DEBT CAPACITY ADVISORY COMMITTEE
COMMONWEALTH OF VIRGINIA
December 19, 2017

1:30 P.M.
TREASURY BOARD CONFERENCE ROOM
James Monroe Building
101 North 14th Street, 3rd Floor
Richmond, Virginia 23219

Members Present:	Richard D. Brown, Chairman Manju S. Ganeriwala Harold E. Greer April R. Kees Martha S. Mavredes Ronald L. Tillett Daniel S. Timberlake Robert P. Vaughn David A. Von Moll Jody M. Wagner
Others Present:	Janet A. Aylor, Department of the Treasury Bradley L. Jones, Department of the Treasury Sherwanda Cawthorn, Department of the Treasury Aubrey L. Layne, Jr. Secretary of Transportation June Jennings, Deputy Secretary of Finance Jason Powell, Interim Co-Director, Senate Finance Committee Tony Maggio, House Appropriations Committee Staff Kimberly Sarte, Joint Legislative Audit & Review Commission Ty Wellford, Davenport & Company James Mahone, Department of the Treasury David Swynford, Department of the Treasury Chris Whyte, Vectre Corporation Bill Zuk, J. P. Morgan

Call to Order and Opening Remarks

Chairman Brown called the meeting to order at 1:35 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 19, 2016 meeting. Mrs. Ganeriwala made a motion to approve the minutes. Mr. Tillett seconded the motion and it carried unanimously by the members present.

Review of the 2017 DCAC Report

Chairman Brown asked Mr. Jones to present the 2017 DCAC Report. (Exhibit 1) Mr. Jones began his presentation by acknowledging this would be Chairman Brown's last DCAC meeting as he is retiring at the end of the current administration. Mr. Jones also welcomed to the Committee, Ms. April Kees who has taken on the role of Interim Co-Director of Senate Finance.

Mr. Jones said the cover letter of the report would be reviewed at the end of the presentation. He then directed the Committee's attention to the report and said that the use of the report is a planning tool to assist the Commonwealth's leadership in the planning of future obligations within future resource constraints. Mr. Jones reminded the Committee the model compares annual blended revenues from the Official Revenue Forecast to existing debt service as well as authorized and unissued debt. He also explained the tax-supported debt included the general obligation bonds, the 9 (d) obligations secured by the Transportation Fund (TTF), obligations issued by the Virginia Public Building Authority (VPBA) and the Virginia College Building Authority(VCBA) but exclude the 9 (c) obligations where debt service is paid from project revenues. He added that the target is for model's debt service on tax-supported obligations is less than 5 percent of blended revenues.

Mr. Jones then reviewed the potential risks to the Commonwealth's forecast namely the uncertainty with the Federal Government. At the time of this meeting, the proposed federal tax reform is currently up for a vote by the House of Representatives (the House). Once passed by the House, the Bill will go to the Senate and once passed there it will be given to the President to sign. Mr. Jones highlighted the potential benefits of the passage of the Tax Reform Bill. The corporate tax would be reduced to 21 percent and that could increase business expansion. Also, a reduction in tax rates for individuals could increase consumer spending.

Of the potential harmful effects of the tax reform bill, Mr. Jones highlighted the plan to repeal the ability to advance refund municipal bonds on a tax-exempt basis. He said that the Commonwealth has used advanced refundings to generate savings as an economic benefit. Transportation Secretary Aubrey Lane asked if advanced refundings were done for any other reason other than for savings. Mr. Jones responded that advance refundings are not typically done for any other reason; however, some localities occasionally want to restructure their debt and use this method. Mr. Tillett also mentioned that his firm had completed a few Higher Education bond issues on a taxable basis to expand the use of the facilities to have additional private sector involvement. Chairman Brown said that the Commonwealth has also restructured debt the same way for certain entities.

Mr. Jones stated that another risk factor is the federal budget deliberations in Washington. A failure to act on federal budget plan could potentially cause economic chaos within the Commonwealth. Due to the risk with the Tax Reform and Federal Budget, Mr. Jones said that staff recommends it would be prudent to again include a cautionary statement in the letter to the Governor and General Assembly that if there is a one hundred basis points rise in the market interest rate; this would result in a $71 million decline in annual debt capacity.

At this point in the meeting, Chairman Brown made comments regarding the federal tax reform bill and its timing when Virginia's budget was completed. He commented that Virginia's budget is tied to December forecasts and not to the Federal Budget. He said that once provisions are finalized on the Federal side and Virginia conforms to the new structure, revenues would be adjusted as they get into the forecast.

Chairman Brown then asked Mr. Jones to proceed with the recommendation section of the report. Mr. Jones stated that the 2017 Debt Capacity Recommendation was $580 million annually, an increase from $446 million in 2016.

Additional recommendations include that while the opportunity has not presented itself, the Commonwealth should consider general obligation bonds (GO) if a large amount of projects are proposed. The other recommendation is that if GO bonds are not going to be pursued, traditional financing methods offered through the Virginia Public Building Authority (VPBA) or the Virginia College Building Authority (VCBA) are to be used.

Mr. Jones then reviewed the Trends in Tax-Supported Debt section of the report. Highlights included that the outstanding debt of the Commonwealth increased by 173% or $13.6 billion from $7.9 billion in 2008 to $21.4 billion in 2017. Also, between fiscal year 2016 and 2017 tax-supported debt increased $0.5 billion or 3% over the last fiscal year.

Mr. Jones reviewed the total outstanding appropriation debt (9 (d)). He said the total outstanding 9 (d) debt as of 2017, was $9.68 billion compared to $4.41 billion at fiscal year-end 2008, equivalent to a 120% increase over a ten-year period. He mentioned that the increase is attributed to the significant authorizations for transportation bonds in 2007 that were issued over the last 10 years and the significant authorizations of VPBA and VCBA in, 2008, 2009, 2010, 2013, and 2014. Mr. Jones also mentioned that timing delays between project authorizations and issuance shifted several planned bond issuances from fiscal year 2017 to fiscal year 2018, 9 (d) debt declined 2 percent or $154 million between fiscal years 2016 and 2017.

Mr. Jones then said that Other Long-Term Obligations have experienced the most growth, increasing $8.33 billion, or 427%, from $1.95 billion at fiscal year-end 2008 to $10.28 billion at fiscal year-end 2017. It is the largest category of tax-supported debt. The significant increase has caused this category to surpass the amount of 9(d) obligations. Between fiscal year 2016 and fiscal year 2017, other long-term obligations increased $721 million, which is equivalent to 8% growth over the last fiscal year. The increase over the last fiscal year related to growth in pension liabilities and OPEB liabilities increasing to $528 million, or 7%, and $218 million, or 13%, respectively.

Most recently, during the 2017 General Assembly Session, an additional $230 million was authorized, with VPBA and VCBA collectively receiving an authorization of $216 million and $14 million being for 9(c) projects. Between fiscal year 2008 and fiscal year 2017, the General Assembly collectively authorized $12.13 billion of tax-supported debt.

The amount of new tax-supported debt issued in fiscal year 2017 was $514 million. Despite significant recent authorizations and a large balance of authorized but unissued debt, the 2017 tax-supported debt issuance amount was the lowest amount issued in the 10-year period. The decline is the result of project timing versus authorizations and issuance limitations placed on certain authorizations by the General Assembly. As a result, certain issuances planned for fiscal year 2017 were delayed until fiscal year 2018.

In his review of the outstanding tax supported debt by use, Mr. Jones said of the total $10.4 billion in debt issued over the last 10 years, 52% has been used for capital projects and teaching and research equipment at state institutions of higher education. Transportation projects paid from the TTF is the next highest category at 22%. (Transportation projects financed with federal revenues are not considered tax-supported debt and are not included.)

Mr. Jones directed the Committee to the State Credit Ratings section of the Report. Virginia continues to be rated Aaa/Stable (Moody's), AAA/Negative (S&P), and AAA/Stable (Fitch). He then reminded the Committee that the Commonwealth is rated AAA with a negative outlook by Standard and Poor's. He also said the ratings on the appropriation debt are one notch below the general obligation rating: Aa1 (Moody's), AA+ (S&P) and AA+ (Fitch). The appropriation-supported bonds carry the same outlooks as the GO ratings. He said the rating agencies continue to note many of the same credit strengths: strong financial management, conservative budgeting practices, a constitutionally restricted Revenue Stabilization Fund, acceleration of planned actions to restore funding to the Virginia Retirement System, a diverse economy and a population with above average education and wealth levels.

Mr. Jones also said, these strengths do not totally insulate Virginia from negative actions. In April 2017, S&P revised its outlook of Virginia from "Stable" to "Negative". S&P based its decision on its view that the Commonwealth's Revenue Stabilization Fund Reserves may not be funded at a sufficient level to provide adequate support in the event of a future economic downturn. S&P disagreed with the Commonwealth's decision to make a withdrawal from the Revenue Stabilization Fund in fiscal years 2017 and 2018 to make up for projected revenue shortfalls given the national economy continued to be in expansion. Following the revised outlook, the Commonwealth ended fiscal year 2017 with a budgetary surplus. He stated that the Governor and General Assembly were collectively working on steps during the S&P downgrade in rebuilding reserves. He added that has been noted by all of the rating agencies and is a positive step towards Virginia management's goal of returning to "Stable" outlook.

Mr. Jones then directed the Committee's attention to the Review of Comparative Ratios section of the Report compiled from information in the Moody's *State Debt Medians 2017 Report*. Mr. Jones noted that in its *State Debt Medians 2015 Report*, Moody's predicted minimal growth for 2016 in that report and minimal growth for 2017 in the 2016 report.

Mr. Jones noted in 2017, Moody's reported 22 states experienced an increase in net tax-supported debt (NTSD) per capita and Virginia was among those states that increased. Virginia ranked as having the 19th highest debt per capita compared to the 20th highest the prior year. Virginia's growth rate was reported at 4.8% with its NSTD increasing to $1,486 compared to $1,418 the prior year. 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 20th highest NTSD as a percentage of personal income compared to a ranking of 21st the prior year and 24th two years ago. He noted that in the 2017 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 falling from the 20th highest NTSD as a percentage of income in 2016 to the 21st highest in the 2017 report.

The Committee discussed the Report and the cover letter. The Committee agreed that the Sensitivity Analysis section of the Report should be expanded to include an analysis of capacity of revenues changed to not include provider assessments. Additionally, the Committee agreed the cover letter should address provider assessments and a recommendation to continue to prioritize the rebuilding of reserve funds.

Other Business

This meeting was Chairman Browns last meeting with the DCAC. He is retiring after a total of 47 years of service with the Commonwealth. Ms. Ganeriwala made comments on behalf of the DCAC Committee and thanked Chairman Brown for his service.

With no further business, the meeting adjourned at 3:05 p.m.

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