

JLBC Staff Report - FY 2023 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:

- 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
- 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.

While the report would typically include debt information on the prior fiscal year (FY 2021), the FY 2022 budget included \$977.1 million of funding for debt payoffs, which would not be reflected in the FY 2021 data. To provide a more accurate display of the state's current outstanding debt, this report instead focuses on outstanding debt as of the upcoming budget year (FY 2023).

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 summarizes issues relating to debt retirement.

Total FY 2023 outstanding bond, lease-purchase and payments deferral balances are \$6.38 billion, of which \$865.7 million is related to payment deferrals. Excluding the payment deferrals, the outstanding FY 2023 balance is \$5.52 billion. This equates to a per capita amount of \$758. By comparison, the outstanding FY 2014 balance was \$8.26 billion.

As of FY 2023, outstanding principal has declined by \$(2.74) billion since FY 2014. In addition to a gradual debt balance decline as the state made regularly scheduled payments over the last 10 years, a significant portion of that decline in debt principal occurred between FY 2020 and FY 2022, as the state allocated \$1.2 billion for early debt payoffs.

Of the total FY 2023 outstanding balance of \$5.52 billion, the General Fund share is \$680.0 million. In FY 2023, the General Fund will make debt services payments totaling \$104.3 million.

Table 1 below gives a brief summary of current outstanding debt.

Table 1

**State Debt and Financing Summary
(As of FY 2023)**

| | |
|---|-----------|
| Total Outstanding Balance | \$ 6.38 B |
| Total Outstanding Balance (excludes Payment Deferrals) | \$ 5.52 B |
| General Fund Outstanding Balance | \$ 680 M |
| General Fund Debt Service | \$ 104 M |
| Total Outstanding Balance Per Capita (excludes Payment Deferrals) | \$ 758 |

Table 2

Per Capita State Debt Historical Summary (Excluding Payment Deferrals)

| <u>Fiscal Year</u> | <u>Outstanding Principal (Total Funds - \$ in B)</u> | <u>Per-Capita Outstanding</u> | <u>% Change from Prior FY</u> |
|--------------------|--|-----------------------------------|-----------------------------------|
| 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)% |
| 2019 | 7.57 | 1,053 | (2.0)% |
| 2020 | 6.68 | 916 | (13.0)% |
| 2021 | 6.71 | 921 | 0.5% |
| 2022 | 5.38 | 739 | (19.8)% |
| 2023 | 5.52 | 758 | 2.5% |

Table 3

Lease-Purchase and Bonding Summary

| Lease-Purchase Summary | Overall Balance | ^{1/} GF Balance | Overall FY 23 Payment | ^{2/} FY 23 GF Payment | Retirement FY |
|---|---------------------------|--------------------------|----------------------------|--------------------------------|---------------|
| <u>ADOA Building System</u> | | | | | |
| 2013 A Issuance | | | | | |
| PLTO Refinance - DHS Building | \$ 12,215,000 | \$ 7,329,000 | \$ 2,329,500 | \$ 1,397,700 | FY 29 |
| 2013 B Issuance | | | | | |
| Refinance - 2002A Health Lab ^{3/} | \$ - | \$ - | \$ 2,049,900 | \$ - | FY 23 |
| 2015 Issuance | | | | | |
| Refinance - 2008A ADC and DHS | \$ 63,695,000 | \$ 63,695,000 | \$ 18,864,000 | \$ 18,864,000 | FY 28 |
| 2015 A Issuance | | | | | |
| PLTO Refinance - Capitol Mall | \$ 24,755,000 | \$ 9,902,000 | \$ 6,217,600 | \$ 2,487,000 | FY 28 |
| 2017 Issuance | | | | | |
| ADC 4000 Prison Beds, Wastewater and DHS Forensic Lab | \$ 3,995,000 | \$ 3,995,000 | \$ 75,000 | \$ 75,000 | FY 28 |
| <i>Subtotal - ADOA</i> | \$ 104,660,000 | \$ 84,921,000 | \$ 29,536,000 | \$ 22,823,700 | |
| <u>ADOA/School Facilities Division</u> | | | | | |
| Federal Bonds | \$ 25,144,400 | \$ 25,144,400 | \$ 9,938,100 ^{3/} | \$ 9,938,100 ^{3/} | FY 28 |
| <u>ABOR Building System</u> | | | | | |
| Arizona State University | \$ 188,688,000 | \$ 94,170,000 | \$ 26,059,900 | \$ 13,462,100 | FY 39 |
| Northern Arizona University | 33,070,000 | 33,070,000 | 5,301,500 | 5,301,500 | FY 31 |
| University of Arizona | 148,125,800 | 93,085,000 | 31,529,600 | 14,252,500 | FY 72 |
| <i>Subtotal - ABOR</i> | \$ 369,883,800 | \$ 220,325,000 | \$ 62,891,000 | \$ 33,016,100 | |
| Phoenix Convention Center ^{4/} | \$ 349,610,000 | \$ 349,610,000 | \$ 24,999,400 | \$ 24,999,400 | FY 44 |
| <i>TOTAL - Lease-Purchase</i> | \$ 849,298,200 | \$ 680,000,400 | \$ 127,364,500 | \$ 90,777,300 | |
| <u>Bonding Summary</u> | | | | | |
| Department of Transportation ^{5/} | \$ 1,085,355,000 | \$ - | \$ 168,467,000 | \$ - | FY 14 - 38 |
| <u>ABOR Building System</u> | | | | | |
| Arizona State University | \$ 1,429,300,000 | \$ - | \$ 124,367,400 | \$ - | FY 55 |
| Northern Arizona University | 289,590,000 | - | 24,012,300 | - | FY 44 |
| University of Arizona | 785,215,000 | - | 68,449,400 | - | FY 48 |
| University Lottery Bond (SPEED) | 485,075,000 ^{6/} | - | 47,248,500 | - | FY 48 |
| University Infrastructure (2017) ^{7/} | 595,015,000 | - | 27,062,700 | 13,531,400 | FY 44 |
| <i>Subtotal - ABOR</i> | \$ 3,584,195,000 | \$ - | \$ 291,140,300 | \$ 13,531,400 | |
| <i>TOTAL - Bonding</i> | \$ 4,669,550,000 | \$ - | \$ 459,607,300 | \$ 13,531,400 | |
| TOTAL - Lease-Purchase & Bonding | \$ 5,518,848,200 | \$ 680,000,400 | \$ 586,971,800 | \$ 104,308,700 | |
| TOTAL - Payment Deferrals | \$ 865,727,700 | \$ 865,727,700 | \$ - | \$ - | |
| TOTAL ALL OBLIGATIONS | \$ 6,384,575,900 | \$ 1,545,728,100 | \$ - | \$ - | |

^{1/} Represents principal balances as of June 30, 2023. The "GF Balance" column represents the portion of the overall balance paid from General Fund sources.
^{2/} Represents lease-purchase or debt service payments, including the portion paid from a General Fund source, which is represented in the "FY 23 GF Payment" column.
^{3/} This type of financing originally entitled the state to a federal interest rate subsidy of 4.86% (out of the 6% due on the bonds), shortly after each payment. Taking into account prior federal budget reductions, in FY 2023 this subsidy is expected to be \$3,729,900 of the \$9,938,100 payment.
^{4/} The Convention Center debt service will eventually increase over a number of years to a maximum of \$30,000,000. Monies are given to the city to pay this portion of the lease-purchase payment. Laws 2015, Chapter 10 made a technical change to conform the debt service distribution in A.R.S. § 42-5030 to the distributions contained in A.R.S. § 9-602, which were modified by Laws 2011, Chapter 28 to conform to the actual debt service payments.
^{5/} Includes \$943,450,000 for Highway User Revenue Fund bonds and \$141,905,000 for Grant Anticipation Notes.
^{6/} Represents outstanding balance as of the end of FY 2023 from projects counted under the \$800,000,000 University Lottery bonding authority, otherwise known as SPEED. SPEED was originally authorized by Laws 2008, Chapter 287. (Please see the Capital Outlay Arizona Board of Regents Building System narrative for more information.)
^{7/} The universities will receive \$28,939,500 from the General Fund in FY 2023 for the 2017 Capital Infrastructure Funding program. As of December 2021, JCCR has reviewed a total of 16 projects for the program, of which 9 are funded by system revenue bonds and 7 are cash-funded. The General Fund is expected to pay \$13,531,400 in FY 2023 for debt service.

Table 4

Payment Deferral Summary

| <u>Agency</u> | <u>FY 2023 Overall Deferral Balance</u> | <u>Original Due Date(s) of Deferral</u> | <u>Interest Paid to Date for Deferral</u> |
|-------------------------|--|---|--|
| Department of Education | 865,727,700 ^{1/2/} | \$273 M in FY 2008, \$330 M in FY 2009, \$350 M in FY 2010. \$21.9 M paid off in FY 2013 and \$65 M paid off in FY 2022. | 2,400,100 ^{3/} |
| Total | \$865,727,700 | | \$2,400,100 |

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

^{2/} The enacted FY 2022 included \$65,000,000 to eliminate the deferral for school districts with a student count of less than 2,000 pupils starting in FY 2022. (The rollover had previously been eliminated for school districts and charter schools with less than 600 pupils.)

^{3/} 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 (Retired) – 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.

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.

ADOA/School Facilities Division – Lease-Purchase

The School Facilities Division (SFD) is responsible for providing capital funding for K-12 school districts within the state. A.R.S. § 15-2004 authorizes SFD 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.

2010 Qualified School Construction Bonds – Authorized by Laws 2010, 3rd Special Session, Chapter 12, SFD 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.

Bonding Summary

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). Prior to FY 2022, ABOR was 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. Laws 2021, Chapter 410 eliminated the requirement that \$376.0 million be used specifically for the Phoenix Biomedical Campus, allowing the remaining authority to be used at any campus. 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.

Report on State Debt and Lease-Purchase Financing



Debt Overview

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

- Outstanding principal on State debt
- 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

Uses for State Debt and Lease-Purchase Financing

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

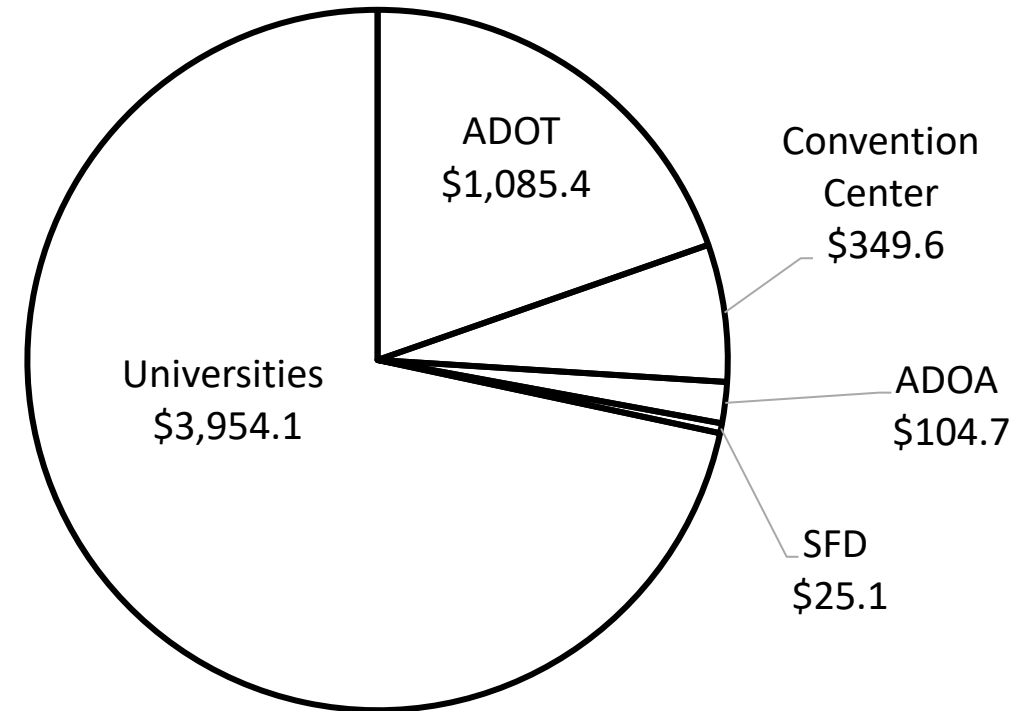
Debt Balance and Payment Information

Recent Debt Payoffs

- In the last few years, more than \$1 billion in state debt has been paid off:
 - \$660 million for sale/leaseback financing
 - \$270 million for Lottery Revenue Bonds
 - \$172 million for ADOA/SFD new construction
 - \$66 million for ADC prison financing
- Payoffs eliminated \$187 million in annual debt service payments

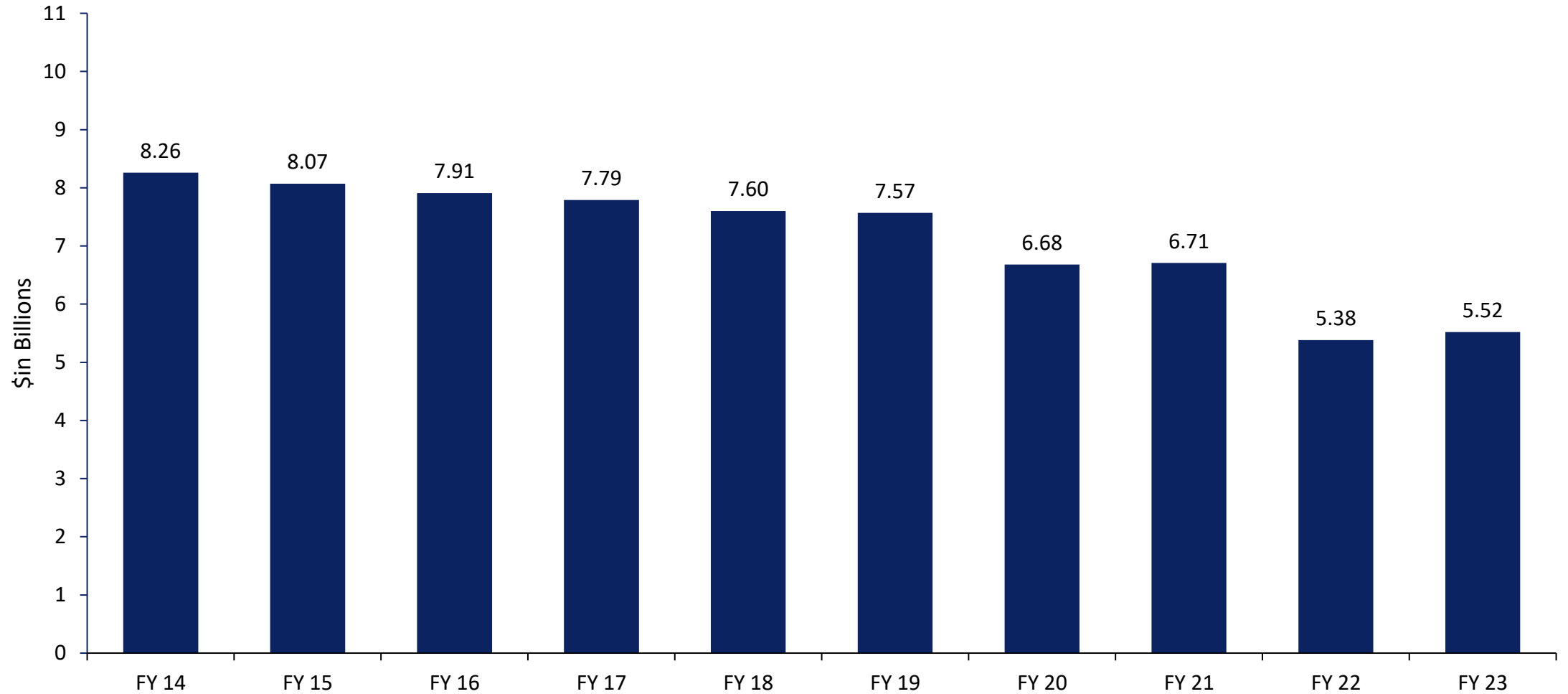
Total Outstanding Debt After Payoffs is \$5.5 Billion

- Debt service is funded by multiple payment sources
- Most remaining debt is for university capital projects and ADOT road projects



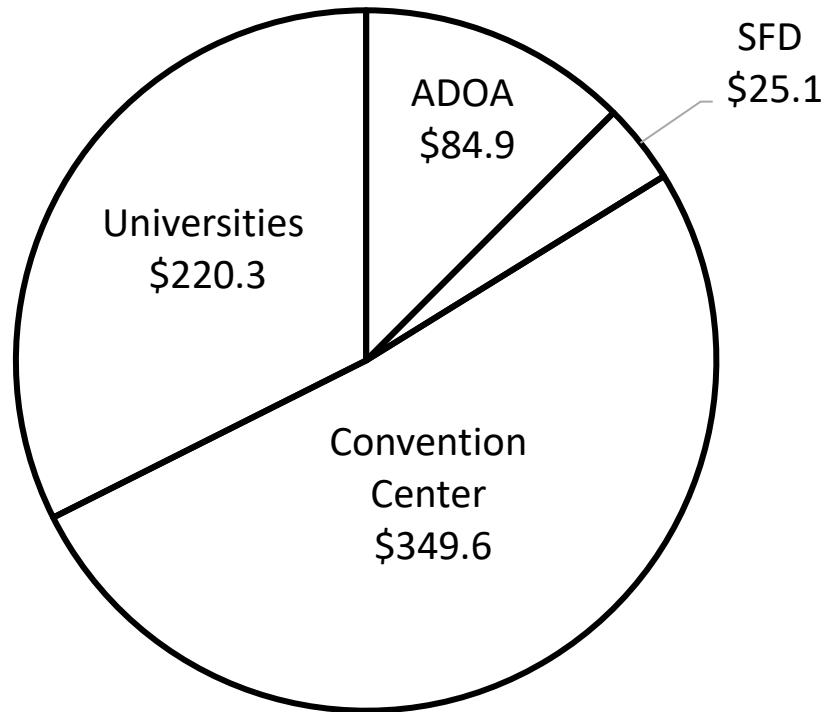
End of FY 2023 - \$ in Millions

Arizona Overall Debt Obligations

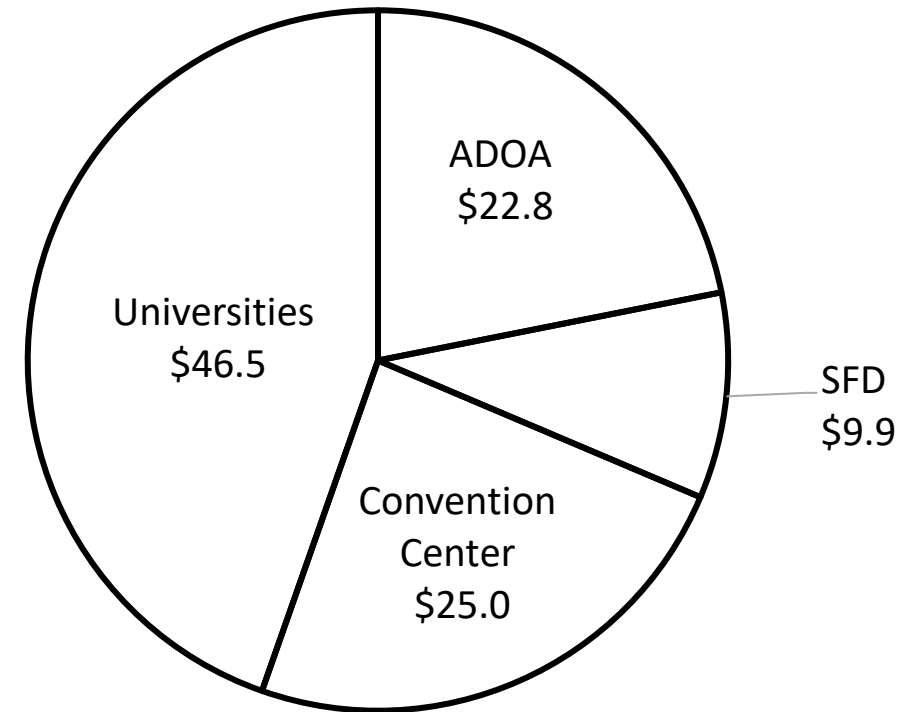


General Fund Share of Outstanding Balances

Total GF Balance = \$680 M



Annual GF Debt Service = \$104 M



End of FY 2023 - \$ in Millions

State Defers \$866 Million of K-12 Payments Annually

-Interest is Not Paid by the State for Rollovers

- Used for one-time solutions during 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
- Prior to FY 2022, only schools districts with less than 1,350 students had no deferral. The enacted budget included \$65 million to eliminate the deferral for school districts with a student count up to 2,000 pupils.

Additional Debt Payoff Scenarios

- Most remaining debt has prepayment restrictions
- As an alternative, state can deposit payoff amount in escrow account, removing debt balance and annual payments from the state's books
- When reviewing debt payoff options, consider both:
 - Size of annual payment being eliminated (impacts ongoing budget capacity)
 - Net debt service savings over remaining term

Debt Payoff Scenarios

| Issuance | Escrow Deposit | Annual Payment Eliminated | Cumulative Net Savings |
|---------------------------|-----------------------|----------------------------------|-------------------------------|
| Phoenix Convention Center | 538.8 | 26.0 | 93.6 |
| University Research | 273.5 | 32.6 | 11.0 |
| ADOA Series 2015/2017 | 93.5 | 15.2 | 1.3 |