DEBT CAPACITY ADVISORY COMMITTEE
COMMONWEALTH OF VIRGINIA
December 19, 2024

10:00 A.M.

Members Present:	Stephen Cummings, Chairman Scott Adams Harold Greer Staci Henshaw Harold Hughey April Kees Michael Maul Anne Oman David Richardson Ronald Tillett
Others Present:	Flora Hezel, Office of the Attorney General Andrea Peeks, House Appropriations Committee Tyler Williams, Senate Finance and Appropriations Committee Ty Wellford, Davenport & Company, LLC Sherwanda Cawthorn, Department of the Treasury Jay Conrad, Department of the Treasury Leslie English, Department of the Treasury Bradley Jones, Department of the Treasury Jay Mahone, Department of the Treasury Richard Rhodemyre IV, Department of the Treasury David Swynford, Department of the Treasury

Call to Order

Chairman Cummings called the meeting to order at 10:00 a.m. and welcomed the attendees.

Opening Remarks and Public Comment Period

Chairman Cummings asked if anyone present desired to make public comments. There were no public comments.

Approval of Minutes from December 21, 2023 Meeting

Chairman Cummings asked the Committee if there were any edits to the draft minutes of the December 21, 2023 meeting. Hearing no changes, the Chairman asked if there was a motion to approve the minutes as presented. April Kees made a motion to approve the minutes. Michael Maul seconded the motion, which received unanimous approval from the Committee.

Review of the 2024 DCAC Report

Chairman Cummings asked Mr. Rhodemyre to present the 2024 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, 2024, 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 determine 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 one quarter of historically low yields from 2021 and has still not fully caught up to market rates. 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 4.00% for GO bonds and 4.25% 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 4.25% appropriation supported interest rate.

Mr. Rhodemyre shared that the Commonwealth had another strong year financially in fiscal year 2024, with total reserve funds growing to $4.7 billion and total general fund revenues of $29.4 billion, which exceeded the 2023 forecast of $28.3 billion by more than $1.1 billion. In addition, the Commonwealth's 2025-2026 biennial budget earmarked more than $3 billion in surplus cash to supplement social spending on education and behavioral health.

Mr. Rhodemyre then discussed the impact of inflation and the Federal Reserve Bank's (the "Fed") monetary policy on borrowing costs, noting that inflation had returned to more normalized levels in fiscal year 2024 due to the Fed's increases in overnight borrowing rates in recent years. However, Mr. Rhodemyre noted that while the Fed had recently decreased overnight borrowing rates by 75 basis points, yields on municipal bonds had increased during this same period. Mr. Rhodemyre noted that since the draft of the report was produced, the Fed had further cut overnight borrowing rates by an additional 25 basis points on December 18, 2024. Discussion ensued. Mr. Rhodemyre then discussed the strong U.S. economic performance in 2024, noting that fears of a recession appeared to be waning. However, Mr. Rhodemyre noted that there are still a number of potential influencing factors that could impact global, national, and state-level economics going forward, including potential Federal policy changes such as corporate tax cuts, tariffs on imports, and reductions to the Federal workforce, geopolitical instability, worsening natural disasters, and labor disputes.

Mr. Rhodemyre informed the Committee that the 2024 Base Model Average Solution debt capacity calculation shows that an additional $1.38 billion in tax-supported debt could be authorized and issued in each of fiscal years 2025 and 2026. However, Mr. Rhodemyre reported that when using the recommended modified model rate of 4.25%, the model indicated that $1.31 billion of additional debt could be prudently authorized and issued in each of the fiscal years of 2025 and 2026.

Mr. Rhodemyre then reviewed the other recommendations and observations made by the Committee. The Committee once again provided its support for the future issuance of 9(b) GO bonds when possible, as these bonds carry the lowest borrowing costs for the Commonwealth. However, the Committee also recognized the additional costs and timing challenges related to the required voter referendum needed to issue such 9(b) GO bonds and recommended the continued use of other traditional financing methods such as the VPBA and VCBA when 9(b) GO bonds are not an option. The Committee also recommended that the Commonwealth continue to be conservative with the planning of any future tax-supported debt issuances and continue to evaluate existing authorized projects that have not moved forward to determine whether these authorizations can be rescinded or amended. Finally, the Committee noted its continued awareness of the Commonwealth's increasing outstanding debt over the last 10 years and how Virginia compares to the country and other triple-AAA state medians for Net Tax-Supported Debt (NTSD) as reported annually by Moody's.

Mr. Rhodemyre discussed the two primary 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, while payments for appropriation supported bonds are made from annual appropriations from the general fund or from the TTF. Appropriation-supported 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.

Mr. Rhodemyre then discussed the Commonwealth's transportation debt. Mr. Rhodemyre explained the transportation-only debt capacity model and noted that projected TTF debt service to TTF revenue ratios ranged from 11.5% to 18.7% 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. Discussion ensued. Ms. Kees requested that next year's report note the percentage of TTF related debt service to Blended Revenues.

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 17.7% or $3.5 billion. Mr. Rhodemyre noted that outstanding tax-supported debt increased by $641 million, or 2.8%, in fiscal year 2024. 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.

Mr. Rhodemyre then discussed the Commonwealth's historical trends for authorizing and issuing tax-supported debt and reviewed the new authorizations and issuances of tax-supported debt in fiscal year 2024. The Commonwealth had $3.7 billion in authorized but unissued tax-supported debt at fiscal year-end 2024, of which $2.6 billion was included in the debt capacity model. Mr. Rhodemyre noted that authorizations of additional tax-supported debt had remained below historical levels over the last four fiscal years. Mr. Rhodemyre then reviewed the Commonwealth's historical usage of tax-supported debt over the last decade, noting that 78.2% of the Commonwealth's tax-supported debt has been used to finance higher education and transportation projects.

Next, Mr. Rhodemyre discussed the historical and estimated annual debt service amounts on the Commonwealth's tax-supported debt, including all authorized but unissued tax-supported debt, noting that the Commonwealth's tax-supported debt service as a percentage of Blended Revenues had remained below the 5% target level over the last decade and was projected to remain below this level going forward. Mr. Rhodemyre then reviewed the interest rate sensitivities for annual debt service on planned issuances for fiscal years 2025 – 2029.

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 $34.2 billion as of June 30, 2024, an increase of $12.2 billion, or 55.8%, over the last decade. Discussion ensued.

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 2024 with reserves of $4.7 billion with projected reserves of more than $4.9 billion by fiscal year-end 2025. Mr.

Rhodemyre emphasized that Virginia's long-term debt burden is considered low and manageable by the rating agencies. 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 the Commonwealth's NTSD per capita and NTSD as a percentage of personal income both declined for the first time since 2017, while Virginia's ranking nationally in these metrics remained unchanged from the prior year's report.

Mr. Rhodemyre then reviewed the model results, noting that the base model resulted in an average annual capacity of $1.38 billion. However, Mr. Rhodemyre reiterated that one quarter of historically low interest rates was 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 4.25% 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 $1.31 billion of additional tax-supported debt in fiscal years 2025 and 2026. 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.

Finally, Mr. Rhodemyre reviewed the cover letter to the report and asked if the Committee had any recommended changes to the draft documents. Discussion ensued. The Committee recommended edits to certain sections of the report, including certain updates to economic data points and the Fed's rate cut action from December 18, 2024. Chairman Cummings asked that a redline version of the report 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. Ron Tillett made the motion and Treasurer Richardson seconded; the motion passed unanimously.

<u>Other Business</u>
With no further business, the meeting adjourned at 11:26 a.m.

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