SSB 5181 Priorities

SB 5181 Requirements	1st Priority	2nd Priority	3rd Priority
Stabilize the capacity to incur new debt in support of sustainable and predictable capital budgets.	Kilmer, Parlette, Sjoblom, Shoemake, Warnick (5)	Ross, Kerr (2)	Brown (1)
Reduce the growth in debt service payments to an appropriate level that no longer exceeds the long-term growth in the general fund expenditures.	Ross, Kerr, Brown (3)	Kilmer, Parlette, Shoemake, Warnick (4)	Sjoblom (1)
Maintain and enhance the state's credit rating.		Sjoblom, Brown (2)	Kilmer, Parlette, Ross, Shoemake, Kerr, Warnick (6)

Commission on State Debt Questions

Answers Summarized

1. Can we articulate a mission statement for the use of debt in state finance?

- Issuance of state debt at the lowest cost.
- Maintain a balance between budgetary flexibility and the need to finance essential public infrastructure.
- Focus capital investments on jobs in the short term *and* laying the foundation for economic growth in the long term.
- Meet the essential needs of all the state's citizens by generating on-going resources to maintain and, when necessary, expand the required inventory of capital projects to meet those needs.
- Discuss what is suitable for finance and what is not.
- Use debt to fund public investments in physical capital to impose intergenerational equity.

2. What types of debt should be subject to a limit? Should general obligation transportation debt, considered by rating agencies as the same as general obligation various purpose debt, be subject to the debt limit?

- Do not include the debt paid from motor vehicle fuel under the debt limit because the motor vehicle fuel tax debt is paid with the dedicated fund source even though investors consider the two types of bonds the same.
- Create a separate debt limit for transportation debt to ensure that we maintain reasonable bond ratings.
- Keep the various purpose debt limit tighter than what is required to maintain bond ratings because its purpose is to avoid over obligating the general fund, which is a different intent than a limit required to maintain bond ratings.
- Combine transportation debt and various purpose debt, but this Commission should not focus on transportation debt.

Should state Certificates of Participation (COPs) and other alternative finance contacts with debt service paid from the general fund be subject to the debt limit?

- No useful purpose is served by reducing general obligation debt capacity by the amount of debt service on COPs and "63-20" deals.
- Do not include alternative finance contracts in the debt limit because the debt service is subject to contracts.
- Include alternative finance contracts in the debt limit but only to the extent that the debt service payments for these alternative finance arrangements come out of the general fund.

3. **How should we manage total general obligation debt exposure from the market perspective? The market looks at all general obligation debt equally, not only state debt limit bonds. Therefore, general obligation backed gas tax bonds are looked at the same in the market as general obligation various purpose bonds. Should we limit debt based on a per capita basis, a percent of personal income, a percent of near general fund expenditures?**

    - Consider funding the construction of transportation and other capital facilities for job creation now because the state is receiving favorable interest rates. Taking this action will strengthen the economy and will change the debt matrix.
    - Manage general state revenue and motor vehicle fuel tax debt separately, but because the state's investors consider the debt fungible, report the consolidated debt.
    - Maintain or revise the constitutional debt limit so that the voters have confidence that there is a limit on the amount of debt that may be issued.
    - Use debt as a percent of near general fund expenditures as a rule of thumb for the executive and legislative branches to ensure that the state is not overcommitted financially, and it would help smooth capacity compared to the use of general revenue and would address controlling debt service relative to general fund expenditures.
    - Do not use personal income and per capita debt measures because they seem too removed from the business of state government borrowing.
    - Limit debt based on a percent of personal income, presuming that all personal income is subject to taxes in one form or another, with higher incomes subject to higher taxation, but a per capita basis may be more realistic for our state.
    - Limit debt based on a trimmed (ten-year) mean of historical inflation adjusted per capita general revenue (redefined to include the state property tax).
    - Use the current debt limit based on a percentage of general state revenues because it's simple, and it best reflects our ability to pay our debt service obligations; although expanding the "look back" provisions of our current debt limit from three years to some larger number to smooth out the peaks and valleys of recessions and their impact on our revenue may be effective.
    - Consider a "cap" or limited percentage of general fund expenditures for debt service payments because this could be beneficial from a market perspective.

4. **Should we attempt to engage in counter cyclical debt investments?**
    - Use cash in good economic times, particularly in the amounts required, which would lead to uncommitted reserves of debt for capital projects in recessionary times.
    - Figure out a way to make counter-cyclical investment makes sense, be predictable, and without confusing the bond markets.

- Engage in counter cyclical debt investment to provide protection for the most vulnerable (the most likely to lose their jobs in a recession) in the down times. It might also keep the state from the phenomenon of having built some amazing buildings that are under-utilized in a downturn because the fees for the services provided in them (such as university tuition or public facility rentals) are prohibitive during a recession.
- Do not use a counter cyclical approach because the pro cyclical nature of construction cost, provide some counter cyclicality in "real" capital expenditures.
- Establishing a Capital Budget "rainy day fund" requirement and/or Legislative spending restraints seem to be warranted, but the state already has the ability to engage in counter cyclical debt investments. This, with exercised fiscal responsibility, will leave bond capacity after every biennium to do capital construction projects during times of economic contraction.

Or should we attempt to smooth our investment schedule?

- Reduce the velocity of the state's issuance and seek to flatten the curve from six percent to closer to five percent, which will also help with debt limit issues as well.
- Project adequate revenue to retire the bonds during bad times.
- Use a counter cyclical approach and smoothing but be able to project adequate revenue to retire the bonds during bad times.

5. **What should our objectives be in terms of maintaining and or enhancing the state's credit rating and market access? Should we risk a lower credit rating and higher interest costs in order to extend capital borrowing? Should we prioritize capital needs based on the cost of borrowing and construction or based purely on the need for projects?**

- Consider what the nature of the "reset" is with respect to the capital budget and its attendant debt service? (The *Seattle Times* is fond of using the expression "reset" when talking about public employee salaries and benefits in this recession.) The state should finance and build essential infrastructure projects. Construction provides good and necessary jobs. The projects are needed for public purposes but the prioritization needs to be tightened up.
- Strive to maintain an AA rating or above.
- Risking a lower credit rating and higher interest costs to extend capital borrowing, done with very careful monitoring, may be a reasonable decision.
- Do not risk a lower credit rating and higher interest costs in order to extent capital borrowing.
- The real need for the debt-financed projects, as measured by the impact of the project in the short and long-term on the most vulnerable, and the extent to which the project will bring us closer to meeting all the citizens' essential needs, should be the deciding factor when prioritizing projects.
- Conduct a benefit/cost analysis to prioritize projects.
- Prioritize capital needs and projects

6. **Should the state expand or reduce its use of debt to finance state/local infrastructure needs?**
    - Available resources will determine the balance between state and local responsibilities.
    - Expand debt financing for local infrastructure if the debt service is paid for with funding that is already going to local government.

If the state chooses to reduce its use of debt, how should the state/local government finance its infrastructure needs?

- Implement *a true tax increment financing tool for this type of investment.*
- Use bonds backed by property taxes and revenue bonds backed by user fees where appropriate and feasible.

What should the balance between state and local responsibilities be?

- Implement state funding for local infrastructure based on clear state policy objectives, not just be a form of revenue sharing.
- Consider the economic resources of various regions of the state when deciding upon essential needs of citizens. In a region with very low (comparatively) resources, some state assistance may be needed – to a greater extent than in regions with more resources – to provide the infrastructure necessary for basic needs (such as reasonably adequate schools and parks).
- Consider the impact on local entities trying to pass bond issues when determining the balance of state and local responsibilities.
- Local government should fund projects where the benefits are local. The state should fund projects where the benefit is statewide.

7. **What amendments, if any, are needed to the state's constitutional debt limit?**
   - Move from the three year average of general state revenues to a ten year.
   - Do not make changes that increase debt limit from the current level.
   - Limit debt based on a trimmed (ten year) mean of historical inflation adjusted per capita general revenue (redefined to include the state property tax).
   - Lower the debt limit.

8. **Absent new legal constraints, what policy procedures could be implemented with respect to constraining debt in good economic times?**
   - Use cash in good economic times, particularly in the amounts required, which would lead to uncommitted reserves of debt for capital projects in recessionary times.
   - Empower the State Finance Committee to drive some of this.
   - Set targets for total new debt based on an economic model similar to the one Dr. Raha presented, before projects are reviewed, and develop criteria to guide the decision-making process concerning which projects will be authorized under the target, and which will be postponed or denied.
   - Short of constitutional amendments, implementing binding practices that would force the Legislature to spend less will be difficult. Possibly adopt a smaller statutory working debt limit that is significantly lower than the constitutional debt limit to guarantee the state still has capacity when revenues drop, but that hasn't been a successful practice in the past.

9. **How could a debt limit or other debt policy better reveal the operating budget spending trade-offs of taking on new debt?**
   - Combine more sensitivity to the impact the capital budget has on the operating budget, the measure of percentage of debt service to near general fund, and the state's position under the constitutional debt limit to encourage prudence among state government stakeholders.
   - Increase the visibility of the debt service payments for new debt beyond only the ensuing biennium.

- Assign debt service payments to specific functional areas (e.g., how much of the debt service payment is attributable to higher education construction, housing, etc.).
- Improve the reporting of debt service on the fiscal.wa.gov website.
- Adopt a new debt limit that is based on the percentage of general state revenues in the operating budget or tied to the state unemployment rate; however, this would be difficult to manage and could be much more volatile, which we know the credit rating agencies do not.