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Review of Commonwealth Debt and Debt Capacity

**A Briefing for the Senate Finance & Appropriations
Capital Outlay and Transportation Subcommittee**

David Richardson
State Treasurer
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Overview

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

- Debt Capacity
 - Background
 - Model
 - December 2023 Recommendation

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 16

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

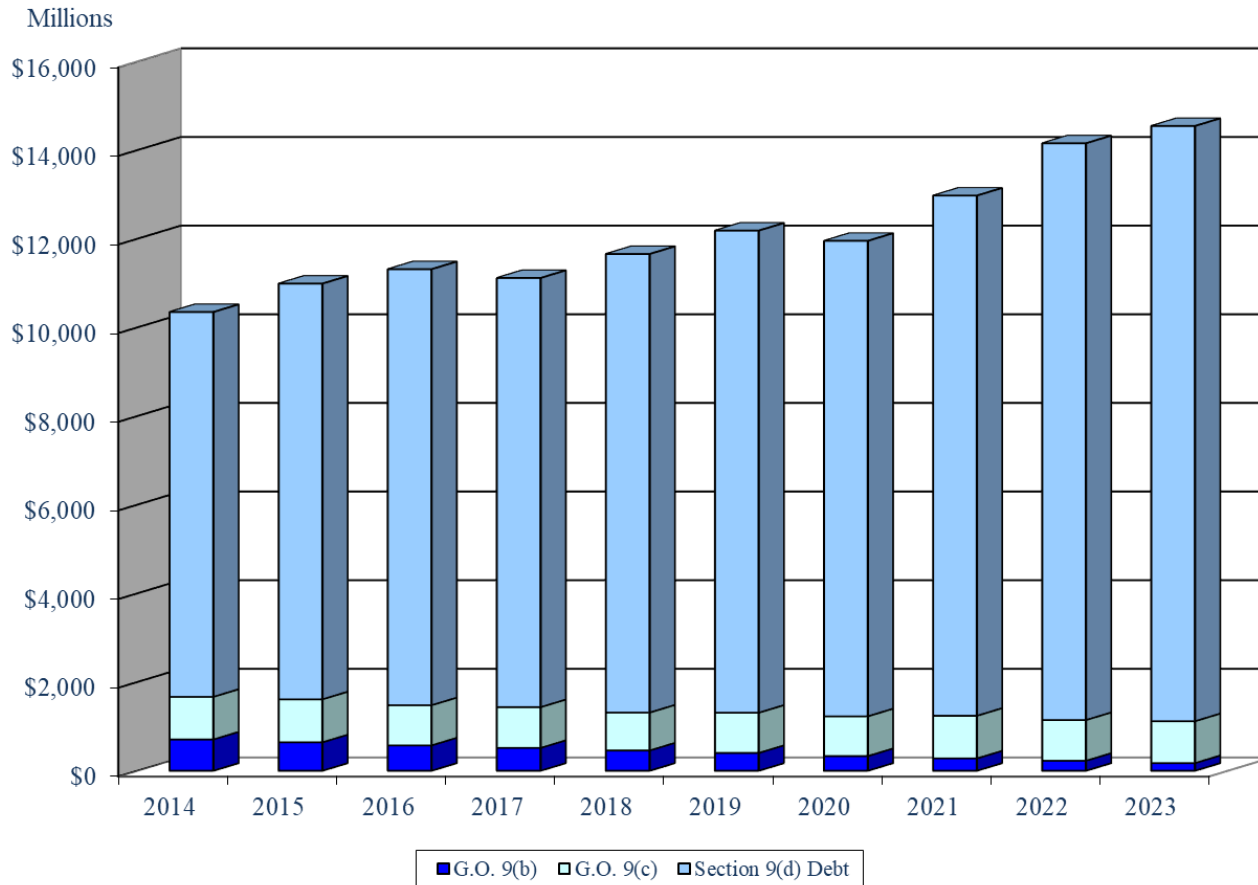
Debt Overview - 9(d) Debt

- 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

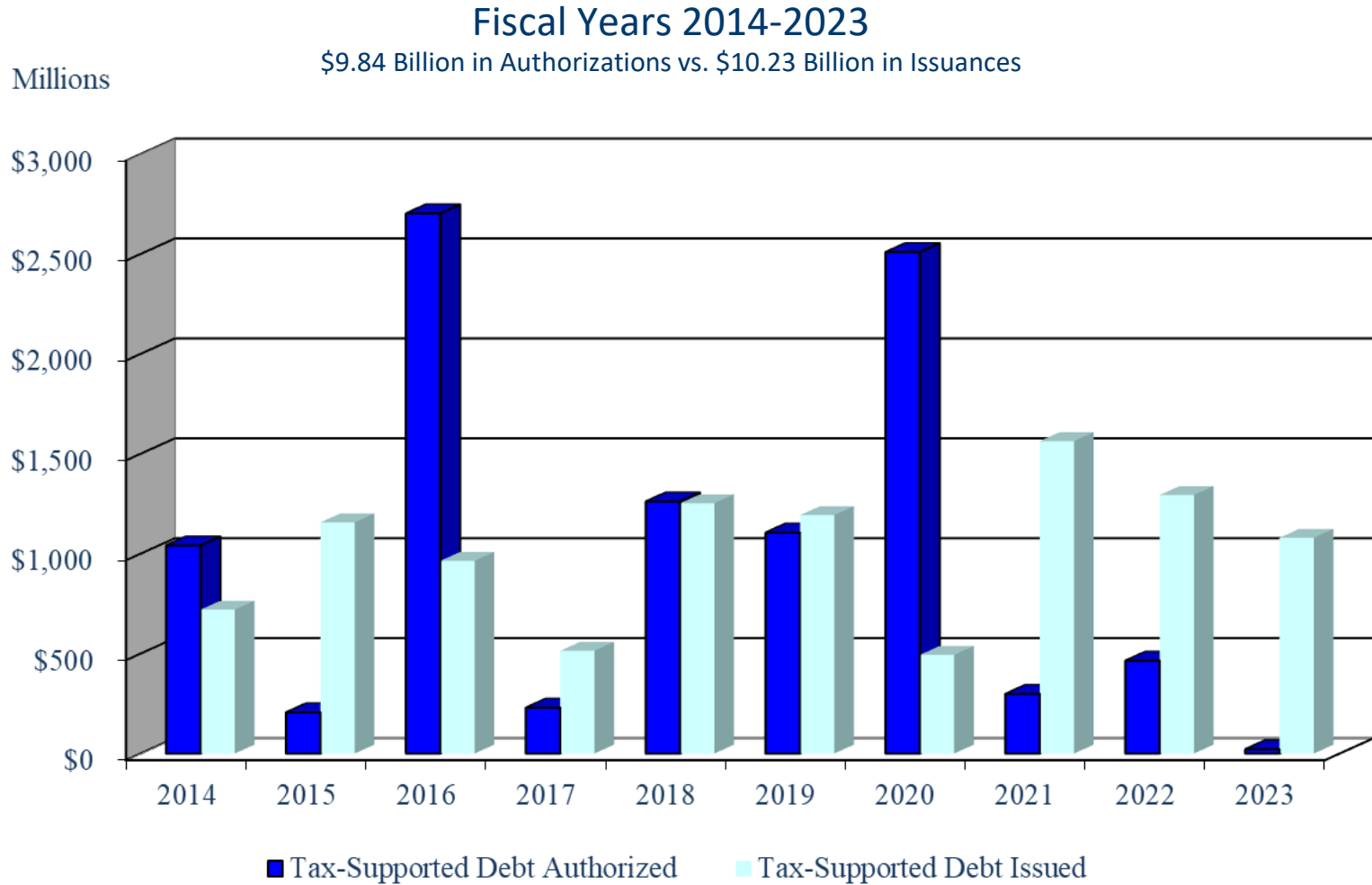
Debt Overview – Outstanding Tax-Supported Debt by Category

Fiscal Years 2014-2023¹



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

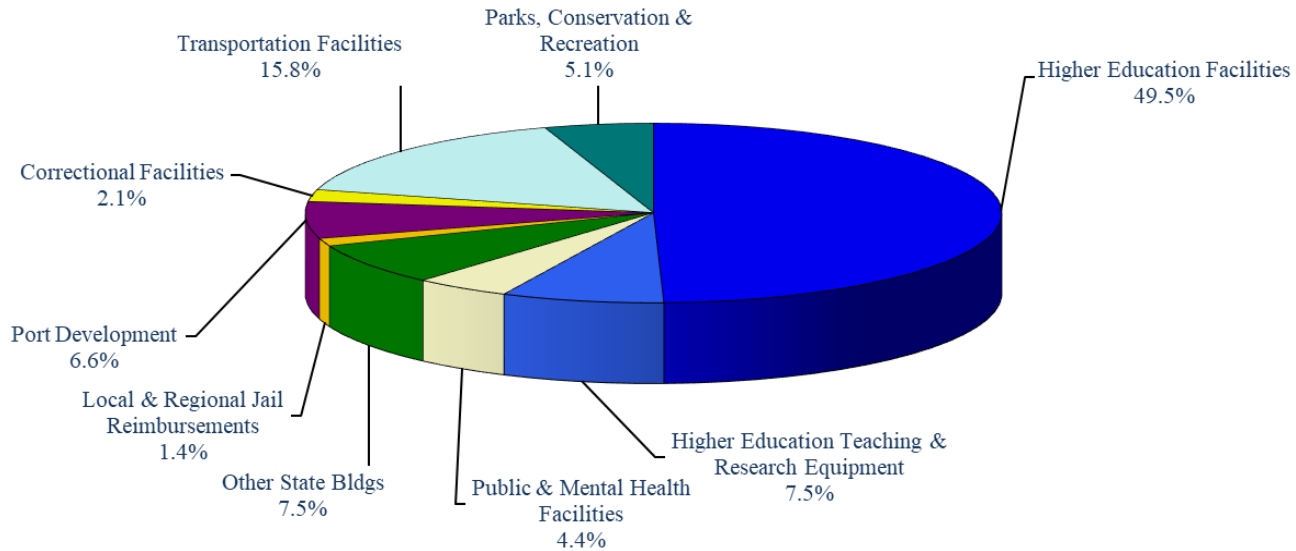
Debt Overview – Tax-Supported Debt Authorizations vs. Issuances



Debt Overview – Uses of Tax-Supported Debt

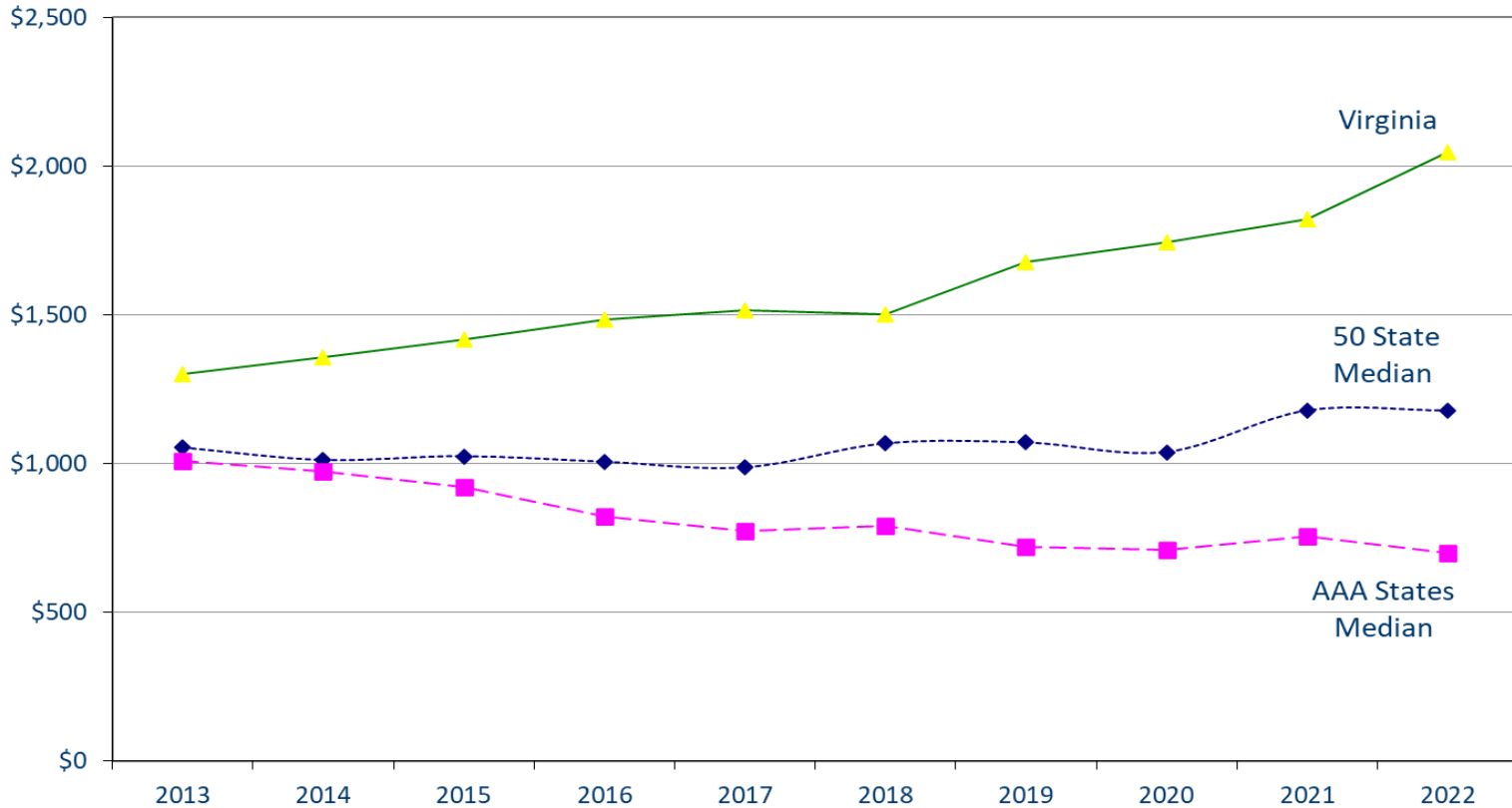
Fiscal Years 2014-2023

Ten-Year Total = \$10.23 Billion



Virginia's Tax-Supported Debt Compared to Other States

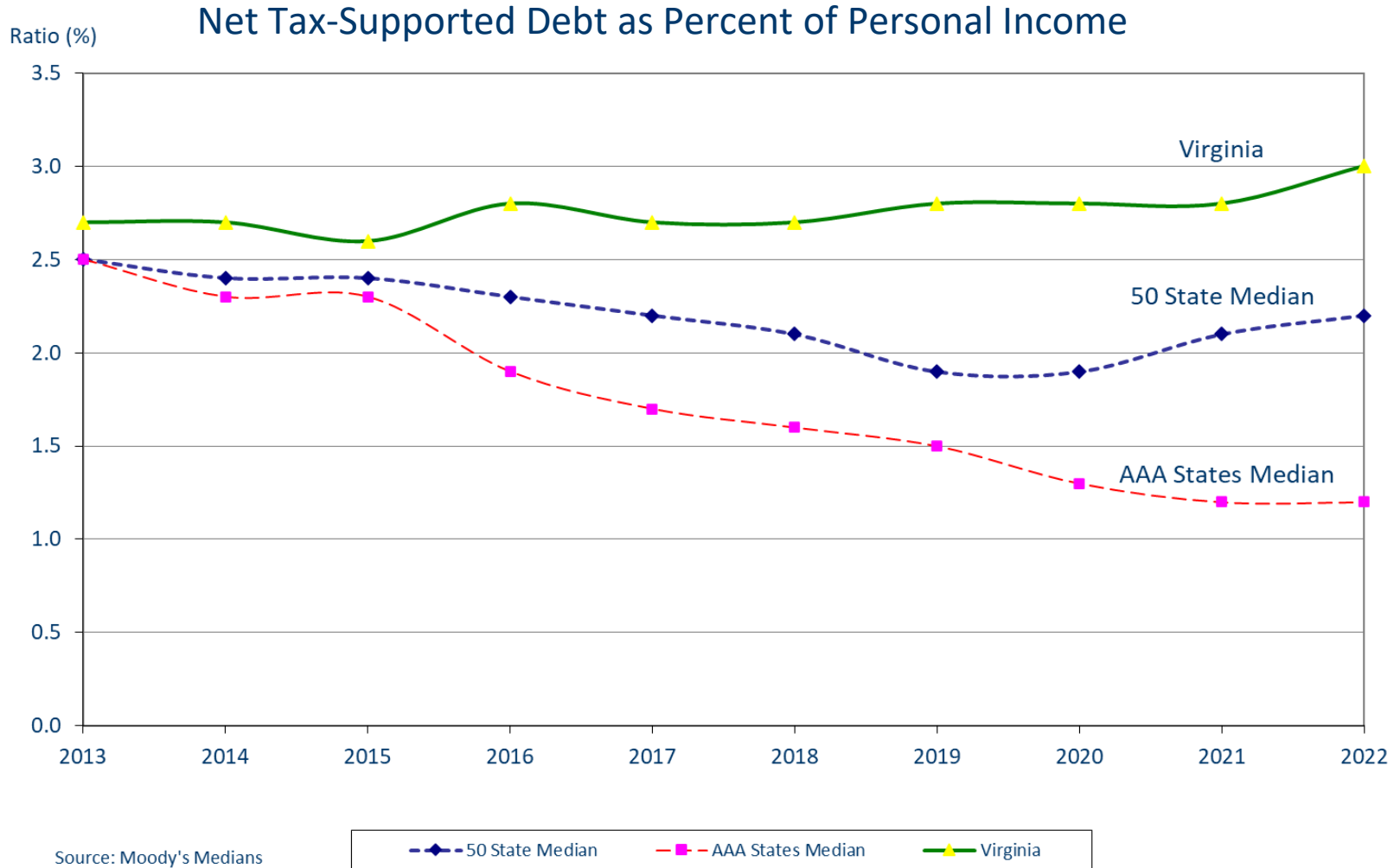
Net Tax-Supported Debt Per Capita



Source: Moody's Medians



Virginia's Tax-Supported Debt Compared to Other States



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). This estimate is advisory and in no way binds the Governor or the General Assembly
 - 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

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 affordability or 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
 - General Fund Transfers – ABC, Sales Tax, Recurring Transfers
 - Virginia Health Care Fund
 - Transportation Trust Fund (TTF)

Debt Capacity Model – Measure and Inputs (Continued)

- Tax-supported debt included in Debt Capacity Model:
 - Debt for which debt service payments are made or pledged to be made from funds derived from state-wide tax revenues
 - 9(b) General Obligation
 - 9(d) VCBA (21st Century and Equipment), VPBA, VPA, and CTB debt secured by the TTF
 - Certain long-term leases and subscription-based IT arrangements, installment purchases and miscellaneous debt
- Debt not included in Debt Capacity Model:
 - 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”)

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:
 - Information from agencies
 - Short-term interest rates
 - Long-term interest rates
- Debt service on proposed new debt in Governor’s Budget is NOT included in the model

Debt Capacity Model – Measure and Inputs (Continued)

- The Model Interest Rate is based on the average of the last 12 quarters of the Bond Buyer 11 Index for G.O. debt and 25 bps is added for 9(d) debt
 - As of the December 21, 2023 DCAC Report, the Model Interest Rate was 2.80% for G.O. bonds and 3.05% for 9(d) bonds
 - Due to unprecedented rate increases in calendar years 2022 and 2023, the Model Interest Rate significantly lagged current market rates
- A Recommended Modified Model Rate of 4.75% for 9(d) bonds was adopted by the DCAC Committee in making its debt capacity recommendation
 - Treasury Staff consulted with financial advisors and the Secretary of Finance to determine a conservative Recommended Modified Model Rate to recommend to the Committee
 - The Federal Reserve has increased interest rates by 525 basis points since March of 2022
 - The Bond Buyer 11 Index yield for G.O. bonds in early November 2023 at 4.1%, but has since declined more than 75 basis points and was at 3.3% as of December 7, 2023

Debt Capacity Model – Currently Authorized & Unissued Debt

As of June 30, 2023

(Dollars in Millions)

VPBA	\$	1,403.7
VCBA		1,101.7
Transportation – CPR		146.6
Transportation – NVTD *		24.7
Transportation – Route 58		226.4
VPA		<u>-</u>
Total	\$	2,903.1

* Transportation - NVTD authorized debt is not expected to be issued

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

December 2023 Model¹

(Dollars in Millions)

Fiscal Year	Blended Revenues	Amount of Additional Debt that may Be Issued	Total Debt Service as a % of Revenues
2024	30,364.06	0.00	4.71%
2025	32,625.82	1,058.96	4.82%
2026	33,549.77	1,058.96	5.01%
2027	34,993.01	1,058.96	4.97%
2028	36,235.75	1,058.96	4.92%
2029	37,103.26	1,058.96	4.89%
2030	38,408.22	1,058.96	4.78%
2031	39,733.07	1,058.96	4.64%
2032	41,132.99	1,058.96	4.53%
2033	42,559.28	1,058.96	4.43%

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

Committee's December 2023 Recommendation

- Up to an additional \$1.06 billion could prudently be authorized and issued during each of fiscal years 2024 and 2025
- Committee noted the Commonwealth's fiscal strength entering 2024, but also noted that material changes to the Commonwealth's revenues or to the prevailing interest rate would impact the Commonwealth's debt capacity
- Committee urged the Governor and the General Assembly to continue to use caution when considering future tax-supported debt authorizations
 - Virginia's debt burden has increased significantly over the last 10 years
 - Nearly \$3 billion in authorized but unissued tax-supported debt
 - Rising construction costs and higher interest rates may require additional funding for previously authorized capital projects
- Committee recognized the Commonwealth's substantial cash contributions in recent fiscal years to address funding shortfalls for existing capital projects

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

Introduced 2024-2026 Budget – Impact on DCAC Model

- Approximately \$503.2 million of proposed new tax-supported debt is included in the Governor’s proposed 2024-2026 biennium budget
 - \$334.9 million of VCBA/VCBA appropriation supported bond authorization
 - \$168.3 million of VCBA higher-education equipment trust fund bond authorization
- 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 \$42 million annually to \$1.02 billion

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
Long-term 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 2023 Model*

(Dollars in Millions)

	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]	[10]	[11]
		Base Capacity to Pay	Annual Payments for Debt Service on Debt Issued	Actual Outstanding Debt Service as a % of Revenues	Annual Payments for Debt Service on All Planned Debt Issuances	Actual & Projected Debt Service as a % of Revenues	Net Capacity to Pay Debt Service	Amount of Additional Debt that may Be Issued	Debt Service on Amount of Additional Debt that may Be Issued	Remaining Capacity to Pay Debt Service	Total Debt Service as a % of Revenues
Fiscal Year	Blended Revenues	Debt Service	on Debt Issued	Revenues	Debt Issuances	Revenues	Debt Service	Be Issued	Be Issued	Debt Service	Revenues
2024	30,364.06	1,518.20	1,233.69	4.06%	195.38	4.71%	89.14	0.00	0.000	89.14	4.71%
2025	32,625.82	1,631.29	1,196.11	3.67%	295.21	4.57%	139.97	1,058.96	81.296	58.67	4.82%
2026	33,549.77	1,677.49	1,155.43	3.44%	362.41	4.52%	159.65	1,058.96	162.591	(2.94)	5.01%
2027	34,993.01	1,749.65	1,101.21	3.15%	393.12	4.27%	255.32	1,058.96	243.887	11.43	4.97%
2028	36,235.75	1,811.79	1,039.02	2.87%	420.27	4.03%	352.50	1,058.96	325.183	27.31	4.92%
2029	37,103.26	1,855.16	986.79	2.66%	420.27	3.79%	448.10	1,058.96	406.478	41.62	4.89%
2030	38,408.22	1,920.41	926.78	2.41%	420.27	3.51%	573.36	1,058.96	487.774	85.59	4.78%
2031	39,733.07	1,986.65	853.17	2.15%	420.27	3.21%	713.21	1,058.96	569.070	144.14	4.64%
2032	41,132.99	2,056.65	808.38	1.97%	405.90	2.95%	842.37	1,058.96	650.366	192.01	4.53%
2033	42,559.28	2,127.96	746.52	1.75%	405.90	2.71%	975.55	1,058.96	731.661	243.89	4.43%
							10 Year Average:	\$1,058.96			

*Based on Recommended Modified Model Rate of 4.75%