JLBC Staff Report - FY 2024 Debt and Lease-Purchase Financing

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 2022), the FY 2023 budget allocated additional funds for debt payoff, which would not be reflected in the FY 2022 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 2024).

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 and summarizes issues relating to debt retirement.

Total FY 2024 outstanding bond, lease-purchase and payments deferral balances are $6.35 billion, of which $800.7 million is related to payment deferrals. Excluding the payment deferrals, the outstanding FY 2024 balance is $5.55 billion. This equates to a per capita amount of $750. By comparison, the outstanding FY 2015 balance was $8.07 billion.

As of FY 2024, outstanding principal has declined by $(2.52) billion since FY 2015. 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 2023, as the state allocated $1.26 billion for early debt payoffs.

Of the total FY 2024 outstanding balance of $5.55 billion, the General Fund share is $873.1 million. In FY 2024, the General Fund will make debt services payments totaling $89.7 million.

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

Table 1

State Debt and Financing Summary
(As of FY 2024)

Total Outstanding Balance	$ 6.35 B
Total Outstanding Balance (excludes Payment Deferrals)	$ 5.55 B
General Fund Outstanding Balance	$ 873 M
General Fund Debt Service	$ 90 M
Total Outstanding Balance Per Capita (excludes Payment Deferrals)	$ 750

Table 2

Per Capita State Debt Historical Summary (Excluding Payment Deferrals)

Fiscal Year	Outstanding Principal (Total Funds - $ in B)	Per-Capita Outstanding	% Change from Prior FY
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%
2024	5.55	750	(1.1)%

Table 3

Lease-Purchase and Bonding Summary

Lease-Purchase Summary		Overall Balance 1/		GF Balance 1/		Overall FY 24 Payment 2/		FY 24 GF Payment 2/	Retirement FY
ADOA Building System									
2013 A Issuance									
PLTO Refinance - DHS Building	$	10,375,000	$	6,225,000	$	2,409,800	$	1,445,900	FY 29
2015 A Issuance									
PLTO Refinance - Capitol Mall	$	19,630,000	$	8,440,900	$	6,224,800	$	2,676,700	FY 28
Subtotal - ADOA	$	30,005,000	$	14,665,900	$	8,634,600	$	4,122,600	
ADOA/School Facilities Division									
Federal Bonds	$	20,155,500	$	20,155,500	$	9,938,100 3/	$	9,938,100 3/	FY 28
ABOR Building System									
Arizona State University	$	155,296,000	$	93,425,000	$	23,420,200	$	13,468,200	FY 39
Northern Arizona University		28,875,000		28,875,000		5,302,900		5,302,900	FY 31
University of Arizona		113,505,400		82,385,000		33,498,500		14,255,300	FY 72
Subtotal - ABOR	$	297,676,400	$	204,685,000	$	62,221,600	$	33,026,400	
Phoenix Convention Center 4/	$	346,610,000	$	346,610,000	$	25,498,600	$	25,498,600	FY 44
TOTAL - Lease-Purchase	*$*	*694,446,900*	*$*	*586,116,400*	*$*	*106,292,900*	*$*	*72,585,700*	
Bonding Summary									
Department of Transportation 5/	$	960,125,000	$	-	$	168,461,400	$	-	FY 14 - 38
ABOR Building System									
Arizona State University	$	1,742,505,000	$	-	$	148,100,200	$	-	FY 55
Northern Arizona University		276,730,000		-		24,923,500		-	FY 44
University of Arizona		744,610,000		-		73,151,400		-	FY 48
University Lottery Bond (SPEED)		561,562,200 6/		-		47,229,000		-	FY 48
University Infrastructure (2017) 7/		573,970,000		286,985,000		34,167,700		17,083,900	FY 44
Subtotal - ABOR	$	3,899,377,200	$	286,985,000	$	327,571,800	$	17,083,900	
TOTAL - Bonding	*$*	*4,859,502,200*	$	286,985,000.00	*$*	*496,033,200*	*$*	*17,083,900*	
TOTAL - Lease-Purchase & Bonding	**$**	**5,553,949,100**	**$**	**873,101,400**	**$**	**602,326,100**	**$**	**89,669,600**	
TOTAL - Payment Deferrals	**$**	**800,727,700**	**$**	**800,727,700**	**$**	**-**	**$**	**-**	
TOTAL - ALL OBLIGATIONS	**$**	**6,354,676,800**	**$**	**1,673,829,100**	**$**	**-**	**$**	**-**	

1/ Represents principal balances as of June 30, 2024. 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 24 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 2024 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 $841,095,000 for Highway User Revenue Fund bonds and $119,030,000 for Grant Anticipation Notes.
6/ Represents outstanding balance as of the end of FY 2024 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 $29,518,300 from the General Fund in FY 2024 for the 2017 Capital Infrastructure Funding program. The General Fund is expected to pay $17,083,900 in FY 2024 for debt service.

Table 4

Payment Deferral Summary

Agency	FY 2024 Overall Deferral Balance	Original Due Date(s) of Deferral	Interest Paid to Date for Deferral
Department of Education	800,727,700 1/	$273 M in FY 2008, $330 M in FY 2009, $350 M in FY 2010. $21.9 M paid off in FY 2013, $65 M paid off in FY 2022, and $65 M paid off in FY 2023.	2,400,100 2/
Total	**$800,727,700**		**$2,400,100**

1/ The current ADE payment deferral balance reflects the following repayment amounts: 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 students; 2) FY 2022 funding of $65,000,000 to eliminate the deferral for school districts with less than 2,000 students; and 3) FY 2023 funding of $65,000,000 to eliminate the deferral for school districts with less than 4,000 students.
2/ Interest was paid for the ADE payment deferral in FY 2008 - FY 2010.

Explanation of Issuances

Lease-Purchase Summary

<u>State Buildings</u>

<u>ADOA Building System – Lease-Purchase</u>

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.

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 ADOA and DEQ buildings through the end of the issuance in FY 2029.

<u>ADOA/School Facilities Division – Lease-Purchase</u>

The School Facilities Division (SFD) is responsible for providing capital funding for K-12 school districts within the state. A.R.S. § 41-5703 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.

Federal Bonds (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.

<u>ABOR Building System – Lease-Purchase</u>

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.

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.

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.

Attachment A

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
- 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

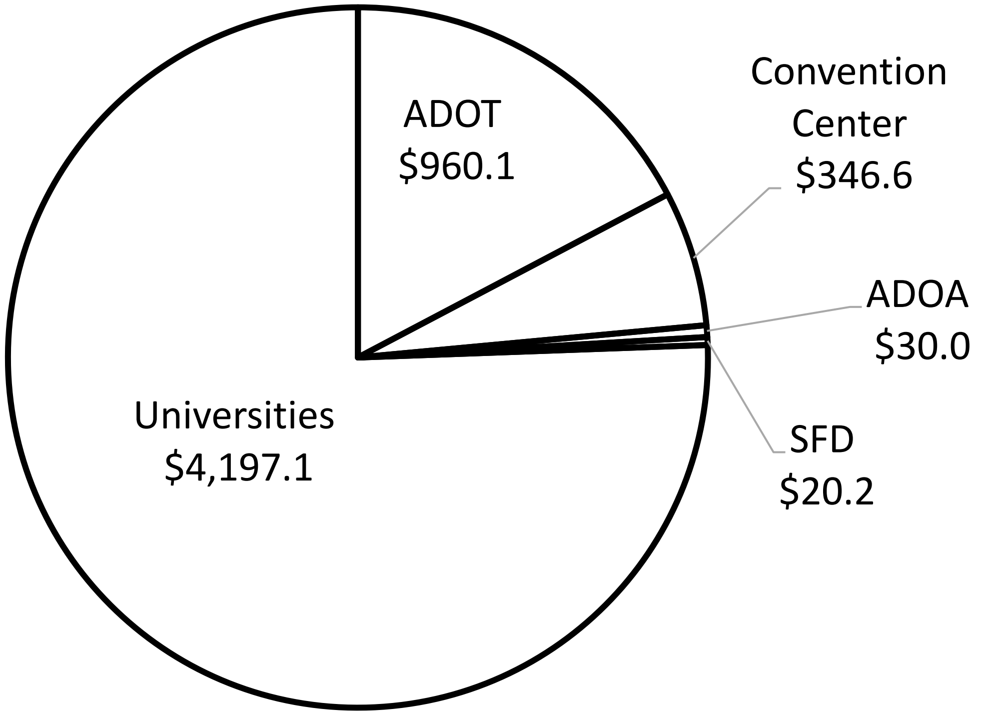
Debt Balance and Payment Information

Recent Debt Payoffs

- In the last several 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
  - $160 million for ADC prison financing and ASH Forensic Unit
- Payoffs eliminated $206 million in annual debt service payments

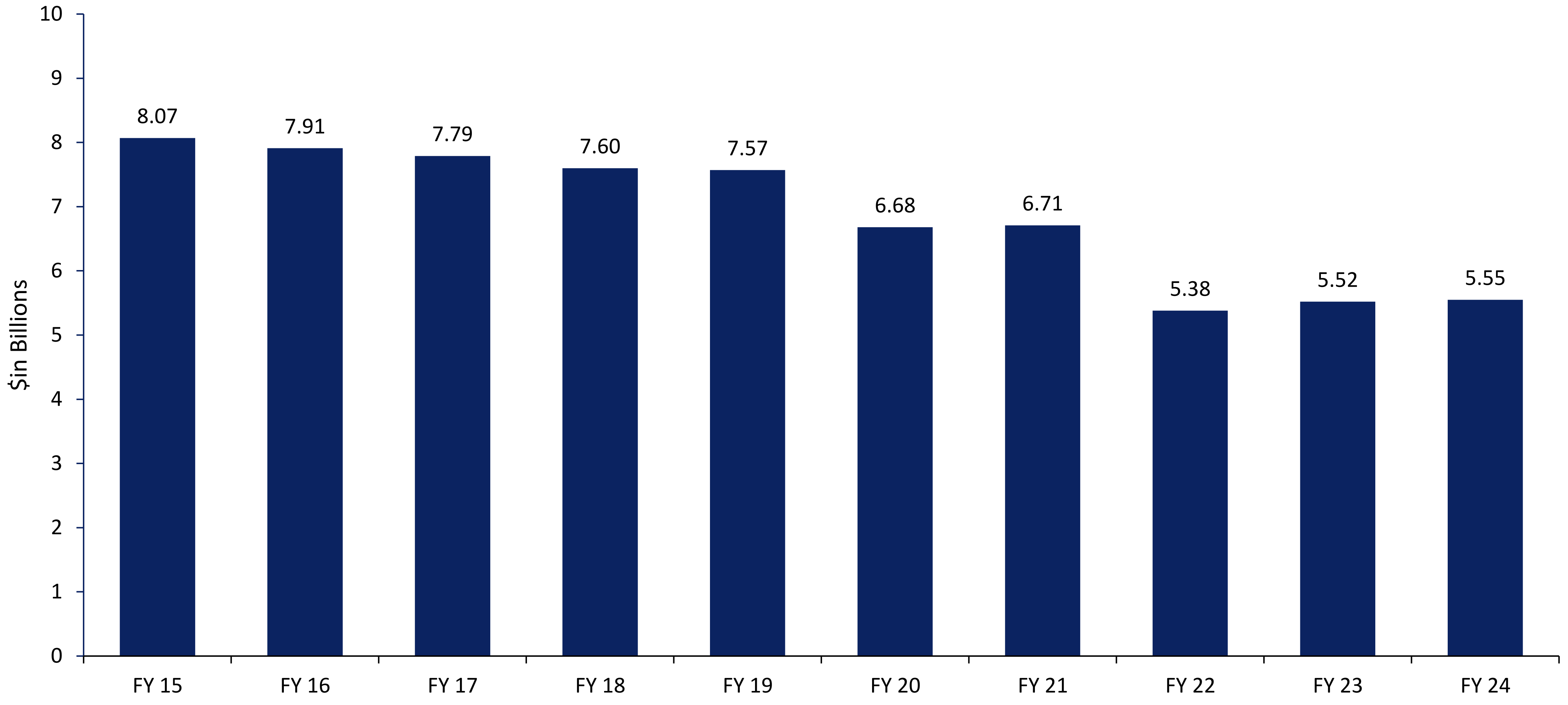
Total Outstanding Debt After Payoffs is $5.6 B

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



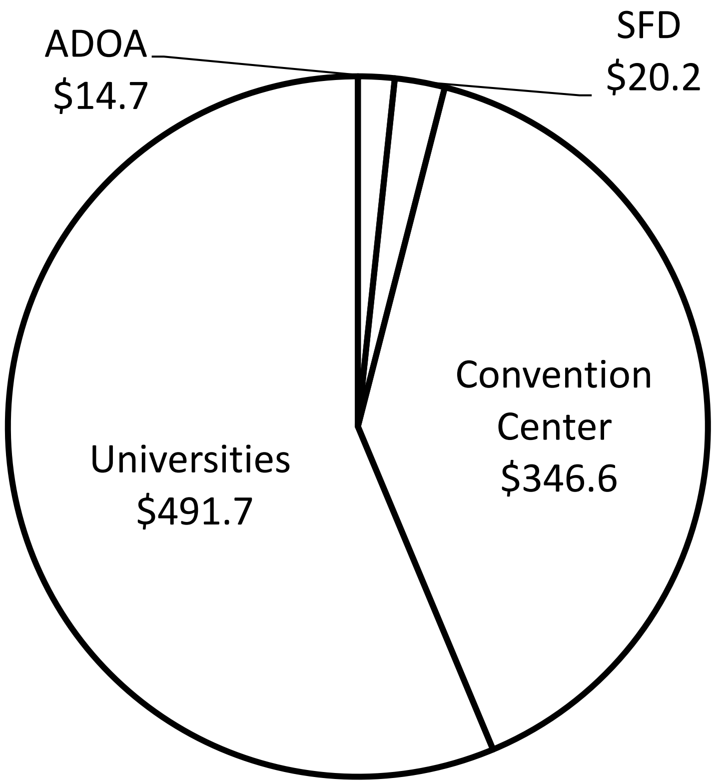
End of FY 2024 - $ in Millions

Arizona Overall Debt Obligations – 10 Year History

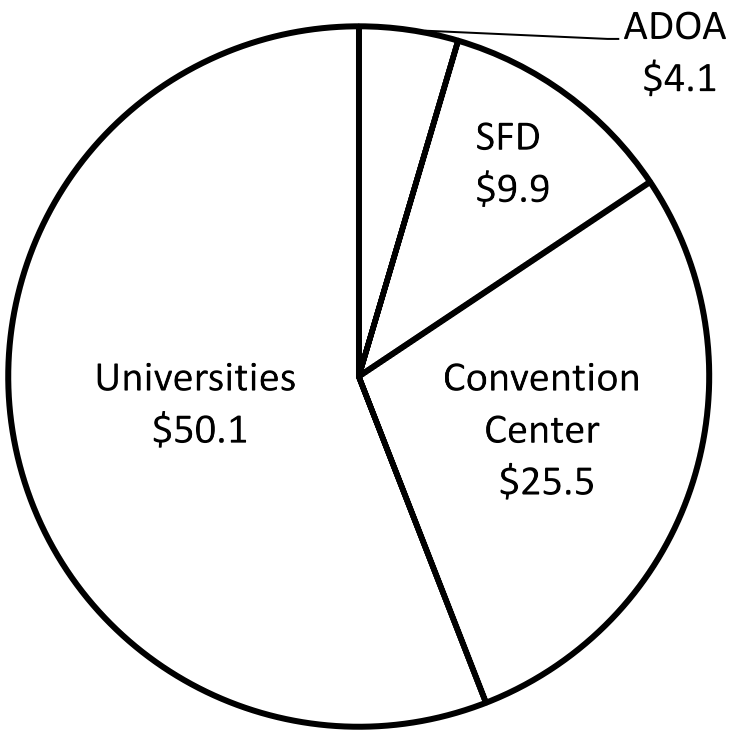


General Fund Share of Outstanding Balances

Total GF Balance = $873 M



Annual GF Debt Service = $90 M



End of FY 2024 - $ in Millions

State Defers $801 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 2023, only schools districts with less than 2,000 students had no deferral. The enacted budget included $65 million to eliminate the deferral for school districts with a student count up to 4,000 students.

Additional Debt Payoff Scenarios

- Given recent payoffs, state only has a limited number of remaining General Fund backed issuances
- 2 direct General Fund backed issuances: Phoenix Convention Center(state portion) and University 2003 Research issuance
- 2 debt issuances with partial connection to General Fund: University Lottery Bonds (80% GF paid) and University 2017 bonding program (50% GF paid) – much more complicated to pay off
- 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 GF Payment Eliminated	Cumulative Net GF Savings
Phoenix Convention Center	430	26	211
University 2003 Research	238	32	27

- Given prepayment restrictions, state would deposit payoff into escrow account, removing debt balance and annual payments from state's books