VIRGINIA TREASURY

Stewardship • Integrity • Excellence

Review of Commonwealth Debt and Debt Capacity

A Briefing for the Senate Finance & Appropriations Capital Outlay Subcommittee

Manju S. Ganeriwala
State Treasurer

January 29, 2021

Overview

- Commonwealth Debt
  - Issuers
  - Constitutional Framework
  - 9(c) vs. 9(d) Debt
  - Amounts Outstanding, Authorized and Issued

- Debt Capacity
  - Background
  - Model
  - December 2020 Recommendation

- Higher Education Debt Service Relief
  - 9(c) General Obligation Bonds
  - 9(d) Virginia College Building Authority Pooled Bonds

Debt Overview – Issuers

- The following are the primary tax-supported* debt issuing boards and authorities:
  - Treasury Board – General Obligation (GO)
  - Virginia College Building Authority (VCBA)
  - Virginia Public Building Authority (VPBA)
  - Commonwealth Transportation Board (CTB)
  - Virginia Port Authority (VPA)

- The following authorities currently issue moral obligation or sum-sufficient appropriation bonds:
  - Virginia Resources Authority (VRA)
  - Virginia Public School Authority (VPSA)

*Defined on slide 15

Debt Overview – Framework of Article X of Constitution

Type	Purpose	G.A. Action	Referendum	Security	Issuer
9(a)	Emergencies, Deficits, Redeem Prior Obligations	General Authorization	No	GO	Treasury Board
9(b)	Capital Projects	Specific Project Authorization	Yes	GO	Treasury Board
9(c)	Revenue Producing Capital Projects	2/3 Majority Project Authorization	No	Revenues +GO	Treasury Board
9(d)	Anything Else	General Authorization	No	Revenues/ Appropriations	Agencies Authorities Institutions

Debt Overview - 9(b) and 9(c) Debt

- 9(b) General Obligation Debt
  - Requires authorization by General Assembly and approval of voters at a referendum
  - Secured by full faith and credit of the Commonwealth (G.O. Pledge)
  - Paid by general fund revenues
  - Impacts debt capacity
  - AAA/Aaa/AAA ratings provide lowest interest rates
  - Last voter approved referendum 2002

- 9(c) General Obligation Debt
  - Revenue producing projects (eg. dorm, dining and toll roads)
  - Paid by revenues from project, but backed by Commonwealth's G.O. Pledge
  - AAA/Aaa/AAA ratings provide lowest interest rates
  - Tax-supported debt, but not included in debt capacity model, doesn't impact debt capacity

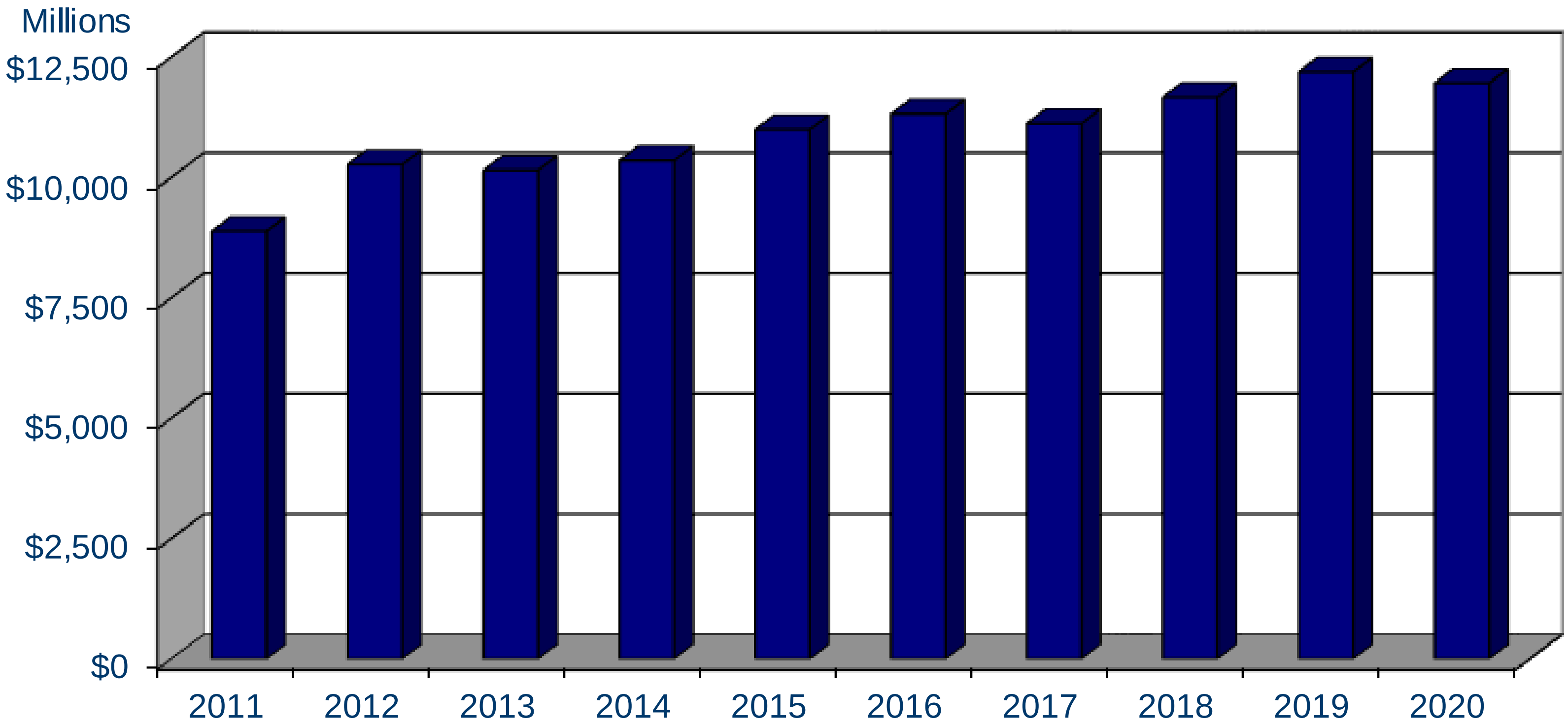
Debt Overview - 9(d) Debt

- 9(d) Appropriation-Backed Debt (eg. VCBA 21st Century Program and VPBA)
  - Higher Education & General state projects
  - Secured by appropriations from the general fund
  - Slightly higher interest rates due to appropriation-backed security (AA+/Aa1/AA+ ratings)
  - Tax-supported debt; included in debt capacity model, impacts debt capacity

- 9(d) Higher Education Debt
  - Eligible for all project types
  - May be issued by institution or through VCBA Pooled Bond Program
  - Secured by general revenues of higher education institution
  - Not considered tax-supported debt

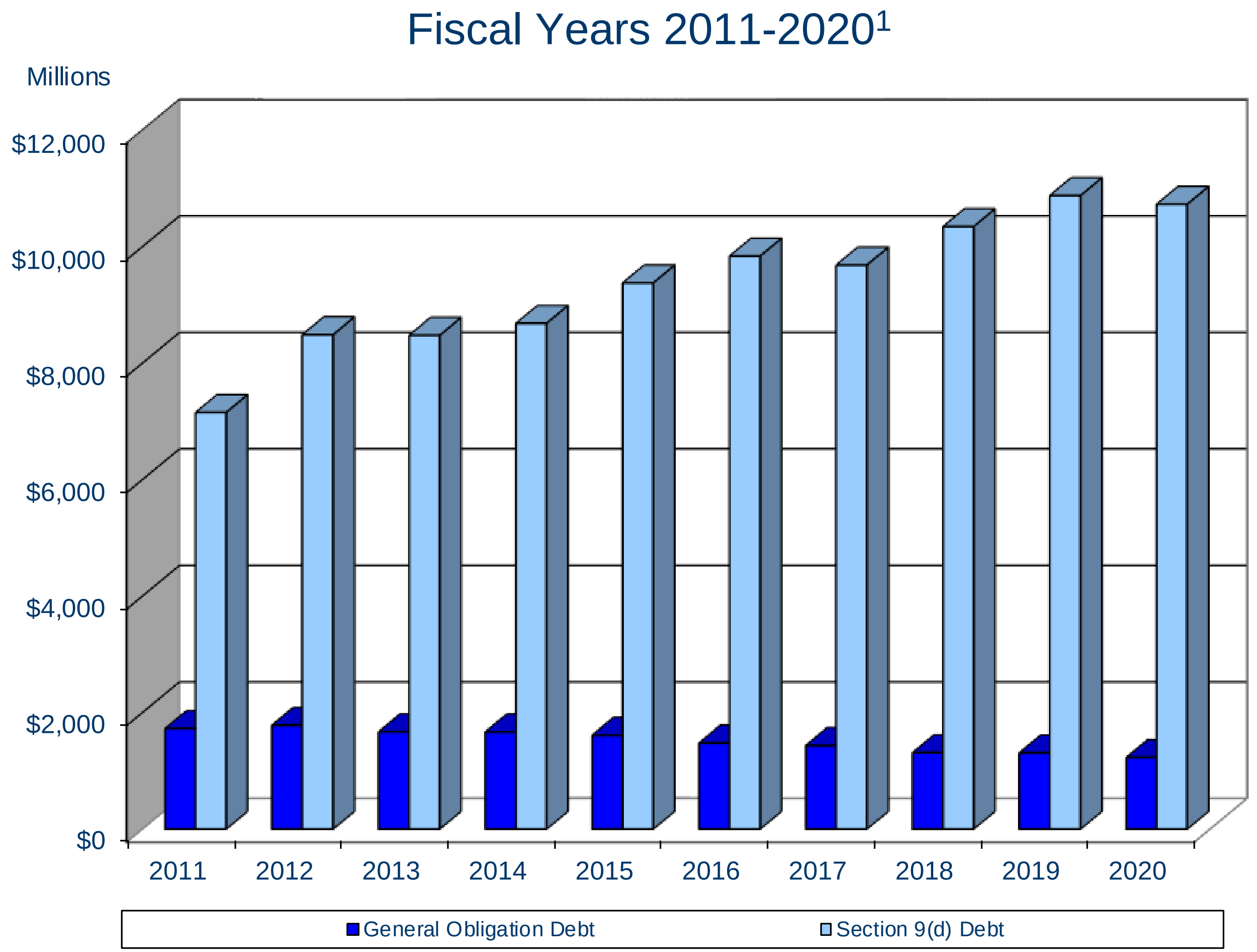
Debt Overview – Outstanding Tax-Supported Debt

Fiscal Years 2011-2020[1]



(1) Excludes other long-term obligations such as pension liabilities, OPEBs and compensated absences.

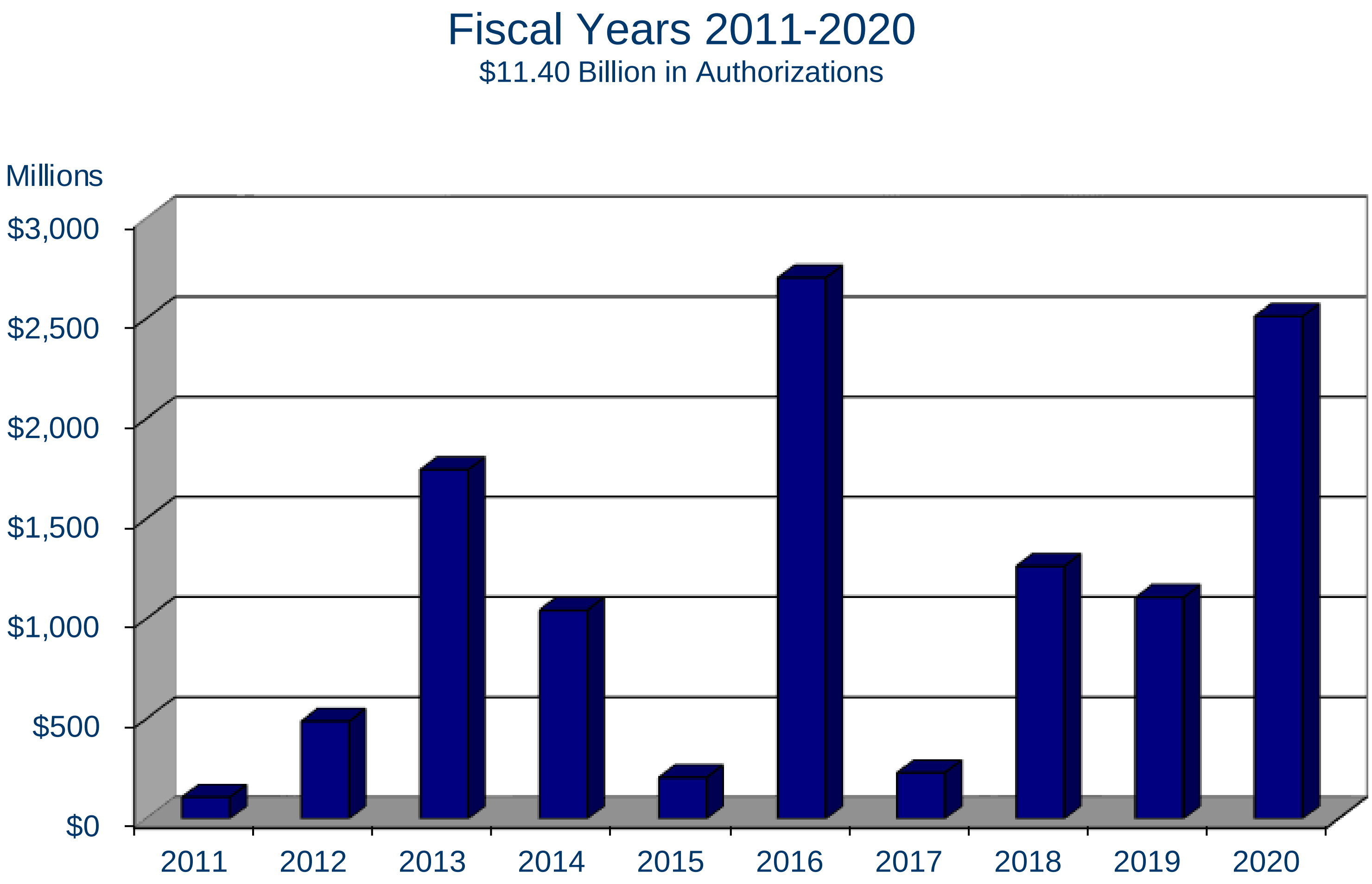
Debt Overview – Outstanding Tax-Supported Debt by Category



(1) Excludes other long-term obligations such as pension liabilities, OPEBs and compensated absences.

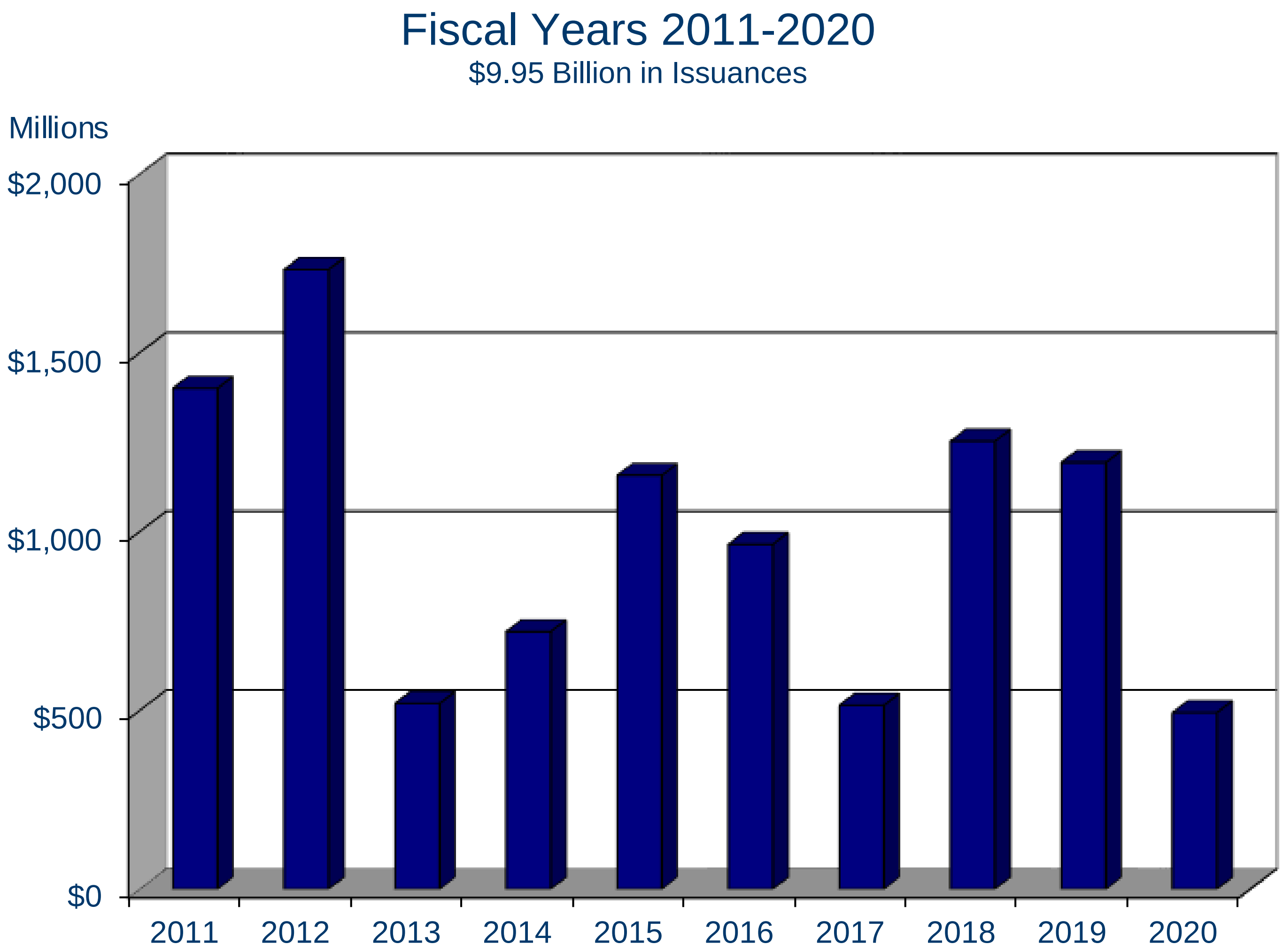
VIRGINIA TREASURY
Stewardship·Integrity·Excellence

Debt Overview – Tax-Supported Debt Authorizations



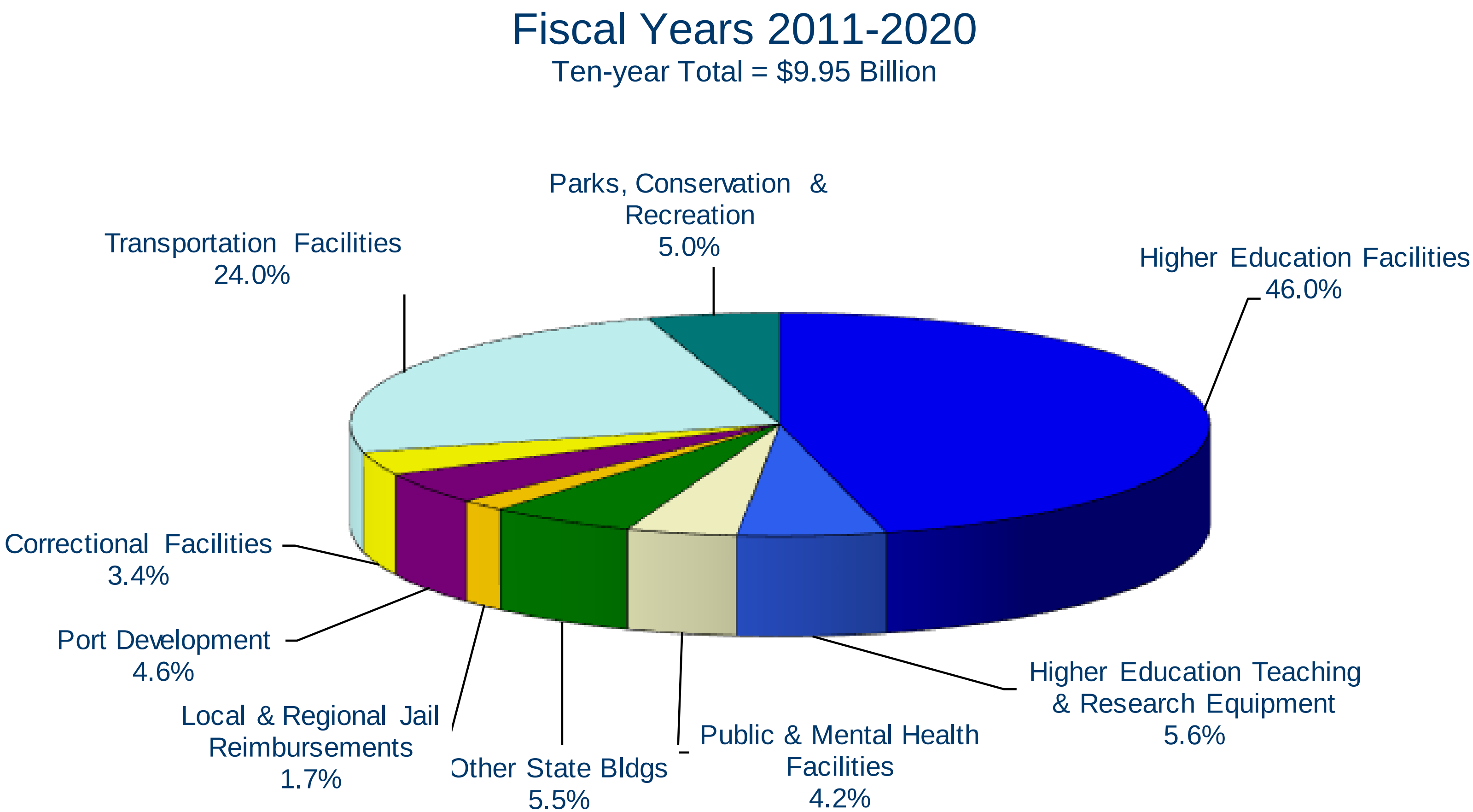
VIRGINIA TREASURY
Stewardship · Integrity · Excellence

Debt Overview – Tax-Supported Debt Issuances



VIRGINIA TREASURY
Stewardship·Integrity·Excellence

Debt Overview – Uses of Tax-Supported Debt



Debt Capacity Advisory Committee (DCAC) Background

- The Committee's general mandate is:
  - Annually review the size and condition of the Commonwealth's tax-supported debt
  - Submit to the Governor and the General Assembly before January 1, an estimate of the maximum amount of new tax-supported debt that prudently may be authorized for the next biennium (Section 2.2-2714 Code of Virginia)*
  - Annually review the amount and condition of moral obligation debt and other debt for which the Commonwealth has a contingent or limited liability
  - Review the amount and condition of Commonwealth obligations that are not general obligations or moral obligations

*This estimate is advisory and in no way binds the Governor or the General Assembly

DCAC Background – Importance of Measuring Debt Affordability

- Debt affordability is a key factor assessed by rating agencies
- Attempts to correlate the borrowing for capital needs with the ability to repay
- Issuance above capacity can cause erosion in credit rating
- Most states perform a debt capacity calculation

DCAC Background – Importance of AAA Bond Rating

- Commonwealth has held a AAA general obligation bond rating from Moody's since 1938, Standard and Poor's since 1962 and Fitch since 1991

- Subject-to-appropriation bonds are rated one notch below the state's GO rating at AA+ (Includes: VCBA 21st Century, VPBA, CTB)

- Bond investors willing to accept lower rate of interest for high credit quality

- Demand for credit quality is high
  - Stock market volatility and global markets unrest resulted in flight to quality
  - Reduced reliance on bond insurers make "natural" AAA's/AA's more valuable
  - Portfolio managers need highly-rated bonds to improve fund profile

Debt Capacity Model – Measure and Inputs

- In order to preserve the Commonwealth's ability to provide core government services, debt service should be limited to an appropriate level

- DCAC adopted the measure that debt service on tax-supported debt should not be greater than 5% of blended revenues
  - Committee has reaffirmed this measure each year
  - Recommendation is expressed in terms of a ten-year average

- Blended revenues include:
  - General Fund Revenues[1]
  - General Fund Transfers – ABC, Sales Tax, Recurring Transfers
  - Virginia Health Care Fund
  - Transportation Trust Fund (TTF)

(1) Adjusted by Department of Taxation to exclude one-time, temporary state revenues resulting from the Federal Tax Cuts and Jobs Act.

Debt Capacity Model – Measure and Inputs (Continued)

- Tax-supported debt includes:
  - Debt for which debt service payments are made or pledged to be made from funds derived from tax revenues
    - 9(b) General Obligation
    - 9(d) VCBA (21^{st} Century and Equipment), VPBA, VPA, and CTB debt secured by the TTF
    - Capital leases, installment purchases and miscellaneous debt

- Tax-supported debt does not include:
  - 9(c) G.O. since payments are to be paid by project revenues
  - Debt/Notes of Institutions of Higher Education supported by General Revenues of the Institution
  - Moral Obligation issued by VRA
  - Sum-Sufficient Appropriation issued by VPSA
  - Grant Anticipation Revenue Vehicles (“GARVEES”)

VIRGINIATREASURY
Stewardship·Integrity·Excellence

Debt Capacity Model – Measure and Inputs (Continued)

- All scheduled debt service on outstanding tax-supported debt is included in the model

- Estimated debt service on authorized but unissued debt is included in model and is based on:
  - DPB draw schedules and information from agencies
  - Short-term interest rates
  - Long-term interest rates

- Debt service on <u>proposed</u> new debt in Governor's Budget is not included in the model

VIRGINIA TREASURY
Stewardship·Integrity·Excellence

Debt Capacity Model – Currently Authorized & Unissued Debt

As of June 30, 2020

(Dollars in Millions)

9(b)	$	-
VPBA[1]	$	2,488.2
VCBA	$	3,178.1
Transportation - CPR	$	243.2
Transportation - NVTD	$	24.7
Transportation - Route 58	$	595.7
VPA	$	-
Total	**$**	**6,529.9**

(1) VPBA amount includes an additional $1.5 million that was authorized through Chapter 56 of the 2020 Special Session I that occurred after June 30.

Debt Capacity Model – Factors Affecting Debt Capacity

- Revisions to revenue estimates
  - Driven by economy
  - Policy changes

- Authorization of additional tax-supported debt

- Changes to issuance assumptions
  - Actual financing dates/terms vs. estimated
  - Revisions to project spending schedules
  - Changes in interest rates

How Does the DCAC Recommendation Impact Authorizations?

- Recommendation is non-binding, but is taken into consideration by the Governor and the General Assembly when developing the budget

- Available debt capacity may constrain the ability to finance capital needs

- Previously authorized projects can be delayed, rescinded, or adjusted to impact the timing and amount of debt service

December 2020 Model[1]

(Dollars in Millions)

Fiscal Year	Blended Revenues	Amount of Additional Debt that may Be Issued	Total Debt Service as a % of Revenues
2021	24,727.35	**0.00**	4.60%
2022	25,561.29	**544.11**	4.90%
2023	26,414.79	**544.11**	5.08%
2024	27,014.89	**544.11**	5.30%
2025	27,934.81	**544.11**	5.33%
2026	28,812.36	**544.11**	5.29%
2027	29,174.09	**544.11**	5.17%
2028	29,897.22	**544.11**	4.98%
2029	30,647.55	**544.11**	4.83%
2030	31,417.34	**544.11**	4.66%

(1) A summary portion of the Model is shown above. A more complete view is shown in the Appendix.

What was the Committee's December 2020 Recommendation?

- Up to an additional $544 million could prudently be authorized and issued during each of fiscal years 2021 and 2022

- Committee urged the Governor and the General Assembly to consider the implication of a future rise in interest rates that could occur between when any new debt is authorized and when it is issued
  – 100 basis points increase to model interest rate would result in a decline in capacity to $457 million annually

- Committee urged the Governor and the General Assembly to consider whether any new debt authorizations are necessary at this time
  – Uncertainties related to pandemic
  – Significant amount of authorized and unissued debt

Introduced 2021 Session Budget – Impact on DCAC Model

- Approximately $136 million of proposed new tax-supported bond projects
- If the additional debt service related to the proposed new debt in the budget is included in the DCAC model, the debt capacity would decline by $11 million annually to $533 million
- While not factored into the DCAC Model, an additional $34 million is proposed for self-supporting 9(c) G.O. Higher Education Bonds
  - House Bill 2178
  - Senate Bill 1145

Higher Education Debt Service Relief

- Higher education institutions have been severely impacted by COVID-19 and there is significant uncertainty regarding the next academic years

- The Commonwealth primarily has issued debt for public institutions of higher education through two programs:
  - General Obligation Bonds: 9(c) Debt
  - VCBA: 9(d) Debt, Educational Facilities Revenue Bonds (Public Higher Education Financing Program) ("Pooled Bonds")

- In September 2020 Governor Northam announced a plan to give institutions of higher education short-term debt service relief

- The Governor identified the potential to provide debt service relief in fiscal years 2021, 2022 and 2023 through refunding opportunities and debt restructuring

Proposed Debt Service Relief on 9(c) General Obligation Bonds

- Restructuring to defer June 1, 2021 and June 1, 2022 principal payments
  - Amortize debt over longer term:
    - Defer debt service for two years past the original final maturity of each eligible project
    - Potential present value debt service relief of $59 million in FY2021 and $50 million in FY2022
    - Savings accrue to the participating institutions of higher education
  - Fourteen institutions have 9(c) debt that can be restructured
    - Comprised of 100+ projects

- Debt service relief associated with deferral of principal will vary by institution and is subject to market conditions at the time of the bond sale
  - Participation is optional and bonds can be structured to provide debt service relief for 1 or 2 years

Proposed Debt Service Relief on 9(c) General Obligation Bonds (Continued)

- To proceed with the restructuring for 9(c) bonds, legislation is required
- Senate Bill 1134 and House Bill 2179 were introduced to amend the prior legislation that provided the authority to refund bonds issued under Article X Section 9(c) of the Constitution
- The bills contain an emergency clause that once signed by the Governor Treasury can proceed with the issuance of bonds so that the restructuring is completed by the next principal payment date of June 1, 2021

Debt Service Relief on VCBA 9(d) Pooled Bonds

- The VCBA proceeded with the restructuring of 9(d) debt secured by the general revenues of each participating institution
  - Additional savings were identified by refunding certain bonds that generated present value savings

- Institutions were given the option to restructure 1 or 2 years of debt service on projects of their selection
  - Nine institutions opted to restructure some or all of their 9(d) outstanding bonds
    - A total of 126 projects were restructured (includes projects refunded for savings for these nine institutions)

- An additional four institutions benefitted from savings from refunding for savings only
  - A total of 45 projects were refunded for savings for these four institutions

Debt Service Relief on VCBA 9(d) Pooled Bonds (Continued)

- On January 13, 2021 the VCBA sold $386,710,000 of refunding bonds
  - Aggregate Debt Service Relief on Refunded Bonds:
    FY 2022: $68,067,869

    FY 2023: $52,472,545
  - Present Value Debt Service Savings: $22,033,016 (6.13% of Refunded Par)
  - Savings accrue to the institutions of higher education

Appendix
Description of Types of Debt

	Types of State Bonded Debt	Primary Security	Rating (Moody's, S&P, and Fitch)	Typical Purpose	Authorization Required	Debt Capacity	Typical term
General Obligation Bonds							
GO - 9(b)	Voter-approved GO's	GF	Aaa/AAA/AAA	Capital	GA + voters	Yes	20
GO - 9(c)	Project revenues + GO pledge	NGF/Auxiliary, Tolls + GO backstop	Aaa/AAA/AAA	Revenue-producing capital (dorm, dining, parking)	GA + Feasibility	No (1)	20-30
Subject to Appropriation/Revenue Bonds							
VCBA	21st Century Program	GF	Aa1/AA+/AA+	Capital - E&G, Maint Reserve	GA	Yes	20
VCBA	Equipment Trust Fund	GF	Aa1/AA+/AA+	Educational/Research Equipment	GA	Yes	7
VPBA		GF	Aa1/AA+/AA+	Capital - Maint Reserve, regional jails, water quality/ stormwater grants	GA	Yes	20
Other 9(d) Debt							
VCBA	Higher Ed Projects	NGF-General Revenue Pledge + State aid intercept	Aa1/AA/AA+	Capital - Rec/sports facilities, Athletic, Convocation, etc.	GA	No	20-30
College/ University	Higher Ed Projects	NGF-General or specific revenue pledge	Varies	Capital - Rec/sports facilities, dormitories, athletic, Convocation, etc.	GA (except Level 3's)	No	20-30
Capital leases, support agreements	Foundations, conduit issuers	NGF-General or specific revenue pledge	Varies	Capital - dormitory, multi-use facilities	GA (except Level 3's)	No	20-30

(1) So long as net revenues provide for debt service

Appendix
December 2020 Model

(Dollars in Millions)

December 17, 2020

Average Scenario

Fiscal Year	[1] Blended Revenues	[2] Base Capacity to Pay Debt Service	[3] Annual Payments for Debt Service on Debt Issued	[4] Actual Outstanding Debt Service as a % of Revenues	[5] Annual Payments for Debt Service on All Planned Debt Issuances	[6] Actual & Projected Debt Service as a % of Revenues	[7] Net Capacity to Pay Debt Service	[8] Amount of Additional Debt that may Be Issued	[9] Debt Service on Amount of Additional Debt that may Be Issued	[10] Remaining Capacity to Pay Debt Service	[11] Total Debt Service as a % of Revenues
2021	24,727.35	1,236.37	1,043.55	4.22%	94.91	4.60%	97.91	**0.00**	0.000	97.91	4.60%
2022	25,561.29	1,278.06	1,005.97	3.94%	210.49	4.76%	61.61	**544.11**	36.029	25.58	4.90%
2023	26,414.79	1,320.74	972.75	3.68%	296.25	4.80%	51.74	**544.11**	72.059	(20.32)	5.08%
2024	27,014.89	1,350.74	947.03	3.51%	377.67	4.90%	26.04	**544.11**	108.088	(82.05)	5.30%
2025	27,934.81	1,396.74	893.55	3.20%	451.36	4.81%	51.83	**544.11**	144.118	(92.29)	5.33%
2026	28,812.36	1,440.62	854.27	2.96%	490.29	4.67%	96.06	**544.11**	180.147	(84.09)	5.29%
2027	29,174.09	1,458.70	801.40	2.75%	490.29	4.43%	167.01	**544.11**	216.176	(49.16)	5.17%
2028	29,897.22	1,494.86	755.80	2.53%	479.39	4.13%	259.67	**544.11**	252.206	7.46	4.98%
2029	30,647.55	1,532.38	724.34	2.36%	466.33	3.89%	341.71	**544.11**	288.235	53.47	4.83%
2030	31,417.34	1,570.87	685.01	2.18%	453.50	3.62%	432.35	**544.11**	324.264	108.09	4.66%
							10 Year Average:	$544.11			

VIRGINIA TREASURY
Stewardship·Integrity·Excellence