicle Fuel Tax and Triple Pledge General Obligation Bonds

Motor Vehicle Fuel Tax bonds issued for transportation projects are not subject to the constitutional debt limit and are constrained in practice by current and projected revenues, even when they are backed by the general obligation of the state.

Motor Vehicle Fuel Tax general obligation (MVFT GO) bonds are backed by the full faith, credit and taxing power of the state. In keeping with the State Constitution, debt service on these bonds is first payable from the proceeds of state excise taxes on motor vehicle and special fuels.

In addition, "triple pledge" general obligation bonds have been authorized to finance major transportation improvements (ex. SR-520 Corridor) where debt service is first payable from toll revenues; second, from the excise taxes on motor vehicle and special fuels; and third, backed by the general obligation pledge of the state's full faith, credit and taxing power.

Significant bond authorizations for transportation have been historically tied to fuel tax increases. Before 2003, no significant fuel tax increase had been enacted in over a dozen years. During that period, some bonds were authorized, but few issuances were made.

In 2003 and 2005, the Legislature enacted fuel tax increases of 5 and 9.5 cents, respectively, as part of larger funding packages. At the same time, transportation bond authorizations of $2.6 billion (in 2003) and $5.1 billion (in 2005) were enacted. The expectation was that most of the revenue streams from the fuel tax increases would be leveraged to finance the bonds.

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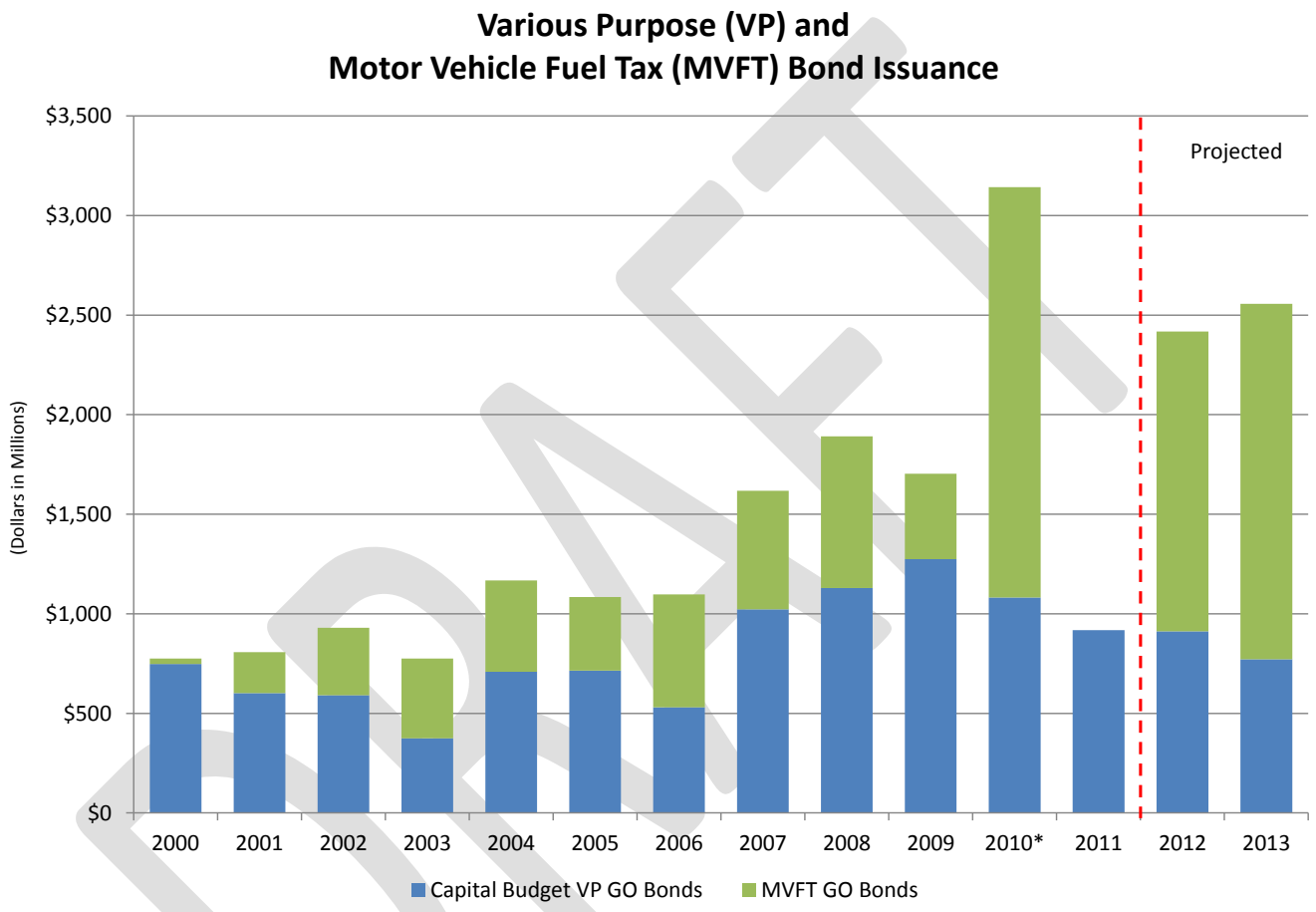
Since the passage of the 2003 and 2005 transportation packages, the Legislature enacted additional bonding authorizations ($5.3 billion for the Transportation Partnership Act and $3.2 billion for the Nickel Act).

Washington is currently at the peak of bond issuance to build the transportation projects authorized by the 2003 and 2005 gas tax increases.



Preliminary MVFT bond projections as of 6/30/11 include bonds for the 520 bridge. Preliminary VP bond projections from 2011 session conference debt model.

* The 2010 MVFT issuance includes bonds that would have been issued in 2011, but were issued in 2010 to take advantage of the low Build America Bonds (BABs) interest rate.

Other Debt

The Commission on State Debt considered other debt obligations that fall outside the debt limit, including certificates of participation (COPs) and other alternatively financed projects such as those supported with 63-20 financing and voter-approved bonds.

Findings

Although debt issued for transportation projects is not included in the debt limit, rating agencies consider it in state's overall debt obligations. In fact, much of the debt issued for transportation projects is general obligation debt, meaning the state pledges the full faith, credit and taxing power to pay the debt service and is a market consideration for the state's investors.

Rating agencies have identified Washington's relatively high net tax-supported debt as one of the risks for rating downgrades. This means that transportation debt may affect the cost of borrowing for capital budget purposes and vice versa.

Most debt service for state certificates of participation is paid from dedicated fund sources, but some COP debt service is paid from general fund revenues.

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Recommendations

The recommendations by the Commission on State Debt are intended to accomplish the following objectives:

- Smooth the amount of bond capacity over time while maintaining a predictable and sustainable capital budget;
- Reduce the amount of debt service as a share of the state operating budget over the long run; and
- Create a better planning process for debt financing, including the implications to the financial markets and capital planning in state government.

To accomplish these objectives, the Commission recommends amending the constitutional debt limit and Chapter 46, Laws of 2011 (SSB 5181), establishing a Debt Policy Council, and reviewing and enhancing the state's capital planning process.

RECOMMENDATION 1 – Majority Approved
Constitutional Changes to the Debt Limit

The Commission recommends amending the Constitution to smooth the level of bond capacity over time by 1) calculating average general state revenue over a six year period instead of the existing three year period; 2) adding the state property tax to the definition of general state revenue, and 3) decreasing the debt limit percentage from nine percent to eight and three-quarters percent.

1. Increasing the number of years for calculating the average of general state revenue that the debt limit is based upon allows for a smoother projection of bond capacity, which reduces the growth of bond appropriations in good economic years but increases the amount of bonds available for appropriation in bad economic times. As previously mentioned, the existing constitutional debt limit requires that principal and interest payments in any year may not exceed nine percent of the average of the prior three years of general state revenues.
2. Adding the state property tax, which is a stable revenue source to general state revenues, will smooth the amount of revenue that the debt limit is based upon, which will smooth the bond capacity. The state property tax is dedicated by statute to the support of common schools. So, although it is deposited into the general fund, it is not included in the definition of general state revenue. The Commission recommends retaining the property tax dedication to common schools in statute, but amending the Constitution to add the tax to general state revenue. Including property tax would increase general revenue a little over 10 percent. Property tax also grows more slowly (about 2% per year) than other major revenue sources in the general fund (about 4.5% per year).
3. Reducing the Constitutional debt limit from nine percent to eight and three-quarters percent will balance the net effect of the first two recommendations. Increasing the number of years in

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the general state revenue calculation will reduce long term debt capacity because the three additional years are typically years with lower amounts. Adding property tax to the definition of general state revenue expands debt capacity more than the increased number of years in the average general state revenue reduces it.

The combination of these three changes will result in a more stable and predictable projected bond capacity with a slight reduction in the amount of bond capacity, based on debt model, available under the constitutional debt limit. These changes will also stabilize the amount of debt service required in the future.

See Appendix E for the Washington State Constitution, Article 23, amending the Constitution.

RECOMMENDATION 2 – Majority Approved
Statutory Changes to the Working Debt Limit

In conjunction with the Constitutional changes described above, the Commission recommends amending the working debt limits in Chapter 46, Laws of 2011 (SSB 5181) to allow for the limit to increase during recessions and phase back down as economic recovery takes place. The working debt limit is used by the Governor and Legislature for budget development. It is less than the constitutional debt limit which is the ultimate limit on the issuance of debt. The following are the recommended changes to the working debt limit:

1. Change the entity that recommends the working debt limit from the State Finance Committee to a newly developed Debt Policy Council (see recommendation 3 below).
2. Change the working debt limit in statute for non-recessionary periods to eight percent.
3. Allow the Debt Policy Council to increase the working debt limit up to eight and a half percent during recessionary periods, and require the working debt limit to phase back down to eight percent within eight years following the recessionary period. The Debt Policy Council will determine the recessionary and recovery periods.

Changes to the working debt limit in SB 5181, without changes to the constitutional debt limit, result in lower bond capacity. The charts and tables in Appendix D demonstrate that the recommendation to amend both the Constitution and SSB 5181 smoothes the amount of bond capacity available over time as the state's economy weathers recessions. The amount of debt service remains approximately the same percentage of near general fund, but rises due to debt service on existing debt outstanding, and then declines as the debt issuances are reduced over time.

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RECOMMENDATION 3 – Majority Approved

Debt Policy Council

The Commission on State Debt recommends creating a Debt Policy Council to advise, in a manner similar to the Economic and Revenue Forecast Council and the Caseload Forecast Council, the Governor and the Legislature regarding the appropriate level of state debt, including balancing the need for funding essential capital projects, preserving future budgetary flexibility, and protecting the State's credit position and market access.

This recommendation includes shifting duties from the State Finance Committee that were identified in SSB 5181 to this Debt Policy Council. The council would be given the mandate of advising the Governor and Legislature on the working debt limit and the overall amount of debt the state issues, including debt paid from the Motor Vehicle Fuel Tax and other types of state-issued debt. The Debt Policy Council would also be required to determine a feasible amount of future debt issuance, the impact of the state's debt on the bond market, and the impact of the debt service required to pay for different types of debt. This may include possibilities such as banking bond capacity in the debt modeling process and recommending levels of banked capacity and future debt service payments.

The Commission on State Debt recommends that the Legislature decide on the membership of the Debt Policy Council.

RECOMMENDATION 4 – Unanimously Approved

Ten-Year Capital Plan – Enhanced

The Commission on State Debt recommends enhancement of the required ten-year capital plan submitted by state agencies to the Governor by including estimated debt service payments for the current biennia and over the life of the financing. This recommendation includes all debt-financed projects, including transportation projects, certificates of participation and 63-20 financing. The purpose of this recommendation is to assist the Governor and the Legislature in long term debt planning to manage the State's credit rating and cost of and to manage overall debt service in the long run.

RECOMMENDATION 5 – Majority Approved

Capital Planning

The Commission on State Debt acknowledges that a lack of comprehensive capital planning exists, especially in regards to the interactions between transportation debt and debt for capital budget purposes; therefore Commission recommends further analysis of this issue to result in steps to create a comprehensive and coordinated capital and transportation plan.

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RECOMMENDATION 6 – Majority Approved

Amend RCW 43.88.031, Capital appropriation bill — Estimated General Fund Debt Service Costs

The Commission on State Debt recommends requiring state agencies, the Office of Financial Management, and the Legislature to estimate debt service for capital projects. This recommendation includes two parts: 1) compliance with RCW 43.88.031, which requires the capital budget to include the estimated general fund debt service, for the current and two succeeding biennia, for the new appropriations; and 2) amending RCW 43.88, which requires state agencies to submit a ten-year capital spending plan to the Office of Financial Management, by requiring agencies to estimate the debt service from all funds for the current biennium and over the life of the financing for proposed capital projects and programs. The purpose of this recommendation is for long term debt planning.

The current requirements under RCW 43.88.031 are, "A capital appropriation bill shall include the estimated general fund debt service costs associated with new capital appropriations contained in that bill for the biennia in which the appropriations occur and for the succeeding two biennia."

RECOMMENDATION 7 – Unanimously Approved

Commission on State Debt Discontinuation

The Commission on State Debt recommends discontinuing the Commission, as the work will continue through the Debt Policy Council in recommendation3.

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Glossary

Certificates of Participation (COP): A type of financing where an investor purchases a share of the lease revenues of a program rather than the bond being secured by those revenues. The issuances are usually structured as revenue bonds, and annual payment, paid by a state or local government, cover all costs including operations, maintenance, and debt service. COP's are not backed by the full faith and credit of the state and are not subject to the constitutional debt limit.

General Obligation Bonds: Debt instruments issued by states, counties, town cities, and school districts and secured by the issuers' general taxing powers.

Near General Fund-State: For purposes of this report, Near General Fund-State includes the~~The~~ state general fund, ~~and~~ the Education Legacy Trust Account, ~~and~~ the Pension Funding Stabilization Account, and the Opportunities Pathway Account.

Opportunity Pathways Account: A Washington State account created in 2010 that collects lottery revenue ~~from~~ for financial aid purposes..

Permanent Common School Account: A Washington State Account established in the Washington State Constitution (Article 9, section 3) that is a permanent and irreducible fund in the state treasury. Income derived from the fund is used for support of the common schools.

Revenue Bonds: Bonds issued for project or enterprise financings secured by the revenues generated by the completed projects themselves, or for general public-purpose financings in which the issuers pledge to the bondholders tax and revenue resources that were previously part of the general fund.

63-20 Financings – An Internal Revenue Service ruling for financings that involve a single purpose nonprofit corporation that is created in order to issue bonds. Using bond proceeds, the nonprofit funds the project and contracts with a developer for its construction. The state then leases the completed building from the nonprofit. Debt service on the bonds and other costs are covered by lease payments. At the end of the lease, which coincides with bond maturity, ownership of the building transfers to the state.

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Appendix A

SUBSTITUTE SENATE BILL 5181

Passed Legislature - 2011 1st Special Session

State of Washington 62nd Legislature 2011 1st Special Session

By Senate Ways & Means (originally sponsored by Senators Parlette, Kilmer, Zarelli, Murray, Litzow, Rockefeller, Stevens, Becker, Baumgartner, and Hill)

READ FIRST TIME 05/24/11.

AN ACT Relating to limitations on state debt; adding a new section to chapter 39.42 RCW; creating new sections; and making an appropriation.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

NEW SECTION. **Sec. 1.** The legislature intends to examine the various kinds of debt incurred by Washington state and the limitations that control the amount and use of debt. To assist in this examination, the legislature seeks the assistance and recommendations of a commission on state debt.

NEW SECTION. **Sec. 2.** (1) The commission on state debt is created. The commission shall include the following members: The state treasurer, who shall chair the commission; the director of the office of financial management; one member each from the two largest caucuses of the senate, appointed by the president of the senate; one member each from the two largest caucuses of the house of representatives, appointed by the speaker of the house of representatives; six independent members, three appointed by the state treasurer in

consultation with the state finance committee and three appointed by the governor in consultation with the state finance committee. These six independent members must not have a financial interest in debt-financed state expenditures and shall include appointees with experience in public or private finance, local government, or related academic or legal backgrounds. The members of the commission shall serve without additional compensation, but shall be reimbursed in accordance with RCW 44.04.120 for attending meetings of the commission. Staffing for the commission shall be provided by the state treasurer's office, the office of financial management, and legislative capital budget staff.

(2) The commission shall examine the following:

(a) Trends in the use of all kinds of state obligations including general obligation bonds; revenue bonds and other debt that supports the transportation budget; financing contracts; lease purchase agreements; and other forms of obligations including long-term liabilities such as pension liabilities and long-term leases. The examination of trends must also examine the impact of debt service payments on operating budget expenditures.

(b) Major uses of state debt, the debt service expenditures associated with those major uses, and a comparison of the debt service expenditures and other operating budget expenditures that addresses similar policy objectives as the major uses of debt.

(c) Existing limitations and policies on the use of various kinds of debt and how those policies and limitations compare with other states with similar or higher credit ratings. The comparisons will include an examination of relative debt burden and the relationship between state debt and debt incurred by local governments in the comparison states.

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(3) The commission must recommend improvements in state debt policies and limitations, including possible amendments to state constitutional debt limitations that will accomplish the following:

(a) Stabilizes the capacity to incur new debt in support of sustainable and predictable capital budgets;

(b) Reduces the growth in debt service payments to an appropriate level that no longer exceeds the long-term growth in the general fund expenditures;

(c) Maintain and enhance the state's credit rating.

(4) The commission must consult affected stakeholders.

(5) The commission must report its findings and recommendations to the state finance committee and the appropriate committees of the legislature by December 1, 2011.

NEW SECTION. **Sec. 3.** A new section is added to chapter 39.42 RCW to read as follows:

The state finance committee must recommend a working debt limit for purposes of budget development for various purpose capital bond appropriations. Nothing in this section shall in any manner affect the validity of indebtedness incurred in compliance with the provisions of Article VIII, section 1 of the state Constitution. The working debt limit must be updated periodically following forecasts of the economic and revenue forecast council. The governor and legislature must develop capital bond budgets within the most recent recommended working debt limit. The working debt limit must be lower than the state constitutional debt limit in order to reserve capacity under the constitutional limit for emergencies and economic uncertainties. In order to begin to accomplish the objectives of stabilizing debt capacity and reducing the debt service burden on the operating budget, the state finance committee must recommend working debt limits of eight and one-half percent from July 1, 2015, to and including June 30, 2017;

eight and one-quarter percent from July 1, 2017, to and including June 30, 2019; eight percent from July 1, 2019, to and including June 30, 2021; seven and three-quarters percent from July 1, 2021, and thereafter. The state finance committee may recommend modified working debt limits in response to extraordinary economic conditions. The state finance committee is authorized to reduce or delay the issuance of bonds if an issuance would result in exceeding the recommended working debt limit.

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Appendix B

Article 8, Section 1, State, County, and Municipal Indebtedness, Washington State Constitution

SECTION 1 STATE DEBT. (a) The state may contract debt, the principal of which shall be paid and discharged within thirty years from the time of contracting thereof, in the manner set forth herein.
(b) The aggregate debt contracted by the state shall not exceed that amount for which payments of principal and interest in any fiscal year would require the state to expend more than nine percent of the arithmetic mean of its general state revenues for the three immediately preceding fiscal years as certified by the treasurer. The term "fiscal year" means that period of time commencing July 1 of any year and ending on June 30 of the following year.
(c) The term "general state revenues" when used in this section, shall include all state money received in the treasury from each and every source whatsoever except: (1) Fees and revenues derived from the ownership or operation of any undertaking, facility, or project; (2) Moneys received as gifts, grants, donations, aid, or assistance or otherwise from the United States or any department, bureau, or corporation thereof, or any person, firm, or corporation, public or private, when the terms and conditions of such gift, grant, donation, aid, or assistance require the application and disbursement of such moneys otherwise than for the general purposes of the state of Washington; (3) Moneys to be paid into and received from retirement system funds, and performance bonds and deposits; (4) Moneys to be paid into and received from trust funds including but not limited to moneys received from taxes levied for specific purposes and the several permanent and irreducible funds of the state and the moneys derived therefrom but excluding bond redemption funds; (5) Proceeds received from the sale of bonds or other evidences of indebtedness.
(d) In computing the amount required for payment of principal and interest on outstanding debt under this section, debt shall be construed to mean borrowed money represented by bonds, notes, or other evidences of indebtedness which are secured by the full faith and credit of the state or are required to be repaid, directly or indirectly, from general state revenues and which are incurred by the state, any department, authority, public corporation, or quasi public corporation of the state, any state university or college, or any other public agency created by the state but not by counties, cities, towns, school districts, or other municipal corporations, but shall not include obligations for the payment of current expenses of state government, nor shall it include debt hereafter incurred pursuant to section 3 of this article, obligations guaranteed as provided for in subsection (g) of this section, principal of bond anticipation notes or obligations issued to fund or refund the indebtedness of the Washington state building authority. In addition, for the purpose of computing the amount required for payment of interest on outstanding debt under subsection (b) of this section and this subsection, "interest" shall be

reduced by subtracting the amount scheduled to be received by the state as payments from the federal government in each year in respect of bonds, notes, or other evidences of indebtedness subject to this section.

(e) The state may pledge the full faith, credit, and taxing power of the state to guarantee the voter approved general obligation debt of school districts in the manner authorized by the legislature. Any such guarantee does not remove the debt obligation of the school district and is not state debt.

(f) The state may, without limitation, fund or refund, at or prior to maturity, the whole or any part of any existing debt or of any debt hereafter contracted pursuant to section 1, section 2, or section 3 of this article, including any premium payable with respect thereto and interest thereon, or fund or refund, at or prior to maturity, the whole or any part of any indebtedness incurred or authorized prior to the effective date of this amendment by any entity of the type described in subsection (h) of this section, including any premium payable with respect thereto and any interest thereon. Such funding or refunding shall not be deemed to be contracting debt by the state.

(g) Notwithstanding the limitation contained in subsection (b) of this section, the state may pledge its full faith, credit, and taxing power to guarantee the payment of any obligation payable from revenues received from any of the following sources: (1) Fees collected by the state as license fees for motor vehicles; (2) Excise taxes collected by the state on the sale, distribution or use of motor vehicle fuel; and (3) Interest on the permanent common school fund: Provided, That the legislature shall, at all times, provide sufficient revenues from such sources to pay the principal and interest due on all obligations for which said source of revenue is pledged.

(h) No money shall be paid from funds in custody of the treasurer with respect to any debt contracted after the effective date of this amendment by the Washington state building authority, the capitol committee, or any similar entity existing or operating for similar purposes pursuant to which such entity undertakes to finance or provide a facility for use or occupancy by the state or any agency, department, or instrumentality thereof.

(i) The legislature shall prescribe all matters relating to the contracting, funding or refunding of debt pursuant to this section, including: The purposes for which debt may be contracted; by a favorable vote of three-fifths of the members elected to each house, the amount of debt which may be contracted for any class of such purposes; the kinds of notes, bonds, or other evidences of debt which may be issued by the state; and the manner by which the treasurer shall determine and advise the legislature, any appropriate agency, officer, or instrumentality of the state as to the available debt capacity within the limitation set forth in this section. The legislature may delegate to any state officer, agency, or instrumentality any of its powers relating to the contracting, funding or refunding of debt pursuant to this section except its power to determine the amount and purposes for which debt may be contracted.

(j) The full faith, credit, and taxing power of the state of Washington are pledged to the payment of the debt created on behalf of the state pursuant to this section and the legislature shall provide by appropriation for the payment of the interest upon and installments of principal of all such debt as the

same falls due, but in any event, any court of record may compel such payment.
(k) Notwithstanding the limitations contained in subsection (b) of this section, the state may issue certificates of indebtedness in such sum or sums as may be necessary to meet temporary deficiencies of the treasury, to preserve the best interests of the state in the conduct of the various state institutions, departments, bureaus, and agencies during each fiscal year; such certificates may be issued only to provide for appropriations already made by the legislature and such certificates must be retired and the debt discharged other than by refunding within twelve months after the date of incurrence.
(l) Bonds, notes, or other obligations issued and sold by the state of Washington pursuant to and in conformity with this article shall not be invalid for any irregularity or defect in the proceedings of the issuance or sale thereof and shall be incontestable in the hands of a bona fide purchaser or holder thereof. [**AMENDMENT 103**, 2010 Senate Joint Resolution No. 8225, p 3129-3132. Approved November 2, 2010.]

Amendment 92, (1999) Art. 8 Section 1 STATE DEBT *(a) The state may contract debt, the principal of which shall be paid and discharged within thirty years from the time of contracting thereof, in the manner set forth herein.*
(b) The aggregate debt contracted by the state shall not exceed that amount for which payments of principal and interest in any fiscal year would require the state to expend more than nine percent of the arithmetic mean of its general state revenues for the three immediately preceding fiscal years as certified by the treasurer. The term "fiscal year" means that period of time commencing July 1 of any year and ending on June 30 of the following year.
(c) The term "general state revenues" when used in this section, shall include all state money received in the treasury from each and every source whatsoever except: (1) Fees and revenues derived from the ownership or operation of any undertaking, facility, or project; (2) Moneys received as gifts, grants, donations, aid, or assistance or otherwise from the United States or any department, bureau, or corporation thereof, or any person, firm, or corporation, public or private, when the terms and conditions of such gift, grant, donation, aid, or assistance require the application and disbursement of such moneys otherwise than for the general purposes of the state of Washington; (3) Moneys to be paid into and received from retirement system funds, and performance bonds and deposits; (4) Moneys to be paid into and received from trust funds including but not limited to moneys received from taxes levied for specific purposes and the several permanent and irreducible funds of the state and the moneys derived therefrom but excluding bond redemption funds; (5) Proceeds received from the sale of bonds or other evidences of indebtedness.
(d) In computing the amount required for payment of principal and interest on outstanding debt under this section, debt shall be construed to mean borrowed money represented by bonds, notes, or other evidences of indebtedness which are secured by the full faith and credit of the state or are required to be repaid, directly or indirectly, from general state revenues and which are incurred by the state, any department, authority, public corporation, or quasi public corporation of the state, any state university or college, or any other public agency created by the state but not by counties, cities, towns, school districts, or other municipal corporations, but shall not include obligations for the payment of current expenses of state government, nor shall it include debt hereafter incurred pursuant to section 3 of this article, obligations guaranteed as provided for in subsection (g) of this section, principal of bond anticipation notes or obligations issued to fund or refund the indebtedness of the Washington state building authority.
(e) The state may pledge the full faith, credit, and taxing power of the state to guarantee the voter approved general obligation debt of school districts in the manner authorized by the legislature. Any such guarantee does not remove the debt obligation of the school district and is not state debt.
(f) The state may, without limitation, fund or refund, at or prior to maturity, the whole or any part of any existing debt or of any debt hereafter contracted pursuant to section 1, section 2, or section 3 of this article, including any premium payable with respect thereto and interest thereon, or fund or refund, at or prior to maturity, the whole or any part of any indebtedness incurred or authorized prior to the effective date of this amendment by any entity of the type described in subsection (h) of this section, including any premium payable with respect thereto and any interest thereon. Such funding or refunding shall not be deemed to be contracting debt by the state.
(g) Notwithstanding the limitation contained in subsection (b) of this section, the state may pledge its full faith, credit, and taxing power to guarantee the payment of any obligation payable from revenues received from any of the following sources: (1) Fees collected by the state as license fees for motor vehicles; (2) Excise taxes collected by the state on the sale, distribution or use of motor vehicle fuel; and (3) Interest on the permanent common school fund: Provided, That the legislature shall, at all times, provide sufficient revenues from such sources to pay the principal and interest due on all obligations for which said source of revenue is pledged.
(h) No money shall be paid from funds in custody of the treasurer with respect to any debt contracted after the effective date of this amendment by the Washington state building authority, the capitol committee, or any similar entity existing or operating for similar purposes pursuant to which such entity undertakes to finance or provide a facility for use or occupancy by the state or any agency, department, or instrumentality thereof.
(i) The legislature shall prescribe all matters relating to the contracting, funding or refunding of debt pursuant to this section, including: The purposes for which debt may be contracted; by a favorable vote of three-fifths of the members elected to each house, the amount of debt which may be contracted for any class of such purposes; the kinds of notes, bonds, or other evidences of debt which may be issued by the state; and the manner by which the treasurer shall determine and advise the legislature, any appropriate agency, officer, or instrumentality of the state as to the available debt capacity within the limitation set forth in this section. The legislature may delegate to any state officer, agency, or instrumentality any of its powers relating to the contracting, funding or refunding of debt pursuant to this section except its power to determine the amount and purposes for which debt may be contracted.
(j) The full faith, credit, and taxing power of the state of Washington are pledged to the payment of the debt created on behalf of the state pursuant to this section and the legislature shall provide by appropriation for the payment of the interest upon and installments of principal of all such debt as the same falls due, but in any event, any court of record may compel such payment.
(k) Notwithstanding the limitations contained in subsection (b) of this section, the state may issue certificates of indebtedness in such sum or sums as may be necessary to meet temporary deficiencies of the treasury, to preserve the best interests of the state in the conduct of the various state institutions, departments,

bureaus, and agencies during each fiscal year; such certificates may be issued only to provide for appropriations already made by the legislature and such certificates must be retired and the debt discharged other than by refunding within twelve months after the date of incurrence.
(l) Bonds, notes, or other obligations issued and sold by the state of Washington pursuant to and in conformity with this article shall not be invalid for any irregularity or defect in the proceedings of the issuance or sale thereof and shall be incontestable in the hands of a bona fide purchaser or holder thereof. [AMENDMENT 92, 1999 Senate Joint Resolution No. 8206, p 2387. Approved November 2, 1999.]

Amendment 60, part, (1972) -- Art. 8 Section 1 STATE DEBT -- *(a) The state may contract debt, the principal of which shall be paid and discharged within thirty years from the time of contracting thereof, in the manner set forth herein.*
(b) The aggregate debt contracted by the state shall not exceed that amount for which payments of principal and interest in any fiscal year would require the state to expend more than nine percent of the arithmetic mean of its general state revenues for the three immediately preceding fiscal years as certified by the treasurer. The term "fiscal year" means that period of time commencing July 1 of any year and ending on June 30 of the following year.
(c) The term "general state revenues" when used in this section, shall include all state money received in the treasury from each and every source whatsoever except: (1) Fees and revenues derived from the ownership or operation of any undertaking, facility, or project; (2) Moneys received as gifts, grants, donations, aid, or assistance or otherwise from the United States or any department, bureau, or corporation thereof, or any person, firm, or corporation, public or private, when the terms and conditions of such gift, grant, donation, aid, or assistance require the application and disbursement of such moneys otherwise than for the general purposes of the state of Washington; (3) Moneys to be paid into and received from retirement system funds, and performance bonds and deposits; (4) Moneys to be paid into and received from trust funds including but not limited to moneys received from taxes levied for specific purposes and the several permanent and irreducible funds of the state and the moneys derived therefrom but excluding bond redemption funds; (5) Proceeds received from the sale of bonds or other evidences of indebtedness.
(d) In computing the amount required for payment of principal and interest on outstanding debt under this section, debt shall be construed to mean borrowed money represented by bonds, notes, or other evidences of indebtedness which are secured by the full faith and credit of the state or are required to be repaid, directly or indirectly, from general state revenues and which are incurred by the state, any department, authority, public corporation, or quasi public corporation of the state, any state university or college, or any other public agency created by the state but not by counties, cities, towns, school districts, or other municipal corporations, but shall not include obligations for the payment of current expenses of state government, nor shall it include debt hereafter incurred pursuant to section 3 of this article, obligations guaranteed as provided for in subsection (f) of this section, principal of bond anticipation notes or obligations issued to fund or refund the indebtedness of the Washington state building authority.
(e) The state may, without limitation, fund or refund, at or prior to maturity, the whole or any part of any existing debt or of any debt hereafter contracted pursuant to section 1, section 2, or section 3 of this article, including any premium payable with respect thereto and interest thereon, or fund or refund, at or prior to maturity, the whole or any part of any indebtedness incurred or authorized prior to the effective date of this amendment by any entity of the type described in subsection (g) of this section, including any premium payable with respect thereto and any interest thereon. Such funding or refunding shall not be deemed to be contracting debt by the state.
(f) Notwithstanding the limitation contained in subsection (b) of this section, the state may pledge its full faith, credit, and taxing power to guarantee the payment of any obligation payable from revenues received from any of the following sources: (1) Fees collected by the state as license fees for motor vehicles; (2) Excise taxes collected by the state on the sale, distribution or use of motor vehicle fuel; and (3) Interest on the permanent common school fund: Provided, *That the legislature shall, at all times, provide sufficient revenues from such sources to pay the principal and interest due on all obligations for which said source of revenue is pledged.*
(g) No money shall be paid from funds in custody of the treasurer with respect to any debt contracted after the effective date of this amendment by the Washington state building authority, the capitol committee, or any similar entity existing or operating for similar purposes pursuant to which such entity undertakes to finance or provide a facility for use or occupancy by the state or any agency, department, or instrumentality thereof.
(h) The legislature shall prescribe all matters relating to the contracting, funding or refunding of debt pursuant to this section, including: The purposes for which debt may be contracted; by a favorable vote of three-fifths of the members elected to each house, the amount of debt which may be contracted for any class of such purposes; the kinds of notes, bonds, or other evidences of debt which may be issued by the state; and the manner by which the treasurer shall determine and advise the legislature, any appropriate agency, officer, or instrumentality of the state as to the available debt capacity within the limitation set forth in this section. The legislature may delegate to any state officer, agency, or instrumentality any of its powers relating to the contracting, funding or refunding of debt pursuant to this section except its power to

determine the amount and purposes for which debt may be contracted.
(i) The full faith, credit, and taxing power of the state of Washington are pledged to the payment of the debt created on behalf of the state pursuant to this section and the legislature shall provide by appropriation for the payment of the interest upon and installments of principal of all such debt as the same falls due, but in any event, any court of record may compel such payment.
(j) Notwithstanding the limitations contained in subsection (b) of this section, the state may issue certificates of indebtedness in such sum or sums as may be necessary to meet temporary deficiencies of the treasury, to preserve the best interests of the state in the conduct of the various state institutions, departments, bureaus, and agencies during each fiscal year; such certificates may be issued only to provide for appropriations already made by the legislature and such certificates must be retired and the debt discharged other than by refunding within twelve months after the date of incurrence.
(k) Bonds, notes, or other obligations issued and sold by the state of Washington pursuant to and in conformity with this article shall not be invalid for any irregularity or defect in the proceedings of the issuance or sale thereof and shall be incontestable in the hands of a bona fide purchaser or holder thereof. [**AMENDMENT 60,** part, 1971 House Joint Resolution No. 52, part, p 1836. Approved November, 1972.]

Original text -- Art. 8 Section 1 LIMITATION OF STATE DEBT -- *The state may to meet casual deficits or failure in revenues, or for expenses not provided for, contract debts, but such debts, direct and contingent, singly or in the aggregate, shall not at any time exceed four hundred thousand dollars ($400,000), and the moneys arising from the loans creating such debts shall be applied to the purpose for which they were obtained or to repay the debts so contracted, and to no other purpose whatever.*

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Appendix C

Legislative Changes to Expand General State Revenues

2000 (Initiative 728)	Added lottery revenue to the statutory definition of general state revenues.
2002 (SB 6818)	Added the Real Estate Excise Tax to the statutory definition of general state revenues.
2003 (HB 2242)	Added the State Property Tax to the statutory definition of general state revenues. This allowed the Legislature to authorize $750 million in VP 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.
2009 (ESSB 5073)	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.
2009 (SSB 5537)	Repealed the 7% statutory debt limit. This created a single debt limit for the state.
2011 (HB 2019)	Undedicated the Cigarette Tax (permanent). This increased the amount of general state revenues used to calculate the constitutional debt limit.
2011 (ESHB 1497)	Temporarily undedicated the Public Works Assistance Account revenue that was transferred to the state general fund in FY 2011. This increased the amount of general state revenues used to calculate the constitutional debt limit.

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Appendix D
Bond Capacity and Debt Service Options

The details of implementing the changes recommended above affect the results of predicting the amount of bond capacity, the resulting debt service, and the share of debt service payments in the operating budget relative to near general fund revenue. The charts and tables on the following pages compare the bond capacity, debt service, and general fund debt service as a percent of near general fund, without a recessionary period and with a recessionary period, for the following debt policy scenarios:

1. Current law (Constitution and statute);
2. Amended constitutional debt limit (six year average, property tax, and 8.75% debt limit/8% working debt limit);
3. Amended statutory working debt limit in SSB 5181 (8% working debt limit that increase to 8.5% during recessions and reduces to 8% in eight years after a recovery); and
4. Amended constitutional debt limit along with amended SSB 5181.

Note, the scenarios modeled below include the following:

- The addition of the property tax and six year average in the amended constitutional debt limit scenario are implemented in 2014.
- The recession period used in the models is in 2026 and 2027.
- The amended SSB 5181 (#5 and #10) includes the amended constitutional debt.

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Chart 1

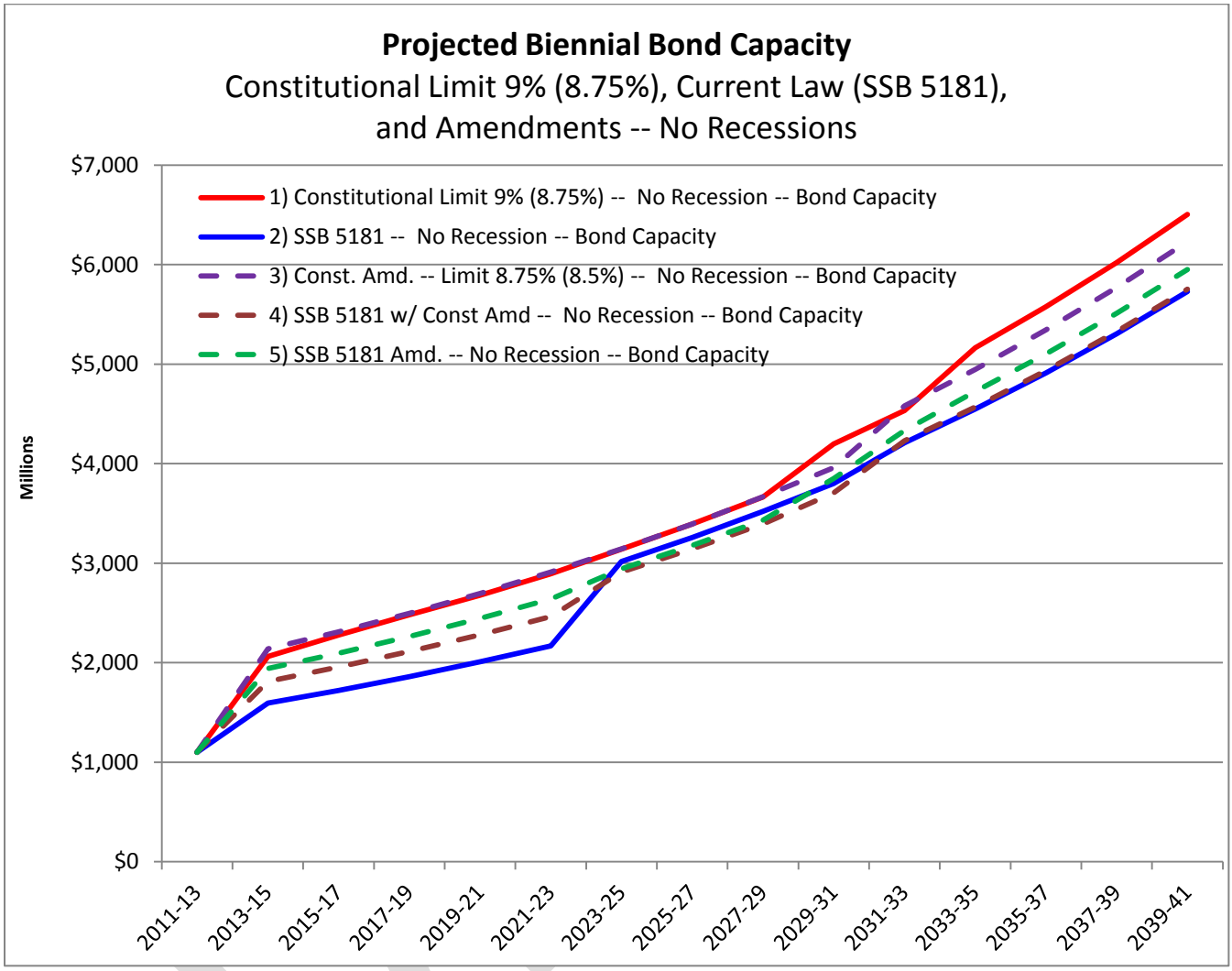

Projected Biennial Bond Capacity
Constitutional Limit 9% (8.75%), Current Law (SSB 5181),
and Amendments -- No Recessions
1) Constitutional Limit 9% (8.75%) -- No Recession -- Bond Capacity
2) SSB 5181 -- No Recession -- Bond Capacity
3) Const. Amd. -- Limit 8.75% (8.5%) -- No Recession -- Bond Capacity
4) SSB 5181 w/ Const Amd -- No Recession -- Bond Capacity
5) SSB 5181 Amd. -- No Recession -- Bond Capacity
Millions
$7,000
$6,000
$5,000
$4,000
$3,000
$2,000
$1,000
$0
2011-13
2013-15
2015-17
2017-19
2019-21
2021-23
2023-25
2025-27
2027-29
2029-31
2031-33
2033-35
2035-37
2037-39
2039-41

Chart 2

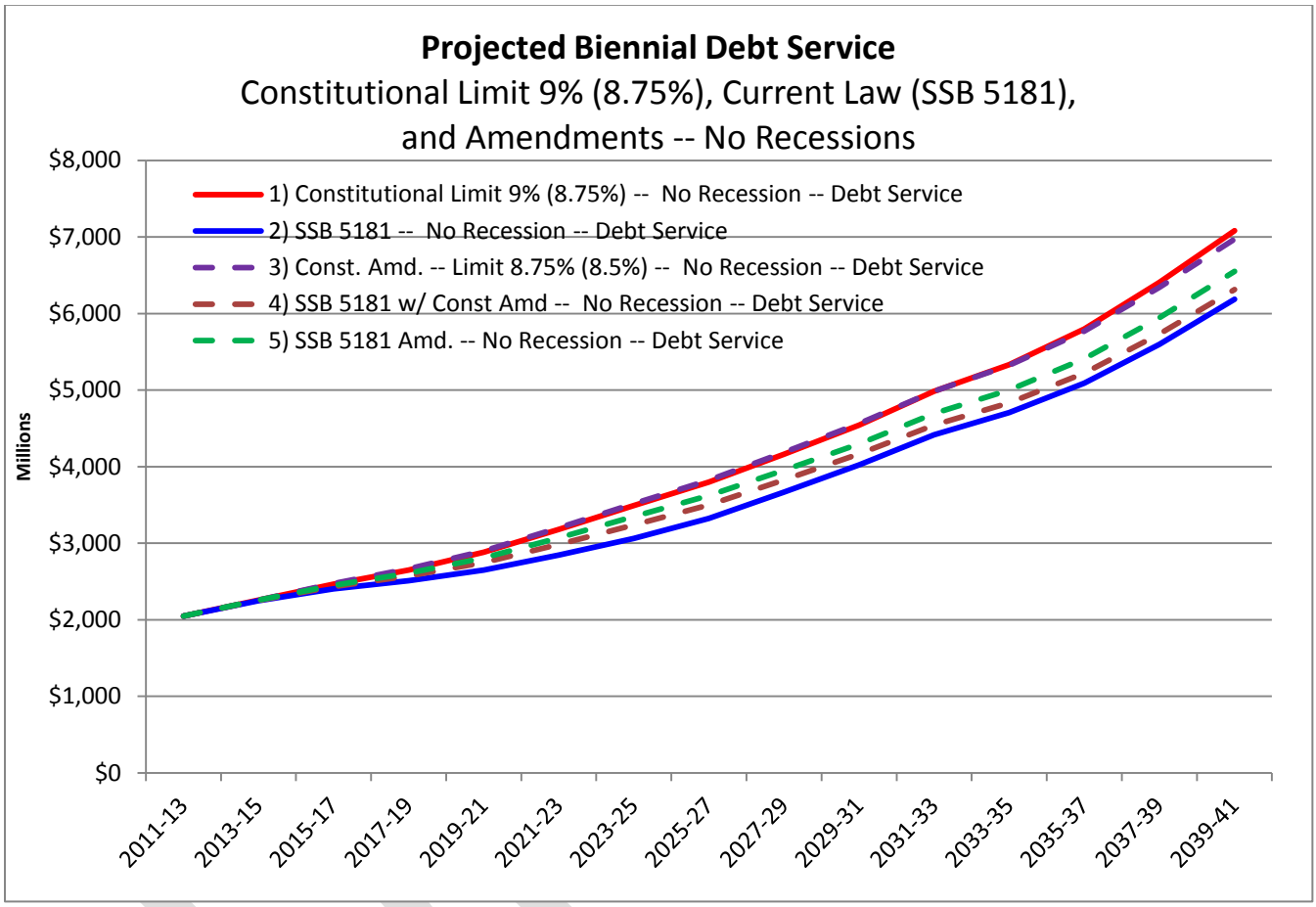
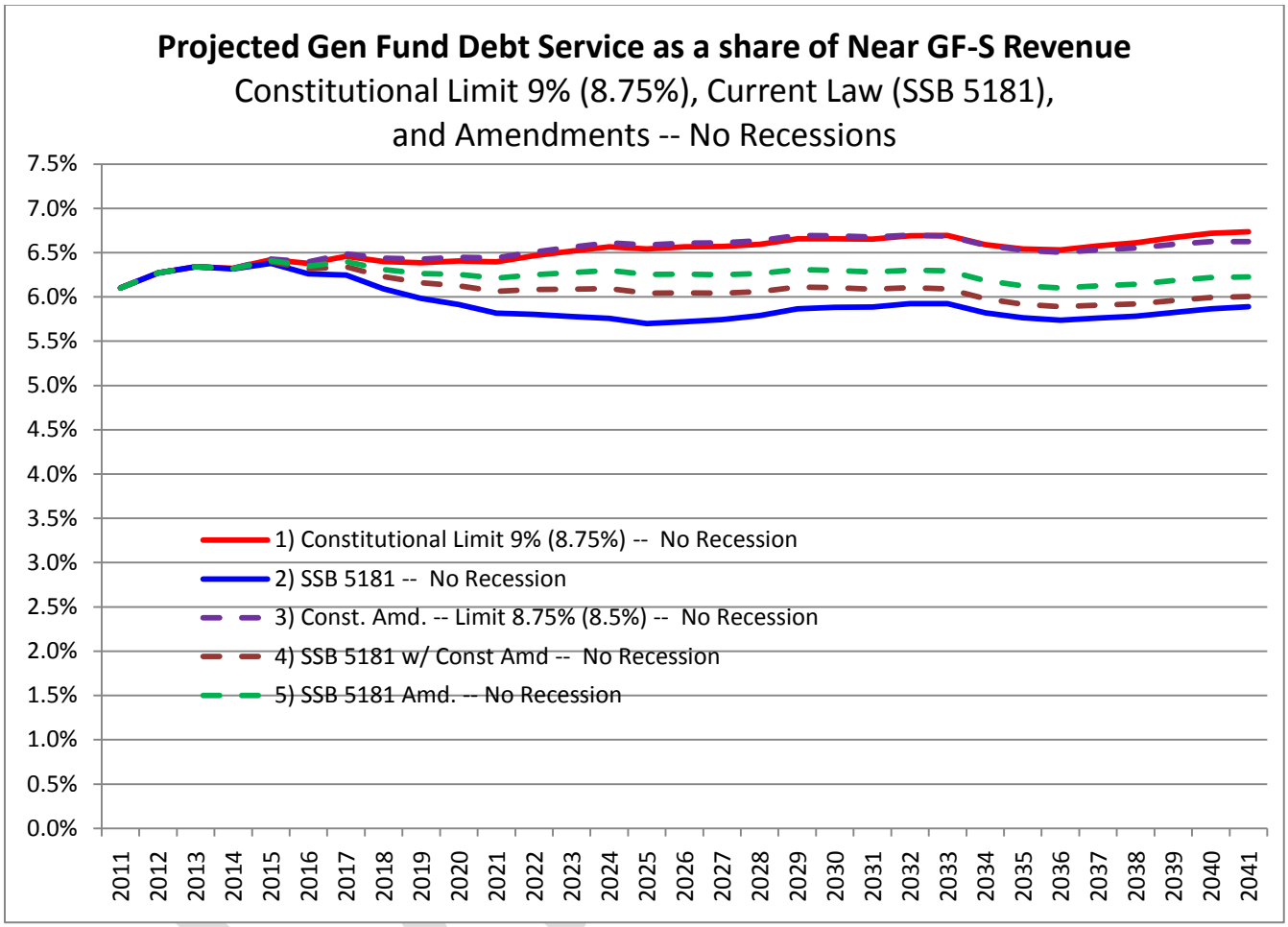

Projected Biennial Debt Service
Constitutional Limit 9% (8.75%), Current Law (SSB 5181),
and Amendments -- No Recessions
Millions
$8,000
$7,000
$6,000
$5,000
$4,000
$3,000
$2,000
$1,000
$0
1) Constitutional Limit 9% (8.75%) -- No Recession -- Debt Service
2) SSB 5181 -- No Recession -- Debt Service
3) Const. Amd. -- Limit 8.75% (8.5%) -- No Recession -- Debt Service
4) SSB 5181 w/ Const Amd -- No Recession -- Debt Service
5) SSB 5181 Amd. -- No Recession -- Debt Service
2011-13
2013-15
2015-17
2017-19
2019-21
2021-23
2023-25
2025-27
2027-29
2029-31
2031-33
2033-35
2035-37
2037-39
2039-41

Chart 3


Projected Gen Fund Debt Service as a share of Near GF-S Revenue
Constitutional Limit 9% (8.75%), Current Law (SSB 5181),
and Amendments -- No Recessions
7.5%
7.0%
6.5%
6.0%
5.5%
5.0%
4.5%
4.0%
3.5%
3.0%
2.5%
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0.0%
1) Constitutional Limit 9% (8.75%) -- No Recession
2) SSB 5181 -- No Recession
3) Const. Amd. -- Limit 8.75% (8.5%) -- No Recession
4) SSB 5181 w/ Const Amd -- No Recession
5) SSB 5181 Amd. -- No Recession
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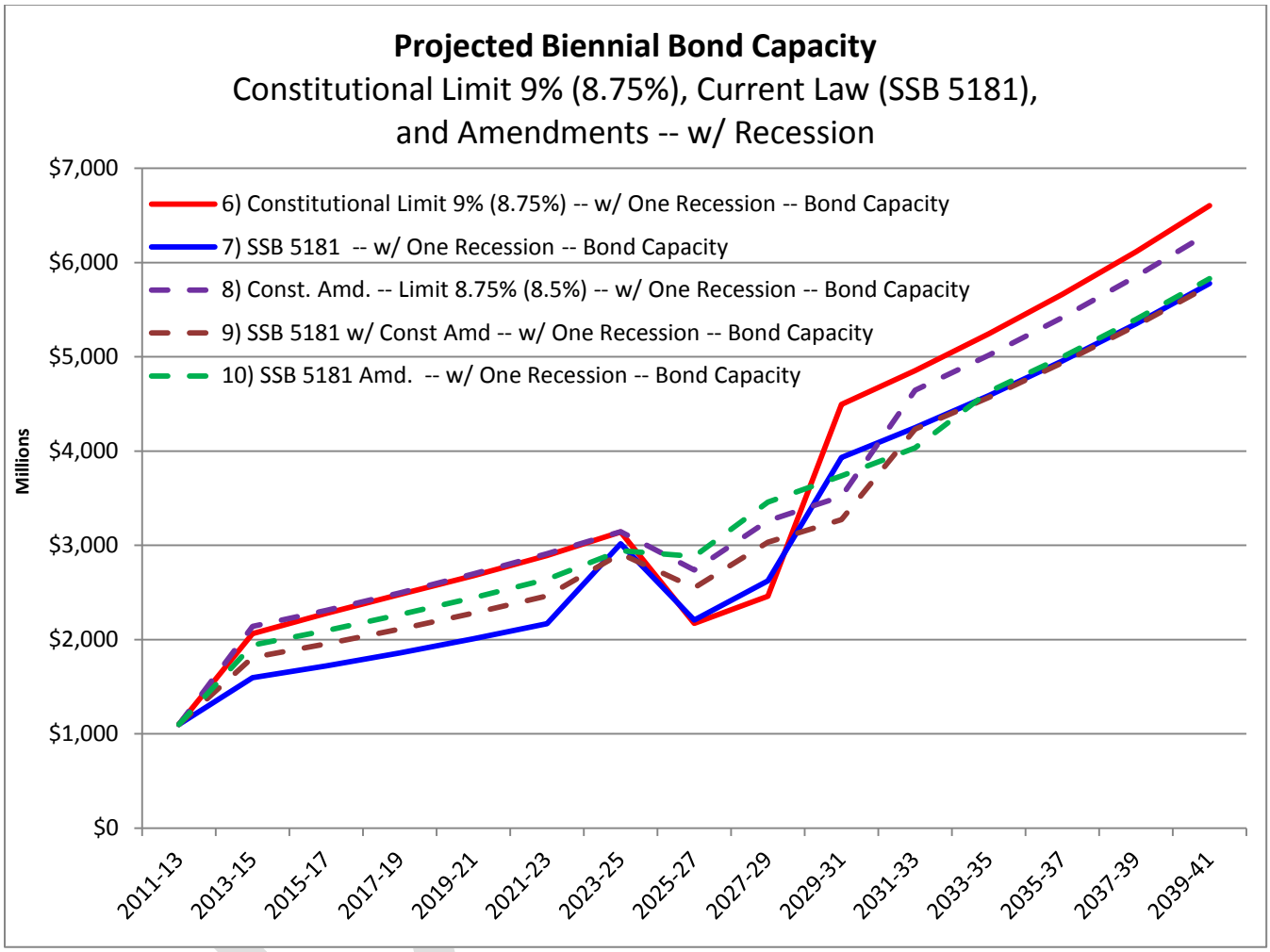
Chart 4


Projected Biennial Bond Capacity
Constitutional Limit 9% (8.75%), Current Law (SSB 5181),
and Amendments -- w/ Recession
Millions
$7,000
$6,000
$5,000
$4,000
$3,000
$2,000
$1,000
$0
6) Constitutional Limit 9% (8.75%) -- w/ One Recession -- Bond Capacity
7) SSB 5181 -- w/ One Recession -- Bond Capacity
8) Const. Amd. -- Limit 8.75% (8.5%) -- w/ One Recession -- Bond Capacity
9) SSB 5181 w/ Const Amd -- w/ One Recession -- Bond Capacity
10) SSB 5181 Amd. -- w/ One Recession -- Bond Capacity
2011-13
2013-15
2015-17
2017-19
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2021-23
2023-25
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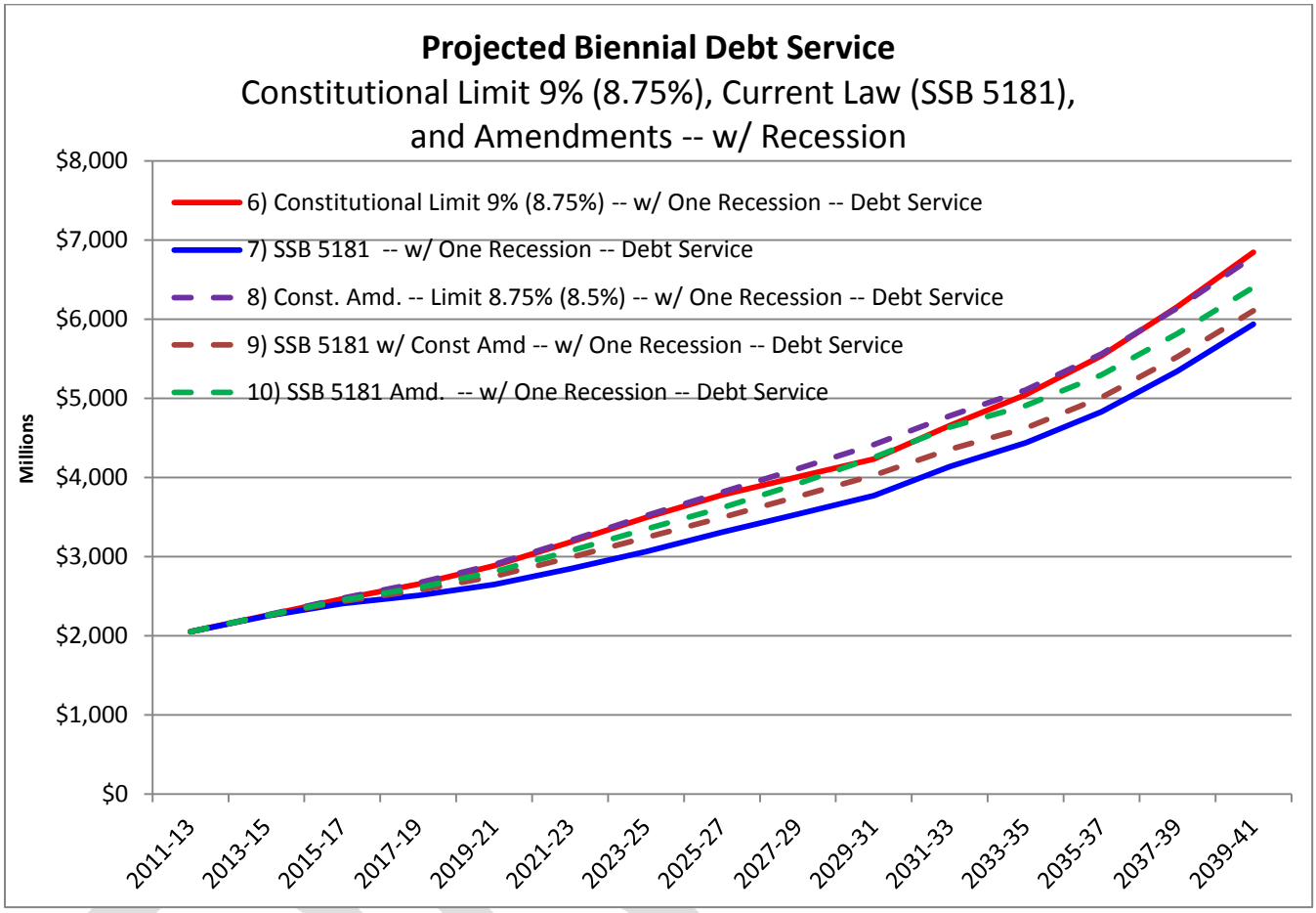
2033-35
2035-37
2037-39
2039-41

Chart 5


Projected Biennial Debt Service
Constitutional Limit 9% (8.75%), Current Law (SSB 5181),
and Amendments -- w/ Recession
$8,000
$7,000
$6,000
$5,000
$4,000
$3,000
$2,000
$1,000
$0
Millions
6) Constitutional Limit 9% (8.75%) -- w/ One Recession -- Debt Service
7) SSB 5181 -- w/ One Recession -- Debt Service
8) Const. Amd. -- Limit 8.75% (8.5%) -- w/ One Recession -- Debt Service
9) SSB 5181 w/ Const Amd -- w/ One Recession -- Debt Service
10) SSB 5181 Amd. -- w/ One Recession -- Debt Service
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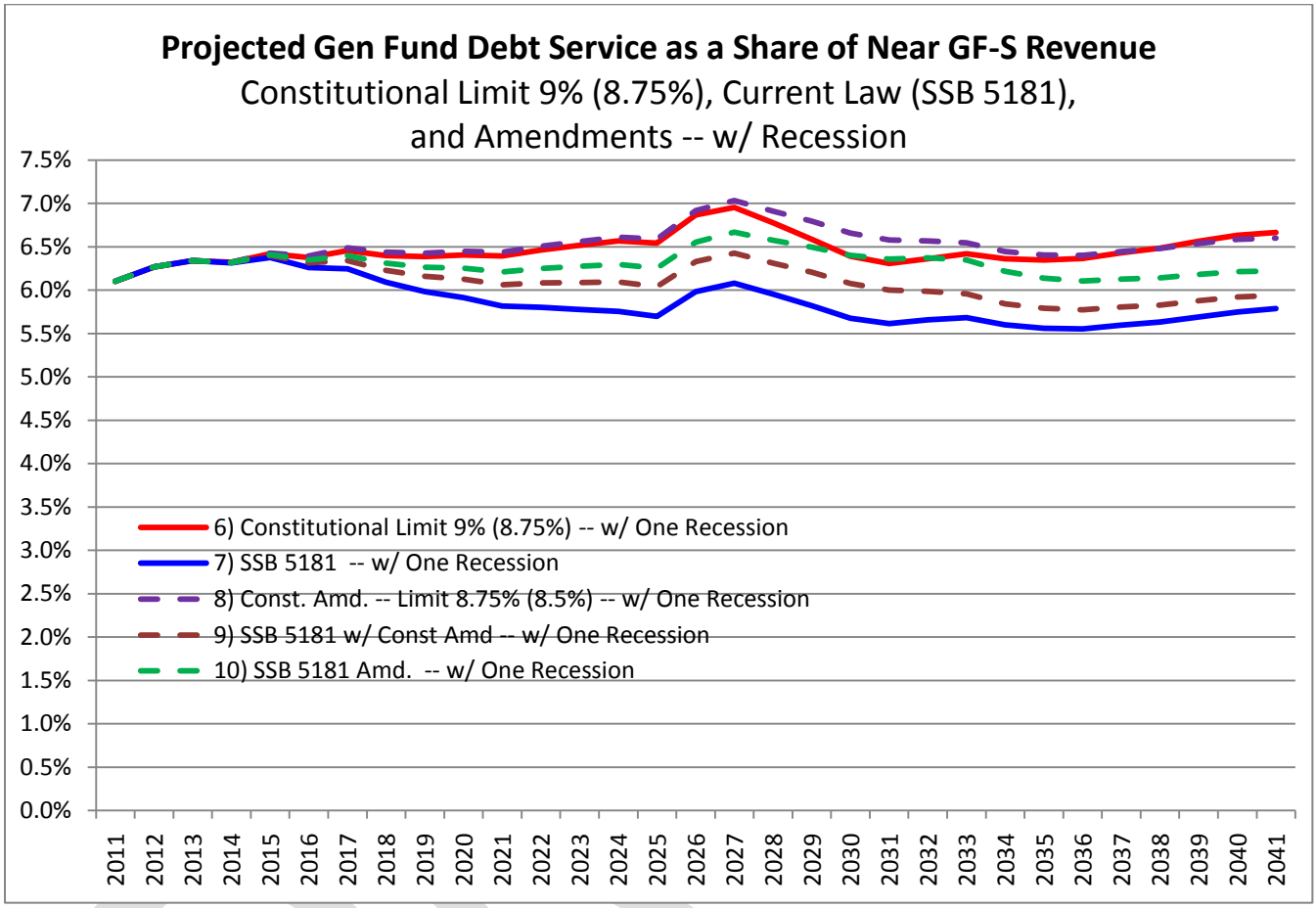
2039-41

Chart 6


Projected Gen Fund Debt Service as a Share of Near GF-S Revenue
Constitutional Limit 9% (8.75%), Current Law (SSB 5181),
and Amendments -- w/ Recession
7.5%
7.0%
6.5%
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6) Constitutional Limit 9% (8.75%) -- w/ One Recession
7) SSB 5181 -- w/ One Recession
8) Const. Amd. -- Limit 8.75% (8.5%) -- w/ One Recession
9) SSB 5181 w/ Const Amd -- w/ One Recession
10) SSB 5181 Amd. -- w/ One Recession
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Modeled Scenarios with *No* Recessionary Period

The title notations, 1-10, refer to the scenarios in the charts above.

Bond Capacity – No Recession

Biennium	Constitutional Debt Limit[1]	SSB 5181[2]	Amended Constitution[3]	Amended Constitution, SSB 5181 - Not Amended[4]	Amended Constitution & Amended SSB 5181[5]
2013-15	$2,062,241,570	$1,594,628,454	$2,139,778,712	$1,810,837,391	$1,940,612,990
2015-17	$2,278,371,010	$1,722,198,731	$2,310,961,009	$1,955,704,382	$2,095,862,030
2017-19	$2,480,092,139	$1,859,974,629	$2,495,837,889	$2,112,160,733	$2,263,530,992
2039-41	$6,504,256,115	$5,729,812,161	$6,232,360,577	$5,754,809,032	$5,951,992,096

Debt Service – No Recession

Biennium	Constitutional Debt Limit[1]	SSB 5181[2]	Amended Constitution[3]	Amended Constitution, SSB 5181 - Not Amended[4]	Amended Constitution & Amended SSB 5181[5]
2013-15	$2,257,742,721	$2,249,502,945	$2,259,108,998	$2,253,312,747	$2,255,599,513
2015-17	$2,465,042,529	$2,404,719,711	$2,473,942,077	$2,432,173,599	$2,448,652,311
2017-19	$2,651,199,703	$2,509,167,257	$2,666,615,694	$2,571,611,984	$2,609,093,330
2039-41	$7,082,351,633	$6,189,145,646	$6,974,515,952	$6,315,414,152	$6,550,989,636

General Fund Debt as a Percent of Near General Fund – No Recession

Biennium	Constitutional Debt Limit[1]	SSB 5181[2]	Amended Constitution[3]	Amended Constitution, SSB 5181 - Not Amended[4]	Amended Constitution & Amended SSB 5181[5]
2013-15	6.37%	6.35%	6.38%	6.36%	6.37%
2015-17	6.42%	6.25%	6.44%	6.33%	6.37%
2017-19	6.39%	6.04%	6.43%	6.19%	6.29%
2039-41	6.73%	5.88%	6.62%	6.00%	6.22%

Modeled Scenarios *with* One Recessionary Period

Bond Capacity – Recession

Biennium	Constitutional Debt Limit[6]	SSB 5181[7]	Amended Constitution[8]	Amended Constitution, SSB 5181 - Not Amended[9]	Amended Constitution & Amended SSB 5181[10]
2013-15	$2,062,241,570	$1,594,628,454	$2,139,778,712	$1,810,837,391	$1,940,612,990
2015-17	$2,278,371,010	$1,722,198,731	$2,310,961,009	$1,955,704,382	$2,095,862,030
2017-19	$2,480,092,139	$1,859,974,629	$2,495,837,889	$2,112,160,733	$2,263,530,992
2039-41	$6,604,743,824	$5,778,940,649	$6,319,190,694	$5,756,977,614	$5,830,742,507

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Debt Service – Recession

Biennium	Constitutional Debt Limit[6]	SSB 5181[7]	Amended Constitution[8]	Amended Constitution, SSB 5181 - Not Amended[9]	Amended Constitution & Amended SSB 5181[10]
2013-15	$2,257,742,721	$2,249,502,945	$2,259,108,998	$2,253,312,747	$2,255,599,513
2015-17	$2,465,042,529	$2,404,719,711	$2,473,942,077	$2,432,173,599	$2,448,652,311
2017-19	$2,651,199,703	$2,509,167,257	$2,666,615,694	$2,571,611,984	$2,609,093,330
2039-41	$6,845,653,671	$5,937,518,846	$6,787,993,559	$6,106,044,441	$6,402,360,461

General Fund Debt as a Percent of Near General Fund – Recession

Biennium	Constitutional Debt Limit[6]	SSB 5181[7]	Amended Constitution[8]	Amended Constitution, SSB 5181 - Not Amended[9]	Amended Constitution & Amended SSB 5181[10]
2013-15	6.37%	6.35%	6.38%	6.36%	6.37%
2015-17	6.42%	6.25%	6.44%	6.33%	6.37%
2017-19	6.39%	6.04%	6.43%	6.19%	6.29%
2039-41	6.65%	5.77%	6.59%	5.93%	6.22%

- The constitutional debt limit is 9% of the three year average of general state revenues, but uses a working debt limit of 8.75%.
- The SSB 5181 statutory working debt limit phases down from 8.75% in 2016 to 7.75% in 2022. See Appendix A for the entire law.
- The amended constitutional debt limit includes a six year average of general state revenues and property taxes, and reduces the debt limit to 8.75%, but uses a working debt limit of 8.5%.
- The amended SSB 5181 includes the amended constitutional debt limit and requires a 8% working debt limit that increases to 8.5% during recessions, and phases back down to 8% eight years after a recession.

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Appendix E

Article 23, Amendments, Washington State Constitution

SECTION 1 HOW MADE. Any amendment or amendments to this Constitution may be proposed in either branch of the legislature; and if the same shall be agreed to by two-thirds of the members elected to each of the two houses, such proposed amendment or amendments shall be entered on their journals, with the ayes and noes thereon, and be submitted to the qualified electors of the state for their approval, at the next general election; and if the people approve and ratify such amendment or amendments, by a majority of the electors voting thereon, the same shall become part of this Constitution, and proclamation thereof shall be made by the governor: *Provided,* That if more than one amendment be submitted, they shall be submitted in such a manner that the people may vote for or against such amendments separately. The legislature shall also cause notice of the amendments that are to be submitted to the people to be published at least four times during the four weeks next preceding the election in every legal newspaper in the state: *Provided,* That failure of any newspaper to publish this notice shall not be interpreted as affecting the outcome of the election. [**AMENDMENT 37,** 1961 Senate Joint Resolution No. 25, p 2753. Approved November, 1962.]

Original text -- Art. 23 Section 1 HOW MADE -- *Any amendment or amendments to this Constitution may be proposed in either branch of the legislature; and if the same shall be agreed to by two-thirds of the members elected to each of the two houses, such proposed amendment or amendments shall be entered on their journals, with the ayes and noes thereon, and be submitted to the qualified electors of the state for their approval, at the next general election; and if the people approve and ratify such amendment or amendments, by a majority of the electors voting thereon, the same shall become part of this Constitution, and proclamation thereof shall be made by the governor:* Provided, *that if more than one amendment be submitted, they shall be submitted in such a manner that the people may vote for or against such amendments separately. The legislature shall also cause the amendments that are to be submitted to the people to be published for at least three months next preceding the election, in some weekly newspaper, in every county where a newspaper is published throughout the state.*

SECTION 2 CONSTITUTIONAL CONVENTIONS. Whenever two-thirds of the members elected to each branch of the legislature shall deem it necessary to call a convention to revise or amend this Constitution, they shall recommend to the electors to vote at the next general election, for or against a convention, and if a majority of all the electors voting at said election shall have voted for a convention, the legislature shall at the next session, provide by law for calling the same; and such convention shall consist of a number of members, not less than that of the most numerous branch of the legislature.

SECTION 3 SUBMISSION TO THE PEOPLE. Any Constitution adopted by such convention shall have no validity until it has been submitted to and adopted by the people.

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Appendix F

Minority report – Representative Hans Dunshee

Recommendation 3

The creation of a Debt Policy Council or a similarly named entity has value. The problem with the recommendation as presented is that it is much more comprehensive than will be practicable. The scope of work must be useful. Attempting policy recommendations would render the body advisory at best.

To calculate the possible capital projects costs and the method of financing for twenty years seems impossible. For example, in the transportation arena we do not know how tolls, gas tax increases, and citizen demand for more roads will play out. It seems problematic to assume a level of general state revenue and to forecast limited bonding capacity given the variables of the initiative process and future legislative membership; let alone the unprecedented economic difficulties that have racked us recently.

Identifying the gap between financing capacity and facilities needed to keep our state a quality place to live seems impossible since the definition of "essential capital projects" is in the eye of the beholder—what is essential to one person is not essential to another. The assumptions needed to even start building the formula are dependent on a full volume legislative discussion.

I am very willing to help construct a Council that will provide an added net value, but voted 'no' to highlight the above problems. Hopefully we can create a useful entity.

Recommendation 4

Information becomes useless for making good decisions unless it has context. Just reporting debt service charts does not serve either policy makers or citizens well unless we know what we are getting for that investment. The true economic value of a community college building or a quality school building is not reflected in this discussion of price and product. In fact, this recommendation only speaks of price, not the value of the product. I'm not opposed to having the price stamped all over what we are buying, we just need to also add the value that the product brings to our state, communities and economy—at the time of purchase and for the full length of the financing. Agencies should also be required to calculate the jobs created through construction and also any permanent jobs or other long term economic benefit created by use of the facility.

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Appendix G

Minority report – Tim Kerr

To: Commissioners, Commission on State Debt
Fm: Tim Kerr, Commissioner
December 1, 2011
Re: Minority Report to Vote on Recommendations No. 1 and No. 2

Introduction I was privileged to serve much of my career in Washington's Office of the State Treasurer as Deputy State Treasurer for Debt Management. This position is on the front line of our State's relations with the financial markets. The duties and responsibilities of the debt management division involve the issuance and sale of Washington's various purpose general obligation bonds and motor vehicle fuel tax general obligation bonds. Bonds can only be sold if there is a bond authorization approved by 60% of each house in the legislature and signed into law by the governor. Bond proceeds can only be spent if they are appropriated by the legislature for capital projects, e.g., buildings and facilities for the several state institutions of higher education, DSHS, the Department of Corrections, the Parks and Recreation Commission, and the Department of Transportation.

When I retired from State service in 1999, the State's outstanding indebtedness was $6.8 billion. Currently, our indebtedness is $17 billion and climbing, an increase of over 150%. According to Moody' Investor Service 2011 State Debt Medians Report, Washington is in the top 7 or 8 states in a number of statistical categories relating to net tax supported debt. While these statistics do not include bonds secured by user charges or tolls, they still paint a picture of a state with higher than average indebtedness.

	1999	2011	% Change
Various Purpose G.O. Bonds	$5.843B	$10.764B	85%
Motor Vehicle Fuel Tax G.O. Bonds	$1.035B	$6.004B	480%
Total	$6.878B	$17.768B	158%

Source: Office of the State Treasurer

Meanwhile, our State's population has grown about 15+%. Granted that some measure of this debt has been spent on deteriorating infrastructure and alleviating overcrowded K12, higher education, toll bridges, and corrections facilities. The point has also been made that our economy is in a tailspin and

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that the money from State bond sales is supporting our construction industry—an estimated direct, indirect, and induced 10 jobs created for every $1 million spent.

The counter-arguments involve the cost burden of that debt. Debt service, the State's mortgage payments, if you will, on various purpose bonds is paid from the General Fund. For a number of years, our State has spent about 5% of its operating budget on interest payments. Now that share has risen to 6% and is expected to increase—notwithstanding interest rates at historical lows. Everyone has heard about the State's precarious budget situation. Once bonds are sold, debt service is a fixed cost item in the budget—it cannot be cut. As debt service increases, the State's financial flexibility is impaired and the burden of cuts rests on the more discretionary parts of the budget: K12, Medicaid, State support of higher education.

Earlier I mentioned being on the front line with the financial markets. This is where the State's credit rating and the supply and demand for State bonds come into play. Our preferred investors are large institutional players, banks, bond funds, and insurance companies. We are competing for investors' attention against other states and large issuers. Investor desire for portfolio diversification is a major factor. It is not unusual for investors' portfolios to be "full" of a name like Washington. Sometimes investors can be induced to increase their holdings—at a price. That price is higher yield (interest cost) representing increased burden on the State's budget and the taxpayers' pocketbooks.

Attention must also be paid to the current holders of the State's $17 billion in outstanding bonds, not only big institutional investors, but also "moms and pops", as small investors are known. Over time, as the bond market tries to absorb the new bonds, the inducements to new investors affect the value of the outstanding bonds in portfolios, creating book losses as bonds are "marked to market". Our existing investors, as they may sell investments, can actually take principal losses. Our investor base may decide to avoid us entirely or join the inducement game referred to above. Although this happens at a glacial pace, it feeds on itself. We're seeing the end game of profligate borrowing in Europe.

The meat of the matter In 1972, the voters passed HJR 52, the debt limit, codified as Article VIII of the State Constitution. Article VIII sets forth a formula for determining the amount of debt service (our mortgage payment) which can be paid on outstanding debt. That formula is currently an amount equal to 9 percent of the 3-year mean of general state revenues. I believe most voters saw the word "limit" and inferred the concept of an automobile speed limit from their daily lives. Contrary to the concept of a speed limit, however, the State's debt limit has exhibited surprising fluidity.

As with most things, the devil is in the details. What constitutes "general state revenues" is spelled out generally in Article VIII. Over the years this definition has been expanded through the elimination of dedications or earmarks of funds in the state treasury. The Legislature did this to respond to the capital needs of various constituency groups, chiefly state higher education and K-12. A listing of recent changes is included in Appendix C "Legislative Changes to Expand General State Revenues",

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page 35 of the Commission's Preliminary Findings and Recommendations, 11/16/2011. There is nothing malevolent about these changes. The Legislature is simply taking advantage of flexible language. However, the changes have resulted in higher debt levels than the 1972 voters may have anticipated.

I voted against the Commission's Recommendation No. 1, and its companion, Recommendation No. 2, out of my concern for the current volume of debt issuance and its impact on the operating budget. I see nothing in the recommendations constraining the Legislature from driving debt to unsustainable levels and adversely affecting the State's future access to the bond market.

I likewise voted against the Commission's Recommendation No. 2 because of its proposed changes in the working debt limit from those shown in SSB 5181. I feel the SSB 5181 working debt limit schedule approved only months ago showed a recognition that a constraint was needed on the issuance and sale of debt. I support a program that would move the State to a more restrained financing effort and aspires to a 5 per cent of near general fund outlays. No such proposal is on the table today.

I have outlined a situation that has some of the hallmarks of a debt program in need of restraint. The process is largely invisible to the public, but is conducted in plain sight. Bond authorizations and capital budget appropriations are approved by the Legislature in an open process, but the complexity of that process and the arcane nature of debt holds the issue remote from most citizens' daily concerns. The operating budget gets all the press.

The solutions of the present are not those of the future. This system is adversely affecting the current operating budget and threatening the resources and choices of future generations. There will always be a capital budget. There must be a capital budget. But we need to take a long, clear-eyed view of possible outcomes and impose a constraint mechanism for the protection of our children's financial futures. The State Debt Commission's recommendation for a Debt Policy Council (Recommendation #3), properly implemented for **both** various purpose bonds and motor vehicle fuel tax bonds, could impose this very necessary constraint.

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