

**DEBT CAPACITY ADVISORY COMMITTEE
COMMONWEALTH OF VIRGINIA
December 21, 2023**

10:30 A.M.

Members Present: Stephen Cummings, Chairman
Harold Greer
Staci Henshaw
Harold Hughey
April Kees
Sharon Lawrence
Michael Maul
Anne Oman
David Richardson
Ronald Tillett

Others Present: J. W. Grenadeir, Citizen
Andrea Peeks, House Appropriations Committee
Donald Ferguson, Office of the Attorney General
Scott Laws, Office of the Attorney General
Janet Lee, Public Resources Advisory Group (via telephone)
John Markowitz, Secretary of Finance Office
Jason Powell, Secretary of Finance Office
Tyler Williams, Senate Finance and Appropriations Committee
Vernita Boone, Department of the Treasury
Sherwanda Cawthorn, Department of the Treasury
Bradley Jones, Department of the Treasury
Richard Rhodemyre IV, Department of the Treasury
Yvonne Scruggs, Department of the Treasury
David Swynford, Department of the Treasury

Call to Order

Chairman Cummings called the meeting to order at 10:35 a.m. and welcomed the attendees.

Opening Remarks and Public Comment Period

Chairman Cummings asked if anyone present desired to make public comments. J.W. Grenadeir provided public comments.

April Kees expressed interest in speaking about the upcoming closed session, to which Chairman Cummings acknowledge her request and asked if she would like to speak at that time or later. She noted she would speak later, prior to going into closed session. Richard Rhodemyre welcomed new Committee member, Harold “Chip” Hughey.

Approval of Minutes from December 16, 2022, Meeting

Chairman Cummings asked the Committee if there were any edits to the draft minutes of the December 16, 2022, meeting. Hearing no changes, the Chairman asked if there was a motion to approve the minutes as presented. Ron Tillett made a motion to approve the minutes. Treasurer David Richardson seconded the motion, which received unanimous approval from the Committee.

Review of the 2023 DCAC Report

Chairman Cummings asked Mr. Rhodemyre to present the 2023 Draft DCAC Report (Exhibit 1). Mr. Rhodemyre stated that the cover letter for the report would be reviewed at the end of the presentation.

Mr. Rhodemyre reviewed the background of the DCAC and its establishment in 1991 and discussed the purpose and duties of the DCAC.

Mr. Rhodemyre reviewed the model inputs, including an overview of the 5% debt service to revenues capacity measure, noting that the amount is not a legal limit, but a policy that is to serve as a guideline to the Governor and state policymakers. Mr. Rhodemyre then reviewed the definition of Blended Revenues used in the model, noting that they are comprised of general fund revenues, certain recurring non-general fund transfers including ABC profits, state revenues of the Transportation Trust Fund (TTF), and Virginia Health Care Fund revenues. Mr. Rhodemyre discussed what is included in tax-supported debt, noting that the model includes actual debt service as of June 30, 2023, on all existing tax-supported debt, as well as estimated debt service on future issuances of tax-supported debt that has already been approved by the General Assembly but has yet to be issued. Mr. Rhodemyre then expanded on the various types of state debt that is considered tax-supported, noting that it includes general obligation (GO) bonds (with the exception of 9(c) GO bonds as these are supported by project revenues), debt supported by the TTF, obligations of the Virginia College Building Authority (VCBA) and Virginia Public Building Authority (VPBA) that are appropriation supported, obligations payable under regional jail reimbursement agreements, certain long-term leases and installment purchases, and long-term subscription-based information technology arrangements (SBITAs).

Mr. Rhodemyre noted that historically, the DCAC Model has used an average of the most recent 12 quarters of Bond Buyer 11 Index yields for AA+ rated GO municipal bonds to estimate the model interest rate for the future issuances of GO bonds, with a 25 basis-point spread added to model future appropriation secured bond issuances. As a result, the standard model rate currently includes four quarters of historically low yields from 2021 and has not yet fully caught up with the dramatic rate increases that have occurred over the last two years. To address this issue, Treasury

staff consulted with financial advisors and the Office of the Secretary of Finance to determine recommended rates to use in the model, which were rates of 4.50% for GO bonds and 4.75% for appropriation supported bonds, in lieu of the standard model rates. Given the Commonwealth does not currently have any authorization to issue 9(b) GO bonds, all the long-term future det service currently included in the model is projected at the recommended 4.75% appropriation supported interest rate. Mr. Rhodemyre stated that Janet Lee, Financial Advisor with Public Resources Advisory Group, was on the telephone line if there were any questions.

Mr. Rhodemyre reviewed the potential influencing factors that could impact the Commonwealth's debt capacity in the coming year. Mr. Rhodemyre shared that fiscal year 2023 general fund revenues totaled \$28.7 billion, exceeding the budgeted revenues from Chapter 769 of the 2023 Session by \$3.1 billion and the December 2022 revenue forecast by \$1.6 billion. As a result of the recent revenue surpluses, the Commonwealth made additional deposits to the Revenue Stabilization Fund of approximately \$900 million and the Revenue Reserve Fund of approximately \$290 million, resulting in total reserves of approximately \$3.8 billion as of fiscal year-end 2023, exceeding 15% of general fund revenues. The Commonwealth also set aside an additional \$2.1 billion into a reserve fund to support additional taxpayer relief efforts and future budget priorities, providing increased cushion for potential economic downturns in the years ahead. The Commonwealth's financial success has continued in fiscal year 2024. Through October 2024, general fund revenues are up more than 12% compared to this time in fiscal year 2023, although the majority of this is due to timing impacts of tax policy changes. After adjusting for the impacts of tax policy changes, general fund revenues are up a modest 1.8% compared to the prior year. Mr. Rhodemyre reported that the most pressing topics in U.S. economics over the last two years have been widespread inflation, the Federal Reserve Bank's (Fed) aggressive interest rate hikes to rein in this inflation, and discussion of if and/or when those rate increases would trigger an economic recession. Historically, high levels of inflation were seen both nationally and globally in both fiscal years 2022 and 2023, with year-over-year U.S. consumer price index (CPI) inflation peaking at 9.1% in June of 2022, the highest CPI inflation rate in the last 40 years. Since the Fed's initial increase of overnight borrowing rates in March of 2022, overnight borrowing rates have been increased a total of 10 additional times. CPI inflation registered at 3.1% as of November 2023, inching closer to the Fed's stated goal of 2% annual CPI inflation. These increases in overnight borrowing rates effectively increased the cost of borrowing across the economy and municipal bond yields saw similar increases over this period. However, as of December 7, 2023, the Bond Buyer 11 Index yield had fallen to approximately 3.3%. The downward movement in municipal interest rates over the last month is a result of the market's reaction to recently improved inflation data and is not the result of a Fed rate cut. Mr. Rhodemyre stated that fortunately, the Fed's monetary tightening did not result in a U.S. recession in fiscal year 2023 as was feared by many, and the U.S. economy demonstrated remarkable resilience during this time. However, despite the recent positive economic performance, the threat of a potential recession still looms.

Mr. Rhodemyre informed the Committee that the 2023 Base Model Average Solution debt capacity calculation shows that an additional \$1.29 billion in tax-supported debt could be authorized and issued in each of fiscal years 2024 and 2025. However, Mr. Rhodemyre reported that when using the recommended modified model rate of 4.75%, the model indicated that \$1.08 billion in

additional debt could be prudently authorized and issued in each of the fiscal years of 2024 and 2025.

Mr. Rhodemyre then reviewed the other recommendations made in the report, including a continued recommendation to consider 9(b) GO bonds to secure the lowest possible interest rates, the recommendation to continue using other traditional financing methods such as the VPBA and VCBA when 9(b) GO bonds are not an option, the recommendation to continue to be conservative with the planning of any future tax-supported debt issuances, and the recommendation to continue to evaluate existing authorized projects that have not moved forward to determine whether these authorizations can be rescinded or amended.

Mr. Rhodemyre noted the continued awareness of the Commonwealth's increasing outstanding debt over the last 10 years. He discussed how Virginia compares to the country and triple-AAA state medians for Net Tax-Supported Debt (NTSD) as reported annually by Moody's. Virginia remained steady nationally as the 12th highest ranked state in terms of total net tax-supported debt. However, its other comparative ratios increased over the last decade, going from the 19th highest NTSD per capita to the 14th highest and the 24th highest NTSD as a percentage of personal income to the 18th highest, as Virginia's total NTSD burden continued to grow. Discussion ensued regarding Virginia's outstanding debt, how it is compared nationally, and how it is viewed by the rating agencies.

Mr. Rhodemyre discussed the two types of tax-supported debt: GO bonds and various kinds of appropriation-supported obligations. GO bonds are secured by the full faith and credit of the Commonwealth and are rated in the highest rating category by the rating agencies. Mr. Rhodemyre shared that 9(b) bonds require state-wide approval by voters through referendum. He further stated that 9(c) bonds are first secured by project revenues, but also are provided the backstop of the Commonwealth's full faith and credit if net project revenues are insufficient to service debt. Voter approval is not required for 9(c) bonds, but they do require a 2/3 super majority vote of both houses of the General Assembly. While 9(c) debt is considered tax-supported debt for financial reporting purposes, it is not included in the debt capacity model due to the project revenue pledge. Next, Mr. Rhodemyre discussed the 9(d) bonds. This debt is authorized by the General Assembly. Principal and interest payments on these obligations are made from annual appropriations from the general fund or from the TTF. These bonds are rated slightly lower than Virginia's GO bonds. The Commonwealth has increasingly relied on appropriation-supported debt to provide financing for capital projects. We have not seen new 9(b) debt authorization in approximately 20 years. Discussion ensued.

Mr. Rhodemyre then discussed the Commonwealth's transportation debt. The TTF was established in 1986 and the rating agencies also consider any transportation debt paid for by generally applied state-wide taxes as tax-supported debt. Mr. Rhodemyre explained the transportation-only debt capacity model and noted that projected TTF debt service to TTF revenue ratios ranged from 9.8% to 19.6% over the last decade. However, this number is expected to decline as existing tax-supported transportation debt is being paid-off more quickly than new tax-supported transportation debt is being issued. He noted that to the extent that TTF debt service to

TTF revenues exceeds 5%, the TTF is essentially utilizing the capacity of the general fund to issue additional tax-supported debt. Discussion ensued. Ms. Kees requested that in the future that the non-tax-supported transportation debts of the Commonwealth, some of which are very large, be discussed further. Mr. Jones noted that following a special report prepared by Treasury staff in 2021, a section was added to the report to bring more attention to these obligations not supported by taxes, but that staff can continue to improve this effort.

Mr. Rhodemyre then reviewed the trends in Virginia's tax-supported debt over the last 10 fiscal years, noting that Virginia's tax-supported debt has increased by 46.3% or \$7.2 billion. Mr. Rhodemyre noted that outstanding tax-supported debt increased by \$1.4 billion, or 6.7%, in fiscal year 2023 as a result of increasing pension liabilities and the addition of approximately \$183.5 million of long-term SBITAs under the implementation of Governmental Accounting Standards Board statement 96. The increases in tax-supported debt over the last decade are primarily the result of growing Section 9(d) debt and large increases in pension and OPEB liabilities. Some of the growth is related to changes in accounting standards over this period.

As of June 30, 2023, total GO debt outstanding amounted to \$1.1 billion, down \$549.3 million, or 32.9%, over the last decade. In fiscal year 2023, GO debt decreased by \$25.5 million, or 2.2%. Section 9(d) debt totaled \$13.4 billion as of June 30, 2023, increasing by \$4.7 billion, or 54.7%, over the 10-year period. The outstanding balance of Section 9(d) debt increased 3.1%, or \$415.9 million, in fiscal year 2023. The Commonwealth had \$2.9 billion in additional authorized but unissued tax-supported debt at fiscal year-end 2023. Mr. Rhodemyre noted that the Commonwealth has also seen construction costs increase dramatically in recent years due to inflationary pressures, and as a result, there are now questions surrounding the actual cost to finance many of the previously authorized but not yet financed projects going forward, and it is possible that additional debt authorizations or cash funding may be needed to fully fund projects that were previously authorized.

Mr. Rhodemyre discussed how the Commonwealth utilized surplus cash balances to fund a significant portion of its net pension liabilities in fiscal year 2022. Nonetheless, other long-term obligations have still seen significant growth over the last ten fiscal years, increasing by \$3.0 billion, or 58.0%, over this period. In fiscal year 2023, other long-term obligations increased by \$1.0 billion, or 12.8%, driven by a \$1.1 billion increase in pension liabilities. Despite this increase, total other long-term obligations were at their second lowest point since 2015.

Mr. Rhodemyre then discussed the Commonwealth fiscal year 2023 authorizations and issuances of tax-supported debt and provided an overview of the Commonwealth's historical authorizations and issuances of tax-supported over the last decade, noting that the issuance of authorized debt often takes many years and does not correspond with the year in which that debt was authorized. Mr. Rhodemyre then reviewed the Commonwealth's historical usage of tax-supported debt over the last decade, noting that 79.4% of the Commonwealth's tax-supported debt has been used to finance higher education and transportation projects.

Next, Mr. Rhodemyre discussed the debt service on the Commonwealth's tax-supported debt. Existing debt service as a percentage of revenues has been on a downward trend from its peak of nearly 4.7% in fiscal year 2017 to a ten-year low of 3.4% in fiscal year 2022. However, in fiscal year 2023, debt service as a percentage of Blended Revenues ticked back up to 3.7% as the impacts of recent tax cuts were recognized in lower Blended Revenues for the year. Future debt service payments are projected to increase through fiscal year 2026, and then decline annually through fiscal year 2033 as existing debt is retired. Mr. Rhodemyre then reviewed the interest rate sensitivity for debt service on planned issuances for fiscal years 2023 – 2027.

Mr. Rhodemyre then reviewed the state's non-tax supported debt, noting that this section of the report was also expanded on in recent years to give a more thorough review of these obligations. Other debt not supported by taxes totaled \$32.7 billion as of June 30, 2023, an increase of \$10.7 billion, or 48.7%, over the last decade. As of June 30, 2023, Virginia's total debt outstanding was \$55.3 billion, an increase of \$17.9 billion, or 47.7%, over the last 10 years.

Mr. Rhodemyre then reviewed the State Credit Rating Overview section of the report. He noted that Virginia is rated Aaa/Stable (Moody's), AAA/Stable (S&P), and AAA/Stable (Fitch), with its appropriation supported debt one notch below the GO ratings: Aa1 (Moody's), AA+ (S&P) and AA+ (Fitch). Mr. Rhodemyre then noted that Virginia ended fiscal year 2023 with reserves of \$3.8 billion with projected reserves of more than \$4.6 billion by fiscal year-end 2024. Mr. Rhodemyre emphasized that Virginia's long-term debt burden is considered low and manageable by the rating agencies. Ron Tillet asked about the rating agency's thoughts on Virginia's revenue sources and credit rating. Discussion ensued. Treasurer Richardson shared that all three credit reporting agencies were happy with Virginia's Debt Capacity Model. Ms. Kees inquired about the rating agencies views on the Commonwealth exceeding its 15% reserve limits and the related removal of excess funds from the reserves. Chairman Cummings and Treasurer Richardson stated that they do not foresee that being a difficult conversation and that the rating agencies should view it as a positive for the Commonwealth. Discussion ensued. Mr. Tillet asked about the rating agencies' thoughts on the Commonwealth's recent use of excess revenues. Discussion ensued. Ms. Oman asked about Interstate 81 and Hampton Roads Transportation Accountability Commission obligations and rating agency viewpoints on tax-supported debt. Discussion ensued.

Mr. Rhodemyre provided an overview of the comparative ratios for state NTSD from the most recent Moody's Medians Report. Mr. Rhodemyre noted that Moody's changed the way that they compare states, now comparing on each state's fiscal year-end rather than calendar year-end as in the prior reports. Moody's reported that the 2022 median NTSD per capita was \$1,178, a decrease of \$1 compared to fiscal year 2021. Virginia increased two spots to the 14th highest NTSD per capita. Virginia's NTSD as a percentage of personal income increased to 2.2% from 2.1% in fiscal year 2021. Virginia increased from 19th highest to 18th highest in this ranking. Ms. Kees inquired about why Virginia increased two spots in the highest NTSD per capita ranking. Discussion ensued. Michael Maul shared that this is not a surprise because Virginia has invested a lot through debt issuances. Chairman Cummings asked Mr. Rhodemyre to share with the Committee the rankings chart for the full list of all 50 states. Discussion ensued. Mr. Maul shared that historically,

Virginia has looked different. Mr. Tillet asked about trends in higher education issuances. Brad Jones stated that rating agencies had no concerns about the issuances, and Mr. Maul elaborated.

Mr. Rhodemyre then reviewed the model results, noting that the base model resulted in an average annual capacity of \$1.29 billion. However, Mr. Rhodemyre reiterated that four quarters of historically low interest rates are still being incorporated into the model, resulting in a DCAC Model interest rate that lags current market rates. As a result, the recommended modified model rate of 4.75% should be used to model the Commonwealth’s debt capacity for the next biennium. Using the recommended modified model rate, the model results indicated that the Commonwealth could prudently authorize and issue up to \$1.08 billion of additional tax-supported debt in fiscal years 2024 and 2025. Mr. Rhodemyre asked if there were any questions on the model results and discussion ensued.

Mr. Rhodemyre then reviewed the sensitivity analyses. Discussion ensued.

Mr. Rhodemyre then reviewed the State’s contingent liability and moral obligation debt sensitivities. Discussion ensued.

Chairman Cummings asked for a motion to enter a closed meeting. April Kees informed the Committee that she did not believe in discussing the matter in closed meeting with the Debt Capacity Advisory Committee prior to the relevant project being authorized by the General Assembly. Discussion ensued. Treasurer Richardson made the motion to enter closed meeting and Mr. Tillett seconded, with approval of all Committee members except Ms. Kees, who abstained from the vote. The meeting entered closed session.

Chairman Cummings declared the meeting was returned to open session and Ms. J.W. Grenadier, public citizen, returned to the meeting.

Treasurer Richardson made a motion to certify the closed meeting as follows: “Whereas the Debt Capacity Advisory Committee convened a closed meeting on this date pursuant to an affirmative recorded vote and in accordance with the provision of the Virginia Freedom of Information Act; and whereas the Act requires a certification by this Committee that such closed meeting was conducted in conformity with the Act; now, therefore, be it resolved, that the Committee certifies that, to the best of each member’s knowledge, (I) only public business matters lawfully exempted from open meeting requirements under the Act were discussed in the closed meeting to which this certifications resolution applies, and (II) only such public business matters as were identified in the motion by which the closed meeting was convened were heard, discussed, or considered in the closed meeting by the Committee.” Ron Tillett seconded the motion. A roll call vote was conducted.

Committee Member	Vote
Sharon Lawrence	Yes
Staci Henshaw	Yes
Michael Maul	Yes

Anne Oman	Yes
David Richardson	Yes
Stephen Cummings	Yes
Ronald Tillett	Yes
April Kees	Abstained
Harold Greer	Yes
Harold Hughey	Yes

Treasurer Richardson made a motion to consider that the financing for Potter Project, if authorized by the General Assembly with materially the same terms and structure as presented to the DCAC and MEI Commission, should not be included in the base Debt Capacity Model as tax-supported debt, but should be included as part of the moral obligation sensitivity analysis within the appendices of the DCAC Report. Mr. Tillett seconded the motion. Ms. Kees stated that she believes more analysis is needed and reiterated that she would abstain from voting on the motion prior to General Assembly authorization. Discussion ensued. Staci Henshaw stated that she would also abstain from voting on the matter prior to General Assembly authorization in order to maintain an independent stance on the financing given her role as the Commonwealth's Auditor of Public Accounts. Discussion ensued. Mr. Greer asked if any other members had concerns that they wished to share. Mr. Tillett shared that he has years of experience issuing moral obligation debt and had no concerns with the security for the financing. Ms. Kees asked for confirmation from Mr. Tillett that he had no concerns about not being able to intercept State-aid, to which Mr. Tillett confirmed that he did not. Mr. Hughey shared that he sees the league step-in rights during a case of non-payment by the teams as a unique positive for the credit. He further stated that he views it as having no material impact on how rating agencies would view the Commonwealth. The motion passed; Ms. Kees and Ms. Henshaw abstained.

Mr. Rhodemyre then reviewed the cover letter to the report and asked if the Committee had any recommended changes. Discussion ensued. The Committee recommended changes to the letter and report. Chairman Cummings asked that a redline version of the report and cover letter with the suggested changes be sent to the committee for a final review before the final report is submitted.

Chairman Cummings asked for a motion to approve the cover letter and report subject to the edits necessary to incorporate the comments of the Committee. Treasurer Richardson made the motion and Mr. Hughey seconded; the motion passed, with Ms. Kees and Ms. Henshaw abstaining.

Other Business

With no further business, the meeting adjourned at 12:50 p.m.

Exhibits may be obtained by contacting the Department of the Treasury at (804) 786-3669.