

## JLBC Staff Report - FY 2018 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 2018):

- 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 2018/FY 2019)
- 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 Administration'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 the Executive Budget and debt retirement.

Total FY 2018 outstanding bond, lease-purchase and payments deferral balances were \$8.53 billion, of which \$931 million was related to payments deferrals. Excluding the payment deferrals, the outstanding FY 2018 balance was \$7.60 billion. This equates to a per capita amount of \$1,074. In comparison to the FY 2009 level of \$7.60 billion, the outstanding FY 2009 balance was \$7.29 billion.

The growth in debt from FY 2009 to the \$8.71 billion peak in FY 2012 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. As of FY 2018, outstanding principal has declined by \$1.11 billion since FY 2012.

Of the total FY 2018 outstanding balance of \$7.60 billion, the General Fund share was \$2.11 billion. In FY 2018, the General Fund made debt services payments totaling \$351 million, of which 26% was paid towards interest. By comparison, in FY 2017, the General Fund debt service payments totaled \$340 million, of which 34% was paid towards interest.

Laws 2017, Chapter 328 established the University Capital Investment Program, which provides annual General Fund appropriations from

FY 2019 – FY 2043 for new university research facilities, building renewal, or other capital construction projects. The universities may use these monies for debt service on infrastructure long-term-financing, with debt issued under this program not to exceed \$1.0 billion. For debt issued under this program, debt service is paid 50% with tuition and 50% with General Fund monies. The first debt under this program was issued in FY 2018.

Table 1 below gives a brief summary of the report.

<b>Table 1</b>	
<b>State Debt and Financing Summary (As of FY 2018)</b>	
Total Outstanding Balance	\$ 8.53 B
Total Outstanding Balance (excludes Payment Deferrals)	\$ 7.60 B
General Fund Outstanding Balance	\$ 2.11 B
FY 2018 General Fund Debt Service	\$ 351 M
Interest as a % of General Fund Debt Service	26%
Total Outstanding Balance Per Capita	\$ 1,074

<b>Table 2</b>			
<b>Per Capita State Debt Historical Summary</b>			
<b><u>Fiscal Year</u></b>	<b><u>Outstanding Principal (Total Funds - \$ in B)</u></b>	<b><u>Per-Capita Outstanding</u></b>	<b><u>% Change from Prior FY</u></b>
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	1,141	(4.4)%
2017	7.79	1,110	(2.7)%
2018	7.60	1,074	(3.2)%

Table 3

Lease-Purchase and Bonding Summary 1/

	Overall Balance <u>2/</u>	GF Balance <u>2/</u>	Overall FY 18 Payment <u>3/</u>	FY 18 Principal Payment <u>3/</u>	FY 18 Interest Payment <u>3/</u>	FY 18 GF Payment <u>4/</u>	FY 18 GF Principal Payment <u>4/</u>	FY 18 GF Interest Payment <u>4/</u>
<b>LEASE-PURCHASE SUMMARY</b>								
<b>State Buildings</b>								
2008A Issuance (ADC Prisons Expansions/DHS Forensic Hospital)	\$0	\$0	\$13,505,700	\$12,560,000	\$945,700	\$13,505,700	\$12,560,000	\$945,700
2013A Issuance (DHS Building Refinance)	19,350,000	0	1,982,700	1,095,000	887,700	1,189,500	656,900	532,600
2013B Issuance (Health Lab Refinance/ADC Prison Issuance Refinance)	12,010,000	2,995,000	5,095,100	4,385,000	710,100	3,065,800	2,638,500	427,300
2015 Issuance (2008A ADC and DHS - Partial)	107,555,000	107,555,000	5,332,300	0	5,332,300	5,332,300	0	5,332,300
2015 A Issuance (PLTO Refinance - Capitol Mall)	46,885,000	46,885,000	5,948,700	3,635,000	2,313,700	1,250,900	764,400	486,500
2016 Issuance (ADC Kingman Refinance)	100,585,000	100,585,000	17,463,300	12,445,000	5,018,300	17,463,300	12,445,000	5,018,300
2017 Issuance (Refinance Balance of 2008A)	31,570,000	31,570,000	234,800	0	234,800	234,800	0	234,800
<i>Subtotal - ADOA</i>	<i>317,955,000</i>	<i>289,590,000</i>	<i>49,562,600</i>	<i>34,120,000</i>	<i>15,442,600</i>	<i>42,042,300</i>	<i>29,064,800</i>	<i>12,977,500</i>
<b>ABOR Building System</b>								
Arizona State University	299,594,500	143,883,500	30,780,500	19,591,700	11,188,800	13,139,700	8,363,400	4,776,300
Northern Arizona University	49,550,000	49,550,000	5,981,700	3,490,000	2,491,700	5,981,700	3,490,000	2,491,700
University of Arizona	280,274,700	133,994,400	45,769,800	31,824,200	13,945,600	14,227,500	9,892,500	4,335,000
<i>Subtotal - ABOR</i>	<i>629,419,200</i>	<i>327,427,900</i>	<i>82,532,000</i>	<i>54,905,900</i>	<i>27,626,100</i>	<i>33,348,900</i>	<i>21,745,900</i>	<i>11,603,000</i>
<b>Other</b>								
Phoenix Convention Center <u>5/</u>	258,640,300	258,640,300	22,499,000	21,015,000	1,484,000	22,499,000	21,015,000	1,484,000
<b>Subtotal - State Building System</b>	<b>\$1,206,014,500</b>	<b>\$875,658,200</b>	<b>\$154,593,600</b>	<b>\$110,040,900</b>	<b>\$44,552,700</b>	<b>\$97,890,200</b>	<b>\$71,825,700</b>	<b>\$26,064,500</b>
<b>Operating Shortfall</b>								
2010 Sale/Leaseback A/B Issuance	756,730,000	756,730,000	84,095,000	45,370,000	38,725,000	84,095,000	45,370,000	38,725,000
<b>School Facilities Board</b>								
New School Construction - FY 2008 - FY 2009 <u>6/</u>	43,735,000	43,735,000	44,922,100	41,455,000	3,467,100	44,922,100	41,455,000	3,467,100
2010 Qualified School Construction Bonds <u>6/</u>	50,288,800	50,288,800	9,306,200	4,397,000	4,909,200	9,306,200	4,397,000	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	13,530,000	13,530,000	9,182,200	8,375,000	807,200	9,182,200	8,375,000	807,200
2014 Refinance	55,605,000	55,605,000	91,721,800	89,850,000	1,871,800	91,721,800	89,850,000	1,871,800
2015 Refinance	257,835,000	257,835,000	11,465,800	0	11,465,800	11,465,800	0	11,465,800
<i>Subtotal - SFB</i>	<i>479,778,800</i>	<i>479,778,800</i>	<i>169,047,900</i>	<i>144,077,000</i>	<i>24,970,900</i>	<i>169,047,900</i>	<i>144,077,000</i>	<i>24,970,900</i>
<b>TOTAL - Lease-Purchase</b>	<b>\$2,442,523,300</b>	<b>\$2,112,167,000</b>	<b>\$407,736,500</b>	<b>\$299,487,900</b>	<b>\$108,248,600</b>	<b>\$351,033,100</b>	<b>\$261,272,700</b>	<b>\$89,760,400</b>

<b>Table 3 (Cont'd)</b>								
	<b>Overall Balance 2/</b>	<b>GF Balance 2/</b>	<b>Overall FY 18 Payment 3/</b>	<b>FY 18 Principal Payment 3/</b>	<b>FY 18 Interest Payment 3/</b>	<b>FY 18 GF Payment 4/</b>	<b>FY 18 GF Principal Payment 4/</b>	<b>FY 18 GF Interest Payment 4/</b>
<b>Bonding Summary</b>								
<u>School Facilities Board</u>								
Deficiencies Correction:								
Proposition 301	\$124,640,000	\$0	\$64,133,500	\$60,955,000	\$3,178,500	\$0	\$0	\$0
State Land Trust	0	0	23,299,500	22,190,000	1,109,500	0	0	0
<i>Subtotal - SFB</i>	<i>124,640,000</i>	<i>0</i>	<i>87,433,000</i>	<i>83,145,000</i>	<i>4,288,000</i>	<i>0</i>	<i>0</i>	<i>0</i>
Department of Transportation 7/	1,654,580,000	0	225,139,300	140,565,000	84,574,300	0	0	0
<u>ABOR Building System</u>								
Arizona State University	1,362,610,000	0	103,922,800	41,775,000	62,147,800	0	0	0
Northern Arizona University	537,980,000	0	38,316,200	13,205,000	25,111,200	0	0	0
University of Arizona	1,166,915,000	0	144,619,000	34,725,000	109,894,000	0	0	0
<i>Subtotal - ABOR</i>	<i>3,067,505,000</i>	<i>0</i>	<i>286,858,000</i>	<i>89,705,000</i>	<i>197,153,000</i>	<i>0</i>	<i>0</i>	<i>0</i>
<u>Operating Shortfall</u>								
Lottery Revenue Bonds 8/	312,585,000	0	37,500,800	21,025,000	16,475,800	0	0	0
<b>TOTAL - Bonding</b>	<b>\$5,159,310,000</b>	<b>\$0</b>	<b>\$636,931,100</b>	<b>\$334,440,000</b>	<b>\$302,491,100</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>
<b>TOTAL - Lease-Purchase &amp; Bonding</b>	<b>\$7,601,833,300</b>	<b>\$2,112,167,000</b>	<b>\$1,044,667,600</b>	<b>\$633,927,900</b>	<b>\$410,739,700</b>	<b>\$351,033,100</b>	<b>\$261,272,700</b>	<b>\$89,760,400</b>
<b>TOTAL - Payment Deferrals</b>	<b>\$930,727,700</b>	<b>\$930,727,700</b>						
<b>TOTAL ALL OBLIGATIONS</b>	<b>\$8,532,561,000</b>	<b>\$3,042,894,700</b>	<b>\$1,044,667,600</b>	<b>\$633,927,900</b>	<b>\$410,739,700</b>	<b>\$351,033,100</b>	<b>\$261,272,700</b>	<b>\$89,760,400</b>
<p>1/ Pursuant to A.R.S. § 41-1277, all information listed is from the FY 2018 Arizona Department of Administration Bonded Indebtedness Report, except where noted. The Arizona Department of Administration 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.</p> <p>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 2018.</p> <p>3/ Represents total FY 2018 lease-purchase or debt service payments from all fund sources, along with the portions of the payments consisting of principal and interest costs.</p> <p>4/ Represents lease-purchase or debt service payments paid from a General Fund source in FY 2018, along with the portions of the payments consisting of principal and interest costs.</p> <p>5/ Phoenix Convention Center financing was not included in the Arizona Department of Administration Bonded Indebtedness 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.</p> <p>6/ Balances adjusted to match the issuance's official statement.</p> <p>7/ Excludes Regional Area Road Fund (RARF) Bonds which are paid from the local Maricopa County regional transportation sales tax.</p> <p>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.</p>								

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 18</u>	<u>Interest to be Paid in FY 19</u>
Department of Education	930,727,700 <sup>1/</sup>	\$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 <sup>2/</sup>	0	0
<b>Total</b>	<b>\$930,727,700</b>		<b>\$2,400,100</b>	<b>\$0</b>	<b>\$0</b>

<sup>1/</sup> Laws 2013, 1<sup>st</sup> 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.

<sup>2/</sup> Interest was paid for the ADE payment deferral in FY 2008 - FY 2010.

## 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.

The 2015 lease-purchase agreement refinanced a portion of the outstanding 2008A ADC lease-purchase financing. *(Please see the 2015 section below for more information)*. In 2017, the remaining 2008A issuance that was not part of the 2015 lease-purchase agreement was refinanced. The new lease-purchase agreement was favorably reviewed by JCCR in June 2017. The refinancing of \$31.6 million in outstanding principal obligations is estimated to result in a total savings of \$1.6 million through FY 2028.

**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.

**2016** – Issued in November 2016, the 2016 issuance refinanced the Arizona Department of Corrections (ADC) Kingman private prison. This generated a net savings of \$8.8 million. The state will now make direct debt service payments. Prior to the refinancing, the payment was included in the overall funding amount for a private vendor.

**2017** – Issued in September 2017, the 2017 transaction refinanced the remaining balance of the 2008 A transaction. This will generate a net savings of \$1.6 million.

#### 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, 3<sup>rd</sup> Special Session, Chapter 6 and Laws 2010, 6<sup>th</sup> 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.)*

In January 2019, ADOA refinanced the 2010A Leaseback agreements originally issued in January 2010. This refinancing will result in annual savings of approximately \$6.4 million throughout the term of the bonds for a total savings of \$70.4 million. The financing will still be paid off in FY 2030. This has no impact on FY 2018 or FY 2019 payments.

## **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 2008 - 2009** – This group of financing was 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. 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, 3<sup>rd</sup> 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 a portion of the outstanding 2003 and 2004 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 a portion of the outstanding 2005 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, 1<sup>st</sup> 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 a portion of the outstanding 2008 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 original issuance will have been retired. Laws 2018, Chapter 74 extends the Proposition 301 sales tax through FY 2041, however, it removes the allocation for debt service as the bonds will be 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 were 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 2020 JLBC Baseline for more information.)*

Laws 2017, Chapter 328 established the University Capital Investment Program, which provides General Fund appropriations from FY 2019 – FY 2043 for new university research facilities, building renewal, or other capital construction projects. The law appropriates \$27,000,000 to the universities in FY 2019 and increases the appropriation each year thereafter by 2% or the rate of inflation, whichever is less. The universities may use these monies for debt service on infrastructure long-term-financing and for cash construction costs. New debt issued under this program may not exceed \$1.0 billion. Each university will match any General Fund contributions that are used for debt service payments at a 1:1 rate.

### **Operating Shortfall**

**Lottery Revenue Bonds** – FY 2010 budget legislation (Laws 2010, 6<sup>th</sup> 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.)*

In December 2018, ADOA refinanced the 2010 Lottery Revenue Bonds. Laws 2010, Sixth Special Session, Chapter 4 authorizes ADOA to refinance these bonds in later years without additional legislative approval. This refinancing will result in annual savings of approximately \$3.0 million throughout the term of the bonds for a total savings of \$29.9 million. The financing will still be paid off in FY 2029. This has no impact on FY 2018 or FY 2019 payments.

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# Report on State Debt and Lease-Purchase Financing

JLBC

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# Debt Overview

JLBC

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

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- ❑ Outstanding principal on State debt, along with principal and interest payments in the prior fiscal year (FY 2018)
- ❑ 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's Credit Rating Was Upgraded in May 2015

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- ❑ 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 a November 2018 report by Moody's, the rating agency noted the strengthening of Arizona's economy
- ❑ 25 states have a higher rating, 15 have the same rating, and 9 have a lower rating or are not rated

# Uses For State Debt and Lease-Purchase Financing

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- State owned capital facilities/uses
- School Facilities Board to fund local new school construction
- During budget shortfalls, financing has been used for operating expenses – Building Sale/Leaseback and Lottery Revenue Bonds



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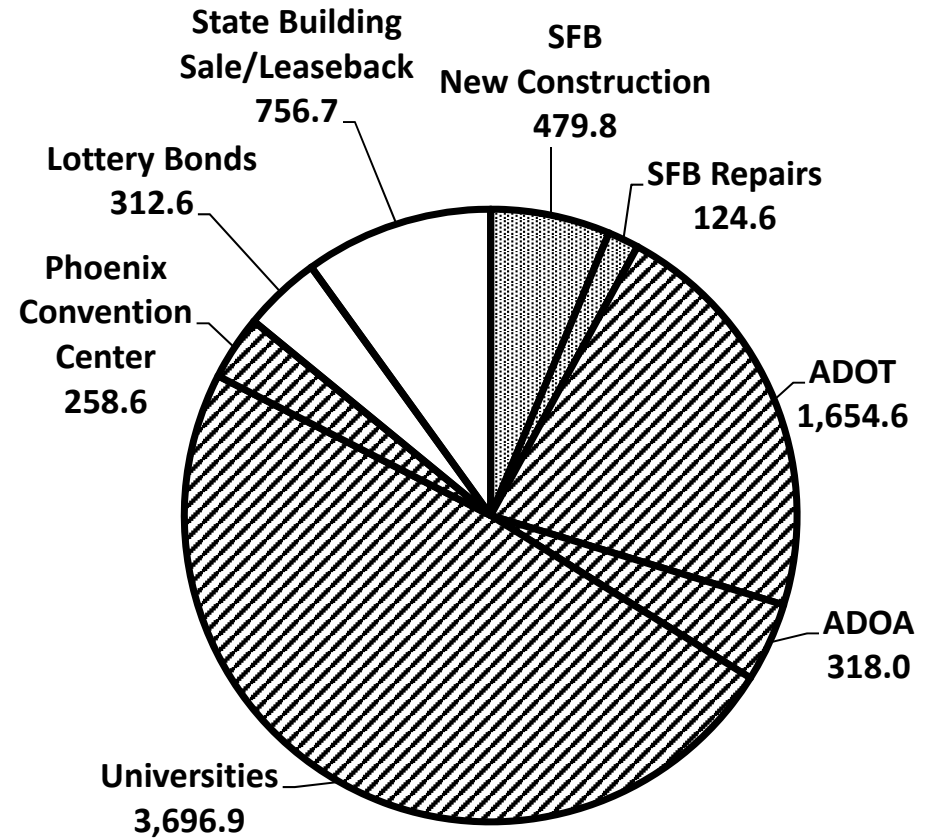
# **Debt Balance and Payment Information**

**JLBC**

# Total Outstanding State Debt/Lease-Purchase Financing is \$7.6 Billion

- Reflects Multiple Payment Sources

Outstanding Balances	
	\$ in B
Capital Facilities/Uses	5.9
School Facilities Board	0.6
2010 Operating Expenses	1.1

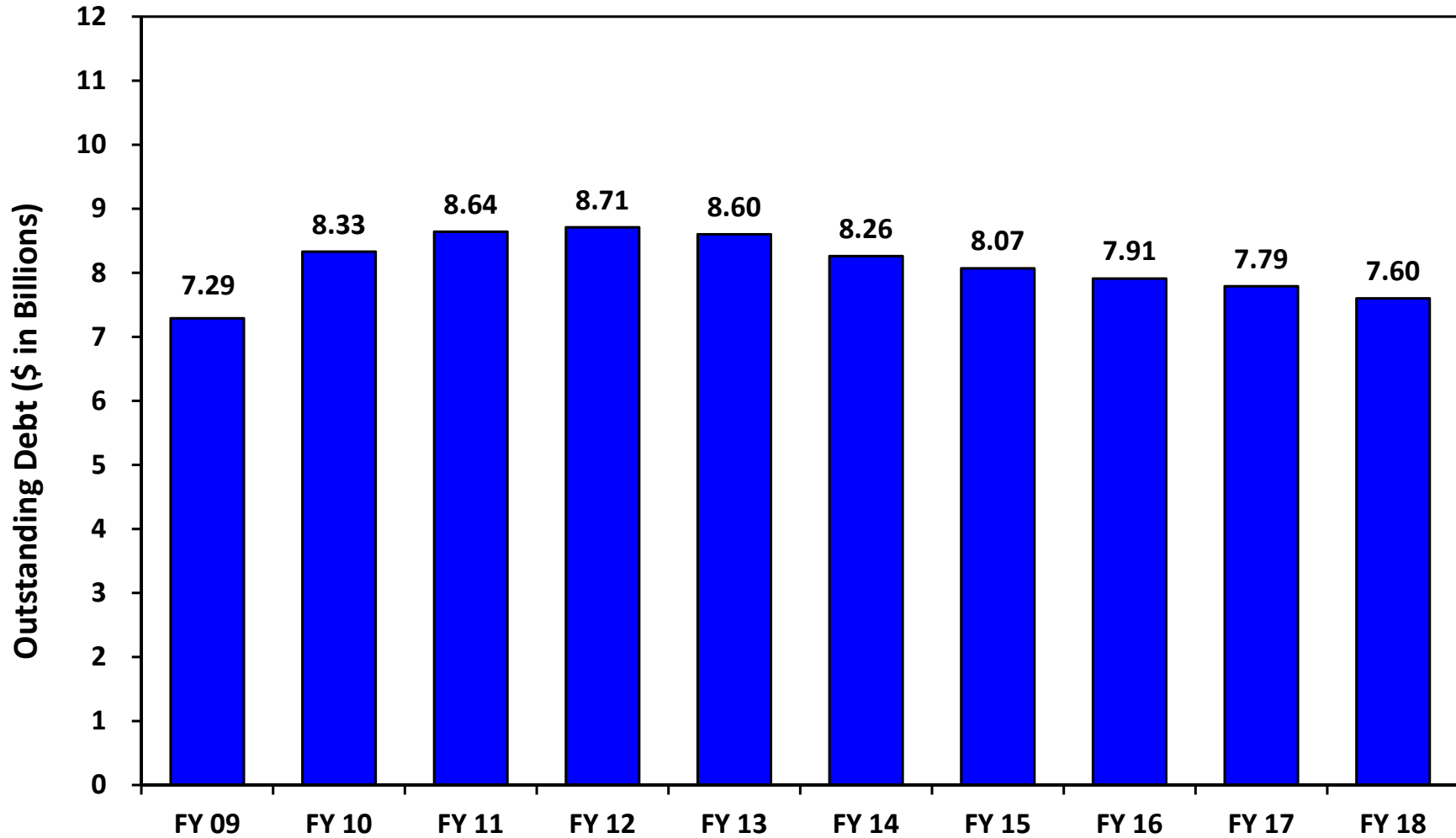


Capital
  SFB
  Operating

End of FY 2018 - \$ in Millions

# Arizona Overall Debt Obligations Peaked in '12

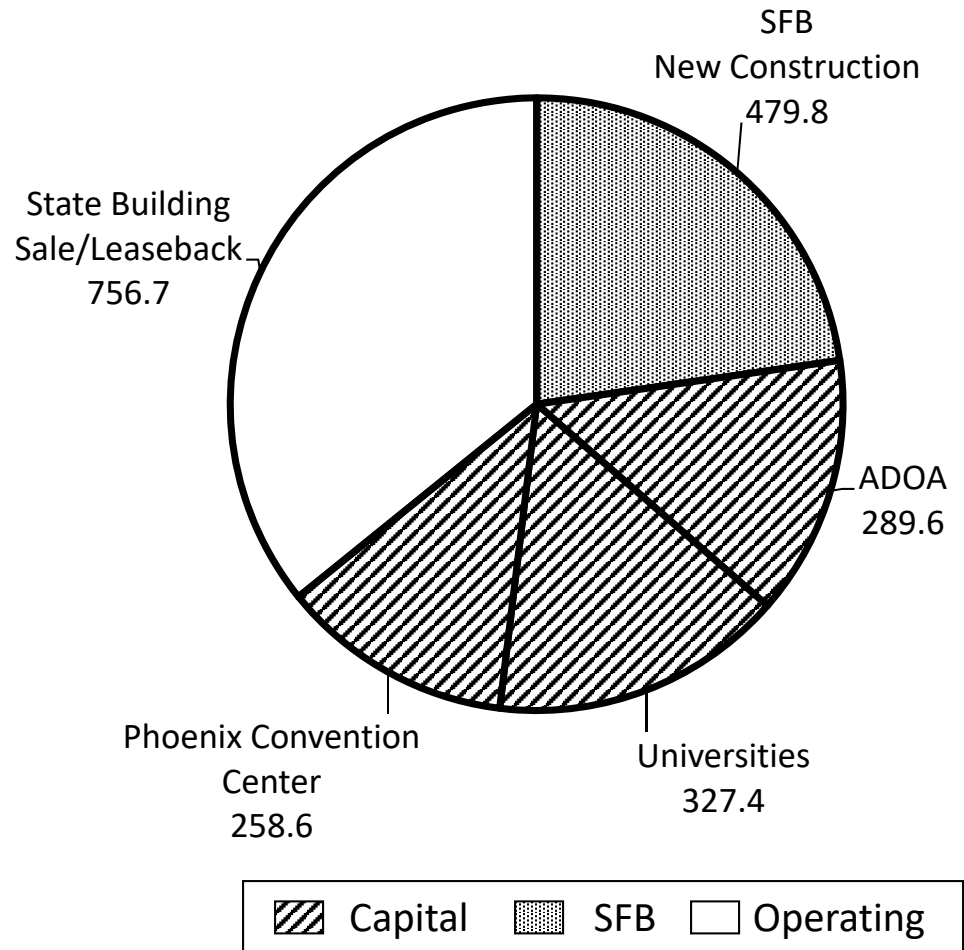
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# General Fund Share of Outstanding Balances Is \$2.1 B

## Outstanding Balances

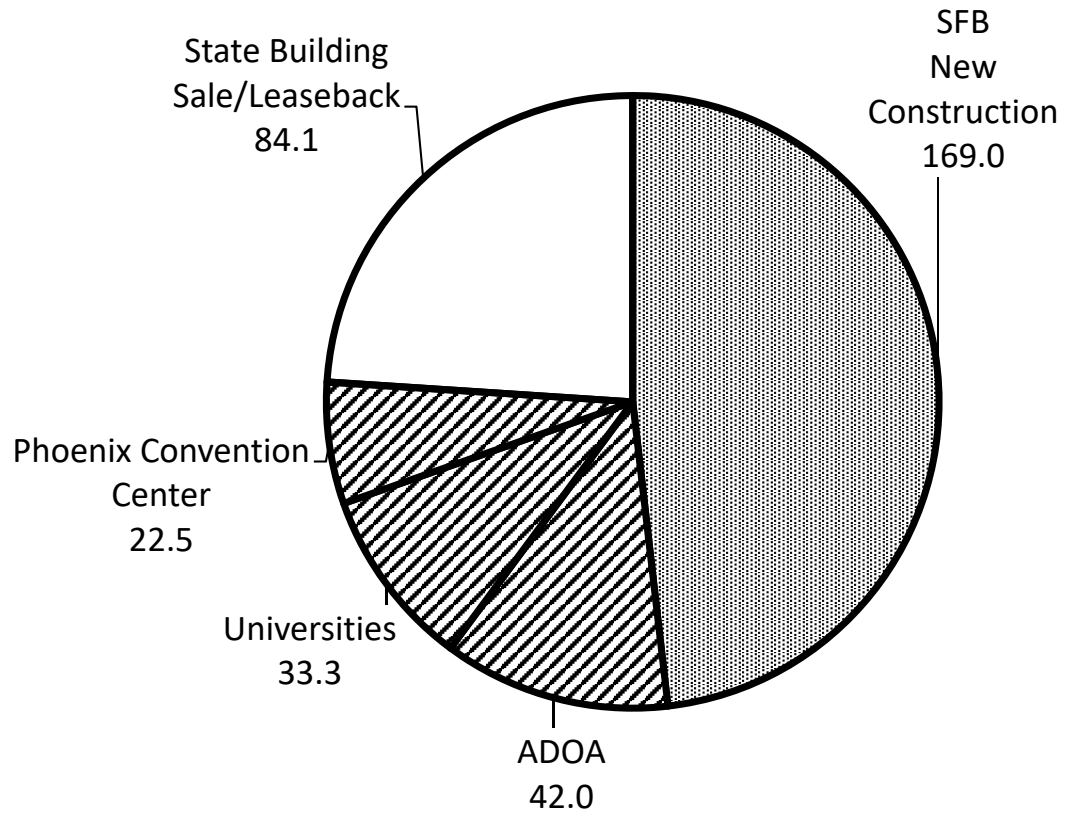
	<u>\$ in M</u>
Capital Facilities/Uses	876
School Facilities Board	480
2010 Operating Expenses	757



End of FY 2018 - \$ in Millions

# General Fund Debt Service Cost \$351 M

Annual Payments	
	<u>\$ in M</u>
Capital Facilities/Uses	98
School Facilities Board	169
2010 Operating Expenses	84



FY 2018 - \$ in Millions

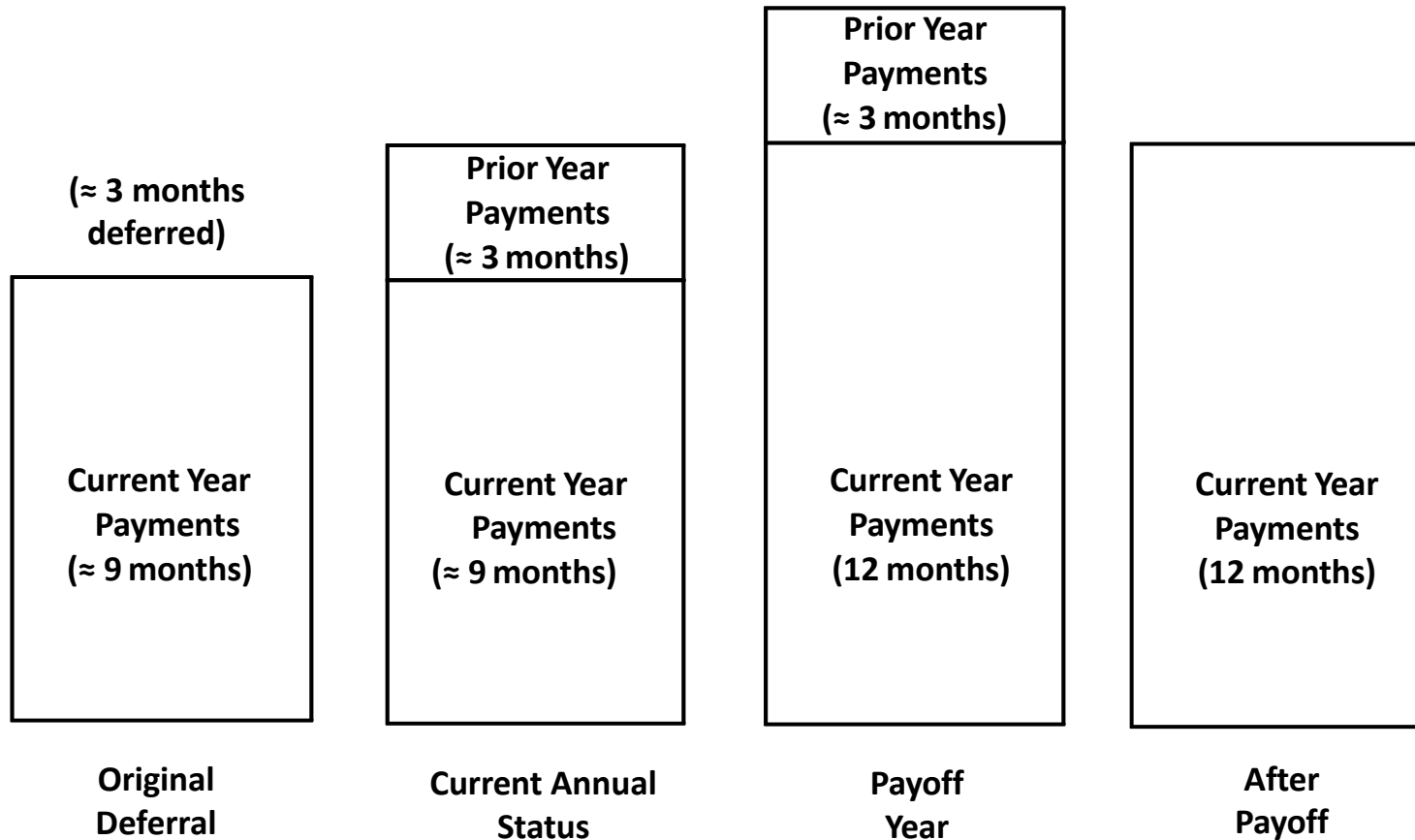
# State Defers \$931 M of K-12 Payments Annually - Interest Is Not Paid By the State For Rollovers

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- ❑ 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
- ❑ Only K-12 rollover now remains
- ❑ Repayment of part or all of K-12 rollover would incur one-time GF cost

# Example of K-12 Rollover Repayment

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# Executive Budget Issues

JLBC



# State Used Operating Financing For \$1.5 B of Solutions To Budget Shortfalls in 2010

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- ❑ \$1.0 B from the sale and leaseback of state properties
  - 2 Transactions – Original Issuance = \$735 M “2010A” and \$300 M “2010B”
  - Building titles transferred to 3<sup>rd</sup> party trustee – 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

# Sale Leaseback Property Release

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- ❑ State properties were used as collateral to secure \$1.0 B of operating financing in 2010
- ❑ As principal balance is paid down, less collateral is needed
- ❑ State can ask trustee to release properties as principal is paid down
- ❑ Release of 10 properties has been executed. Title transfers back to state in July.

# Sale Leaseback Buildings (2018 Values)

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## List of Sale/Leaseback Properties

<b>Property</b>	<b>2018 Replacement Value <u>\$ in Millions</u></b>
<u>Still Pledged</u>	
ADC – Prison Complex Units (From Florence/Eyman/Tucson)	341
DPS – Headquarter Buildings (Phoenix/Tucson/Forensic Lab)	113
DES – Office Building (1789 W Jefferson)	68
AZ Schools for the Deaf and Blind – Phoenix Day School	49
ADOA – Tucson Office Building (400 W Congress)	47
DOR – Office Building and Parking Garage (1600 W Monroe)	47
<u>Released Property</u>	
State Fairgrounds (Includes Coliseum)	113
Judiciary – Supreme Court Building	71
Executive Tower	58
AZ Schools for the Deaf and Blind – (Tucson Campus, Select Buildings)	50
Legislature (House/Senate are both \$24.4 million)	49
Polly Rosenbaum Library/Archives Building (1901 W Madison)	40
AHCCCS Office Buildings (701/801 E Jefferson)	35
Arizona Historical Society - Museum/Library (Tempe)	<u>24</u>
<b>TOTAL VALUE</b>	<b>\$1,105</b>



## Sale Leaseback Refinance – 2010A Issuance

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- ❑ At end of FY '20, 2010A Sale Leaseback issuance was projected to have a principal balance of \$470 M
- ❑ This month, ADOA refinanced the 2010A debt, reducing interest rate from 5.1% to 2.5%
- ❑ No legislative approval needed
- ❑ Refinancing is projected to save \$6.4 M annually (\$70 M over 11 years)
- ❑ Savings are included in the Executive Budget, not in JLBC Baseline
- ❑ Financing does not extend term - still paid off in FY 30

## Sale Leaseback Refinance – 2010B Issuance

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- At end of FY '20, 2010B Sale Leaseback issuance was projected to have a principal balance of \$190 M
- 2010B was not involved in refinance that recently occurred, although Exec assumes refinance will occur later this year
- Because of this assumption, Executive Budget does include \$4.8 M of annual savings
- Savings not include in JLBC Baseline

# Does Leaseback Refinance Impact Payoff Options?

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- ❑ 2010B issuance payoff is straight forward – has not been refinanced, state can “call” the bonds and repay early
- ❑ After refinance, payoff of 2010A more complex:
  - Refinancing issuance has another 10-year call period
  - State can still payoff early through escrow account process, which legally removes debt from the state’s books
  - Had state not refinanced, 2010A payoff would have cost \$470 M. Escrow account process may cost similar amount
  - Process would be unusual – state would pay transaction costs to refinance then payoff early
- ❑ Debt retirement not included in Exec. Budget priorities:
  - Significant one-time spending but no debt retirement
  - Executive chose to refinance bonds during December/January

# Lottery Bond Refinance

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- In December, ADOA refinanced the 2010 Lottery Revenue Bonds, reducing interest rate from 5.0% to 2.7%
- No legislative approval needed
- Refinancing projected to save \$3 M annually (\$30 M over 10 years)
- Savings included in Executive Budget and JLBC Baseline
- Financing did not extend term – still paid off in FY '29
- Same call period/escrow account issue with Lottery Bond refinance

# Annual General Fund Debt Service

\$ in Millions

	<u>'18</u>	<u>'19</u>	<b>Baseline</b> <u>'20</u>	<b>Executive</b> <u>'20</u>
Capital Facilities/Uses	98	103	101	101
School Facilities Board	169	134	132	132
Operating	<u>84</u>	<u>84</u>	<u>84</u>	<u>73</u>
<b>Total</b>	<b>\$351 M</b>	<b>\$321 M</b>	<b>\$317 M</b>	<b>\$306 M</b>

- ❑ '19 General Fund decrease due to a reduction of SFB debt service
- ❑ Executive Baseline debt service in '20 is lower to reflect refinancing of 2010A Sale Leaseback debt and planned refinance of 2010B Sale Leaseback debt.