

X00A00
Public Debt

Operating Budget Data

(\$ in Thousands)

	<u>FY 11</u> <u>Actual</u>	<u>FY 12</u> <u>Working</u>	<u>FY 13</u> <u>Allowance</u>	<u>FY 12-13</u> <u>Change</u>	<u>% Change</u> <u>Prior Year</u>
Special Fund	\$825,630	\$871,203	\$909,649	\$38,446	4.4%
Adjusted Special Fund	\$825,630	\$871,203	\$909,649	\$38,446	4.4%
Federal Fund	9,202	11,060	11,955	894	8.1%
Adjusted Federal Fund	\$9,202	\$11,060	\$11,955	\$894	8.1%
Adjusted Grand Total	\$834,833	\$882,263	\$921,603	\$39,340	4.5%

- The budget bill includes a \$437,153 deficiency appropriation. These are federal funds supporting debt service. The bonds are taxable bonds with a direct federal tax subsidy.
- Debt service costs continue to climb, reflecting increased debt issuances and debt outstanding.

Note: Numbers may not sum to total due to rounding.

For further information contact: Patrick S. Frank

Phone: (410) 946-5530

Analysis in Brief

Issues

Out-year Trends Suggest Ongoing Shortfalls in the Annuity Bond Fund: From fiscal 2012 to 2017, debt service costs are expected to increase by 6% annually. Over the same period, projected State property tax receipts remain fairly flat. In fiscal 2013, debt service exceeds revenues by \$196 million. This increases to \$463 million in fiscal 2017. **The State Treasurer should brief the committees on the long-term outlook of the Annuity Bond Fund and the benefits of a dedicated revenue source for debt service. Insofar as there is a long-term general fund deficit and the State has identified a dedicated revenue source for general obligation (GO) bond debt service, the Department of Legislative Services (DLS) recommends that any shortfall in the Annuity Bond Fund be supported by additional State property taxes.**

Fiscal 2013 Budget Assumes Large Bond Sale Premiums: State debt service costs are supported by bond sale premiums, in addition to State property tax revenues. The premiums have been sufficient to close the gap between revenues and expenditures in recent years. Current estimates assume a substantial premium at the March 2012 bond sale. It is possible that the full premium will not be realized. **The Department of Budget and Management should discuss plans to fund the Annuity Bond Fund if bond sale premiums realized in the March 2012 bond sale are insufficient.**

Additional Revenues Increase Debt Capacity: State debt policy is that debt service cannot exceed 8% of revenues and debt outstanding cannot exceed 4% of personal income. The Administration proposes to increase the general fund, the Bay Restoration Fund, and transportation revenues. This provides additional debt capacity. **The State Treasurer should brief the committees on the effect of additional revenues on State debt capacity under current debt affordability guidelines.**

Recent Authorizations Confirm State Policy to Manage State Debt within Affordability Limits: From 2001 to 2009, the State regularly increased authorizations. Last year, the State has reduced GO bond authorizations. This year, the budget proposes to increase the 2012 session authorization and decrease the calendar 2017 authorizations. The State has moved from continuously increasing debt to managing debt. **The State Treasurer should brief the committees on the efforts of the Capital Debt Affordability Committee to keep State debt within affordability guidelines.**

The Cost of the Health Lab Lease Financing Exceeds General Obligation Bond Issuance Cost: Is the State Leasing Too Much?: The State is currently at the debt limit. DLS is concerned that the State is tempted to structure project financing so as to avoid being counted as State debt and that this could increase State costs. An example of this is financing for the Department of Health and Mental Hygiene's (DHMH) new lab. In November 2011, the Maryland Economic Development Corporation issued bonds for this project. When completed, the lab will be leased to DHMH. The State chose this lease arrangement instead of issuing GO bonds. **DLS recommends that, prior to entering into a capital lease, the State compare the cost of leasing with the cost of issuing GO bonds and pursue the most cost effective approach.**

Will the State Be Issuing Taxable Bonds Soon? Data from recent bond sales shows that taxable debt is more expensive than tax-exempt debt. Since fiscal 2011, the State has increased bond authorizations for private purpose projects. This could require the State to issue taxable debt. **The State Treasurer’s Office should brief the committees on the level of proposed bond authorizations that are subject to private purpose restrictions. This should include a discussion of the likelihood, timing, and amount of any taxable debt issuance.**

Recommended Actions

1. Concur with Governor’s allowance.

Updates

Capital Debt Affordability Committee Revises Process: During the 2011 legislative session, concerns were raised about how debt affordability limits were being allocated. In response to these concerns, the Capital Debt Affordability Committee has modified its policies. A key change is that the Governor will identify limits on all kinds of State debt in the November advisory letter to the General Assembly. The update reviews the issues that were raised and changes adopted.

X00A00 – Public Debt

X00A00
Public Debt

Operating Budget Analysis

Program Description

The Public Debt appropriates funds for general obligation (GO) bonds' debt service payments. This includes principal and interest payments. GO bonds support the State's general construction program, such as prisons, office buildings, higher education facilities, school construction, and mental health facilities. GO bonds do not pledge specific revenues but rather pledge the State's full faith and credit. Issuances include:

- tax-exempt bonds sold to institutional investors;
- tax-exempt bonds sold to retail investors;
- taxable bonds sold to institutional investors;
- Build America Bonds (BAB), which were taxable bonds for which the State receives a direct subsidy from the federal government;
- Qualified Zone Academy Bonds (QZAB) that support specific education projects. Depending on the date of issuance, these bonds have received federal tax credits or direct federal subsidies;
- Qualified School Construction Bonds (QSCB), which supported specific education projects. Depending on the date of issuance, these bonds have received federal tax credits or direct federal subsidies; and
- Qualified Energy Conservation Bonds (QECBs), which are direct federal subsidy bonds that support energy efficiency capital expenditures in public building, renewable energy production, and other related projects.

GO bond debt service payments are supported by the Annuity Bond Fund (ABF). The ABF revenues include State property tax revenues, federal subsidies, bond sale premiums, and repayments from certain State agencies, subdivisions, and private organizations. General funds may subsidize debt service if these funds are insufficient.

Performance Analysis

The interest rate that Maryland pays for the bonds it sells is referred to as the True Interest Cost (TIC). This rate is derived by calculating a bond's internal rate of return. The TIC is calculated at each

competitive bond sale, and the bidder with the lowest TIC is awarded the bid. This process awards the bonds to the lowest cost bid.

Financial literature provides information about factors that influence the TIC of State and municipal bond sales. The Department of Legislative Services (DLS) has estimated what factors influence the TIC Maryland receives on new GO bonds issued since 1991. The analysis examines data from the 56 bond sales (refunding sales are excluded): 43 competitively bid, tax-exempt; 3 competitively bid, taxable GO bond sales; 4 competitively bid, BABs; 5 negotiated, retail bond sales; and 1 negotiated bay bond sale. The complete analysis is provided in the *Effect of Long-term Debt on the Financial Condition of the State* prepared by DLS.

The sum of least squares regression analysis is used to evaluate the factors that could influence the TIC. In all, over 30 independent variables were tested, including Maryland gross State product to United States gross domestic product, State budget growth, average years to maturity, and use of a financial advisor. **Appendix 3** provides all the data for the statistically significant variables. **Exhibit 1** shows which 7 independent variables are statistically significant factors that influence the TIC:

- ***Delphis Scale:*** The key variable is the Delphis Scale. This is an estimate of the market rate for AAA-rated state and municipal bonds.
- ***Ratio of Maryland Total Personal Income to the United States Total Personal Income:*** The regression equation uses a ratio that compares state personal income to United States personal income. If the ratio increases, Maryland is doing relatively better than the rest of the United States, and a GO bond issuance's TIC should tend to decline.
- ***Taxable Debt:*** The State issued taxable bonds in March 2005 (\$25 million issued), July 2005 (\$20 million issued), and March 2006 (\$20 million issued). Since investors are required to pay federal income taxes on the interest earnings of taxable bonds, these bonds require a higher return and sell at a higher TIC.
- ***Build America Bonds:*** In February 2009, the American Recovery and Reinvestment Act of 2009 authorized the issuance of BABs. These are taxable bonds that support the same types of projects that traditional tax-exempt bonds support. The difference is that the buyers do not receive any federal tax credits or deductions so that the interest earnings are subject to federal taxes. Instead, Maryland receives a subsidy equal to 35% of the interest costs from the federal government. In concept, the bonds expand the number of buyers of State and municipal debt since they are also attractive to individuals and institutions that do not pay federal taxes. Because the tax-exempt bond benefit is greater for shorter maturities, the State issued tax-exempt bonds with shorter maturities and BABs with longer maturities. The analysis estimates that the State realized savings by issuing BABs instead of tax-exempt bonds.

Exhibit 1
True Interest Cost Regression Equation Independent Variables
Bond Sales from 1991-2011

<u>Ind. Variable</u>	<u>Coefficient</u>	<u>Std. Error</u>	<u>Beta</u>	<u>t-test</u>	<u>Sig.</u>	<u>Tol.</u>	<u>Comment</u>
Delphis Scale	0.96	0.04	0.78	27.162	0.000	0.59	Highest t-test suggests with confidence that the Delphis Scale is significant.
MD PI/US PI	-1.24	0.56	-0.06	-2.238	0.030	0.66	Negative coefficient suggests that as the Maryland economy strengthens, compared to the United States, the TIC declines.
Years to Maturity	0.32	.02	0.62	13.867	0.000	0.24	Positive coefficient means that longer maturities tend to have higher TICs.
Taxable Debt	2.45	0.16	0.53	15.603	0.000	0.42	Suggests taxable bonds are more expensive than tax-exempt bonds.
Bay Bonds	0.45	0.18	0.06	2.586	0.013	0.98	Suggests bonds are more expensive than tax-exempt bonds.
BABs	-1.67	0.15	-0.41	-11.322	0.000	0.37	Negative coefficient suggests BABs are less expensive.
Negative Outlook	0.23	0.14	0.04	1.696	0.096	0.84	Suggests credit watch increased TIC at the last sale.
Constant	-0.127						

BAB: Build America Bonds

Ind.: Independent

MD PI/US PI: Maryland Total Personal Income to United States Personal Income

Sig.: Significance or confidence interval

Std.: Standard

TIC: True interest cost

Tol: Tolerance, a test of multicollinearity

Source: Department of Legislative Services, January 2012

X00A00 – Public Debt

- ***Years to Maturity:*** Under normal economic conditions, bonds with shorter maturities have lower interest costs than bonds with longer maturities. This is referred to as a positive yield curve. The analysis estimates that every year adds 32% (32 basis points) to the TIC.
- ***Bay Bonds:*** The Bay Restoration Fund was created in 2004 to provide grants for enhanced nutrient removal (ENR) pollution reduction upgrades at the wastewater treatment plants. The fund is administered by the Maryland Department of the Environment's Water Quality Financing Administration (MWQFA). There has been one issuance of bay bonds totaling \$50 million. The analysis estimates that bay bonds are 0.45% (45 basis points) more expensive than GO bonds. The high t-test implies that DLS is 98.0% confident that this result is statistically significant.
- ***Negative Outlook:*** Maryland's GO bonds have been rated AAA since they were first rated. For example, Standard & Poor's has given Maryland a stable AAA rating since 1961. This changed in July 2011; as discussed below, Moody's announced that it would review the credit ratings of five AAA-rated states, including Maryland. In spite of the rating agency action, the competitive sales scheduled for July 27, 2011, proceeded as planned. Insofar as the sale received AAA ratings from all three rating agencies, and the State has a reputation for timely budgets and strong financial management, the State concluded that it was reasonable to expect a successful bond sale. The regression analysis suggests that Moody's action did have an effect on the bonds' TIC. The equation estimates that negative outlook added 0.23% (23 basis points) to the TIC. This is the only variable that does not meet the 95.0% confidence interval; instead, the confidence interval is 90.0%. Insofar as this high level of confidence was achieved from only two issuances, the July 2011 retail and competitive sales, the results are reported and included in the model.

Policy Implications

Analysis Suggests That Negative Outlooks Increases Borrowing Costs

Unlike recent bond sales, July 2011 GO bonds were sold at a time of uncertainty in the financial markets stemming from the federal government reaching its debt ceiling. Further complicating matters, two days before the State was scheduled to begin selling retail bonds, Moody's announced that it would review the credit ratings of five AAA-rated states, including Maryland. Moody's believes these states to be especially vulnerable to a downgrade of the U.S. government's credit (or actions possibly taken to preserve it).

In response to Moody's announced pending re-evaluation, Maryland officials consulted the Treasurer's financial advisor, bond council, and underwriters to determine the appropriate course of action. The decision was made to delay the start and condense the retail bond sale and continue with the competitive sale as scheduled.

The retail sale was initially scheduled to begin on Friday, July 22, 2011, and end on Monday, July 25, 2011. In hopes that a federal debt agreement could be brokered over the weekend,

the sale was condensed to Monday, July 25, 2011. Notwithstanding the absence of a deal, the sale went forward.

The three competitive sales scheduled for Wednesday, July 27, 2011, proceeded as planned. Insofar as the sale received AAA ratings from all three rating agencies and the State has a reputation for timely budgets and strong financial management, the State concluded that it was reasonable to expect a successful bond sale. In the end, the sale was considered to be successful. The State issued \$512.3 million in GO bonds with a TIC of 2.82%. Market conditions were such that the interest cost was among the lowest over the last 20 years. It was also lower than the most recent sale in March 2011, which had a TIC of 3.33%.

Nonetheless, the regression analysis suggests that Moody's action did have an effect on the bonds' TIC. The equation estimates that negative outlook added 0.23% (23 basis points) to the TIC. Based on these results, DLS calculates that being under credit watch added \$11.1 million to debt service costs, assuming similar maturities and retail bond issuances. From fiscal 2015 to 2026, when debt service costs are approximately \$51.0 million annually, negative outlook is estimated to add an average of over \$800,000 to annual debt service costs.

In December 2011, Moody's affirmed a negative outlook with the State's AAA rating. After the March 2012 bond sale, DLS will evaluate the effect of this designation on the TIC. It is possible that other factors influenced the August 2011 bond sale, such as uncertainty in the U.S. Congress regarding the federal debt ceiling and the very low absolute yields may not have been appealing to retail investors. If these other factors were in fact influential, it is likely that this variable will not be significant and fade out of the equation. DLS will continue to monitor and analyze the GO bonds' yields.

Build America Bonds Are Less Expensive Than Tax-exempt GO Bonds

The DLS analysis suggests that savings were realized by issuing BABs; the equation estimates that the yield on BABs (after adjusting for the federal subsidy) is 1.67% (167 basis points) less than the yield for 10-year tax-exempt bonds. The Treasurer's Office surmised that BABs with longer maturities would be less expensive than tax-exempt bonds with longer maturities. Consequently, BABs were issued with longer maturities, which must be taken into account when analyzing the cost of BABs. DLS estimates that each year adds approximately 0.32% onto the TIC and that the BABs maturities were an average of 14 years (4 years more than the 10-year rate). Since this adds approximately 1.28% to the cost of BABs, which is less than the 1.67% savings, the statistical analysis suggests that BABs did reduce State debt service costs. In January 2011, DLS estimated that BABs reduced State borrowing costs by \$39 million.

However, the future of the BABs program is unclear. Under current federal law, BABs expired on January 1, 2011. Most proposals have reduced the federal interest subsidy below 35%. It is possible that a lower subsidy rate no longer makes BABs attractive for Maryland. If BABs are reauthorized by the federal government, the State should evaluate whether issuing BABs will be cost effective.

Regression Analysis Suggests That Bay Restoration Bonds Are More Expensive Than General Obligation Bonds

The Bay Restoration Fund was created in 2004 to provide grants for ENR pollution reduction upgrades at the wastewater treatment plants. The fund is administered by MWQFA. The fund is financed by a bay restoration fee on users of wastewater facilities and septic systems and sewage holding tanks. Bay bonds are not considered to be GO bonds; unlike GO bonds, bay bonds are not supported by the full faith and credit of the State. However, they are considered to be State debt. Bond counsel noted that there is a substantial likelihood that, if challenged in court, the Maryland courts would consider bay bonds to be State debt since the bonds are supported by an involuntary exaction that serves a general public purpose.

On June 12, 2008, MWQFA issued \$50 million in bay restoration bonds. This was the first issuance of bay bonds. MWQFA estimates that another \$480 million in bay bonds will be issued through fiscal 2015. The bonds were rated AA and were issued through a negotiated sale. The regression analysis estimates that bay bonds are 0.45% (45 basis points) more expensive than GO bonds with a standard deviation of 0.18% (18 basis points). Also important is the t-test, which measures the reliability of the result. The t-test result is 2.586, which suggests that the test is in the 98.0% confidence level.

Because bay bonds have a number of unique features, it is unclear exactly what accounts for the difference. Some of the differences include a lower bond rating (bay bonds were rated AA instead of AAA), the new introduction to the market (this was the initial bay bond sale while GO bonds have been issued regularly for decades), and a negotiated bond sale (GO bonds issued to institutional investors are issued through competitive sales).

At best, DLS can only partially quantify the various factors that influence bay bonds' costs. At the time that bay bonds were issued, the Delphis Scale estimates that the difference between AAA and AA bonds was 0.16% (16 basis points); AAA rate was 3.92% and the AA rate was 4.08%. This suggests that 0.29% (29 basis points) of the additional interest is attributable to other factors, such as the newness of the bonds and the negotiated sale. With respect to any costs that may be attributable to the newness of the sale, these may decline as the State continues to issue bay bonds.

Part of the bay bonds' additional costs may be attributable to the negotiated sale. While it may make sense to structure the initial issuance of a bond that has a new revenue source as a negotiated sale, it also makes sense to reconsider this after the bonds have been successfully marketed.

Fiscal 2012 Actions

Proposed Deficiency

The budget bill includes a federal fund deficiency appropriation totaling \$437,153. This includes \$322,593 that supports interest payments for QZABs and another \$114,559 that supports interest payments for QECBs. The State issued \$15.9 million in QZABS in July 2011. QZABs support public school construction projects. These are taxable bonds with a direct federal interest subsidy for the issuer (the State of Maryland in this case). The federal funds fully subsidize the State's interest payment, so that the effective interest rate for the State is 0%.

Similarly, the State issued \$6.5 million in QECBs in July 2011. The proceeds support projects in public schools to promote energy efficiency. These are also taxable bonds with a direct interest subsidy. In this case, the subsidy is not 100%. The net State interest payment in fiscal 2012 is \$18,908 and the TIC is 0.62%, after adjusting for the federal subsidy.

DLS recommends that the deficiency appropriation is approved.

Actions Since Enactment of Fiscal 2012 Budget

Since the fiscal 2012 budget was enacted, debt service costs have been reduced by almost \$3,696,000. The reduction is attributable to:

- debt service costs for the July 2011 bond sale are approximately \$1,235,000 less than anticipated;
- the September 2011 refunding reduced costs by about \$1,949,000; and
- sinking fund payments for the 2009 QSCB issuance were over \$512,000 less than appropriated.

Anticipated debt service expenditures are \$878.6 million in fiscal 2012 and not \$882.3 million as is currently in the working appropriation. The lower appropriation reduces special fund appropriations from the ABF, which increases the fiscal 2012 end-of-year fund balance. The estimates prepared by DLS in this analysis reflect these changes and assume \$878.6 million in the working appropriation, as well as a higher ABF balance.

Proposed Budget

The fiscal 2013 allowance totals \$921.6 million. This continues the steady increase in GO bond debt service costs experienced in recent years. These increases are attributable to higher GO bond authorizations and issuances in recent years resulting in more debt outstanding. For example, the amount of new GO bonds issued increased from just over \$400.0 million annually in fiscal 2001

X00A00 – Public Debt

and 2002, approximately \$700.0 million from fiscal 2005 to 2008, and over \$900.0 million in fiscal 2011.

Most of the revenues supporting GO bond debt service are derived from State property taxes. **Exhibit 2** shows that State property taxes provide \$725.7 million, which represents 78.7% of the appropriation. In fiscal 2013, much of the remaining revenues are provided by depleting the ABF's fund balance, which is reduced to \$3.1 million at the end of the fiscal year. State property tax revenues decline approximately 4.7% in fiscal 2012 and 4.7% in fiscal 2013. The fund balances are available because bonds have been selling at a premium in recent years. The implications of this policy are discussed in Issue 2.

Exhibit 2
Annuity Bond Fund Revenues and
General Obligation Bond Debt Service Expenditures
Fiscal 2011-2013
(\$ in Thousands)

	FY 2011 Actual Expenditures	FY 2012 Working Appropriation	FY 2013 Allowance
Annuity Bond Fund Activity			
Beginning Balance	\$105,315	\$162,135	\$182,566
Property Tax Receipts	798,290	752,631	725,724
Interest and Penalties on Property Taxes	3,077	2,250	2,250
Other Repayments and Receipts	1,084	734	645
Bond Premium	78,791	130,326	0
Transfer to Reserve	-162,135	-182,566	-3,098
ABF Special Fund Appropriations	\$824,422	\$865,509	\$908,088
Federal Fund Appropriations ¹	9,202	11,498	11,955
Reimbursable Fund Appropriations ²	1,209	1,561	1,561
Projected Total Debt Service Expenditures³	\$834,833	\$878,568	\$921,603

¹ Fiscal 2012 includes \$437,153 in federal subsidies.

² Supports bonds issued for Program Open Space in 2010.

³ Fiscal 2012 includes adjustments to debt service since enactment of the budget.

Source: Department of Budget and Management, January 2012

X00A00 – Public Debt

In December 2011, the Capital Debt Affordability Committee (CDAC) proposed that an additional \$150 million in GO bonds be authorized in the 2012 legislative session. The Department of Budget and Management (DBM) advises that they expect to issue an additional \$50 million on bonds at the July 2012 and March 2013 bond sales and an additional \$25 million at the July 2013 and March 2014 bond sales. **Exhibit 3** shows the estimated debt service costs generated by this short-term increase in capital spending.

Exhibit 3
Debt Service Costs of \$150 Million Capital Budget Increase
(\$ in Thousands)

<u>Fiscal Year</u>	<u>July 2012 Bond Sale</u>	<u>March 2013 Bond Sale</u>	<u>July 2013 Bond Sale</u>	<u>March 2014 Bond Sale</u>	<u>Total</u>
2013	\$1,250	\$0	\$0	\$0	\$1,250
2014	2,500	2,500	625	0	5,625
2015	2,500	2,500	1,250	1,250	7,500
2016	5,252	5,323	1,250	1,250	13,075
2017	5,249	5,323	2,626	2,661	15,859
2018	5,245	5,323	2,624	2,661	15,854
2019	5,241	5,323	2,622	2,661	15,848
2020	5,237	5,323	2,621	2,661	15,842
2021	5,233	5,323	2,619	2,661	15,835
2022	5,228	5,323	2,616	2,661	15,829
2023	5,223	5,323	2,614	2,661	15,822
2024	5,219	5,323	2,612	2,661	15,814
2025	5,213	5,323	2,609	2,661	15,807
2026	5,208	5,323	2,607	2,661	15,799
2027	5,202	5,323	2,604	2,661	15,790
2028	5,196	5,323	2,601	2,661	15,781
2029	0	0	2,598	2,661	5,259
Total	\$74,196	\$74,196	\$37,098	\$37,098	\$222,589

Source: Department of Legislative Services, January 2012

Exhibit 4 provides a breakdown of debt service costs projected in the fiscal 2013 allowance. The allowance includes \$887.0 million in debt service from bonds that have already been issued and \$34.6 million on debt service from issuances projected in March and July of 2012. Prior to fiscal 2001, the State debt service was traditional GO bonds (tax-exempt debt issued to institutional investors). The exhibit identifies debt service payments attributable to the new kinds of debt that have been added since 2001.

Exhibit 4
Fiscal 2013 Debt Service Costs
(\$ in Millions)

<u>Type of Debt</u>	<u>Principal</u>	<u>Interest</u>	<u>Sinking Fund</u>	<u>Total</u>
Traditional GO Bonds	\$564.3	\$314.2	\$0.0	\$799.7
Retail Bonds	21.6	18.7	0.0	40.3
Taxable Bonds	8.7	0.3	0.0	9.0
Build America Bonds	0.0	25.3	0.0	25.3
Qualified Zone Academy Bonds	0.8	1.0	2.2	4.1
Qualified School Construction Bonds	0.0	2.0	6.4	8.3
Qualified Energy Conservation Bonds	0.0	0.3	0.0	0.3
Subtotal	\$564.3	\$314.2	\$8.6	\$887.0
Projected Issuances				
March 2012 Bond Sale	\$0.0	\$21.5	\$0.0	\$21.5
Summer 2012 Bond Sale ¹	0.0	11.9	0.0	11.9
Additional \$150 Million	0.0	1.3	0.0	1.3
Subtotal	\$0.0	\$34.6	\$0.0	\$34.6
Total	\$564.3	\$348.7	\$8.6	\$921.6

GO: general obligation

¹ Excludes additional \$150 million proposed to be authorized in 2012 capital budget.

Note: Numbers may not sum to total due to rounding.

Source: Comptroller's Office, October 2011; Department of Budget and Management, January 2012

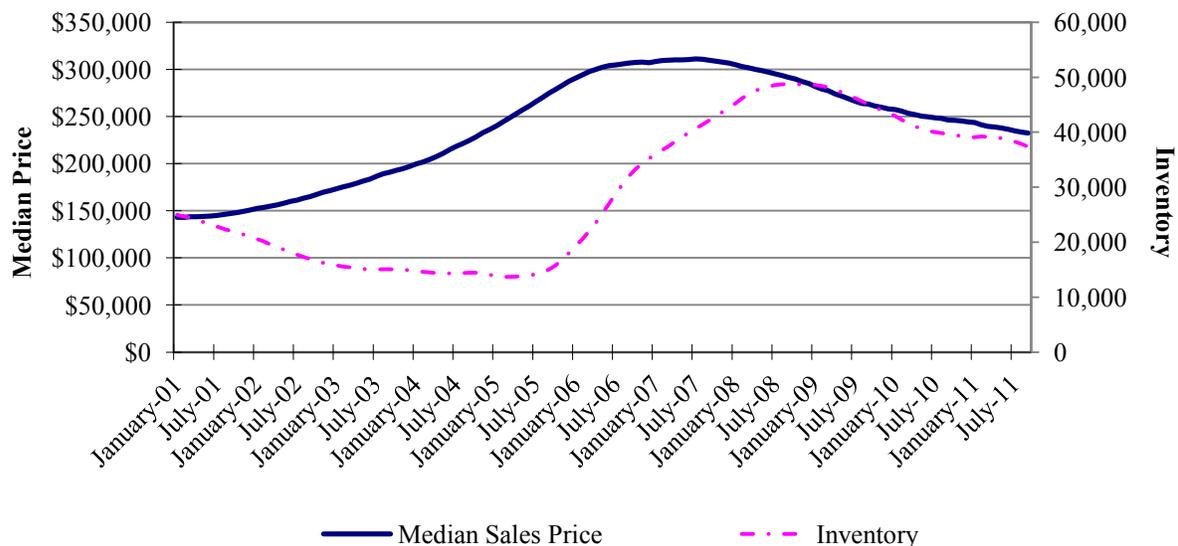
Issues

1. Out-year Trends Suggest Ongoing Shortfalls in the Annuity Bond Fund

GO bond debt service costs are supported by the ABF. The fund’s largest revenue sources include State property tax revenues and proceeds from bond sale premiums. Other revenue sources include interest and penalties on property taxes and repayments for local bonds. When the ABF has not generated sufficient revenues to fully support debt service, general funds have subsidized debt service payments. In April 2006, the State property tax rate was set at \$0.112 per \$100 of assessable base.

State property tax collections are influenced by trends in the housing market. **Exhibit 5** shows that since 2001 there has been a substantial increase in real estate values followed by a decline in values. It also appears that inventories remain high, even though they have declined since peaking in 2008. The recent declines in property values are expected to lead to declining State property tax receipts. In November 2011, the State Department of Assessments and Taxation’s (SDAT) reduced out-year assessable base estimates. It is unclear at this point when the decline in property values will end.

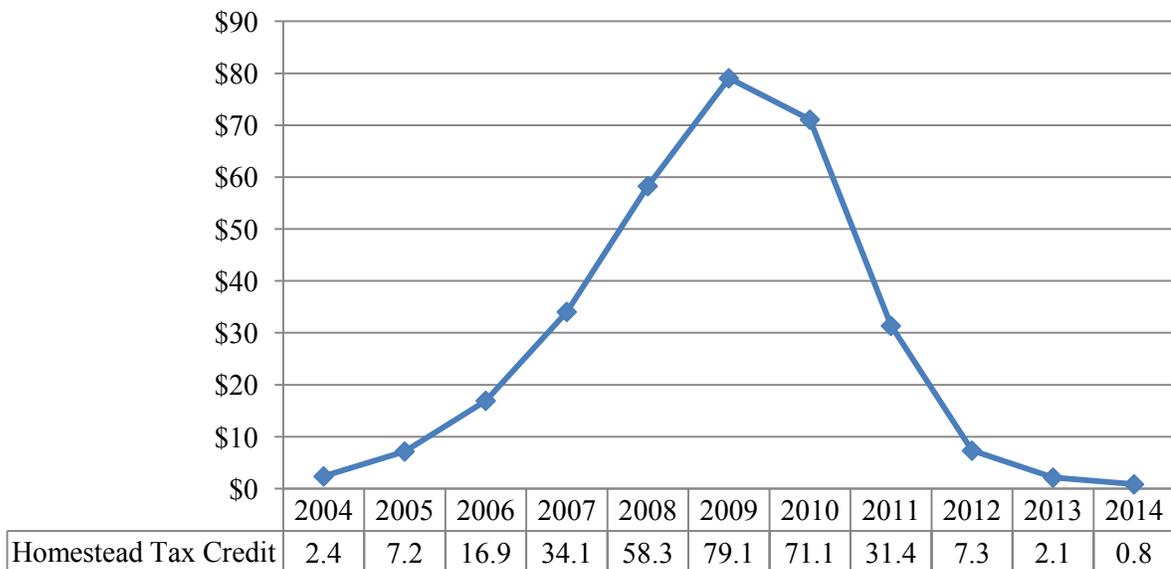
Exhibit 5
Maryland Housing – Median Prices and Inventory
12-month Moving Average
January 2001 to November 2011



Source: Maryland Association of Realtors

A concern about the November 2011 SDAT estimates is the steep decline of the projected Homestead Tax Credit. This credit limits the annual increase in State property assessments subject to the property tax to 10%. If reassessing a resident’s property results in an increase that exceeds 10%, the homeowner receives a credit for any amount above 10%. This limits growth in revenues when property values rise quickly. As home values declined, the homestead credit declined and revenues continued to slowly increase. The result was to smooth State revenues; State property tax revenue growth was slower as home values increased, and there was no decline in revenues when home values began to drop. After a period of sharp increases in real estate values, the homestead credit provides the State a hedge should property values decline. **Exhibit 6** shows that State credits increased to \$79 billion in fiscal 2009, in response to increases in assessments. By fiscal 2013, the aggregate homestead credits are projected to be \$2 billion.

Exhibit 6
State Property Tax Homestead Tax Credits
Fiscal 2004-2014
(\$ in Billions)



Source: State Department of Assessments and Taxation, November 2011

In subsequent years, declining home values will no longer be hedged. Consequently, reductions in home assessments will result in corresponding reductions in State property tax receipts. However, there is some encouraging data that suggests the decline in home values is slowing. SDAT initially estimates the assessable base two years before the beginning of the fiscal year. One year before the fiscal year, this estimate is revised based on the most recent assessments. This is when the most substantial revision occurs. When property values are appreciating rapidly, this usually results

in an upward revision of the estimate; when property values are declining, this usually results in a downward revision of revenues. **Exhibit 7** shows that revenues were revised downward by 5.3% for fiscal 2011 and 4.3% for fiscal 2012. The fiscal 2013 revision only declines 1.3%, suggesting a slowdown in the drop in property values. While this may not signal the end of the decline in property values, at least it signals a slowdown.

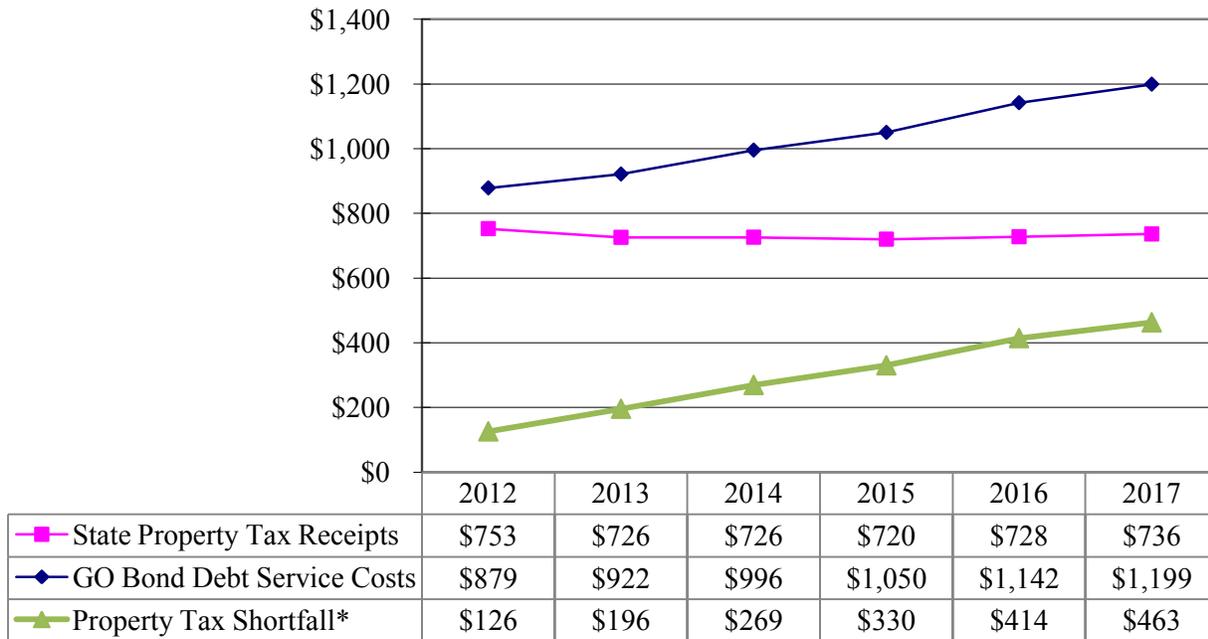
Exhibit 7
Real Property Full Year Assessable Base Estimates
Fiscal 2010-2013
(\$ in Billions)

	<u>2011</u>	<u>2012</u>	<u>2013</u>
Initial Estimate – Prepared 19 months prior to start of fiscal year	\$769.8	\$718.3	\$660.4
Revised Estimate – Prepared with new assessments seven months prior to start of fiscal year	729.0	687.3	651.5
Change to Estimate	-\$40.8	-\$31.0	-\$8.9
Percent Change	5.3%	4.3%	1.3%

Source: Department of Assessment and Taxation, November 2007 to 2011 Estimates

DLS notes that State property tax receipts, which support GO bond debt service, are declining while GO bond debt service costs are increasing. Since the 2000 legislative session, State debt has been increased by authorizing additional GO debt. There have been 11 actions to increase GO bond authorizations. **Appendix 4** provides a list of these actions taken to expand debt. Consequently, annual debt service costs are expected to increase by over 6%, while annual State property tax receipts are expected to decline through fiscal 2015. **Exhibit 8** shows how State property taxes, which are \$126 million less than debt service costs in fiscal 2012, are expected to be \$463 million less than debt service costs in fiscal 2017. (The next section examines the shortfall in the ABF, which is somewhat less because it includes modest funds balances, as well as special and federal fund revenues.)

Exhibit 8
GO Bond Debt Service Costs and State Property Tax Revenue Collections
Fiscal 2012-2017
(\$ in Millions)



GO: general obligation

* The shortfall in the Annuity Bond Fund is somewhat less because it includes special and federal fund revenues.

Sources: State Department of Assessment and Taxation, November 2011; Department of Budget and Management, January 2012

The ABF has been able to support debt service costs with large fund balance that realized substantial bond sale premiums. However, a rise in interest rates, from these historically low levels, is likely to reduce or eliminate bond sale premiums. (The next issue examines bond sale premiums.) **Exhibit 9** shows that the shortfall is expected to increase to \$442 million by fiscal 2017.

The Administration's proposed budget bill, along with the Budget Reconciliation and Financing Act (BRFA) of 2012, reduce the out-year general fund forecast by over half. DBM's general fund forecast, shown in Appendix F of the Budget Books, estimates that the fiscal 2017 general budget deficit is \$374 million. (The December 2011 general fund forecast prepared for the Spending Affordability Committee shows a \$1,054 million structural deficit in fiscal 2017.) The new deficit estimate is less than the general fund subsidy in the ABF, which is projected to be \$442 million. The remaining general fund deficit could be eliminated by funding debt service with property taxes.

Exhibit 9
Estimated Annuity Bond Fund Activity
Fiscal 2012-2017
(\$ in Millions)

	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
Special Fund Revenues						
State Property Tax Receipts	\$753	\$726	\$726	\$720	\$728	\$736
Bond Sale Premiums	130	0	0	0	0	0
Other Revenues	3	3	3	3	3	3
Annuity Bond Fund Balance Transferred from Prior Year	<u>162</u>	<u>183</u>	<u>3</u>	<u>0</u>	<u>0</u>	<u>0</u>
Subtotal Special Fund Revenues Available	\$1,048	\$911	\$732	\$723	\$731	\$739
General Funds	0	0	246	309	393	442
Reimbursable Funds ¹	2	2	6	6	6	7
Federal Funds ²	11	12	12	12	12	12
Total Revenues	\$1,061	\$925	\$996	\$1,050	\$1,142	\$1,199
Projected Debt Service Expenditures	\$879	\$922	\$996	\$1,050	\$1,142	\$1,199
ABF End-of-year Fund Balance	\$183	\$3	\$0	\$0	\$0	\$0
Property Tax Rate per \$100 of Assessable Base	\$0.112	\$0.112	\$0.112	\$0.112	\$0.112	\$0.112

¹ Support \$70 million of general obligation bonds issued in calendar 2010 to support Program Open Space.

² Federal interest subsidies for Build America Bonds, Qualified Zone Academy Bonds, Qualified School Construction Bonds, and Qualified Energy Conservation Bonds.

Sources: State Department of Assessment and Taxation, November 2011; Department of Budget and Management, January 2012

Since fiscal 2004, State policy has been to provide a dedicated revenue source for GO bond debt service costs. This policy has provided a stable funding source and reduced the State's general fund deficit. In recent years, debt service costs have increased while State property taxes have declined. Consequently, a deficit is forecast in the out-years. **The State Treasurer should brief the committees on the long-term outlook of the Annuity Bond Fund and the benefits of a dedicated revenue source for debt service. Insofar as there is a long-term general fund deficit and the State has identified a dedicated revenue source for GO bond debt service, the Department of Legislative Services (DLS) recommends that any shortfall in the Annuity Bond Fund be supported by additional State property taxes.**

2. Fiscal 2013 Budget Assumes Large Bond Sale Premiums

GO bond debt service is supported by the ABF and general funds. ABF's revenue sources include property tax revenues, interest generated by fund balances, loan repayments for local bonds, and miscellaneous revenues generated from bond sales such as bond sale premiums. The purpose of the bond fund is to support debt service. If ABF revenues are insufficient to support the entire GO bond debt service, general funds are also appropriated.

Before calendar 2001, more than 95% of revenues were generated from either property taxes (distributed through the ABF) or general fund appropriations. In recent years, bond sale premiums have been a substantial revenue source for the ABF. Since fiscal 2001, the State generated over \$650 million in bond sale premiums. This is almost 10% of debt service expenditures over the same period.

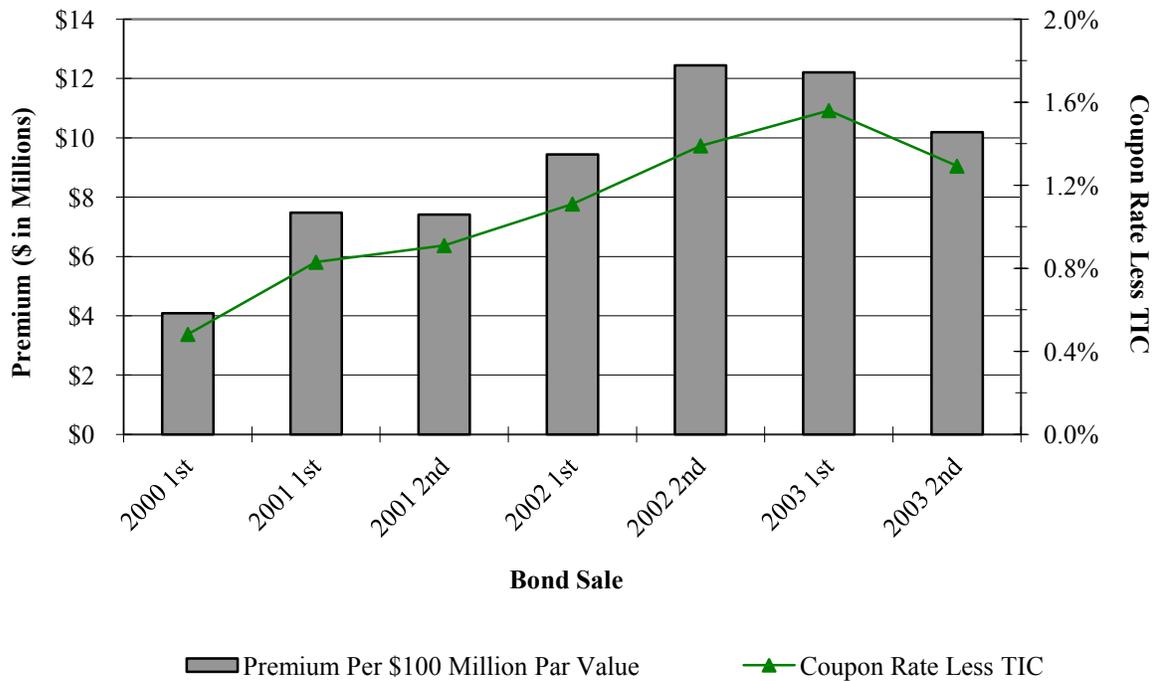
Bond Sale Premiums Have Increased as Interest Rates Have Fallen

When bonds are sold, they have a par value (cost of the bond as shown in the Official Statement) and a coupon rate (interest rate paid to the bondholder). When the bonds are bid, the Treasurer's Office determines the value of the bonds sold and when the bonds mature. The market determines the coupon rate and the sale price of the bonds. In the current low-interest rate climate, the coupon rate has been substantially higher than the market interest rate, as measured by the TIC. If the TIC is less than a bond's coupon rate, the markets bid up the price of the bonds to a level that is higher than par value. The difference between the par value and the sale price of the bonds is a premium. Conversely, when the TIC is above the coupon rate, the bonds cannot sell at par value and sell for less. This difference is referred to as a discount.

For most bond sales before 2001, the TIC was slightly below the coupon rate. This generated a small premium and provided sufficient funds for the capital program. Since 2001, interest rates have declined while coupon rates have remained constant. The result has been substantial premiums. This relationship was examined by DLS in calendar 2003 in the *Effect of Long-term Debt on the Financial Condition of the State*.

The increases in premiums are attributable to the difference between the bonds' coupon rates and TIC. The coupon rates have declined less than market interest rates (as measured by the TIC) in recent years. **Exhibit 10** shows how the spread between the coupon rate and the TIC affects bond sale premiums in bond sales from 2000 to 2003, when the State began realizing large premiums. Over the same period, bond sale premiums increased from \$4 million sale to \$12 million per \$100 million of bonds sold. The actual premium realized is even more stunning, as total amount of bonds sold increased. The first 2000 bond sale generated an \$8 million premium while the first 2003 bond sale generated a \$61 million premium.

Exhibit 10
Differences Between Coupon Rates and True Interest Cost Affect Premiums
2000-2003 Bond Sales



TIC: True Interest Cost

Source: Department of Legislative Services, November 2003

Bond Sale Premiums Protect Investors Against Rising Interest Rates

The return an investor receives for purchasing a bond is referred to as the yield. When bonds are sold, the yield is the TIC. At the July 2011 bond sale, the State competitively sold \$29.0 million of GO bonds with 15-year maturities. The coupon rate of the bonds was 5.00% and the yield was 3.30%. The value of each \$5,000 bond with a 5.00% coupon rate was \$5,999. The additional \$999 was the premium investors paid to increase the coupon rate from 3.30% to 5.00%. At the time of the bond sale, the value of a \$5,000 bond with a 3.30% coupon rate is the same as a \$5,999 bond with a 5.00% coupon rate.

Even though the two bonds in the previous example are worth the same on the day of the sale, investors prefer to purchase bonds at a premium. The reason for this is that bonds sold at a premium hold their value better than bonds sold at par if interest rates rise. If interest rates increase from 3.30 to 4.30%, the value of bonds sold for \$5,999 decline 10.30% while the value of bonds sold at par (\$5,000) decline 11.00%.

Current interest rates are historically low. According to data from the Federal Reserve Board, the yield on 10-year Treasury Bills on the Friday after the most recent bond sale was among the lowest since 1962. In fact, only 41 out of 2,586 weeks had lower yields. In this environment, it certainly makes sense for investors to protect themselves against rising interest rates, and this is done by purchasing bonds at a premium.

Risks Associated with Counting on Premiums to Pay Debt Service

In the November 2003 *Effect of Long-term Debt on the Financial Condition of the State*, DLS recommended that the State estimate premiums when preparing the budget. At the time, DLS noted that this should be done cautiously because bond markets can be volatile. DLS' concern is that bond sale premiums can vary substantially. Even a slight change in market interest rates or the coupon rates proposed by the winning bidder can increase or reduce the premium by millions of dollars.

The allowance assumes that the March 2012 bond sale will generate \$72.6 million in premiums (after adjusting for the cost of issuance and underwriters discount). This is sufficient to fund the fiscal 2013 allowance and leave a \$3.1 million fund balance. If the premium is less than \$69.5 million, the funds in the ABF will be insufficient to support GO bond debt service. This will require either additional State property tax rates revenues or general funds.

At the March bond sale, the Treasurer's Office is proposing to issue \$75.0 million in bonds for retail investors and \$390.0 million in bonds for institutional investors. The financial advisor is projecting coupon rates between 2 and 4% for the retail bonds and 5% for institutional bonds. Because more bonds are sold to institutional investors and these bonds have a higher coupon rate, almost the entire premium is generated from the bonds sold to institutional investors; in fact, these bonds are projected to generate a \$69.1 million premium (after adjusting for the cost of issuance and underwriters discount).

The concern is that it is quite possible that the premium may not be enough. DLS estimates that if the average coupon rate is 4.50%, instead of 5.00%, the projected bond sale premium for \$390.0 million in bonds is reduced by \$16.5 million. Insofar as the ABF only has a \$3.1 million cushion, this is more than enough to result in a shortfall in the ABF. It is quite common for average coupon rates to be below 5.00%. For example, the winning bidder for the March 2011 bond sale for institutional investors had coupon rates as low as 3.00% and below 5.00% for all 12-year to 15-year maturities. If the March 2012 bond sale's winning bid has similar coupon rates, the premium may not be sufficient to fund debt service in fiscal 2013. However, there is one advantage if the coupon rate is below 5.00%; out-year debt service costs decline.

In previous years, the ABF has had a substantial fund balance. A rise in debt service coupled with a decline in State property taxes has eroded this fund balance. The fiscal 2013 allowance assumes that the March 2012 bond sale will generate the largest bond sale premium in State history. This analysis is not a critique of the budget's estimate of premiums or the methods used by DBM. Rather it is an examination of the risks inherent with assuming a bond sale premium when the ABF balance is low. While this estimate is reasonable, it is quite possible that the premium will be insufficient to support GO bond debt service costs. Because the bonds are sold a month before the

end of the current legislative session, there is ample time to address any shortfall in the ABF. **The Department of Budget and Management should discuss plans to fund the Annuity Bond Fund if bond sale premiums realized in the March 2012 bond sale are insufficient.**

3. Additional Revenues Increase Debt Capacity

State debt consists of GO bonds, transportation bonds, Grant Anticipation Revenue Vehicles (GARVEE), stadium authority bonds supported by State revenues, bay restoration bonds, and capital leases supported by State revenues. State debt issuances are constrained by the State's personal income and the revenues supporting State debt. State debt policy is that State debt outstanding cannot exceed 4% of State personal income and that State debt service costs cannot exceed 8% of revenues supporting State debt.

These estimates are not limited to the current or allowance year. The State estimates these ratios for 6 to 10 years. Debt service payments climb for years after GO bond debt is authorized. Factors that influence debt service payments are how debt is structured and how soon authorized debt is issued. With respect to authorizations, the State issues approximately 31% of debt the first year. The remaining debt is issued in subsequent years. This is because debt is issued when payments are required, and it often takes years to complete a project. With respect to debt structure, GO and transportation bonds do not pay principal until the third year. Consequently, the first two years' debt service payments are substantially lower than the remaining payments. Therefore, the State estimates debt affordability ratios for at least six years.

Exhibit 11 shows that current State debt authorizations are affordable through fiscal 2021. The debt outstanding ratio peaks in fiscal 2014, and the debt service ratio peaks in fiscal 2017.

Exhibit 11
Debt Affordability Ratios
Fiscal 2011-2021
(\$ in Millions)

<u>Fiscal Year</u>	<u>Debt Service</u>		<u>Debt Outstanding</u>	
	<u>Total Costs</u>	<u>Percent of Revenues</u>	<u>Total Outstanding</u>	<u>Percent of Personal Income</u>
2011	\$1,153	6.58%	\$9,575	3.20%
2012	1,218	6.80%	10,305	3.35%
2013	1,288	6.95%	11,130	3.49%
2014	1,423	7.30%	11,770	3.53%
2015	1,524	7.49%	12,068	3.44%
2016	1,636	7.73%	12,168	3.31%
2017	1,725	7.83%	12,294	3.20%
2018	1,772	7.76%	12,371	3.08%
2019	1,782	7.49%	12,487	2.97%
2020	1,788	7.24%	12,690	2.89%
2021	1,795	7.12%	13,005	2.84%

Note: Includes all State debt.

Source: Department of Budget and Management, January 2012

The State is below the limit so there is excess capacity. **Exhibit 12** shows that fiscal 2017 debt service costs are 2% under capacity and debt outstanding is 13% under capacity. Since the State policy is to adhere to both, the limiting ratio is debt service to revenues. This 2% capacity is a small cushion against changes in revenues. A revenue reduction in excess of 2%, which certainly has happened in the recent past, would bring the State over the limit and force either revenue increases or reductions in capital spending to stay within State policy.

Exhibit 12
Excess State Debt Capacity
(\$ in Millions)

Fiscal Year	Debt Service			Debt Outstanding		
	Capacity	Excess Capacity	Percent Under Capacity	Capacity	Excess Capacity	Percent Under Capacity
2011	1,402	249	18%	11,969	2,394	20%
2012	1,433	215	15%	12,316	2,011	16%
2013	1,483	195	13%	12,750	1,620	13%
2014	1,559	136	9%	13,326	1,557	12%
2015	1,628	104	6%	14,029	1,961	14%
2016	1,694	58	3%	14,707	2,539	17%
2017	1,762	37	2%	15,355	3,061	20%
2018	1,826	54	3%	16,066	3,696	23%
2019	1,903	120	6%	16,805	4,318	26%
2020	1,977	189	10%	17,557	4,867	28%
2021	2,017	223	11%	18,312	5,307	29%

Note: Includes all State debt.

Source: Department of Budget and Management, January 2012

Proposals to Increase State Revenues Increase Debt Capacity

Since the revenue ratio is close to capacity, State debt issuances are limited by State revenues. The Administration has proposed to increase revenues to fund bay restoration and transportation, as well as to reduce the general fund deficit. This section examines the effect of additional revenues on debt affordability.

Bay Restoration Fund

The fund is financed by a bay restoration fee on users of wastewater facilities (WWTP Fund) and septic systems and sewage holding tanks (Septic Fund). These fees support debt service costs for bay restoration bonds. The Bay Restoration Fund was created in 2004 primarily to provide grants for ENR pollution reduction upgrades.

X00A00 – Public Debt

The bay fund legislation developed clear goals. Current estimates indicate that the funding provided will not be able to meet these goals. Overall, the program plans to issue \$530 million in revenue bonds through fiscal 2015. These revenue bonds, in addition to revenues expended from the fund as pay-as-you-go (PAYGO) special funds, would fund approximately \$1,002 million of the \$1,385 million upgrade cost, a shortfall of \$383 million. To fund this shortfall, the Administration proposes to double the fee and provide GO bonds for any remaining capital requirements.

The Administration estimates that increasing the fee will generate approximately \$60 million in fiscal 2017, when State capacity is at its lowest level. These revenues allow the State to issue a total of \$45 million in additional bonds.

Additional General Fund and Transportation Revenues

The BRFA of 2012 proposes changes to State tax rates that are expected to generate additional general fund revenues. The changes include capping income tax deductions and limiting exemptions, requiring online sellers to collect sales taxes, and aligning the tax on tobacco products with the cigarette tax. When the analysis was prepared, out-year estimates of these proposed tax changes had not yet been prepared by DLS.

The Administration is expected to propose to increase transportation revenues. When the analysis was prepared, the legislation had not yet been submitted.

At this time, precise estimates of the additional capacity generated by increasing general fund and transportation revenues cannot be prepared. However, DLS can prepare an estimate of the effect per \$100 million in revenues it has on debt capacity. Assuming current interest rates (5.00% TIC) and issuance of bonds in fiscal 2013, every \$100 million provides an additional \$75 million in debt capacity. Should the issuance of bonds be delayed, additional capacity could be realized. DLS will prepare precise estimates of capacity if details regarding the revenues generated and timing of bond issuances become available.

The State Treasurer should brief the committees on the effect of additional revenues on State debt capacity under current debt affordability guidelines.

4. Recent Authorizations Confirm State Policy to Manage State Debt within Affordability Limits

The State issues GO bonds to support the capital program. As the State's financial situation changes, the State's debt policies also change. This issue examines recent policies.

Calendar 2001 to 2009 Was a Period of Expanding State Debt

In calendar 2000, the State was well under the affordability limits. At the time, debt service was 5.7% of revenues and debt outstanding was 2.5% of personal income. This capacity allowed the State to expand State debt from the 2001 to 2009 legislative sessions. The State has expanded debt

X00A00 – Public Debt

authorizations in 17 separate actions: 11 actions increase GO bond authorizations; 3 actions increase transportation bond authorizations; GARVEEs are authorized; Program Open Space bonds are authorized (which are later issued as GO bonds); and bay restoration bonds are authorized. Appendix 4 lists all the actions that were taken to increase debt.

These new and expanded authorizations increased the amount of debt outstanding. **Exhibit 13** shows that State debt outstanding totaled \$4.6 billion at the end of fiscal 1999. By the end of fiscal 2011, total debt outstanding increased to \$9.6 billion (an increase of 6.1% annually).

Exhibit 13
Increase in State Debt
Fiscal 1999 to 2011
(\$ in Billions)

	<u>1999</u>	<u>2011</u>	<u>Increase</u>
State Debt Outstanding	\$4.6	\$9.6	\$4.9
GO Bond Authorizations	4.5	9.3	4.8
GO Bond Debt/Outstanding	3.5	7.0	3.5
Unissued GO Bonds	1.0	2.4	1.3

GO: general obligation

Source: State Treasurer's Office

State Policy Shifts from Expansion of Debt to Management of Debt

Since the State began expanding its capital program in calendar 2000, the State has been through two recessions. The 2007 through 2009 recession was especially deep and resulted in lower out-year income and revenue estimates, which reduced the State's debt capacity.

In December 2009, CDAC met to revise its recommended GO bond authorization. Since the committee had made its recommendation in September 2009, the Board of Revenue Estimates had substantially reduced the State's general fund revenue projections. The revised revenue projections were low enough to reduce the State debt service to revenues ratio to the point that it exceeded the CDAC's 8% limit. In response to these lower revenues, the committee reduced the out-year GO bond authorizations so that the debt service to revenues ratio is below the limit. The fiscal 2012 GO authorization was reduced to \$925 million, \$215 million less than peak spending in fiscal 2011, which totaled \$1,140 million. The September 2011 recommendation maintains GO bond authorizations at the level that was proposed in December 2009.

X00A00 – Public Debt

In December 2011, CDAC met and increased the 2012 session GO bond debt limit from \$925 million to \$1,075 million. To remain within affordability limits, the committee recommended reducing 2017 session GO bond authorizations by \$150 million. So instead of increasing \$245 million (from \$955 million to \$1,200 million), the 2017 authorization is projected to increase \$95 million. Moving authorizations from calendar 2012 to 2017 is affordable; debt outstanding and debt service costs are below affordability ratios.

CDAC's recommendations for the 2011 and 2012 session are examples of the type of recommendations that are expected when the State is at debt capacity. To avoid exceeding the limit, the capital program needed to be reduced by \$215 million in the 2011 session. During the 2012 session, the State was able to increase the program by \$150 million by reducing growth in the out-years. Although \$925 million is proposed for the 2013 session, it would not be surprising if conditions allow the State to either increase debt or force a reduction in debt. The point is that the State is managing its debt within limits while attempting to maximize bond issuances.

This is quite different than the period from calendar 2001 to 2010. At that time, authorizations were only increased. For example:

- In the 2002 legislative session, \$200 million in GO bonds were authorized to accommodate the PAYGO capital program. At the time, no reduction needed to keep debt within the affordability limits, and no reduction was made.
- In the 2004 legislative session, the GO program was increased \$100 million a year from fiscal 2005 to 2009. At the time, no reduction needed to keep debt within the affordability limits, and no reduction was made.
- In the 2006 legislative session, the State modified the annual increase from a fixed \$15 million to 3%. Another \$100 million was added annually to the program beginning in fiscal 2010. This was to avert a reduction in the program created by the proposed level of authorizations made in calendar 2004. At the time, no reduction needed to keep debt within the affordability limits, and no reduction was made.
- In the 2008 legislative session, authorizations were again increased \$100 million annually. At the time, no reduction needed to keep debt within the affordability limits, and no reduction was made.

The State Treasurer should brief the committees on the efforts of the Capital Debt Affordability Committee to keep State debt within affordability guidelines.

5. The Cost of the Health Lab Lease Financing Exceeds General Obligation Bond Issuance Cost: Is the State Leasing Too Much?

The State is currently approaching the debt limit. DLS is concerned that the State will be tempted to structure project financing so as to avoid being counted as State debt and that this could increase State costs. An example of this is financing for the Department of Health and Mental Hygiene's (DHMH) new lab. In November 2011, the Maryland Economic Development Corporation (MEDCO) issued bonds for this project. When completed, the lab will be leased to DHMH. The State chose this lease arrangement instead of issuing GO bonds.

Maryland Public Health Lab Project Background

DHMH is mandated to maintain a public health laboratory to provide testing, consulting, and regulatory support and to protect the citizens of Maryland against the spread of communicable and infectious diseases (Health-General Article 17-101). The current public health laboratory, located at 201 West Preston Street and occupied by DHMH since 1974, was deemed insufficient to meet the needs of a modern public health laboratory and is currently operating beyond its intended maximum capacity. The existing physical structure and design lacks the flexibility and capacity to add or delete a particular lab function with minimal renovation and disruption to utilities.

In the 2006 session, the General Assembly agreed to move forward with the design and construction of a replacement facility by authorizing \$9.4 million of GO bonds to fund preliminary design. In the 2007 session, the prior authorized funds were de-authorized and a pre-authorization provided for the 2008 session to accommodate delays in obtaining and approving a program plan for new facility. In addition, committee narrative adopted in the 2007 session that recommended that DHMH initiate a study on alternate methods to finance the new lab.

While the consultant report made no specific recommendations concerning the funding options studied, during the 2009 session, the Administration proposed a financing approach using MEDCO-issued lease-revenue bonds in conjunction with a private developer rather than issuing State tax-exempt GO bonds, which is the customary method of financing the construction of State-owned buildings. The Administration supported the MEDCO financing alternative, despite greater projected total costs that would be incurred if the project were to be funded with GO bonds, on the premise that it will enable the State to direct its limited GO bond resources to fund other State capital purposes and, if structured as an operating lease between MEDCO and the State, it would not count as State-supported debt within the debt limits.

Late in the 2009 session, the Administration alerted the committees that some initial GO funding would be necessary to initiate pre-development and design prior to any eventual MEDCO lease-revenue bond issuances to fund remaining design and construction of the new facility. To this end, the General Assembly included a \$6.45 million GO bond authorization for the lab in the Maryland Consolidated Capital Bond Loan (MCCBL) of 2009. The General Assembly added language to the authorization that restricted the release and use of the bond funds until DHMH, DBM, and the Department of General Services (DGS) provided the budget committees with a report that outlines the Administration's plans for constructing and financing the new lab.

X00A00 – Public Debt

In July 2009, DHMH presented a number of alternative financing proposals for this project, which included funding the project with GO bonds, capital leases, operating leases, and public-private partnerships (P3) arrangements. There was a consensus that arrangements that include the project in the debt affordability limits (GO bonds and capital leases) were more cost effective for the State than arrangements that did not (operating leases and P3s). In December 2009, after several years of extensive and intensive analysis, the budget committees authorized DHMH to allow MEDCO to finance the design and construction of the new public health laboratory at the Life Sciences and Technology Park East.

In January 2010, the Board of Public Works (BPW) approved an Interagency Agreement between DHMH, DGS, and MEDCO, that among other provisions calls for MEDCO to finance and cause the design, development, and management of the new lab. The lab will be leased to DHMH. For debt affordability purposes, this is considered to be a capital lease and is included in the State's debt calculations. This agreement was the first step in the process and necessary to activate the \$6.45 million in pre-development funds appropriated in the MCCBL of 2009. In November 2011, MEDCO issued bonds to construct the facility.

Maryland Public Health Lab Project Financing Analysis

The par value of the MEDCO bonds sold was \$171 million. **Exhibit 14** shows that the bonds generated a \$16 million premium. These additional funds are required to support the project. The State will not appropriate funds for this project until fiscal 2014. Instead the proceeds from the bond sale will support the first five interest payments.

Exhibit 14
Source and Use of Public Health Lab Project Bond Proceeds
(\$ in Millions)

<u>Source of Funds</u>	<u>Amount</u>
Par Value of Bonds	\$170.9
Premium	16.0
Fund Earnings	0.3
Total Funds	\$187.2
Use of Funds	
Project Construction	\$164.7
Capitalized Interest	19.3
Other ¹	3.2
Total Funds	\$187.2

¹ This includes the underwriter's discount, cost of issuance, and rounding amount.

Source: Wye River Group, Inc., November 2011

X00A00 – Public Debt

Another financing approach for this project is to issue GO bonds, instead of MEDCO bonds and a lease. The Treasurer’s financial advisor, Public Financial Management, Inc. (PFM), estimated the cost of issuing GO bonds instead of MEDCO bonds. **Appendix 5** shows that the total GO bond debt service costs would be \$233 million, compared to \$244 million for MEDCO bonds.

The advantages of issuing GO bonds are:

- **Lower TIC:** PFM estimates a TIC of 2.68% for GO bonds, compared to 3.61% for the MEDCO bonds;
- **Lower Total Debt Service Costs:** Total debt service costs for GO bonds are \$233 million, compared to \$244 million for MEDCO bonds;
- **A Larger Premium That Can Be Applied to GO Bonds Debt Service Costs:** As is the case with MEDCO bonds, the GO premium can be applied to support debt service costs. In the case of GO bonds, the premium is \$24.2 million, instead of \$16.0 million for MEDCO bonds;
- **Lower Net Present Value of Debt Service Costs:** DLS calculates that the net present value of \$35.2 million in savings is \$18.0 million; and
- **Debt Service Payments Ending After 15 Years:** The MEDCO bonds mature in 20 years and the GO bonds mature in 15 years. Consequently, the GO bonds have 5 less years of debt service payments.

The MEDCO bonds have an advantage. The MEDCO bonds have lower debt service payments before fiscal 2027.

The conclusion is that issuing GO bonds is less expensive than issuing MEDCO bonds leasing a facility. **DLS recommends that, prior to entering into a capital lease, the State compare the cost of leasing with the cost of issuing GO bonds and pursue the most cost-effective approach.**

6. Will the State Be Issuing Taxable Bonds Soon?

The State’s capital program supports a number of different public policy objectives, such as, health, environmental, public safety, education, housing, and economic development objectives. Federal government regulations allow the State to issue debt that does not require the buyer to pay federal taxes on interest earnings. In cases where investors do not pay federal income taxes, they are willing to settle for lower returns. Investors in taxable debt require higher returns to offset their tax liabilities. Consequently, the State can offer lower interest rates on tax-exempt bonds.

Federal laws and regulations limit the kinds of activities the proceeds from tax-exempt bonds can support. One such requirement limits private activities or private purposes of the bond proceeds to 5% of the bond sales proceeds. Another requirement limits the bonds to \$15 million for business

use projects and \$5 million for business loans. Examples of programs that support private activities or uses include the Partnership Rental Housing and Neighborhood Business Development programs of the Department of Housing and Community Development; the Public Safety Communications program of the Department of Information Technology; and the Physical Sciences Complex at the University of Maryland, College Park.

To avoid exceeding the private activity limits imposed in the federal regulations, the State has previously appropriated funds in the operating budget instead of issuing debt for private purpose programs and projects. Recent years' fiscal constraints have limited the amount of operating funds available for capital projects. To continue these programs, the State authorized GO bonds. In fiscal 2011, the State began migrating private purpose programs from the operating budget into the capital budget.

Bond Sale Data Shows That Taxable Bonds Are More Expensive

This is not the first time that the State has funded private purpose projects with GO bonds. After the 2001 recession, the State also moved capital projects from the operating budget to the capital budget. In calendar 2005, the State reached its limit with respect to private activity exemptions in tax-exempt issuances, and the State was forced to sell taxable debt. These sales provide data from actual bond sales that can be used to test the hypothesis that taxable debt is more expensive than tax-exempt debt.

The State has had three taxable bond sales. After the sales, DLS prepared an analysis of the costs of the taxable bond sales and compared those costs with tax-exempt bond sales. **Exhibit 15** shows that \$65.0 million in taxable bond sales increased debt service costs by an estimated \$2.8 million.

Exhibit 15
Cost of Taxable Debt Issuances
(\$ in Millions)

<u>Date of Issuance</u>	<u>Years to Maturity</u>	<u>Amount Issued</u>	<u>Total Debt Service</u>	<u>Additional Cost</u>
March 2, 2005	3	\$25.0	\$26.9	\$0.5
July 20, 2005	7	20.0	24.5	1.1
March 1, 2006	7	20.0	25.0	1.2
Total		\$65.0	\$76.4	\$2.8

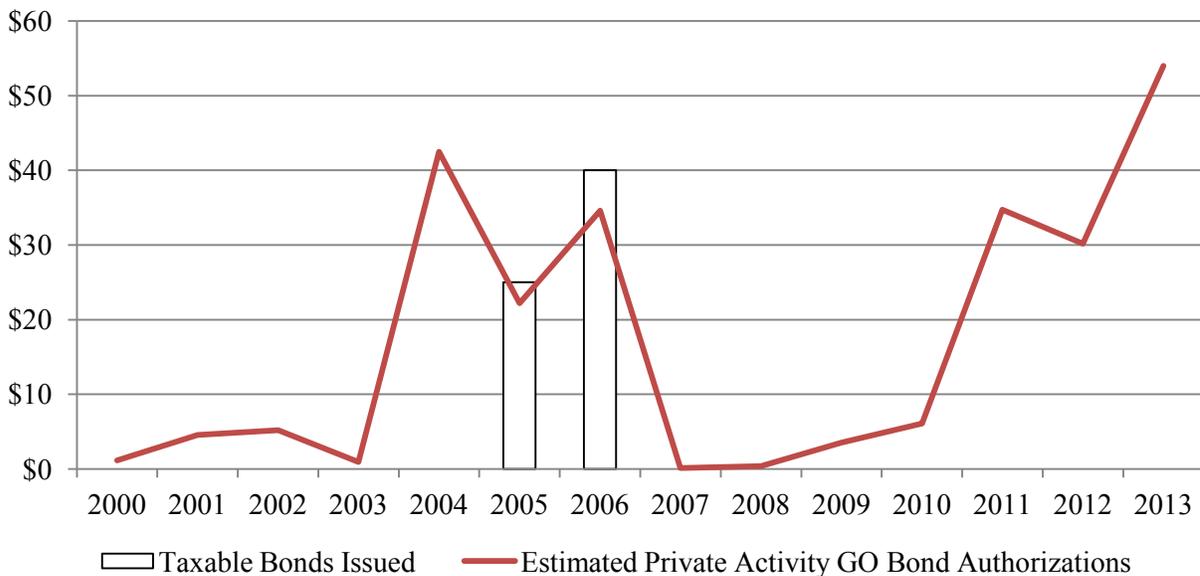
Source: Department of Legislative Services, January 2011

Recent Increase in Private Purpose Authorizations Is Similar to Actions Taken Prior to 2005 Taxable Bond Issuances

Because of the nature of capital projects, a number of capital projects contain some private purpose components. For example, a State building could have a cafeteria that is operated by a private vendor. In that case, there is private activity in the building, but it is only a small share of the buildings operations. To allow some flexibility in public buildings financed with tax-exempt debt, federal regulations provide room for some small portion of private activity. However, this limit is small and cannot indefinitely support large private purpose projects.

Each year, when DBM puts together its capital budget, it acknowledges that there are projects that have a private activity component. **Exhibit 16** shows that in most years, private purpose projects are \$5 million or less. In fiscal 2004, private purpose projects increased to approximately \$43 million and remained at a high level through fiscal 2006. As a result of this high level of private purpose projects, the State issued \$65 million in taxable bonds in fiscal 2005 and 2006.

Exhibit 16
Private Activity Authorizations and Taxable Bond Issuances
Fiscal 2000-2013
(\$ in Millions)



GO: general obligation

Source: Department of Budget and Management’s *Capital Improvement Program*, Fiscal 2000 to 2013; *Joint Chairmen’s Report*, 2010

X00A00 – Public Debt

The fiscal 2011 GO bond program again authorized a substantial amount of private purpose debt; approximately \$54 million is proposed. Considering the strict limits that federal regulations place on private activity projects in tax-exempt debt, it appears as though there is a good chance that the State will need to issue taxable bonds again soon. **The State Treasurer’s Office should brief the committees on the level of proposed GO bond authorizations that are subject to private purpose restrictions. This should include a discussion of the likelihood, timing, and amount of any taxable debt issuance.**

Recommended Actions

1. Concur with Governor's allowance.

Updates

1. **Capital Debt Affordability Committee Revises Process**

Over the past decade, the State has routinely increased capital authorizations. Now the State is limiting capital spending in the foreseeable future. When the State was below the debt affordability limit, authorizations for specific kinds of debt could be increased without affecting other kinds of debt. This is no longer the case. Since the State is approaching the limit, increasing debt for one program often means that another program is reduced. Also, if revenues underattain, capital program reductions may be necessary. The implication is that various capital programs will now be competing against one another.

During the 2011 legislative session, concerns were raised about how debt affordability limits were being allocated. In response to these concerns, CDAC has modified its policies. CDAC's recommended reduction in GO bond authorizations is a major change in the capital program.

CDAC calculates what level of debt is affordable and limits GO bond debt. The committee does not specifically limit other State debt. While this may have been adequate when there was additional debt capacity, it does not reflect the reality that State debt is near the limit.

CDAC was asked by the chairs of the budget committees to evaluate the State's debt affordability process and consider the following:

- ***CDAC Should Recommend an Aggregate Debt Limit Encompassing All Types of State Debt:*** The committee reviews many issues and was created to provide a statewide perspective on debt. Since debt management begins with CDAC, reforming debt policies should also begin with CDAC.
- ***The Administration Should Recommend a Specific Debt Limit for Each Type of State Debt:*** Section 8-113 of the State Finance and Procurement Article requires that by November 1 of each year, the Governor determines total new authorizations that the Governor considers advisable. This has been interpreted to be limited to GO bonds and does not include other types of State debt. Consideration should be given to expanding the definition to include other forms of State debt (Maryland Department of Transportation bonds, GARVEE bonds, bay restoration bonds, stadium authority bonds, and capital leases). This would set debt targets that the Spending Affordability Committee could review each fall.
- ***Each Year, the Governor Should Include Limits to All Types of State Debt in the Capital Budget Bill:*** This would give each kind of State debt a statutory limit. The Governor should also include the details about the State's six-year debt plan with the documentation that is submitted with the budget each year. Submitting a bill that limits State debt would provide the legislature with an opportunity to review the various limits. The limits could be amended to reflect the legislature's priorities.

X00A00 – Public Debt

- ***A Process That Allows the Limits to Be Exceeded Under Clearly Defined Circumstances Should Be Developed:*** Although planning is a critical component to a coherent and efficient budget process, all contingencies cannot be foreseen at all times. At times, there may be a compelling need for the State to increase debt issuances in a particular year. Creating a process to increase limits gives the State additional flexibility. However, this process should have specific limits. The limits should define under what conditions debt could be increased (e.g., responding to a natural disaster upon a declaration of emergency by BPW) and should require that the Administration demonstrate the fiscal impact of additional debt.

The workgroup considered the items set forth by the committees and recommends the following process for establishing debt limits each year.

- As CDAC conducts its annual preliminary affordability analysis based on debt issuance, debt outstanding, and debt service leading up to and through the initial CDAC meeting, the Administration will finalize an allocation of debt capacity among all issuers of tax-supported debt.
- After CDAC updates the affordability analysis, the committee will make a final recommendation on the amount of authorized GO debt and an aggregate tax-supported debt limit for the next legislative session. The Administration shall set specific debt limits for tax-supported debt, in a letter to the Legislature, as required by Section 8-113 of the State Finance and Procurement Article.
- With respect to legislative review, the workgroup recommended that there are already processes in place to facilitate legislative review and did not recommend any changes to the current review process.
- In the event that unusual circumstances prompt consideration for exceeding the aggregate debt limit recommended by CDAC, the committee already may meet at any time to determine if changes are necessary and as such the workgroup made no recommendations to materially change current processes.

Current and Prior Year Budgets

Current and Prior Year Budgets Public Debt (\$ in Thousands)

	<u>General Fund</u>	<u>Special Fund</u>	<u>Federal Fund</u>	<u>Reimb. Fund</u>	<u>Total</u>
Fiscal 2011					
Legislative Appropriation	\$0	\$834,344	\$7,640	\$0	\$841,984
Deficiency Appropriation	0	-6,800	1,562	0	-5,238
Budget Amendments	0	0	0	0	0
Reversions and Cancellations	0	-1,914	0	0	-1,914
Actual Expenditures	\$0	\$825,630	\$9,202	\$0	\$834,833
Fiscal 2012					
Legislative Appropriation	\$0	\$871,203	\$11,060	\$0	\$882,263
Budget Amendments	0	0	0	0	0
Working Appropriation	\$0	\$871,203	\$11,060	\$0	\$882,263

Note: Numbers may not sum to total due to rounding.

Fiscal 2011

The following changes affected fiscal 2011 legislative appropriation:

- A \$6.8 million special fund deficiency appropriation cancelled a new program for Program Open Space bonds. The bonds were instead issued as GO bonds.
- A \$1.6 million deficiency appropriation provided additional federal fund bond subsidies. The funds support BABs issued in July 2010, QSCBs issued in July 2010, and QZABs issued in December 2010.
- Fiscal 2011 debt service costs, from the July 2011 GO bond sale, were \$1.6 million less than budgeted.
- \$1.9 million in cancellations are attributable to estimated debt service costs exceeding actual costs.

**Fiscal Summary
Public Debt**

<u>Program/Unit</u>	<u>FY 11 Actual</u>	<u>FY 12 Wrk Approp</u>	<u>FY 13 Allowance</u>	<u>Change</u>	<u>FY 12 - FY 13 % Change</u>
01 Redemption and Interest on State Bonds	\$ 834,832,518	\$ 882,263,297	\$ 921,603,190	\$ 39,339,893	4.5%
Total Expenditures	\$ 834,832,518	\$ 882,263,297	\$ 921,603,190	\$ 39,339,893	4.5%
Special Fund	\$ 825,630,441	\$ 871,202,830	\$ 909,648,547	\$ 38,445,717	4.4%
Federal Fund	9,202,077	11,060,467	11,954,643	894,176	8.1%
Total Appropriations	\$ 834,832,518	\$ 882,263,297	\$ 921,603,190	\$ 39,339,893	4.5%

Note: The fiscal 2012 appropriation does not include deficiencies.

Maryland State Debt True Interest Cost Analysis
Statistically Significant Variables

<u>Sale Date</u>	<u>TIC</u>	<u>Delphis Rate</u>	<u>MD/US PI</u>	<u>Years to Maturity</u>	<u>Taxable</u>	<u>Bay Bonds</u>	<u>BABs</u>	<u>Negative Outlook</u>
March 13, 1991	6.31%	6.15%	2.261	9.84	No	No	No	No
July 10, 1991	6.37%	6.50%	2.240	9.85	No	No	No	No
October 9, 1991	5.80%	5.70%	2.230	9.80	No	No	No	No
May 13, 1992	5.80%	5.75%	2.220	9.80	No	No	No	No
January 13, 1993	5.38%	5.40%	2.221	9.73	No	No	No	No
May 19, 1993	5.10%	5.10%	2.212	9.73	No	No	No	No
October 6, 1993	4.45%	4.45%	2.206	9.73	No	No	No	No
February 16, 1994	4.48%	4.50%	2.208	9.74	No	No	No	No
May 18, 1994	5.36%	5.35%	2.199	9.74	No	No	No	No
October 5, 1994	5.69%	5.50%	2.191	9.72	No	No	No	No
March 8, 1995	5.51%	5.35%	2.184	9.78	No	No	No	No
October 11, 1995	4.95%	4.80%	2.163	9.65	No	No	No	No
February 14, 1996	4.51%	4.35%	2.159	9.65	No	No	No	No
June 5, 1996	5.30%	5.10%	2.144	9.69	No	No	No	No
October 9, 1996	4.97%	4.90%	2.144	9.70	No	No	No	No
February 26, 1997	4.90%	4.70%	2.136	9.68	No	No	No	No
July 30, 1997	4.64%	4.50%	2.135	9.68	No	No	No	No
February 18, 1998	4.43%	4.25%	2.119	9.68	No	No	No	No
July 8, 1998	4.57%	4.40%	2.128	9.68	No	No	No	No
February 24, 1999	4.26%	4.10%	2.134	9.60	No	No	No	No
July 14, 1999	4.83%	4.80%	2.146	9.60	No	No	No	No
July 19, 2000	5.05%	4.85%	2.157	9.72	No	No	No	No
February 21, 2001	4.37%	4.28%	2.178	9.71	No	No	No	No
July 11, 2001	4.41%	4.39%	2.201	9.68	No	No	No	No
March 6, 2002	4.23%	4.17%	2.233	9.61	No	No	No	No
July 31, 2002	3.86%	3.89%	2.241	9.66	No	No	No	No
February 19, 2003	3.69%	3.77%	2.235	9.60	No	No	No	No
July 16, 2003	3.71%	3.56%	2.250	9.67	No	No	No	No
July 21, 2004	3.89%	3.89%	2.254	9.70	No	No	No	No
March 2, 2005	3.81%	3.72%	2.259	9.70	No	No	No	No
July 20, 2005	3.79%	3.63%	2.268	9.69	No	No	No	No
March 1, 2006	3.87%	3.89%	2.242	9.68	No	No	No	No
July 26, 2006	4.18%	4.09%	2.238	9.64	No	No	No	No
February 28, 2007	3.86%	3.77%	2.228	9.64	No	No	No	No

Analysis of the FY 2013 Maryland Executive Budget, 2012

X00A00 – Public Debt

<u>Sale Date</u>	<u>TIC</u>	<u>Delphis Rate</u>	<u>MD/US PI</u>	<u>Years to Maturity</u>	<u>Taxable</u>	<u>Bay Bonds</u>	<u>BABs</u>	<u>Negative Outlook</u>
August 1, 2007	4.15%	4.02%	2.218	9.65	No	No	No	No
March 2, 2005	3.87%	3.68%	2.259	2.02	Yes	No	No	No
July 20, 2005	4.43%	3.65%	2.268	5.08	Yes	No	No	No
March 1, 2006	4.98%	3.92%	2.242	5.10	Yes	No	No	No
February 27, 2008	4.14%	3.90%	2.208	9.64	No	No	No	No
July 16, 2008	3.86%	3.76%	2.213	9.60	No	No	No	No
March 4, 2009	3.39%	3.51%	2.287	9.01	No	No	No	No
March 2, 2009	3.63%	3.47%	2.287	10.04	No	No	No	No
August 5, 2009	2.93%	3.17%	2.303	8.96	No	No	No	No
August 3, 2009	3.20%	3.16%	2.303	9.01	No	No	No	No
August 5, 2009	3.02%	3.17%	2.303	14.99	No	No	Yes	No
October 21, 2009	2.93%	3.19%	2.242	7.91	No	No	No	No
October 21, 2009	3.06%	3.19%	2.242	14.03	No	No	Yes	No
February 24, 2010	2.85%	3.18%	2.262	12.09	No	No	Yes	No
July 28, 2010	1.64%	3.46%	2.259	5.34	No	No	No	No
July 28, 2010	1.91%	3.46%	2.259	6.20	No	No	No	No
July 28, 2010	2.74%	3.46%	2.259	13.51	No	No	Yes	No
March 7, 2011	2.69%	3.31%	2.286	6.86	No	No	No	No
March 9, 2011	3.49%	3.29%	2.286	10.51	No	No	No	No
June 12, 2011	4.03%	3.92%	2.213	8.34	No	Yes	No	No
July 25, 2011	1.99%	2.87%	2.299	5.65	No	No	No	Yes
July 27, 2011	3.08%	2.87%	2.299	10.05	No	No	No	Yes

BABs: Build America Bonds

MD/US PI: Ratio of Maryland personal income to US personal income

TIC: True Interest Cost

Source for Delphis Rate: The Bond Buyer

Source for Personal Income: Federal Bureau of Economic Analysis

Remaining Sources: Bond Sale Official Statements

New and Increased Debt Authorizations Since 2000

<u>Initial Authorization</u>	<u>Type of Debt Authorized</u>	<u>Amount Authorized</u>	<u>Supporting Revenues</u>	<u>Effect on Capital Spending</u>
Chapter 111 of 2001	GO Bonds	\$30 million annually	State property taxes and general fund	Increase the State capital program
Chapter 440 of 2002	Consolidated Transportation Bonds	Increased debt limit from \$1.2 billion to \$1.5 billion	Transportation Trust Fund revenues	Increase State transportation capital program
Chapter 103 of 2001	GO Bonds	\$5 million annually	State property taxes and general fund	Fund Tobacco Transition Program
Chapter 290 of 2002	GO Bonds	\$200 million in fiscal 2003	State property taxes and general fund	Move PAYGO capital projects into GO bond program
Chapter 204 of 2003	GO Bonds	\$200 million in fiscal 2004	State property taxes and general fund	Move PAYGO capital projects into GO bond program
Chapter 432 of 2004	GO Bonds	\$100 million annually for five years	State property taxes and general fund	Increase the State capital program
Chapter 9 of 2004	Consolidated Transportation Bonds	Increased debt limit from \$1.5 billion to \$2.0 billion	Transportation Trust Fund revenues	Increase State transportation capital program
Chapter 428 of 2004	Bay Restoration Bonds	Estimated \$530 million in total issuances	Bay restoration fee	Fund wastewater treatment plant improvements
Chapter 472 of 2005	GARVEEs	Not to exceed \$750 million	Federal transportation funds	Fund InterCounty Connector

X00A00 – Public Debt

<u>Initial Authorization</u>	<u>Type of Debt Authorized</u>	<u>Amount Authorized</u>	<u>Supporting Revenues</u>	<u>Effect on Capital Spending</u>
Chapter 46 of 2006	GO Bonds	Increase escalation to 3%, \$100 million annually in fiscal 2010	State property taxes and general fund	Increase the State capital program
Chapter 488 of 2007	GO Bonds	\$100 million annually	State property taxes and general fund	Increase the State capital program
Chapter 6, First Special Session of 2007	Consolidated Transportation Bonds	Increased debt limit from \$2.0 billion to \$2.6 billion	Transportation Trust Fund revenues	Increase State transportation capital program
Chapter 336 of 2008	GO Bonds	\$100 million annually	State property taxes and general fund	Increase the State capital program
Chapter 485 of 2009	GO Bonds	\$150 million in fiscal 2010	State property taxes and general fund	Move PAYGO capital projects into GO bond program
Chapter 419 of 2009	POS Bonds	\$70 million in fiscal 2010	State share of transfer tax revenues	Maintain POS spending in fiscal 2010
Chapter 719 of 2009	GO Bonds	\$2 million	State property taxes and general fund reimbursed by Community Development Administration	Contingent authorization for local government infrastructure bonds
Chapter 483 of 2010	GO Bonds	\$150 million in fiscal 2011	State property taxes and general fund	Move PAYGO capital projects into GO bond program

CDAC: Capital Debt Affordability Committee
 GARVEEs: Grant Anticipation Revenue Vehicles
 GO: general obligation
 PAYGO: pay-as-you-go
 POS: Program Open Space

Source: Department of Legislative Services, January 2012

Project Financing Compared to General Obligation Bond Financing
Fiscal 2012-2031
(\$ in Millions)

<u>Fiscal Year</u>	<u>Net Project Debt Service</u>	<u>Estimated GO Bond Debt Service</u>	<u>Premium Supporting GO Bond Debt Service</u>	<u>Savings</u>	<u>PV of Savings</u>
2012	\$0.0	\$3.7	\$24.2	\$20.5	\$20.5
2013	0.0	7.7	0.0	-7.7	-7.3
2014	6.2	17.1	0.0	-10.9	-10.0
2015	14.0	17.0	0.0	-3.1	-2.8
2016	14.0	17.1	0.0	-3.1	-2.7
2017	14.0	17.0	0.0	-3.1	-2.6
2018	14.0	17.1	0.0	-3.1	-2.5
2019	14.0	17.0	0.0	-3.1	-2.5
2020	14.0	17.0	0.0	-3.1	-2.4
2021	14.0	17.1	0.0	-3.1	-2.4
2022	14.0	17.1	0.0	-3.1	-2.3
2023	14.0	17.0	0.0	-3.1	-2.2
2024	14.0	17.1	0.0	-3.1	-2.2
2025	14.0	17.0	0.0	-3.1	-2.1
2026	14.0	17.1	0.0	-3.1	-2.1
2027	14.0	0.0	0.0	14.0	9.2
2028	14.0	0.0	0.0	14.0	8.9
2029	14.0	0.0	0.0	14.0	8.7
2030	14.0	0.0	0.0	14.0	8.5
2031	14.0	0.0	0.0	14.0	8.2
Total	\$244.0	\$233.0	\$24.2	\$35.2	\$18.0

GO: general obligation

PV: present value

Note: Numbers may not sum to total due to rounding.

Source: Wye River Group, Inc. and Public Financial Management, Inc., 2011