

JLBC Staff Report - FY 2012 Debt and Lease-Purchase Financing Report

A.R.S. § 41-1277 requires the JLBC Staff to present to the House and Senate Appropriations Committees a report on state debt and obligations. Due by January 31 of each year, the report is to include the following information from the prior fiscal year (FY 2012):

- The statewide aggregate level of outstanding principal, by type of debt or obligation
- The principal and interest payments on each of the state's long-term obligations
- A description of the state's payment deferrals ("rollovers") by agency, including: the date the payment was originally scheduled to be made, interest paid to date on the deferral, and interest paid in the prior and current fiscal years (FY 2012/FY 2013)
- Historical information on the state's overall debt balance and per capita debt obligations, based on available data.

To the extent possible, A.R.S. § 41-1277 requires data contained in the report to be based on the Department of Revenue (DOR) [Arizona Report of Bonded Indebtedness](#), which is published annually along with an online searchable database.

This report provides a current and historical summary of the state's outstanding financing obligations (*Table 1 and Table 2*). In addition, it includes specific details on each of the individual financing issuances (*Table 3*) and the state's payment deferrals (*Table 4*).

The report also contains a presentation made to the House and Senate Appropriations Committees (*Attachment A*) which includes the above information and gives an overall view of the state's methods and process for using long-term financing. The presentation also contains the relative mix of uses for long-term financing (state government facilities, local school district facilities, and operating shortfalls) and summarizes the process of debt retirement. The FY 2014 Executive budget proposal includes \$40 million for annual debt retirement payments.

Total FY 2012 outstanding bond, lease-purchase and payments deferral balances were \$9.90 billion, of which \$1.19 billion was related to payments deferrals. Excluding the payment deferrals, the outstanding FY 2012 balance was \$8.71 billion. This equates to a per capita amount of \$1,341. In comparison to the FY 2012 level of \$8.71 billion, the outstanding FY 2003 balance was \$3.94 billion. The growth was due to several factors: 1) the state's use of long-term financing for the New School Facilities program; 2) An increase in Universities financing activity (both under their general authority and specifically authorized programs such as Lottery-backed issuances); and 3) Growth in debt related to highway construction.

Of the total FY 2012 outstanding balance of \$8.71 billion, the General Fund share was \$3.55 billion. In FY 2012, the General Fund made debt services payments totaling \$302 million. This amount is projected to increase in FY 2014 to \$373 million, as the state has begun to make principal payments towards both the financing related to Operating shortfalls (building sale/leaseback and Lottery revenues bonds) and the Phoenix Convention Center.

Table 1 below gives a brief summary of the report.

Table 1	
State Debt and Financing Summary	
(As of FY 2012)	
Total Outstanding Balance	\$ 9.90 B
Total Outstanding Balance (excludes Payment Deferrals)	\$ 8.71 B
General Fund Outstanding Balance	\$ 3.55 B
FY 2012 General Fund Debt Service	\$ 302 M
Interest as a % of General Fund Debt Service	56%
Total Outstanding Balance Per Capita	\$1,341

Table 2			
Per Capita State Debt Historical Summary			
<u>Fiscal Year</u>	<u>Outstanding Principal (Total Funds - \$ in B)</u>	<u>Per-Capita Outstanding</u>	<u>% Change from Prior FY</u>
2003	\$ 3.94	\$ 715	-
2004	4.82	852	19.2%
2005	4.98	853	0.1%
2006	5.17	858	0.6%
2007	4.89	793	(7.6)%
2008	5.96	949	19.7%
2009	7.29	1,150	21.2%
2010	8.33	1,299	13.0%
2011	8.64	1,333	2.6%
2012	8.71	1,341	0.6%

Table 3

Lease-Purchase, Bonding, and Payment Deferral Summary ^{1/}

LEASE-PURCHASE SUMMARY	Overall Balance ^{2/}	GF Balance ^{2/}	Overall FY 12 Pymt ^{3/}	FY 12 Principal Pymt ^{3/}	FY 12 Interest Pymt ^{3/}	FY 12 GF Pymt ^{4/}	FY 12 GF Principal Pymt ^{4/}	FY 12 GF Interest Pymt ^{4/}
<u>State Buildings</u>								
<u>ADOA Building System</u>								
2001 A/B Issuance/Refinance (Prisons/ENSCO, Revenue Building, DES Homes, Capital Center)	\$ 0	\$ 0	\$ 2,461,800	\$ 2,410,000	\$ 51,800	\$ 2,381,700	\$ 2,331,600	\$ 50,100
2002A Issuance (Health Laboratory/HRIS)	24,295,000	0	7,861,000	6,290,000	1,571,000	0	0	0
2004A Issuance/Refinance (Records Management, Library for the Blind, ASDB Projects, 1616 West Adams, Tonto Natural Bridge)	0	0	2,952,000	2,880,000	72,000	2,343,000	2,285,900	57,100
2004B Issuance (ADC Prison Expansions)	18,640,000	18,640,000	3,181,800	2,160,000	1,021,800	3,181,800	2,160,000	1,021,800
2008A Issuance (ADC Prison Expansions, DHS Forensic Hospital)	211,025,000	211,025,000	19,823,400	9,705,000	10,118,400	19,823,400	9,705,000	10,118,400
<u>ABOR Building System</u>								
Arizona State University	256,990,000	133,309,500	23,415,800	10,720,000	12,695,800	12,146,500	5,560,800	6,585,700
Northern Arizona University	81,960,300	81,960,300	14,994,600	11,295,000	3,699,600	14,994,500	11,295,000	3,699,500
University of Arizona	<u>425,530,000</u>	<u>160,774,300</u>	<u>43,765,300</u>	<u>21,852,300</u>	<u>21,913,000</u>	<u>16,535,500</u>	<u>8,256,300</u>	<u>8,279,200</u>
Subtotal - ABOR	764,480,300	376,044,100	82,175,700	43,867,300	38,308,400	43,676,500	25,112,100	18,564,400
<u>Other</u>								
Phoenix Convention Center ^{5/}	274,902,200	274,902,200	595,000	460,200	134,800	595,000	460,200	134,800
Subtotal - State Building System	1,293,342,500	880,611,300	119,050,700	67,772,500	51,278,200	72,001,400	42,054,800	29,946,600
<u>Operating Shortfall</u>								
2010 Sale/Leaseback Issuance	998,795,000	998,795,000	49,030,600	0	49,030,600	49,030,600	0	49,030,600
<u>School Facilities Board</u>								
New School Construction - FY 2003 - FY 2005	572,385,000	572,385,000	91,338,000	61,525,000	29,813,000	91,338,000	61,525,000	29,813,000
New School Construction - FY 2008 - FY 2009	520,575,000	520,575,000	58,646,600	30,460,000	28,186,600	58,646,600	30,460,000	28,186,600
2010 Qualified School Construction Bonds	91,325,000	91,325,000	7,671,300	0	7,671,300	7,671,300	0	7,671,300
2010 Refinance	<u>58,785,000</u>	<u>58,785,000</u>	<u>2,449,800</u>	<u>0</u>	<u>2,449,800</u>	<u>2,449,800</u>	<u>0</u>	<u>2,449,800</u>
Subtotal - SFB	1,243,070,000	1,243,070,000	160,105,700	91,985,000	68,120,700	160,105,700	91,985,000	68,120,700
TOTAL - Lease-Purchase	\$ 3,535,207,500	\$3,122,476,300	\$ 328,187,000	\$159,757,500	\$168,429,500	\$281,137,700	\$134,039,800	\$147,097,900

(Continued)

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BONDING SUMMARY	Overall Balance ^{2/}	GF Balance ^{2/}	Overall FY 12 Pymt. ^{3/}	FY 12 Principal Pymt. ^{3/}	FY 12 Interest Pymt. ^{3/}	FY 12 GF Pymt. ^{4/}	FY 12 GF Principal Pymt. ^{4/}	FY 12 GF Interest Pymt. ^{4/}
School Facilities Board								
Deficiencies Correction:								
Proposition 301	\$ 428,600,800	\$ 0	\$ 65,747,900 ^{6/}	\$ 42,943,400 ^{6/}	\$ 22,804,500 ^{6/}	\$ 0	\$ 0	\$ 0
State Land Trust - FY 2004	<u>120,470,000</u>	<u>0</u>	<u>24,246,200</u>	<u>17,400,000</u>	<u>6,846,200</u>	<u>0</u>	<u>0</u>	<u>0</u>
Subtotal - SFB	549,070,800	0	89,994,100	60,343,400	29,650,700	0	0	0
Department of Transportation ^{7/}	2,288,900,000	0	202,124,200	119,760,000	82,364,200	0	0	0
ABOR Building System								
Arizona State University	872,865,000	0	186,553,700	153,545,000	33,008,700	0	0	0
Northern Arizona University	353,820,000	0	24,747,300	5,835,000	18,912,300	0	0	0
University of Arizona	<u>686,090,000</u>	<u>0</u>	<u>48,856,000</u>	<u>17,375,000</u>	<u>31,481,000</u>	<u>0</u>	<u>0</u>	<u>0</u>
Subtotal - ABOR	1,912,775,000	0	\$260,157,000	176,755,000	83,402,000	0	0	0
Operating Shortfall								
Lottery Revenue Bond ^{8/}	425,420,000	425,420,000	20,709,600	0	20,709,600	20,709,600	0	20,709,600
TOTAL - Bonding	\$ 5,176,165,800	\$ 425,420,000	\$572,984,900	\$356,858,400	\$216,126,500	\$ 20,709,600	\$ 0	\$20,709,600
TOTAL - Lease-Purchase/Bonds	\$ 8,711,373,300	\$ 3,547,896,300	\$901,171,900	\$516,615,900	\$384,556,000	\$301,847,300	\$134,039,800	\$167,807,500
TOTAL - Payment Deferrals (Table 4)	\$ 1,187,627,700	\$ 1,187,627,700		See Table 4			See Table 4	
TOTAL - Long-Term Obligations	\$ 9,899,001,000	\$ 4,735,524,000	\$901,171,900	\$516,615,900	\$384,556,000	\$301,847,300	\$134,039,800	\$167,807,500

^{1/} Pursuant to A.R.S. § 41-1277, all information listed is from the FY 2012 Department of Revenue (DOR) Debt Report database, except where noted. The DOR report does not delineate between General Fund and non-General Fund financing. While most issuances have a distinct financing source, in circumstances where this source was unclear the table estimates the GF/Non-GF split using historical averages.

^{2/} Represents outstanding principal on the respective lease-purchase agreement or debt issuance, including the portion paid from a General Fund source, which is represented in the "GF Balance" column. Balances are displayed as of the end of FY 2012.

^{3/} Represents total FY 2012 lease-purchase or debt service payments from all fund sources, along with the portions of the payments consisting of principal and interest costs.

^{4/} Represents lease-purchase or debt service payments paid from a General Fund source in FY 2012, along with the portions of the payments consisting of principal and interest costs.

^{5/} Phoenix Convention Center financing was not included in the DOR Debt Report as the issuance was made by the City of Phoenix. However, the state's portion of the financing is displayed above as the payments are long-term obligations of the state. Displayed payment information reflects the actual debt service due on the issuance, as opposed to the statutory distribution schedule (as modified by Laws 2011, Chapter 28).

^{6/} School Facilities Board (SFB) Proposition 301 bond payment information reflects debt service schedule provided by SFB.

^{7/} Excludes Regional Area Road Fund (RARF) Bonds which are paid from the local Maricopa County regional transportation sales tax.

^{8/} Debt service for the Lottery Revenue Bonds is paid for with Lottery profits which would have otherwise been revenues deposited into the General Fund.

Table 4

Payment Deferral Summary

<u>Agency</u>	<u>Overall Deferral Balance</u>	<u>Original Due Date(s) of Deferral</u>	<u>Interest Paid to Date for Deferral</u>	<u>Interest Paid in FY 12</u>	<u>Interest to be Paid in FY 13</u>
AHCCCS	\$0 ^{1/}	N/A	\$173,900 ^{2/}	\$0	\$0
Department of Education	952,627,700	\$273 M in FY 2008, \$330 M in FY 2009, and \$350 M in FY 2010	2,400,100 ^{2/}	0	0
Department of Economic Security	35,000,000	\$25 M in FY 2009 and \$10 M in FY 2010	0	0	0
Universities	<u>200,000,000</u>	\$100 M in FY 2009 and \$100 M in FY 2010	<u>0</u>	<u>0</u>	<u>0</u>
Total	\$1,187,627,700		\$2,574,000	\$0	\$0

^{1/} The FY 2011 Health Budget Reconciliation Bill (Laws 2010, 7th Special Session, Chapter 10, Section 31) provided for the deferment of \$117,688,200 of General Fund payments to health plans. Due to changes in the federal Medicaid match rate, AHCCCS terminated the scheduled FY 2011 rollover and no AHCCCS funding was deferred from FY 2011 to FY 2012.
^{2/} Interest was paid for the AHCCCS and ADE payment deferrals in FY 2011 and FY 2008 - FY 2010, respectively.

Explanation of Issuances

Lease-Purchase Summary

State Buildings

ADOA Building System – Lease-Purchase

2001 A/B – Reviewed at its August 2001 meeting, the Joint Committee on Capital Review favorably reviewed and approved the \$151.2 million refinancing of 1991 and 1992 Certificates of Participation (COP) issuances. The original 1991 issuance of \$55.1 million was financed through the sale/lease-back of state properties (both buildings and prisons) and was used to pay for the costs of the settlement between the state and Ensco, Inc. and the acquisition of a hazardous waste facility. The 1992 issuances financed the following projects: the

Department of Revenue Building, Department of Economic Security (DES) Group Homes and the 15th Avenue Capital Center state office building. The final debt service payment of \$2.5 million for the refinanced COPs was made in FY 2012.

2002 A – Contained issuances related to 2 separate projects:

- Laws 2001, Chapter 237 authorized ADOA to enter into a lease-purchase agreement to finance the construction of a new state Health Laboratory. The COP issuance was limited to \$30 million and is to be repaid over a 20-year period.
- The Human Resources Information Solution (HRIS) is an enterprise system that processes human resources, payroll, and benefits transactions for every state agency, with the exception of the universities. This includes processing information for over 40,000 employees and calculates the state's annual payroll. HRIS was funded through the issuance of a Certificate of Participation (COP). The first payment was made in FY 2002. The HRIS portion of the COP involved a 12-year agreement with a \$35 million original principal amount. By the end of FY 2013, all COP payments for HRIS will be paid in full.

2004 A (Refinance of 1993 B Certificate) – At its March 2004 meeting, the Joint Committee on Capital Review favorably reviewed and approved the refinancing of a 1993 Certificates of Participation (COP) issuance, which involved the refunding of \$19.9 million in outstanding COPs. The following projects were financed with the original issuance: Arizona State Schools for the Deaf and Blind high school auditorium, Records Management, Library for the Blind, 1616 West Adams, and the Tonto Natural Bridge. The final debt service payment of \$3.0 million for the refinanced COP was made in FY 2012.

2004 B – Laws 2003, Chapter 5, 2nd Special Session authorized the Department of Corrections to issue Certificates of Participation not to exceed \$37.5 million to build 1,000 new state beds. The total project cost was \$33.3 million to be paid over a 15-year period, along with interest totaling \$11.7 million. The funding was used in the construction of 500 beds at the Perryville State Prison Complex (SPC), 300 beds at Tucson SPC, and 200 beds at Douglas SPC. The beds house minimum security inmates and opened in December 2004.

2008 A – Laws 2007, Chapter 261 authorized 4,000 new public prison beds through a \$200.0 million lease-purchase agreement. Laws 2007, Chapter 257 authorized a \$39.0 million lease-purchase agreement for the following 2 projects: \$32.2 million for a new forensic hospital unit at the Arizona State Hospital and \$6.8 million for water supply projects at 4 prison complexes.

The total \$239.0 million in agreements was issued in April 2008; the prison beds have a 20-year term while the forensic unit and water projects have a 15-year term. While Chapter 261 authorized 4,000 beds, the department was able to construct and open 5,000 beds in FY 2011 - 1,250 beds at Perryville SPC, 1,250 beds at Tucson SPC, and 2,500 beds at Yuma SPC.

ABOR Building System – Lease-Purchase

Arizona Board of Regents (ABOR) – Laws 2003, Chapter 267 appropriated \$34.6 million from the state General Fund to the universities to be used to finance lease-purchase payments from FY 2008 to FY 2031 for research infrastructure project agreements entered into prior to

July 1, 2006. These projects include science and technology buildings and the debt service payments are made from annual General Fund appropriations.

Other

Phoenix Convention Center – While not a state building, the Phoenix Convention Center represents a state obligation. Laws 2003, Chapter 266 authorized the state to make distributions to provide for the debt service related to the financing of certain convention center projects, provided that the state funding would account for no more than 50% of the total project cost and would not exceed \$300 million. Funding of the Phoenix Convention Center project was approved by Phoenix voters in 2001, and the renovation and expansion of the center subsequently qualified as an eligible project. In 2005, the City of Phoenix issued \$600 million of bonds, 50% of which were to be paid from the state share of funding, with payments beginning in FY 2012 for a term of 33 years. The state distribution occurs according to a statutory schedule, which was modified by Laws 2011, Chapter 28. The Convention Center expansion was completed in 2009.

Operating Shortfall

2010 State Building Sale/Leaseback – FY 2010 budget legislation (Laws 2009, 3rd Special Session, Chapter 6 and Laws 2010, 6th Special Session, Chapter 4) authorized the Arizona Department of Administration (ADOA) to enter into sale/lease-back agreements for 22 existing state-owned facilities, requiring the funds to be deposited to the General Fund to subsidize state operating expenses. ADOA sold the issuances in 2 series (January 2010 and June 2010) at an average tax-exempt interest rate ranging from 4.37% to 4.57%. These issuances range up to 20 years in period of time.

The transaction generated \$1.04 billion of up front proceeds, in exchange for annual lease payments through the term of the agreements. While the titles of the buildings were used as collateral for the financing, the state maintains operational control of the facilities. Upon the expiration of the agreements, the legal titles to the buildings will be transferred back to the state.

School Facilities Board – Lease-Purchase

SFB – The School Facilities Board (SFB) is responsible for providing capital funding for K-12 school districts within the state. A.R.S. § 15-2004 authorizes SFB generally to enter into lease-purchase financing agreements in order to provide funding for the agency's New School Facilities program. However, these transactions have been prohibited since May 2006, except in cases of specific legislative authorization. SFB has entered into 3 broad types of lease-purchase financing agreements.

- **New Construction Financing 2003 – 2005 and 2008 - 2009** – Both classes of financing were issued as traditional tax-exempt Certificates of Participation. While in some years SFB New Construction has been paid for with cash financing, in certain years the Legislature has authorized SFB to enter into lease-purchase agreements. During FY 2003 – FY 2005, SFB issued financing with a principal amount totaling \$854.0 million, with terms ranging from 11-16 years. In FY 2008/2009, SFB entered into a lease-purchase agreement with a principal amount of \$580.0 million for a term of 15 years.

- **2010 Qualified School Construction Bonds** – Authorized by Laws 2010, 3rd Special Session, Chapter 12, SFB entered into \$91.3 million worth of lease-purchase financing through a federal program known as Qualified School Construction Bonds. This type of financing entitles the state to interest rate subsidy from the federal government, which amounts to 4.86% of the 6.0% due on the bonds, leaving the state with an effective interest rate of 1.14%.
- **2010 SFB Refinance** – Authorized by Laws 2010, 7th Special Session, Section 20, SFB entered into a refinancing agreement whereby \$58.8 million of new financing was issued, and the cash proceeds were used to lower the agency’s FY 2011 debt service obligations to achieve one-time savings. Through FY 2018, the state will pay approximately \$2.4 million of interest annually, until the principal amount is paid in installments during both FY 2019 and FY 2020.

Bonding Summary

School Facilities Board

In addition to the agency’s general lease-purchase authority, SFB was authorized to issue revenue bonds, to be paid for with a dedicated source of funding:

- **Proposition 301 Bonds (State School Improvement Revenue Bonds)** – Proposition 301, approved by voters in 2000, authorized SFB to issue up to \$800 million of revenue bonds to finance its Deficiencies Correction program which made school repairs statewide. The bonds were issued in this amount during FY 2001 – FY 2003, and are paid from the 0.6% sales tax enacted by the ballot measure. The term of the bonds runs through FY 2021, which coincides with the expiration of the measure’s sales tax, at which point the entire issuance will have been retired.
- **State Land Trust Bonds (School Trust Revenue Bonds)** – Laws 2003, Chapter 264 authorized SFB to issue \$246.6 million of State School Trust revenue bonds to provide further funding for the Deficiencies Correction program. Debt service on the bonds is paid from expendable earnings of the state’s land trust, which consists of monies received from the sale or lease of state school trust lands and investment earnings in the fund. Earnings from this fund are first used to fund payments related to the SFB trust revenue bonds, with any excess funds above this amount transferred to the Department of Education. The bonds were issued with a term of 15 years, and are scheduled to be retired in FY 2018.

Department of Transportation

Financing largely consists of 2 broad categories:

- Highway User Revenue Fund (HURF) bonds are used to finance the State Transportation Board's 5-year construction program. HURF consists of monies received in the state from transportation-related licenses, taxes, fees, penalties and interest, such as the motor vehicle fuel tax, vehicle license tax, vehicle registration, driver's license, and others. In order for the department to issue subordinate HURF bonds, State Highway Fund revenues must exceed 3 times the maximum annual debt service on current outstanding debt. The State Highway Fund is the source of debt service for HURF bonds.
- Grant Anticipation Notes (GAN) allow ADOT to issue debt secured by future federal aid for the purposes of accelerating or advancing mostly large highway construction projects. Federal Funds are the source of debt service for GANs.

ABOR Building System

A.R.S. § 15-1683 allows each state university to incur a projected annual debt service for bonds and certificates of participation of up to 8% of each institution's total projected annual expenditures. Universities fund revenue bond debt service payments with university system revenues. While tuition represents the primary source of these revenues, they may also be directly related to the capital project. For instance, the debt service payments for renovations to a student recreation center may be paid for with student recreation fees.

Laws 2008, Chapter 287, as amended by Laws 2009, 1st Special Session, Chapter 6 and Laws 2009, 3rd Special Session, Chapter 9, authorized ABOR to enter into lease-to-own and bond transactions up to \$800 million to pay for building renewal projects and new facilities with university lottery bonds (also known as SPEED bonds). ABOR is required to allocate \$376.0 million of the \$800.0 million for the Phoenix Biomedical Campus. Of the remaining \$424.0 million in proceeds, ABOR plans to allocate \$16.0 million to ASU's School of Construction and \$136.0 million to each of the 3 universities for building renewal, deferred maintenance, and new construction projects. Under Chapter 287, the annual debt payments are comprised of up to 80% lottery revenues and at least 20% university system revenues. *(Please see the Arizona Board Regents Building Systems narrative pages in the FY 2014 JLBC Baseline for more information.)*

Operating Shortfall

Lottery Revenue Bond – FY 2010 budget legislation (Laws 2010, 6th Special Session, Chapter 4) authorized the department to issue a Lottery revenue bond, which generated \$450 million of up front proceeds for the state, in exchange for fixed payments over a 20-year term. Under A.R.S. § 5-572, the funds necessary to make debt service payments relating to the lottery revenue bond receive the first priority in the distribution of lottery profits, and are taken from monies that would have otherwise been transferred to the General Fund.

Overview of State Debt and Lease-Purchase Financing

January 29-30, 2013

Appropriations Committee Hearings

JLBC

Statute Requires JLBC to Annually Report on State Debt and Other Obligations

- ❑ Outstanding principal on State debt, along with principal and interest payments in the prior fiscal year (FY 2012)
- ❑ Summary of payment deferrals (“rollovers”) by budget unit and the cost of these deferrals
- ❑ Information on per-capita State debt and other long-term obligations
- ❑ A 10-year history of State debt and long-term financing based on available data

Arizona Constitution Limits General Fund Backed Debt to \$350,000

- This limit has been interpreted as applying to debt secured by General Fund revenues
- This interpretation does not apply to debt secured by non-General Fund revenues
 - State has outstanding bonds supported by transportation, lottery and University revenues
- Lease-purchase financing has also been viewed as not applying to the limit – unlike bonds, there is no dedicated source of repayment

Lease-Purchase Financing vs. Bonds

- ❑ Lease-purchase financing has no dedicated source of repayment
 - Lease agreements typically have language that payments are “subject to annual appropriation by the State Legislature” and are not “a general obligation or indebtedness of the State”
 - Non-payment would terminate lease and cause loss of property/project
- ❑ Bonds have a dedicated funding source and are secured by non-General Fund source, such as:
 - Lottery Revenue
 - Highway User Fees
 - University Tuition

Uses For State Debt and Lease-Purchase Financing

- State owned capital facilities/uses
- School Facilities Board to fund local new school construction
- During budget shortfalls, financing has been used for operating expenses

State Has Recently Used Operating Financing For \$1.5 B of Solutions To Budget Shortfalls

FY 2010

- ❑ \$1.0 B from the sale and leaseback of 22 state properties
 - Building titles transferred to 3rd party – transfers back after 20 years of lease payments
- ❑ \$450 M from the issuance of lottery revenue bonds
 - Debt service paid from General Fund portion of lottery revenues – represents foregone revenues

FY 2011

- ❑ \$60 M from the refinancing of outstanding SFB lease-purchase agreements

Arizona's Credit Rating

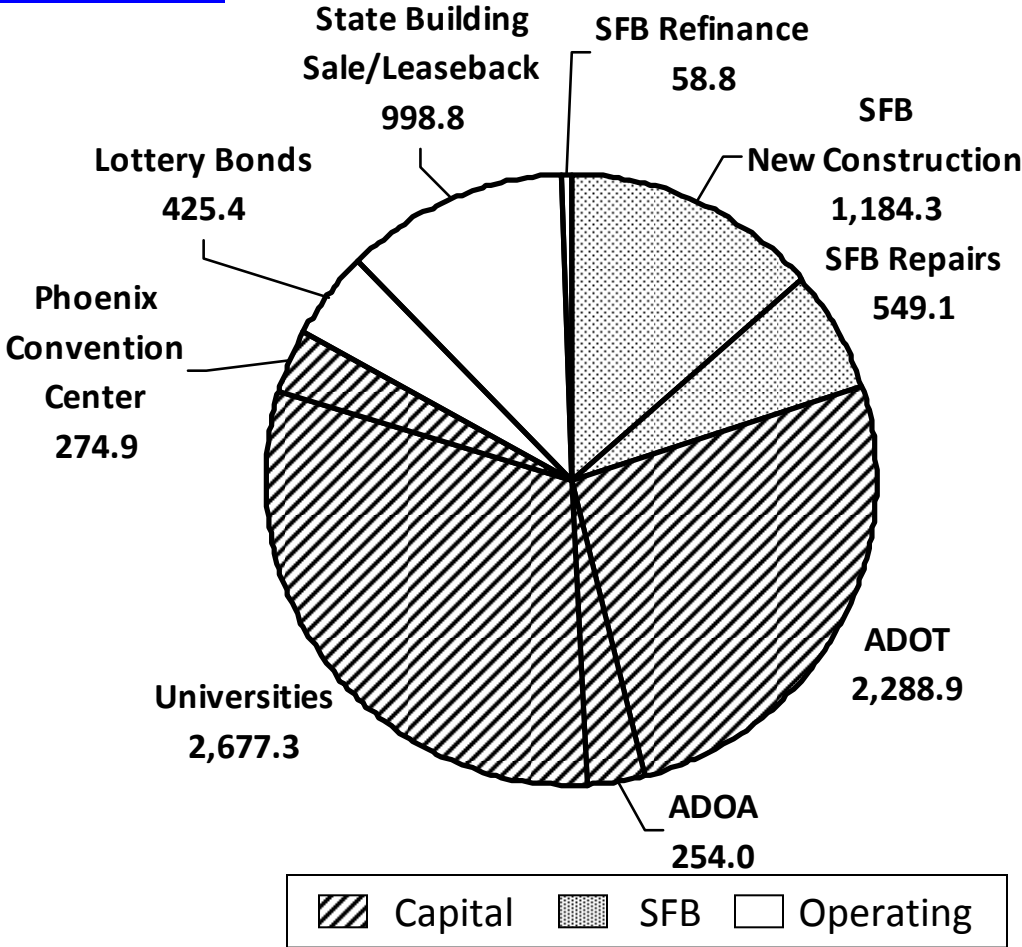
- Tied for third lowest among states

- ❑ With both major credit rating agencies, Arizona has a similar rating (Standard and Poor's: AA-/Moody's: Aa3)
- ❑ Both agencies' outlook for Arizona rating is stable
- ❑ Rating reports have listed several concerns
 - Limited financial flexibility – Proposition 105 (1998) limits changes to ballot propositions and Proposition 108 (1992) requires 2/3rds vote to increase state revenues
 - Continued economic weakness
 - Concerns about the disposition of short-term budget surpluses
- ❑ However, rating agencies noted moderate debt levels and stabilized financial position as positive trends

Total Outstanding State Debt/Lease-Purchase Financing is \$8.7 Billion

- Reflects Multiple Payment Sources

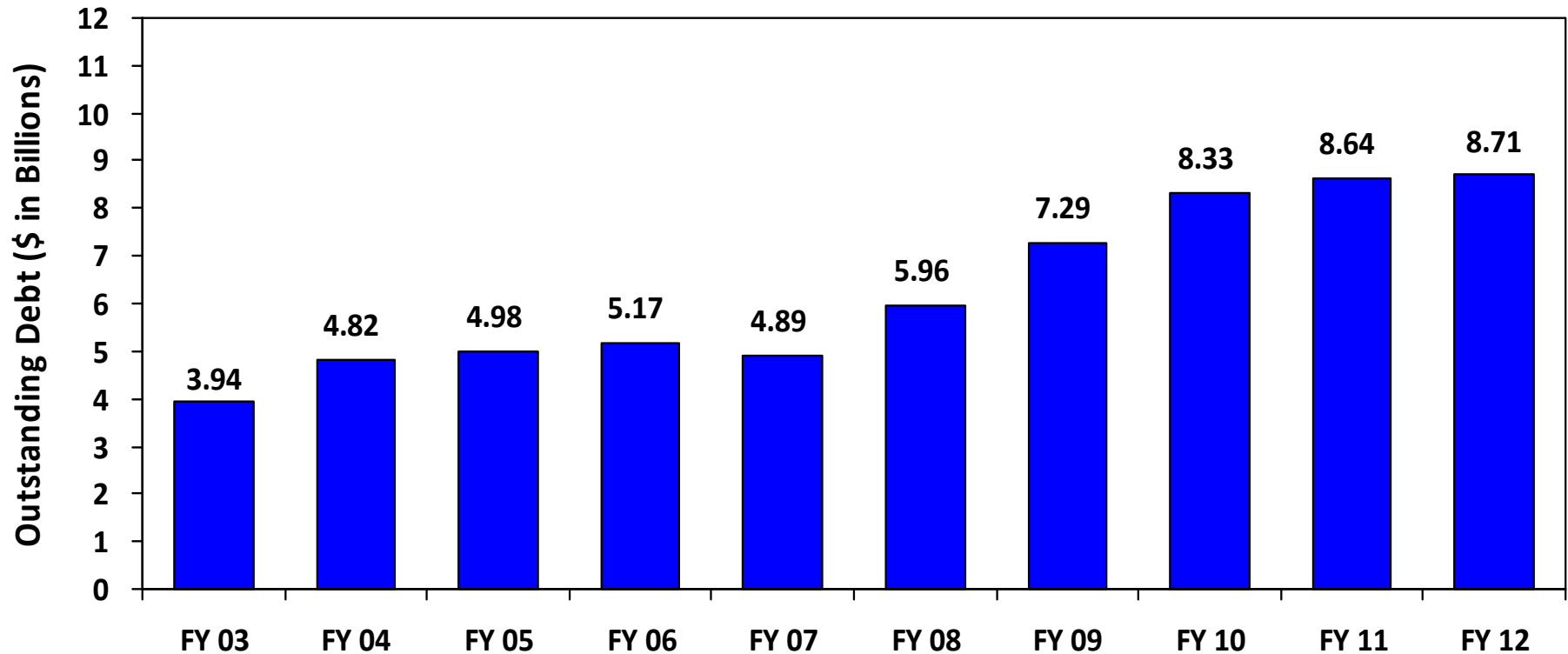
Outstanding Balances	
Capital Facilities/Uses	\$ 5.5 B
School Facilities Board	\$ 1.7 B
Operating	\$ 1.5 B



End of FY 2012 - \$ in Millions

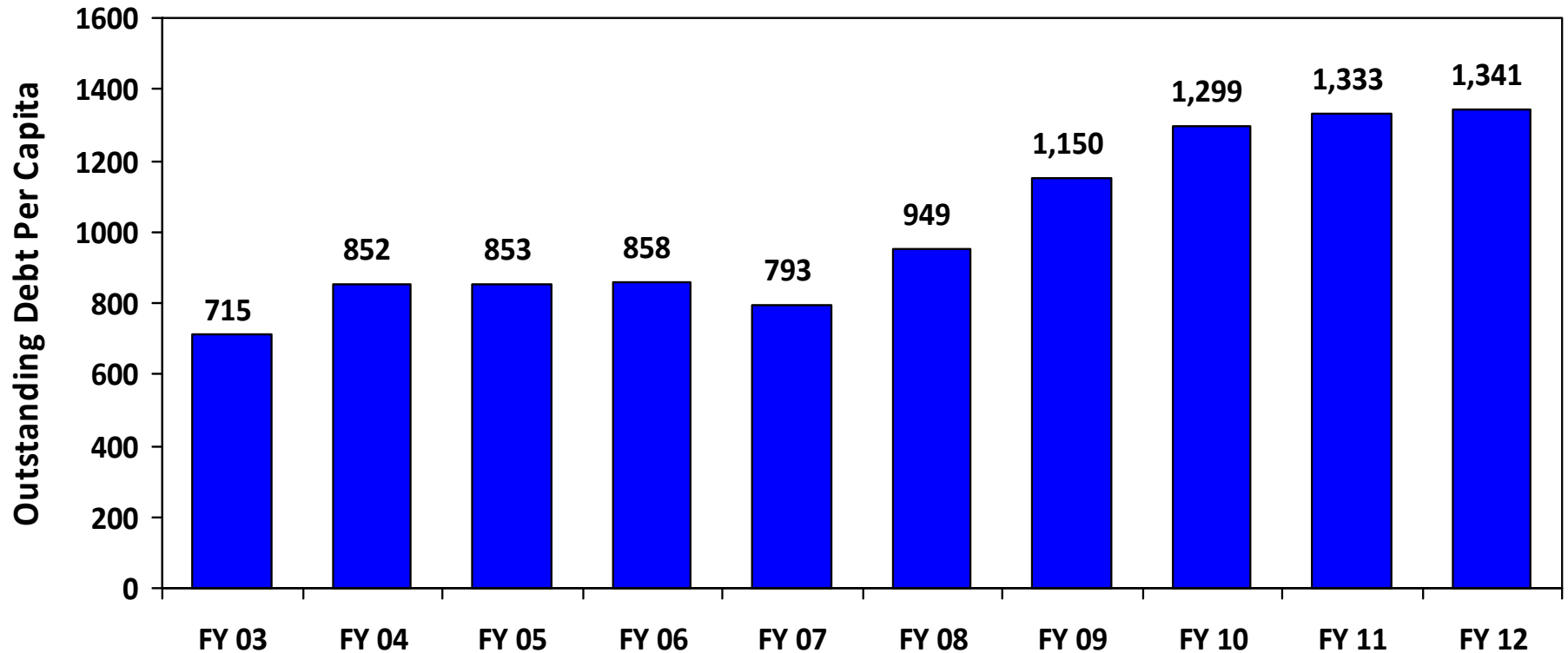
Arizona Overall Debt Obligations Have Increased Significantly Since FY '07

- Increase Is Mostly Due to ADOT, SFB and Operating Financing



Arizona Per Capita Debt Obligations Since FY '03

- State's Assumption of Financing K-12 Construction and Recent Operating Financing Played A Major Role In Growth

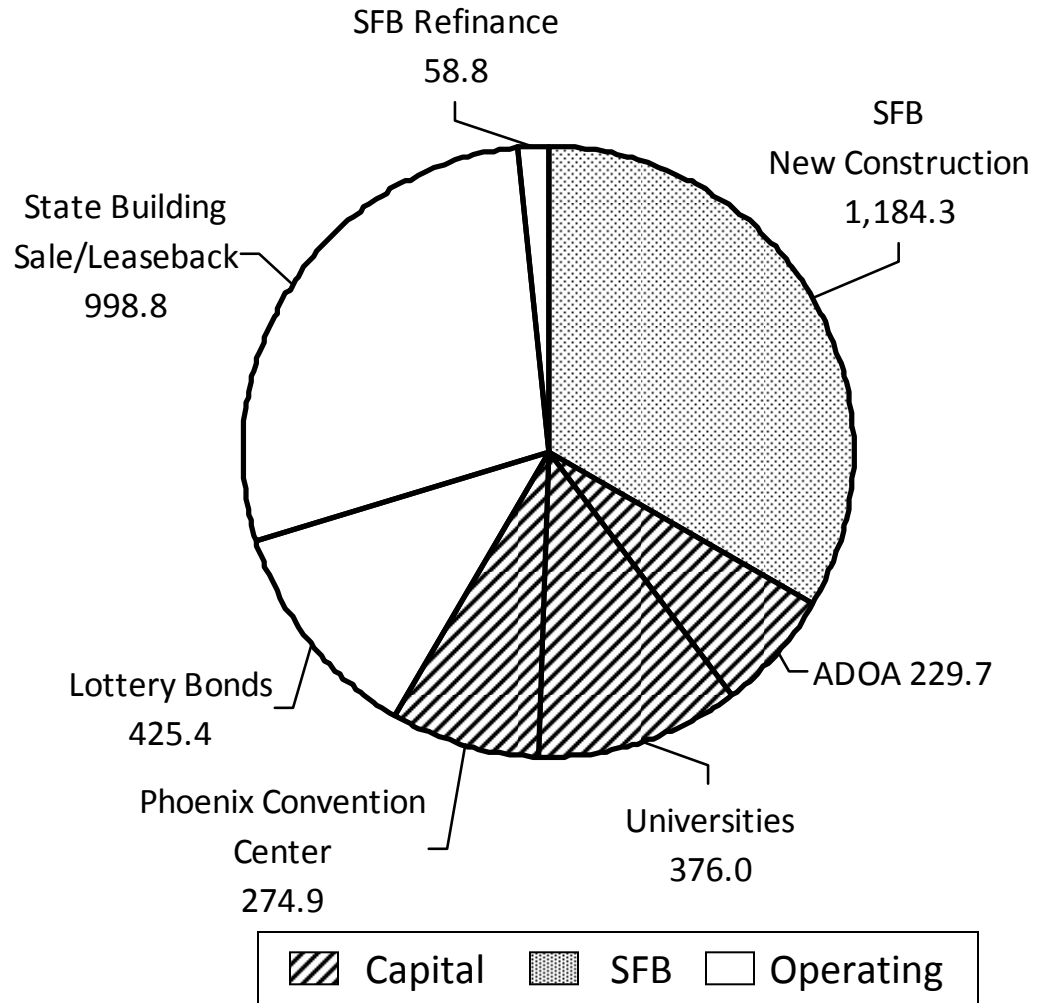


State Also Defers \$1.2 B of Payments Annually - Interest Is Not Paid By the State For Rollovers

- ❑ Used for one-time solutions during recent years with significant budget shortfalls. FY 2013 budget eliminated rollover associated with payments to AHCCCS health plans.
- ❑ K-12 State Aid payments: \$953 M
- ❑ Universities: \$200 M
- ❑ DES: \$35 M

General Fund Share of Outstanding Balances Is \$3.6 B

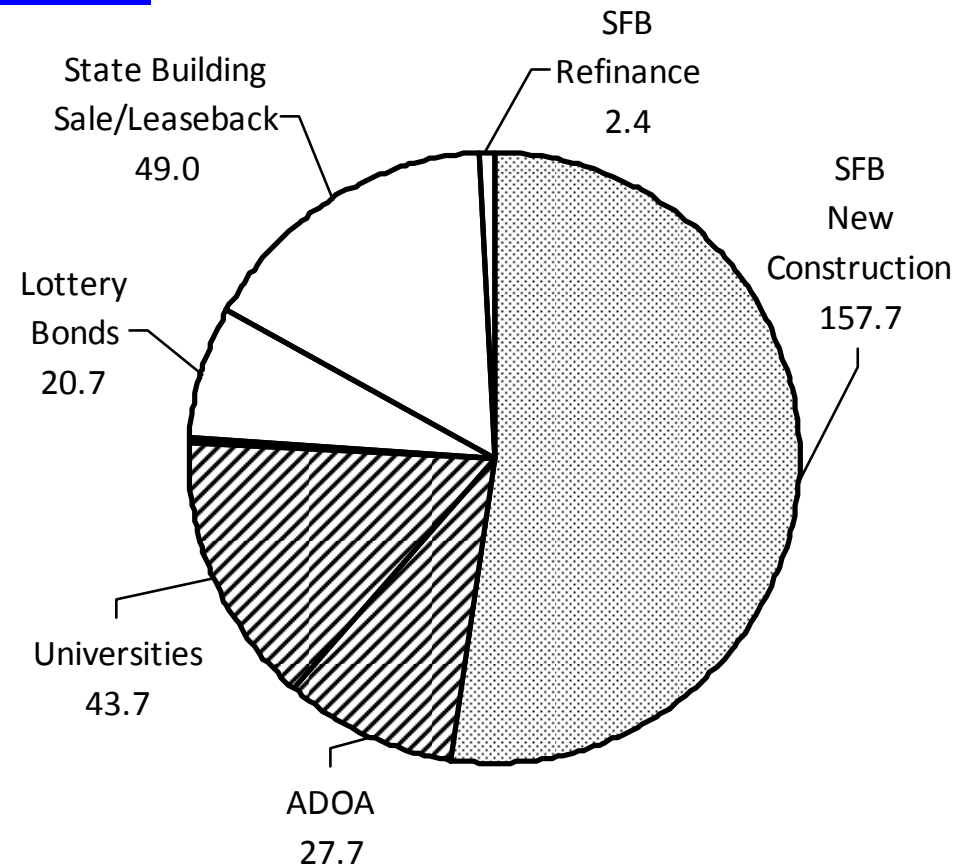
Outstanding Balances	
Capital Facilities/Uses	\$ 0.9 B
School Facilities Board	\$ 1.2 B
Operating	\$ 1.5 B



General Fund Debt Service Cost \$302 M

- Represented 7th Largest Budget Unit

Annual Payments	
Capital Facilities/Uses	\$ 72 M
School Facilities Board	\$ 158 M
Operating	\$ 72 M



Capital
 SFB
 Operating

FY 2012 - \$ in Millions

Annual General Fund Debt Service/Lease-Purchase Financing Costs Will Increase Through FY 2014

<u>\$ in Millions</u>			
	<u>FY '12</u>	<u>FY '13</u>	<u>FY '14</u>
Capital Facilities/Uses	72	63	77
School Facilities Board	158	167	172
Operating	72	124	124
Total	\$302 M	\$354 M	\$373 M

Optional Debt Retirement

- ❑ FY '14 Executive budget includes an on-going \$40 million annually for debt reduction
- ❑ Proposal could include the state's debt/lease-purchase financing or rollovers – no specific debt obligation was identified for retirement.
- ❑ Further analysis would be needed to identify which financing issuance would be most cost-effective to retire based on a variety of financial factors.

Potential Issues for Debt Retirement

- ❑ Variety of factors when selecting which issuances should be retired early
 - Call date – Most financing agreements have a time period where the state is prohibited from paying off the outstanding balance, typically 10 years from issuance
 - Principal amount/interest rate – Both of which affect the level of annual debt service
 - Length of term – As financing period become longer, the state generates more savings from avoided payments
- ❑ Transaction costs may affect whether debt retirement occurs in one transaction or over several years

Mandatory Debt Retirement

- ❑ In order for the \$1.5 B operating debt issuance to qualify as federally tax-exempt, State must begin to retire balance if cash reserves exceed 5%
- ❑ May not be effective until FY '17
- ❑ Limited examples of these requirements being applied in other jurisdictions – more specific guidance is needed

Lease-Purchase and Bonding Summary

	<u>GF Balance After FY 14</u>	<u>Call Date</u>	<u>Interest Rate Range</u>	<u>Retirement FY</u>
2003 Issuances				
School Facilities Board (2003 B)	15,185,000	9/1/2013	4.2% - 5.25%	FY 15
2004 Issuances				
ADC Prison Expansions (2004 B)	13,995,000	Info not available	Info not available	FY 19
School Facilities Board (2004 A)	19,865,000	9/1/2014	5.0%	FY 19
School Facilities Board (2004 B)	43,195,000	9/1/2014	4.25% - 5.25%	FY 17
School Facilities Board (2004 C)	24,860,000	9/1/2014	4.75% - 5.0%	FY 20
ASU Research (2004)	65,455,000	9/1/2014	4.125% - 5.25%	FY 31
NAU Research (2004)	30,445,000	9/1/2014	4.0% - 5.125%	FY 31
U of A Research (2004 A)	275,000	6/1/2014	5.25%	FY 15
2005 Issuances				
School Facilities Board (2005 A1/A2/A3)	320,035,000	9/1/2015	3.625% - 5.0%	FY 20
Phoenix Convention Center (2005 B)	260,124,300	Unable to call	5.50%	FY 44
ASU Research (2005 A)	88,680,000	3/1/2015	3.375% - 5.0%	FY 31
NAU Research (2005)	32,370,000	9/1/2015	3.75% - 5.125%	FY 31
2006 Issuances				
ASU Research (2006)	12,525,000	6/1/2016	4.0% - 5.0%	FY 31
NAU Research (2006)	1,275,000	9/1/2016	4.0%	FY 17
U of A Research (2006)	14,655,000	6/1/2016	4.0% - 5.0%	FY 31
2007 Issuances				
U of A Research (2007 D)	42,630,000	6/1/2017	4.0%	FY 31
2008 Issuances				
ADC 4,000 Prison Beds (2008 A)	162,740,000	Info not available	Info not available	FY 28
ADC Water, and Wastewater (2008 A)	4,815,000	Info not available	Info not available	FY 23
DHS Forensic Hospital (2008 A)	22,790,000	Info not available	Info not available	FY 23
School Facilities Board (2008 A)	454,870,000	9/1/2018	5.0% - 5.75%	FY 24
2010 Issuances				
\$735 M Sale/Leaseback (2010 A)	657,545,000	10/1/2019	4.2% - 5.25%	FY 30
\$300 M Sale/Leaseback (2010 B)	268,070,000	4/1/2020	4.0% - 5.0%	FY 30
Lottery Revenue Bond	391,185,000	1/1/2020	3.5% - 5.0%	FY 29
Federal Bonds	79,909,400	Now, subject to certain conditions	6.0%. State cost after subsidy = 1.14%	FY 28
2011 Refinance	58,785,000	Unable to call	3.0% - 5.0%	FY 20
2012 Issuances				
U of A Research (2012 C)	98,920,000	6/1/2022	5.0%	FY 31
Total	<u>3,185,198,700</u>			