

**DEBT CAPACITY ADVISORY COMMITTEE  
COMMONWEALTH OF VIRGINIA  
December 19, 2016**

2:00 P.M.

TREASURY CONFERENCE ROOM  
James Monroe Building  
101 North 14<sup>th</sup> Street, 5th Floor  
Richmond, Virginia 23219

Members Present:           Richard D. Brown, Chairman  
                                  Elizabeth B. Daley  
                                  Manju S. Ganeriwala  
                                  Harold E. Greer  
                                  Martha S. Mavredes  
                                  Ronald L. Tillett  
                                  Daniel S. Timberlake  
                                  David A. Von Moll  
                                  Jody M. Wagner

Members Absent:           Robert P. Vaughn

Others Present:           Janet A. Aylor, Department of the Treasury  
                                  Bradley L. Jones, Department of the Treasury  
                                  Sherwanda Cawthorn, Department of the Treasury  
                                  Gina Burgin, Deputy Secretary of Finance  
                                  April Kees, Senate Finance Committee Staff  
                                  Jason Powell, Senate Finance Committee Staff  
                                  Tony Maggio, House Appropriations Committee Staff  
                                  Kimberly Sarte, Joint Legislative Audit & Review Commission  
                                  Leah Schubel, Davenport & Company  
                                  Reid Schwartz, Davenport & Company  
                                  Ty Wellford, Davenport & Company  
                                  Jay Mahone, Department of the Treasury

**Call to Order and Opening Remarks**

Chairman Brown called the meeting to order at 2:07 p.m.

## **Public Comment Period**

During the public comment period, Chairman Brown asked that the Debt Capacity Advisory Committee (“DCAC” or “Committee”) members, staff and the audience introduce themselves and make any public comments if they wanted to do so.

There were no public comments.

## **Approval of Minutes**

Chairman Brown asked the Committee for a motion to approve the minutes of the December 18, 2015 meeting. Mr. Tillett made a motion to approve the minutes. Mr. Timberlake seconded the motion and it carried unanimously by the members present.

## **Review of the 2016 DCAC Report**

Chairman Brown asked Mr. Jones to present the 2016 DCAC Report. (Exhibit 1) Mr. Jones began his presentation by directing the Committee’s attention to page A-2, An Explanation of Model and Assumptions. The DCAC Model (“Model”) incorporates the existing debt service, as well as authorized and unissued debt. Blended Revenues from the Official Forecast are used and debt service estimates are based on 20-year level debt service schedules. Mr. Jones said that the current interest rate assumption used in the Model is 3.61% which is based on the average of the last twelve quarters of the Bond Buyer 11 Bond Index. The rate is down from 4.03 % used last year. He highlighted that a lower interest rate environment in 2016 helped Virginia as a borrower, but that in a rising interest rate environment the Committee needs to note the current low rates built into the Model. Mr. Jones briefly reviewed the makeup of the Blended Revenues and debt included and excluded in actual and projected debt service.

Mr. Tillett asked a question regarding how Virginia’s Debt Capacity Model and Report compare to other states and what do rating agencies say regarding the Model. Mr. Jones responded that rating agencies have complimented the Commonwealth on its DCAC Model and Report and have not indicated any concerns with the current treatment of revenues and expenses in the Model. Mr. Jones also mentioned that some states produce a debt affordability study as opposed to a debt capacity study like the Commonwealth. Chairman Brown stated that Virginia classifies more revenue as special non-general funds than other states. To that extent, he said Virginia’s revenue streams are somewhat conservative to other states. Chairman Brown then added that certain other states, for example North Carolina, have a separate debt capacity model for transportation. Mr. Jones added that the Commonwealth’s Transportation debt service supported by Transportation Trust Fund (“TTF”) Revenues is approximately 15% debt service to revenues. He explained that to the extent Transportation debt service exceeds 5% of TTF revenues, general fund debt capacity is used even though the general fund is not paying the debt service. Chairman Brown stated that in 2010, when the Committee looked at revising the Model, the Committee considered separating Transportation and general fund debt. Ms. Daley commented that the 2010 change to the ten-year average approach was in part to facilitate the transportation debt in the Model.

Mr. Jones then directed the Committee's attention to the Currently Authorized Tax-Supported Debt Issuance Assumptions, page A-4 of the Report. He stated that the Model contains \$5.3 billion of debt that has been authorized but unissued as of June 30, 2016.

Mr. Jones then reviewed the Base Model Solution on page A-5 of the 2016 Report. He stated that capacity is calculated to be \$446 million annually compared to last year's calculation of \$603 million annually. He noted that the average capacity calculated to be \$446 million is generated from capacity in the outer years of the Model.

Ms. Daley asked to confirm that if the Committee did not use the ten-year average approach would the Commonwealth have no capacity in the first four model years. Chairman Brown confirmed that is the case. Ms. Wagner asked if the rating agencies have expressed any concerns with using the 10-year average approach. Chairman Brown said no.

Mr. Jones directed the Committee's attention to the Base Model Solution-Average, page A-6 of the Report. He explained that the impact of issuing \$446 million a year would be that the 5% target would be exceeded in eight of the ten years. In the 2015 Model, the 5% target was exceeded in five of the ten years. Mr. Jones commented that historically the 5% target has never been exceeded because low interest rates and slower than anticipated issuances have helped debt service stay under the threshold. Mr. Tillett then stated that the current Model is essentially showing the 5% target being exceeded eighty percent of the time. Chairman Brown said it is based on the assumption that the entire \$446 million is issued in each year.

Mr. Jones then reviewed the Sensitivity Analysis on page A-10 of the Report. Following a review of various sensitivities, he directed attention to the interest rate sensitivity. Chairman Brown said that the Report's cover letter discusses that the Federal Open Market Committee ("FOMC") has mentioned the potential for increasing interest rates several times in 2017. Mr. Jones explained that a 100 basis point increase in the Model interest rate would result in a decrease in average capacity to \$385 million a year. Mr. Tillett asked about the timing and duration of the sensitivity assumption. Mr. Jones responded that the sensitivity analysis assumes the Model interest rate changes from 3.61% to 4.61% immediately for the duration of the Model. Chairman Brown reiterated that the Report's cover letter draws attention to interest rate sensitivity because of the FOMC's intention to raise rates. If the FOMC raises rates there will be a negative impact on capacity.

Mr. Jones then directed the Committee to page 4 of the Report. He reviewed Potential Risks to Underlying Forecast: (1) a continued rise in interest rates; (2) the unknowns of future federal fiscal policy; and (3) unanticipated external shocks to the financial markets.

Mr. Jones then reviewed the 2016 Debt Capacity Recommendations beginning on page 5 of the Report. In addition to the recommendation that up to \$446 million in debt could be authorized, there were two other recommendations proposed that were similar to previous reports. They included taking advantage of the Commonwealth's AAA rating by issuing General Obligation debt at an appropriate time in the future and continued support of the use of traditional financing methods for state projects through the issuance of general obligation bonds, or appropriation-supported programs through the Virginia College Building Authority ("VCBA") or Virginia

Public Building Authority (“VPBA”), since bonded capital lease and other conduit borrowings typically result in higher financing costs, and are ultimately still viewed as tax-supported debt.

Mr. Jones then reviewed Trends in Tax-Supported Debt beginning on page 8 of the Report. He stated that between fiscal year 2015 and 2016 outstanding tax-supported debt increased \$1.1 billion. He explained that this amount also includes OPEB and pension liabilities, and compensated absences. These other liabilities are reviewed by rating agencies but are not included in the DCAC Model.

Mr. Jones mentioned 2016 outstanding General Obligation debt declined 8% or \$133 million compared to 2015. He noted the outstanding balance of section 9 (d) debt increased 5% or \$458 million, between fiscal year 2015 and fiscal year 2016. He also mentioned that between fiscal year 2015 and fiscal year 2016, other long-term obligations increased \$802 million, which is equivalent to 9% growth over the last fiscal year.

Mr. Jones reviewed the breakout of the \$2.72 billion of 2016 tax-supported debt authorizations. He also noted that between fiscal year 2007 and fiscal year 2016, the General Assembly collectively authorized \$15.23 billion of tax-supported debt.

Mr. Jones then noted the amount of tax-supported debt issued in fiscal year 2016 was \$964 million, down from \$1.16 billion in 2015. He noted the fiscal year 2016 issuances were only below the fiscal year 2015 issuances because the VPBA issuance initially planned for spring 2016 was postponed until fall 2016. He noted that between fiscal year 2007 and fiscal year 2016, \$10.82 billion in tax-supported debt was issued and that with the June 30, 2016 authorized and unissued debt amounting to \$6.04 billion, of which \$5.33 billion is for 9 (d) projects, it is likely that significant issuances will continue over the next several years.

Mr. Jones reviewed the uses of the tax-supported debt highlighting that like last year, Higher Education is taking the highest amount of tax-supported debt at 54 % and Transportation is at 21%.

Mr. Jones then noted amounts paid annually for actual debt service have increased and currently it is estimated that in 2021 the Commonwealth’s tax-supported debt service will peak at nearly \$1.2 billion. He noted this amount includes all currently authorized but unissued amounts estimated through the Model assumptions.

Mr. Jones then moved to the Review of State Credit Rating section of the Report. He stated that Virginia continues to be rated AAA with a stable outlook by Moody’s, Fitch and Standard and Poor’s Ratings Service (“S&P”). He noted the appropriation credits are rated one notch below at AA+ with a stable outlook. Mr. Jones said that the rating agencies continue to note the Commonwealth’s strengths; however, he mentioned some strengths have been written with a caveat. Mr. Jones noted that S&P has been more critical than others in their reports. All rating agencies agree Virginia has a long history of having proactive and conservative financial management policies. He mentioned that while Virginia is noted as having a strong and diverse economy, all three rating agencies have noted the effects federal sequestration has had on Virginia’s growth. He mentioned the current biennium shortfall is planned to be addressed by budget cutting measures and the use of the Revenue Stabilization Fund. He noted that the use of

the Revenue Stabilization Fund is restricted by the Virginia Constitution and deposits to the fund are mandated based on certain revenue performance levels. He stated while these restrictions and the mandatory funding are seen as strengths by the rating agencies, any withdrawals of the fund during times of economic growth, albeit slow growth, are being closely watched by the rating agencies, especially S&P.

Mr. Tillett mentioned if the rating agencies are satisfied with the constitutional and statutory way the Revenue Stabilization Fund is restricted, it is odd they would express concern about using the fund in a permitted manner. Chairman Brown commented that rating agencies put a high premium on liquidity.

Mr. Jones then discussed the Review of Comparative Ratios section of the Report and noted that the information in this section comes from Moody's *State Debt Medians 2016 Report*. Mr. Jones noted that in calendar year 2015, 34 states experienced a decline in absolute debt levels, while 16 states, including Virginia, experienced an increase. He also noted that while nationwide the median Net Tax-Supported Debt ("NTSD") per capita increased by 1.3% to \$1,205, Moody's reported 4.6% growth in Virginia's NTSD per capita, which increased to \$1,418. He mentioned Virginia was ranked by Moody's as having the 20<sup>th</sup> highest debt per capita compared to 19<sup>th</sup> the prior year.

Mr. Jones noted that nationwide the median NTSD as a percentage of personal income remained steady at 2.5%. He mentioned that in Moody's 2016 report, Virginia's ranking rose to the 20<sup>th</sup> highest NTSD as a percentage of personal income compared to a ranking of 21<sup>st</sup> the prior year and 24<sup>th</sup> two years ago. He noted that in the 2016 report Moody's calculated Virginia to have had a NTSD as a percentage of personal income of 2.9%. After reviewing the charts and tables relating to the Moody's report, he concluded his review of this section with a mention that Moody's reported Virginia as having increased to the 11<sup>th</sup> highest NTSD compared to 12<sup>th</sup> the prior year.

Mr. Tillett asked Mr. Jones what he had seen in debt trends around the country of bond amortizations extending beyond 20 year terms. Mr. Jones responded that rather than longer terms, states such as Delaware and Maryland are using 10 and 15 year terms respectively.

Mr. Jones then reviewed the Moral Obligation and Contingent Liability Debt section of the Report. The review covered two separate scenarios of debt capacity should the Commonwealth have to take on: (1) all \$907 million of moral obligation debt of the Virginia Resources Authority; or (2) the Sum Sufficient Appropriation debt of the Virginia Public School Authority ("VPSA") amounting to \$3.05 billion. If the moral obligation debt was added to the Model, average capacity would be reduced to \$370 million. If the Sum Sufficient Appropriation VPSA debt was added to the Model, average capacity would be reduced to \$192 million. Mr. Timberlake commented that if VPSA debt needed to be added to the Model the Literary Fund revenues should be included, which would raise capacity from the estimate.

### **Motion to Adopt Final Report and Recommendation of Debt Capacity**

Chairman Brown then asked for a motion to adopt the final report and cover letter that is to include a recommendation that \$446 million can be prudently authorized in 2017 and 2018 along with

cautionary language regarding an anticipated rise in interest rates. Mr. Tillett made a motion to adopt the report and cover letter as presented to the Committee. Mr. Von Moll seconded the motion. The motion passed with unanimous approval by the Committee members present.

**Other Business**

With no further business, the meeting adjourned at 3:17 p.m.

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