DEBT CAPACITY ADVISORY COMMITTEE
COMMONWEALTH OF VIRGINIA
December 18, 2012

2:00 P.M.
TREASURY BOARD CONFERENCE ROOM
James Monroe Building
101 North 14th Street, 3rd Floor
Richmond, Virginia 23219

Members Present:	Richard D. Brown, Chairman William K. Butler Elizabeth B. Daley Manju S. Ganeriwala Walter J. Kucharski Ronald L. Tillett Daniel S. Timberlake Glen S. Tittermary David Von Moll
Members Absent:	Robert P. Vaughn
Others Present:	Evelyn R. Whitley, Department of the Treasury Tracy L. Clemons, Sr., Department of the Treasury Sherwanda Cawthorn, Department of the Treasury R. Neil Miller, Deputy Secretary of Finance Rudy Burgess, Special Assistant to the Secretary of Finance Tony Maggio, House Appropriations Committee April Kees, Senate Finance Committee Jason Powell, Senate Finance Committee Laura Farmer, Virginia Department of Transportation Wai Levy, Virginia Department of Transportation Michael Walsh, Virginia Department of Transportation Toni Walker, Department of Planning and Budget Timothy Wilhide, Department of the Treasury Janet A. Aylor, Department of the Treasury Jeanine Black, Department of the Treasury Debora Greene, Department of the Treasury Melissa Palmer, Department of the Treasury Michael Tutor, Department of the Treasury Peter D'Alema, Virginia Resources Authority Jean Bass, Virginia Resources Authority Suzanne Long, Virginia Resources Authority

Call to Order and Opening Remarks

Chairman Brown called the meeting to order at 2:04 p.m. and welcomed everyone to the annual Debt Capacity Advisory Committee ("DCAC") meeting. Following introductions of the committee members, staff and the audience, Chairman Brown gave opening remarks that included a brief overview of the budget submitted by the Governor.

Public Comment Period and Approval of Minutes

Chairman Brown asked if there were any public comments. Hearing none, he asked the Committee for a motion to approve the minutes of the December 2011 meeting. Mr. Butler made a motion to approve the minutes. The motion was seconded by Mr. Tillett and it was approved unanimously.

Review of the DCAC Report

Ms. Whitley began the presentation of the DCAC report (Exhibit 1) highlighting trends in tax-supported debt issued in fiscal year 2012. She gave an in-depth review of the credit ratings narrative, reminding the committee that the rating agencies' actions on the federal government have had a trickle-down effect on the Commonwealth and certain Commonwealth localities. While all three rating agencies continue to rate Virginia as triple-A, Moody's does so with a negative outlook. Standard and Poor's ("S&P") and Fitch continue to rate the Commonwealth as stable. Ms. Whitley noted that all three rating agencies' fall 2012 reports continue to note Virginia's credit strengths as: a long standing history of proactive and conservative financial management; a low but growing debt burden controlled by a debt affordability model; strong financial policies and practices; and a diverse economy that has fared better than the nation's. Challenges cited were spending pressures from education and transportation needs within the context of more limited resources; managing effects of a sluggish economy; and a recovery that could be significantly affected by federal budget reductions. Ms. Whitley also stated that Moody's has since softened their position and recent publications indicate that it is not clear that Virginia would be automatically downgraded if the US rating was downgraded. Chairman Brown confirmed Ms. Whitley's statement that during meetings with the rating agencies here in Virginia in September 2012, Moody's in particular had softened its stance on an automatic downgrade of Virginia if the federal government was downgraded. Mr. Butler asked if additional insights that staff supplied helped the agencies come to that conclusion. Chairman Brown stated that he did not get a sense that was the case.

Ms. Whitley then reviewed the trends in debt burdens comparing Virginia to peer states. Ms. Whitley ended her comments by stating that what happens in the next few weeks with the federal government will be of great interest as the rating agencies focus on how the Commonwealth deals with federal budget cuts in the coming year. She added that pension liability is also still a very important topic to the rating agencies. Moody's has come out with new measurements for pension liability, but they are different from GASB's requirement of liability for CAFRs. Fitch will also be sending out information on how they will handle pensions; however, she was not aware of S&P's views on the pension issue. Chairman Brown added that whatever is done with pensions could ultimately affect the model and require some future modification.

Ms. Ganeriwala commented that one additional pressure on municipal and state issuers is the debate about the fiscal cliff and the tax-exempt status of municipal bond interest either being totally removed or being capped at 28%. Ms. Ganeriwala added that these changes may cause financing costs to increase. Chairman Brown pointed out past examples, such as, industrial development bonds and student loan financing, where the federal government has capped the amount of the issue to be taxed instead of making it all taxable. He reminded the group that Virginia bonds would still remain tax-exempt for state tax purposes. Chairman Brown noted that changes would not affect the interest costs on bonds the Commonwealth has previously issued, although they could affect the holders of those bonds.

Chairman Brown asked Mr. Clemons to review the exhibits to the report, which included the model solution. Mr. Clemons reviewed the assumptions for currently authorized and not yet issued debt. He continued with a review of the pure base solution, which was solved in accordance with the policy parameters established by the committee which included maintaining debt service below 5% blended revenues and an additional two years of average capacity beyond the 10-year period. The base solution produced a 10-year average capacity of $537.10 million. Mr. Clemons further described that if that amount is assumed to be issued in each year over the model period, the result would be six years in which debt service exceeds 5% of revenues.

Mr. Tillett asked if there was research or examples available of how other states with capacity models approach their limits for purposes of planning and prioritizing among different debt classes, such as transportation and higher education. Ms. Whitley stated that she has not seen this type of analysis; however, she referred to the Moody's medians report noting that nationally, tax-supported debt declined in the last year. This trend is attributed in part to states reaching their debt limits and not issuing debt beyond their limit. Mr. Tillett then asked if the issuance assumptions presented are in line with the Commonwealth's six-year capital plan and if other states that hit their limit were having difficulty setting priorities. Mr. Tillett explained that part of his reason for the question was concern over what is transpiring on the transportation and Virginia Port Authority debt horizon, which would take up a fairly significant portion of available resources. Chairman Brown responded that Virginia's existing six-year capital plan does not include transportation. Chairman Brown referred members to the uses of tax-supported debt chart (page 10 of the DCAC Report) which showed that two-thirds of debt issued is either for transportation or higher education. Ms. Daley, echoed Mr. Tillett's comments. She said that part of her concern in 2010, when the Committee adopted the average solution approach, was related to this issue because transportation could consume all of the state's capacity. Mr. Clemons noted that transportation assumptions have been updated to reflect how that debt is currently expected to be issued. Chairman Brown asked Virginia Department of Transportation ("VDOT") staff to address the revisions. Laura Farmer of VDOT stated that the decrease in revenues supporting the CPR bonds caused VDOT to reevaluate their issuance schedule. Chairman Brown added that the revenue on insurance premiums went down approximately $30 million last year.

Chairman Brown asked if there were any questions on the solution and recommendation. Hearing none, he directed Mr. Clemons to continue with the sensitivity analysis in the report. Mr. Clemons reviewed the sensitivity analysis and then moved to the update on Moral

Obligation Debt ("MOB"), reminding the committee that the only current issuer of MOB debt is the Virginia Resources Authority ("VRA"), which has a cap of $1.5 billion. Mr. Clemons further explained that MOB programs of the Virginia Housing Development Authority ("VHDA") and the Virginia Public School Authority ("VPSA") are listed because their MOB programs have not been rescinded, but neither are currently issuing under their MOB programs. Mr. Tillett asked why we continue to have VHDA and VPSA MOB debt authorization? Ms. Whitley responded that both authorities like the idea of keeping the caps available in case they are ever needed. Mr. Tillett asked if credit rating agencies are concerned about having that authority out there. Ms. Whitley responded that rating agencies have never raised that issue. Mr. Clemons then concluded with the review of the Commonwealth's Sum-Sufficient debt.

Ms. Daley asked if new revenue assumptions are included. Mr. Clemons confirmed the updated model includes the updated revenues from the official forecast. Ms. Daley asked if the recommended capacity took into account the new debt authorizations proposed in the 2013 budget bill. Chairman Brown stated that as a matter of committee policy, items that have not yet been authorized are not included in the formal model. However, Mr. Clemons had run a solution scenario with the proposed debt included. The Chairman requested Mr. Clemons to hand out the additional scenario tables (Exhibit 2) which reflect amounts proposed in the 2013 budget. Chairman Brown then reviewed the assumptions related to the proposed debt in the 2013 budget. Mr. Clemons proceeded to review the solution based on the proposed debt, which would generate a base average capacity of $497.63 million.

Mr. Tillett asked if there are any unintended consequences as a result of changes to the model adopted after the 2010 study. Chairman Brown stated that although the base solution is still solved to maintain the Committee's 5% limitation, the move to the corridor approach and the use of the 10-year average for purposes of the recommendation has been a concern with some members. Under the corridor approach, some years exceed 5% when the average is assumed issued over the model period. He presented to the Committee an option that limits the number of years in which the average illustration exceeds 5% to no more than five of the model's ten years (Exhibit 3). This option was explained to have been achieved by adjusting issuance assumptions for authorized & unissued debt downward in the first two years. Under this approach, the Committee's recommendation would change from $537.10 million to $498.18 million.

Mr. Butler stated that a lot of time and effort was spent in 2010, as the committee worked hard to come up with a solid framework that could be adhered to in the long run. He asked if this alternative solution would be favored by the rating agencies. Secretary Brown replied that the rating agencies were comfortable with the current method. Ms. Ganeriwala expressed that she favored the more conservative $498.18 million solution scenario, since there would be uncertainty for municipal issuers in 2013.

Mr. Maggio voiced concern that the scenario is a change to the policy the committee agreed to in 2010. He felt the change may be viewed as arbitrary. Mr. Timberlake stated that though he understands the reasons for looking at this option, the current debt policy has been in place for only two years. It may look to the rating agencies that the committee is second guessing themselves. Ms. Whitley said her view was the rating agencies would not be alarmed if we recommended a more conservative debt capacity amount. Mr. Kucharski voiced his concern that the large amount of debt for transportation and uncertainty relating to the future treatment of pension liabilities may be a reason to be conservative. Mr. Tillett indicated he didn't object, but was concerned about the precedent that would be set if the committee made a recommendation for an amount less than the model's solution.

Chairman Brown indicated that when asking for this alternative analysis, he had Mr. Tittermary in mind because he had voted against the report the last two years. Mr. Tittermary stated that a lesser solution of $498.18 million would not change his mind. His objection is to the new approach of calculating and recommending an average based debt capacity. Ms. Daley was in agreement with Mr. Tittermary, and Mr. Butler concurred with her statement that if the committee wished to be conservative, it would go back to the model used prior to the 2010 changes. Ms. Daley added that the five years versus six years of average debt capacity over 5% does not make much difference. Chairman Brown said it was just a suggestion and accepted that the committee would pass on this option.

Other Business

Chairman Brown announced that this would be the final meeting for Mr. Kucharski who is retiring. The Chairman thanked him for serving on the DCAC committee since 1994 and presented Mr. Kucharski with a gift given on behalf of the committee.

Motion to Adopt Final Report and Recommendation of Debt Authorization

Chairman Brown then asked for a motion to adopt the final report and recommendation that $537.10 million can be prudently authorized in 2013 and 2014. Ms. Ganeriwala made the motion, which was seconded by Mr. Tillett. The committee members voted as follows:

Richard D. Brown	Yes
William K. Butler	Yes
Elizabeth B. Daley	Yes
Manju S. Ganeriwala	Yes
Walter J. Kucharski	Yes
Ronald L. Tillett	Yes
Daniel S. Timberlake	Yes
Glen S. Tittermary	No
David Von Moll	Yes

With no further business, the meeting adjourned at 3:20 p.m.

Exhibits may be obtained by contacting the Department of Treasury at (804) 225-2142.