

JLBC Staff Report - FY 2016 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 2016):

- 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 2016/FY 2017)
- 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 State Treasurer's [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 slideshow (*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 issues relating to debt retirement.

Total FY 2016 outstanding bond, lease-purchase and payments deferral balances were \$8.84 billion, of which \$931 million was related to payments deferrals. Excluding the payment deferrals, the outstanding FY 2016 balance was \$7.91 billion. This equates to a per capita amount of \$1,157. In comparison to the FY 2016 level of \$7.91 billion, the outstanding FY 2007 balance was \$4.89 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) Operating financing used to solve to the FY 2010 budget shortfall.

Of the total FY 2016 outstanding balance of \$7.91 billion, the General Fund share was \$2.51 billion. In FY 2016, the General Fund made debt services payments totaling \$326 million, of which 36% was paid towards interest. By comparison, in FY 2015, after excluding the Lottery Revenue Bonds for comparability, the General Fund debt service payments totaled \$332 million, of which 38% was paid towards interest.

Table 1 below gives a brief summary of the report.

Table 1

**State Debt and Financing Summary
(As of FY 2016)**

Total Outstanding Balance	\$ 8.84 B
Total Outstanding Balance (excludes Payment Deferrals)	\$ 7.91 B
General Fund Outstanding Balance	\$ 2.51 B
FY 2016 General Fund Debt Service	\$ 326 M
Interest as a % of General Fund Debt Service	36%
Total Outstanding Balance Per Capita	\$ 1,157

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>
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	1,335	2.8%
2012	8.71	1,329	(0.4)%
2013	8.60	1,296	(2.5)%
2014	8.26	1,227	(5.3)%
2015	8.07	1,194	(2.7)%
2016	7.91	1,157	(3.1)%

Table 3

Lease-Purchase and Bonding Summary 1/

	Overall Balance <u>2/</u>	GF Balance <u>2/</u>	Overall FY 16 Payment <u>3/</u>	FY 16 Principal Payment <u>3/</u>	FY 16 Interest Payment <u>3/</u>	FY 16 GF Payment <u>4/</u>	FY 16 GF Principal Payment <u>4/</u>	FY 16 GF Interest Payment <u>4/</u>
LEASE-PURCHASE SUMMARY								
<u>State Buildings</u>								
2008A Issuance (ADC Prisons Expansions/DHS Forensic Hospital)	\$55,400,000	\$55,400,000	\$14,200,600	\$11,505,000	\$2,695,600	\$14,200,600	\$11,505,000	\$2,695,600
2013A Issuance (DHS Building Refinance)	21,435,000	12,861,000	1,852,900	910,000	942,900	1,111,700	546,000	565,700
2013B Issuance (Health Lab Refinance/ADC Prison Issuance Refinance)	20,570,000	8,550,000	5,098,300	3,990,000	1,108,300	3,069,300	2,590,000	479,300
2015 Issuance (2008A ADC and DHS)	107,515,000	107,515,000	4,850,500	0	4,850,500	4,850,500	0	4,850,500
2015 A Issuance (PLTO Refinance - Capitol Mall)	54,115,000	54,115,000	2,103,900	640,000	1,463,900	424,200	129,000	295,200
<i>Subtotal - ADOA</i>	<i>259,035,000</i>	<i>238,441,000</i>	<i>28,106,200</i>	<i>17,045,000</i>	<i>11,061,200</i>	<i>23,656,300</i>	<i>14,770,000</i>	<i>8,886,300</i>
<u>ABOR Building System</u>								
Arizona State University	324,033,000	151,905,000	28,138,000	14,494,000	13,644,000	11,422,000	5,580,000	5,842,000
Northern Arizona University	54,985,000	54,790,000	5,705,100	3,300,000	2,405,100	5,493,200	3,105,000	2,388,200
University of Arizona	348,995,000	151,570,000	65,359,000	47,461,000	17,898,000	9,594,000	2,505,000	7,089,000
<i>Subtotal - ABOR</i>	<i>728,013,000</i>	<i>358,265,000</i>	<i>99,202,100</i>	<i>65,255,000</i>	<i>33,947,100</i>	<i>26,509,200</i>	<i>11,190,000</i>	<i>15,319,200</i>
<u>Other</u>								
Phoenix Convention Center <u>5/</u>	260,124,400	260,124,400	20,449,000	0	20,449,000	20,449,000	0	20,449,000
<i>Subtotal - State Building System</i>	<i>\$1,247,172,400</i>	<i>\$856,830,400</i>	<i>\$147,757,300</i>	<i>\$82,300,000</i>	<i>\$65,457,300</i>	<i>\$70,614,500</i>	<i>\$25,960,000</i>	<i>\$44,654,500</i>
<u>Operating Shortfall</u>								
2010 Sale/Leaseback A/B Issuance	845,280,000	845,280,000	84,094,500	41,135,000	42,959,500	84,094,500	41,135,000	42,959,500
<u>School Facilities Board</u>								
New School Construction - FY 2003 - FY 2005	0	0	66,228,700	64,615,000	1,613,700	66,228,700	64,615,000	1,613,700
New School Construction - FY 2008 - FY 2009	161,945,000	161,945,000	44,926,400	37,385,000	7,541,400	44,926,400	37,385,000	7,541,400
2010 Qualified School Construction Bonds	60,346,600	60,346,600	9,938,100	5,028,900	4,909,200	9,938,100	5,028,900	4,909,200
2010 Refinance (FY 2011)	58,785,000	58,785,000	2,449,800	0	2,449,800	2,449,800	0	2,449,800
2013 Refinance	45,125,000	45,125,000	24,780,300	22,310,000	2,470,300	24,780,300	22,310,000	2,470,300
2014 Refinance	219,020,000	219,020,000	10,345,500	7,105,000	3,240,500	10,345,500	7,105,000	3,240,500
2015 Refinance	257,835,000	257,835,000	12,440,100	5,710,000	6,730,100	12,440,100	5,710,000	6,730,100
<i>Subtotal - SFB</i>	<i>803,056,600</i>	<i>803,056,600</i>	<i>171,108,900</i>	<i>142,153,900</i>	<i>28,955,000</i>	<i>171,108,900</i>	<i>142,153,900</i>	<i>28,955,000</i>
TOTAL - Lease-Purchase	\$2,895,509,000	\$2,505,167,000	\$402,960,700	\$265,588,900	\$137,371,800	\$325,817,900	\$209,248,900	\$116,569,000

Table 3 (Cont'd)

	Overall Balance <u>2/</u>	GF Balance <u>2/</u>	Overall FY 16 Payment <u>3/</u>	FY 16 Principal Payment <u>3/</u>	FY 16 Interest Payment <u>3/</u>	FY 16 GF Payment <u>4/</u>	FY 16 GF Principal Payment <u>4/</u>	FY 16 GF Interest Payment <u>4/</u>
Bonding Summary								
School Facilities Board								
Deficiencies Correction:								
Proposition 301	\$245,885,000	\$0	\$64,138,100	\$59,800,000	\$4,338,100	\$0	\$0	\$0
State Land Trust	46,396,900	0	24,903,500	21,718,500	3,185,000	0	0	0
<i>Subtotal - SFB</i>	292,281,900	0	89,041,600	81,518,500	7,523,100	0	0	0
Department of Transportation <u>5/</u>	1,667,090,000	0	201,345,300	117,545,000	83,800,300	0	0	0
ABOR Building System								
Arizona State University	1,206,720,000	0	101,361,000	45,675,000	55,686,000	0	0	0
Northern Arizona University	548,848,200	0	39,424,700	12,765,300	26,659,400	0	0	0
University of Arizona	943,745,000	0	76,230,000	34,465,000	41,765,000	0	0	0
<i>Subtotal - ABOR</i>	2,699,313,200	0	217,015,700	92,905,300	124,110,400	0	0	0
Operating Shortfall								
Lottery Revenue Bonds <u>7/</u>	353,675,000	0	37,501,800	19,205,000	18,296,800	0	0	0
TOTAL - Bonding	\$5,012,360,100	\$0	\$544,904,400	\$311,173,800	\$233,730,600	\$0	\$0	\$0
TOTAL - Lease-Purchase & Bonding	\$7,907,869,100	\$2,505,167,000	\$947,865,100	\$576,762,700	\$371,102,400	\$325,817,900	\$209,248,900	\$116,569,000
TOTAL - Payment Deferrals	\$930,727,700	\$930,727,700						
TOTAL ALL OBLIGATIONS	\$8,838,596,800	\$3,435,894,700	\$947,865,100	\$576,762,700	\$371,102,400	\$325,817,900	\$209,248,900	\$116,569,000

1/ Pursuant to A.R.S. § 41-1277, all information listed is from the FY 2016 State Treasurer Debt Report, except where noted. The State Treasurer's 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 2016.

3/ Represents total FY 2016 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 2016, along with the portions of the payments consisting of principal and interest costs.

5/ Phoenix Convention Center financing was not included in the State Treasurer's 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.

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

7/ 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 16</u>	<u>Interest to be Paid in FY 17</u>
Department of Education	930,727,700 ^{1/}	\$273 M in FY 2008, \$330 M in FY 2009, and \$350 M in FY 2010. \$21.9 M paid in FY 2013.	2,400,100 ^{2/}	0	0
Department of Economic Security	0	\$25 M in FY 2009 and \$10 M in FY 2010 ^{3/}	0	0	0
Department of Child Safety	0				
Universities	0	\$100 M in FY 2009 and \$100 M in FY 2010 ^{4/}	0	0	0
Total	\$930,727,700		\$2,400,100	\$0	\$0

^{1/} Laws 2013, 1st Special Session, Chapter 1 reduced the outstanding payment deferral by \$(21,900,000) by eliminating the deferral for school districts with less than 600 pupils.

^{2/} Interest was paid for the ADE payment deferral in FY 2008 - FY 2010.

^{3/} With the creation of the new Department of Child Safety, Laws 2014, 2nd Special Session, Chapter 2 paid off \$3 million of the \$35 million Department of Economic Security deferral and allocated \$21 million of the deferral to the Department of Economic Security and \$11 million of the deferral to the Department of Child Safety. Laws 2016, Chapter 117 paid off the \$21 million payment deferral to the Department of Economics Security and paid off the \$11 million payment deferral to the Department of Child Safety in FY 2016.

^{4/} Laws 2016, Chapter 117 paid off the \$200 million payment deferral to the Universities in FY 2016.

Explanation of Issuances

Lease-Purchase Summary

State Buildings

ADOA Building System – Lease-Purchase

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.

2013 A – Issued in January 2013, the 2013 A lease-purchase transaction refinanced the privatized lease-to-own (PLTO) agreement (executed in 2001) which had initially funded the DHS office building at 150 North 18th Avenue. The refinancing transaction reduced the existing payment schedule for the building by approximately \$(330,000) annually through FY 2029. While a PLTO agreement usually requires a private entity to maintain the building until the life of the agreement is complete, the conversion of this agreement into a traditional lease-purchase has been accompanied by an agreement with a private entity that will continue to be responsible for the maintenance of the DHS building through the end of the issuance in FY 2029.

2013 B – Issued in January 2013, the 2013 B transaction refinanced the 2 existing lease-purchase transactions (2002 A and 2004 B). The refinancing transaction reduced the existing payment schedule for these buildings by approximately \$(390,000) annually through FY 2019.

2015 – Issued in July 2015, the 2015 transaction refinanced a portion of the 2008 A transaction. The refinancing transaction reduced the existing payment schedule for these buildings by approximately \$(950,000) annually through FY 2028.

2015 A – Issued in July 2015, the 2015 A lease-purchase transaction refinanced the privatized lease-to-own (PLTO) agreement (executed in 2005) which had initially funded the 2 office buildings on the Capitol Mall. The 2 buildings house ADOA and the Department of Environmental Quality. The refinancing transaction reduced the existing payment schedule for the building by approximately \$(480,000) annually through FY 2028. While a PLTO agreement usually requires a private entity to maintain the building until the life of the agreement is complete, the conversion of this agreement into a traditional lease-purchase has been accompanied by an agreement with a

private entity that will continue to be responsible for the maintenance of the DHS building through the end of the issuance in FY 2029. As a result of the refinanced ADOA and ADEQ buildings, the state currently has no active PLTO agreements.

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. Laws 2016, Chapter 130 modified statute to reflect long-term debt service savings from the refinancing of research infrastructure projects and specified appropriations through the end of the debt service in FY 2031.

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 a tax-exempt yield of approximately 4%. 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.

When the financing was originally issued, the state agreed to the Working Capital Surplus Limitation, which would have required certain cash reserves to be used for mandatory repayment of the financing. Given the concerns about the mandatory repayment, the state

converted to the Investment Yield Restriction in May 2014. The selection of this limitation is irrevocable for the duration of the financing. Because the state is no longer subject to the mandatory repayment requirements of the Working Capital Surplus Limitation, the operating financing is not subject to prepayment by the state until FY 2020. *(Please see the FY 2017 JLBC Baseline Summary for more information on these requirements.)*

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 6 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%. Beginning in FY 2014, the subsidy was reduced due to federal budget reductions.
- **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.
- **2013 SFB Refinance** – Authorized by Laws 2013, 1st Special Session, Chapter 3, SFB entered into a refinancing agreement whereby \$79.6 million of new financing was issued, and the cash proceeds were used to refinance outstanding agreements and lower the agency’s FY 2014 and FY 2015 debt service obligations to achieve non-recurring savings of \$1.4 million in FY 2014 and \$3.8 million in FY 2015.

- **2014 SFB Refinance** – Authorized by Laws 2013, 1st Special Session, Chapter 3, SFB entered into a second refinancing agreement whereby \$226.1 million of new financing was issued, and the cash proceeds were used to refinance outstanding agreements and lower the agency’s debt service obligations to achieve non-recurring savings of \$9.4 million in FY 2015 along with approximately \$100,000 annually between FY 2016 and FY 2020.
- **2015 SFB Refinance** – Authorized by Laws 2015, 1st Special Session, Chapter 15, SFB entered into a refinancing agreement whereby \$263.5 million of new financing was issued, and the cash proceeds were used to refinance outstanding agreements and lower the agency's debt service obligations to achieve debt service savings of approximately \$1.7 million annually through the end of the issuance in FY 2024.

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 allocated \$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 2018 JLBC Baseline for more information.)*

Operating Shortfall

Lottery Revenue Bonds – FY 2010 budget legislation (Laws 2010, 6th Special Session, Chapter 4) authorized the department to issue Lottery revenue bonds, 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 bonds 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.

When the Lottery Revenue Bonds were originally issued, the state agreed to the Working Capital Surplus Limitation, which would have required certain cash reserves to be used for mandatory repayment of the issuance. Given the concerns about the mandatory repayment, the state converted to the Investment Yield Restriction in May 2014. The selection of this limitation is irrevocable for the duration of the financing. Because the state is no longer subject to the mandatory repayment requirements of the Working Capital Surplus Limitation, the Lottery Revenue Bonds are not subject to prepayment by the state until FY 2020. *(Please see the FY 2017 JLBC Baseline Summary for more information on these requirements.)*

Report on State Debt and Lease-Purchase Financing

JLBC

Debt Overview

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 2016)
- ❑ 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

Lease-Purchase Financing vs. Bonds

- ❑ Lease-purchase financing has no pledged 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

Arizona's Credit Rating Was Upgraded in May 2015

- ❑ In May, 2015, both major credit rating agencies upgraded AZ's credit rating (S&P: AA- to AA; Moody's: Aa3 to Aa2)
 - Outlook from both agencies is stable

- ❑ In comparison to other states, 28 states have a higher rating, 12 states have the same rating, and 9 states have a lower rating or are not rated due to a lack of state level debt

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 Used Operating Financing For \$1.5 B of Solutions To Budget Shortfalls in 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
 - Sale/Leaseback financing paid off in FY 2030

- ❑ \$450 M from the issuance of lottery revenue bonds
 - Debt service paid from General Fund portion of lottery revenues – represents foregone revenues
 - Lottery financing paid off in FY 2029

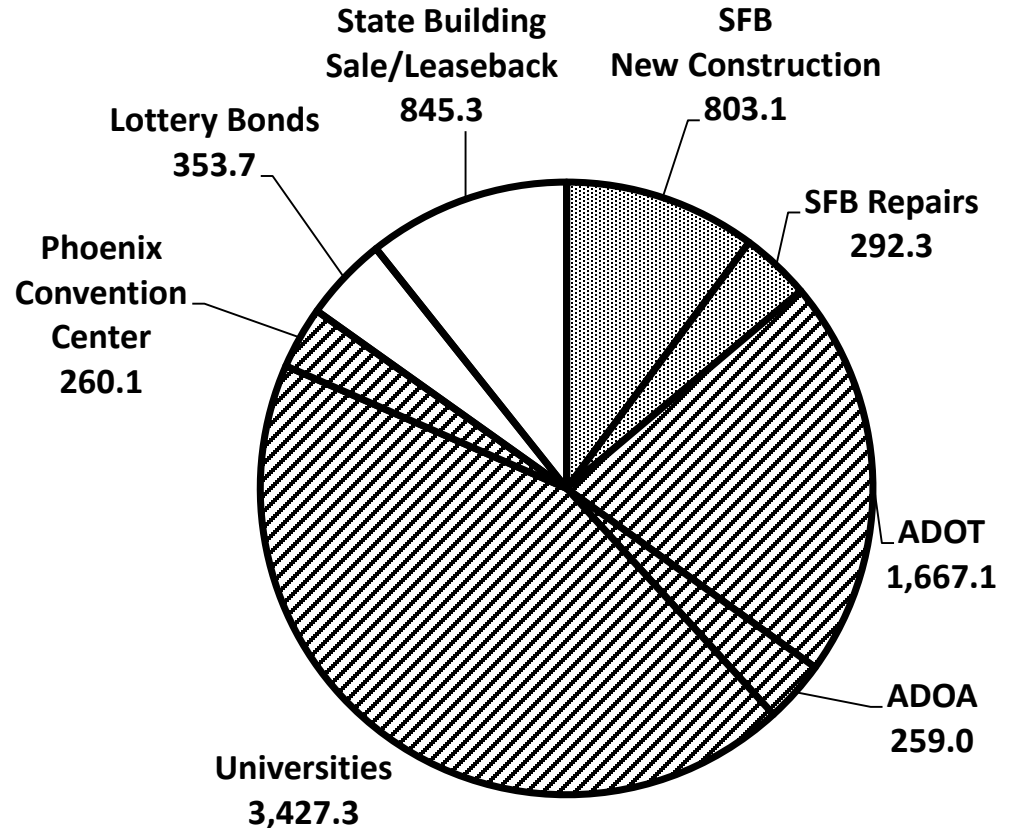
Debt Balance and Payment Information

Total Outstanding State Debt/Lease-Purchase Financing is \$7.9 Billion

- Reflects Multiple Payment Sources

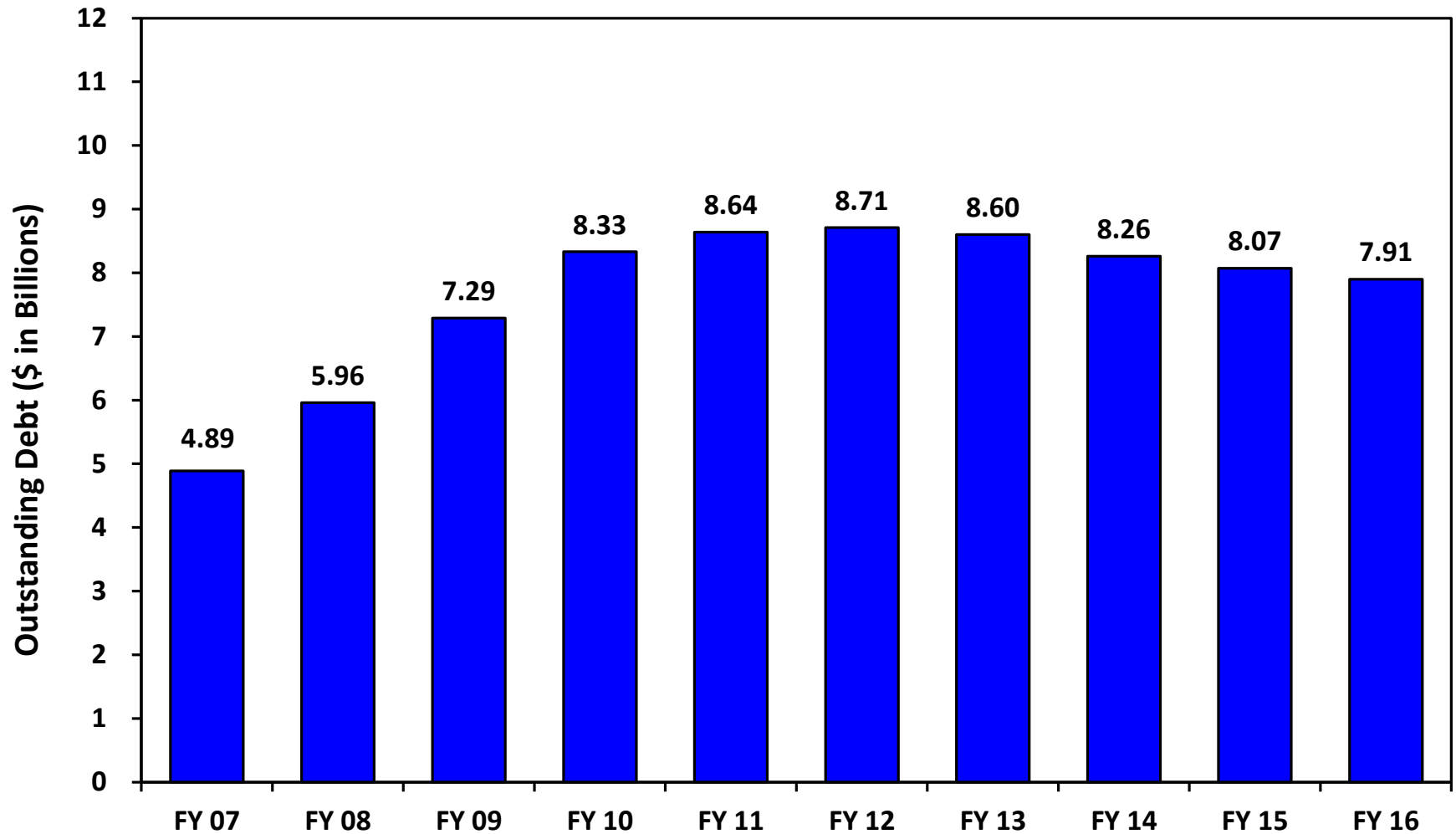
Outstanding Balances

Capital Facilities/Uses	\$ 5.6 B
School Facilities Board	\$ 1.1 B
Operating	\$ 1.2 B

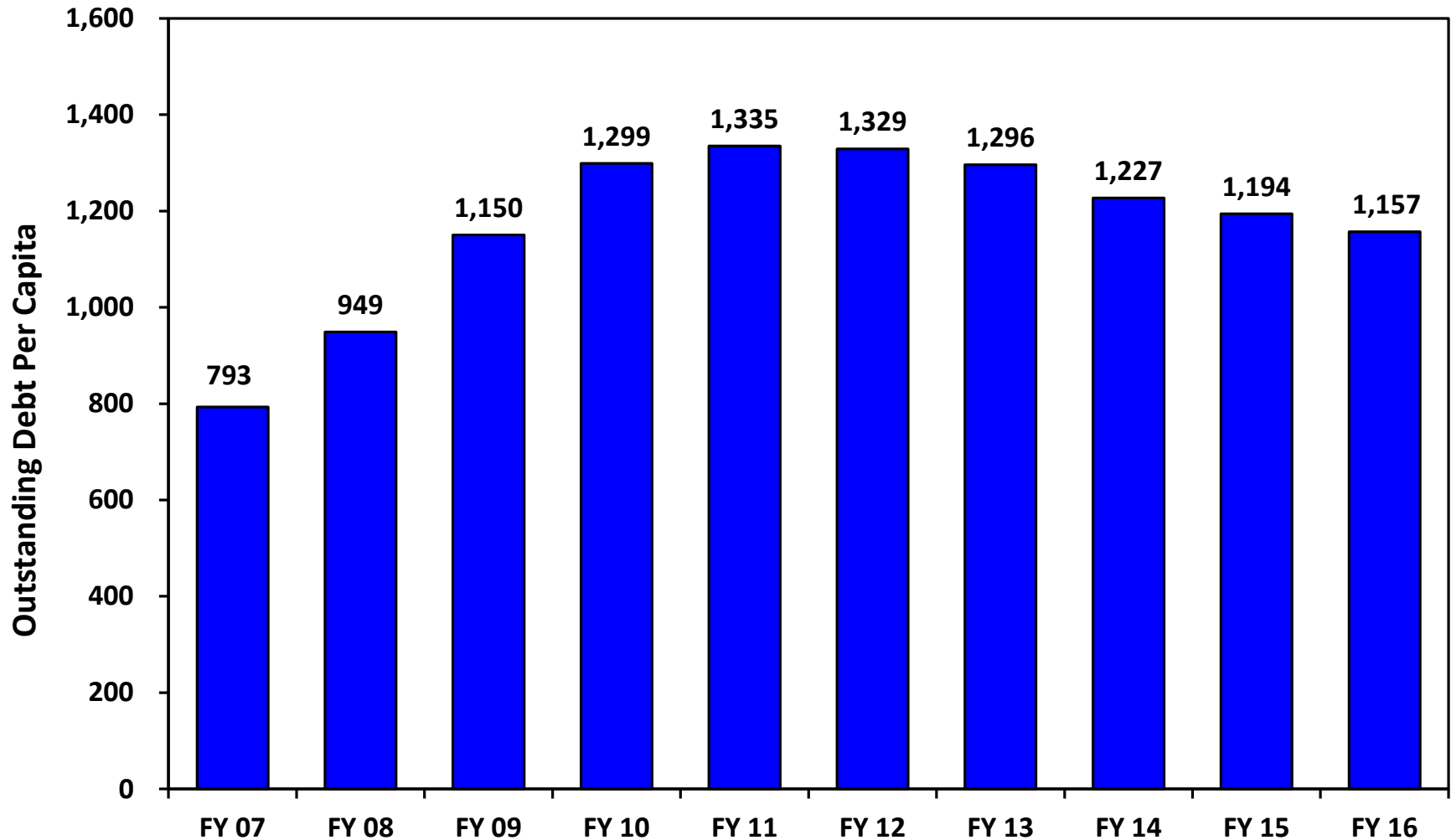


End of FY 2016 - \$ in Millions

Arizona Overall Debt Obligations Peaked in '12



Arizona Per Capita Debt Obligations Since '07



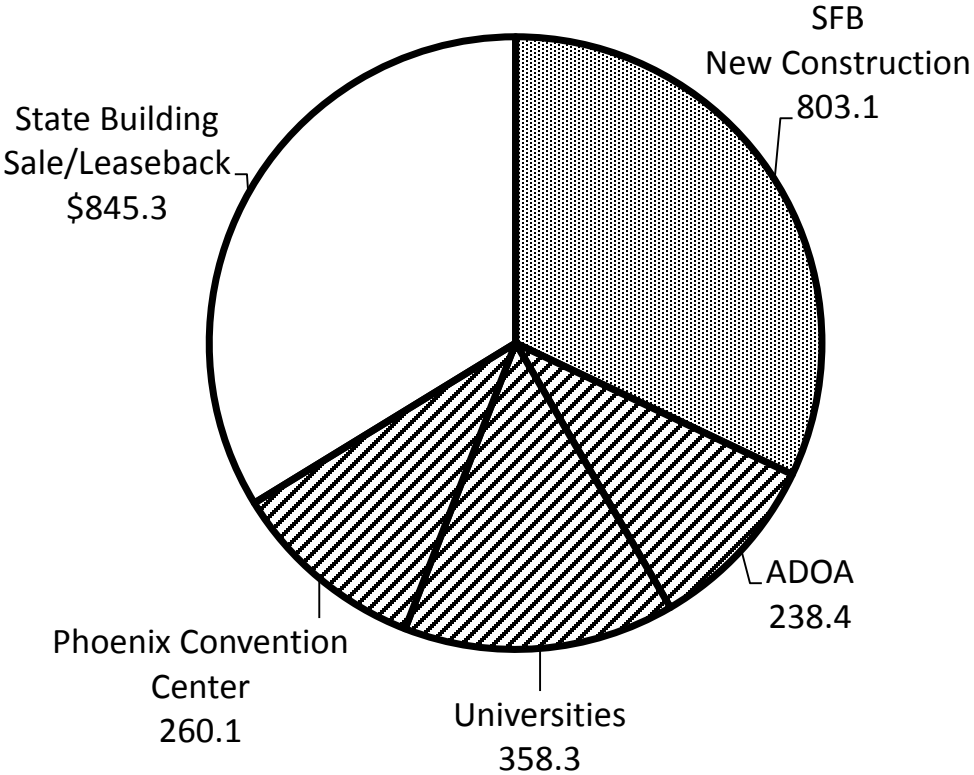
State Defers \$931 M of K-12 Payments Annually

- Interest Is Not Paid By the State For Rollovers

- Used for one-time solutions during recent years with significant budget shortfalls – at its highest, the state had \$1.3 B of active rollovers in FY 2011
 - FY 2013 budget eliminated rollover associated with payments to AHCCCS health plans (\$112.6 M cost)
 - FY 2014 budget eliminated K-12 rollover for school districts with less than 600 pupils (\$21.9 M cost)
 - FY 2014 Special Session eliminated \$3 million of the DES rollover and allocated the remaining between DES/DCS
 - FY 2016 budget eliminated \$232 M of Universities, DES, and DCS rollovers; only K-12 remains

General Fund Share of Outstanding Balances Is \$2.5 B

Outstanding Balances	
Capital Facilities/Uses	\$ 0.9 B
School Facilities Board	\$ 0.8 B
Operating	\$ 0.8 B



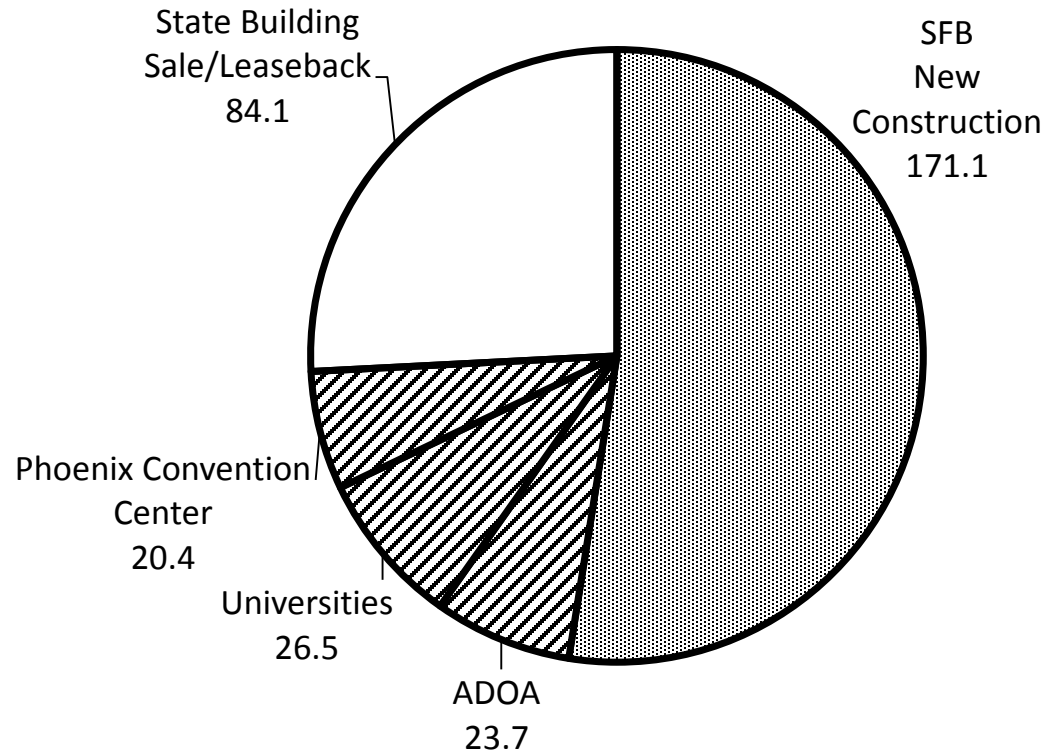
End of FY 2016 - \$ in Millions

General Fund Debt Service Cost \$326 M

- Represented 8th Largest Budget Unit

Annual Payments

Capital Facilities/Uses	\$ 71 M
School Facilities Board	\$ 171 M
Operating	\$ 84 M



FY 2016 - \$ in Millions

Annual General Fund Debt Service Increases in '18

<u>\$ in Millions</u>			
	<u>FY '16</u>	<u>FY '17</u>	<u>FY '18</u>
Capital Facilities/Uses	71	76	100
School Facilities Board	171	170	170
Operating	84	84	84
Total	\$326 M	\$330 M	\$354 M

FY 2018 General Fund Debt Service Increase – \$24 M

- \$18 M – Refinance of ADC Kingman private prison
 - Occurred in November 2016 and generated a net savings of \$8.8 M annually
 - State will now make direct debt service payment – prior to refinance payment was included in overall funding amount for private vendor
- \$4 M – Decline in savings from refinance of Universities research financing
- \$2 M – Phoenix Convention Center debt service

Potential Issues for Debt Retirement

- ❑ Laws 2013, Chapter 99 created an annual report from ADOA on debt retirement options
 - 2016 Report estimated that \$100 M debt retirement would generate future total debt service savings of \$46 M through FY 2030
- ❑ Variety of factors when selecting issuances to retire 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