JLBC Staff Report - FY 2017 Debt and Lease-Purchase Financing Report

A.R.S. § 41-1277 requires the JLBC Staff to present to the House and Senate Appropriations Committees a report on state debt and obligations. Due by January 31 of each year, the report is to include the following information from the prior fiscal year (FY 2017):

- The statewide aggregate level of outstanding principal, by type of debt or obligation
- The principal and interest payments on each of the state's long-term obligations
- A description of the state's payment deferrals ("rollovers") by agency, including: the date the payment was originally scheduled to be made, interest paid to date on the deferral, and interest paid in the prior and current fiscal years (FY 2017/FY 2018)
- Historical information on the state's overall debt balance and per capita debt obligations, based on available data.

To the extent possible, A.R.S. § 41-1277 requires data contained in the report to be based on the Department of Administration's *Arizona Report of Bonded Indebtedness*, which is published annually along with an online searchable database.

This report provides a current and historical summary of the state's outstanding financing obligations *(Table 1 and Table 2)*. In addition, it includes specific details on each of the individual financing issuances *(Table 3)* and the state's payment deferrals *(Table 4)*.

The report also contains a slideshow *(Attachment A)* which includes the above information and gives an overall view of the state's methods and process for using long-term financing. The presentation also contains the relative mix of uses for long-term financing (state government facilities, local school district facilities, and operating shortfalls) and summarizes issues relating to debt retirement.

Total FY 2017 outstanding bond, lease-purchase and payments deferral balances were $8.72 billion, of which $931 million was related to payments deferrals. Excluding the payment deferrals, the outstanding FY 2017 balance was $7.79 billion. This equates to a per capita amount of $1,110. In comparison to the FY 2017 level of $7.79 billion, the outstanding FY 2008 balance was $5.96 billion. The growth was due to several factors: 1) The state's use of long-term financing for the New School Facilities program; 2) An increase in Universities financing activity (both under their general authority and specifically authorized programs such as Lottery-backed issuances); and 3) Operating financing used to solve to the FY 2010 budget shortfall.

Of the total FY 2017 outstanding balance of $7.79 billion, the General Fund share was $2.33 billion. In FY 2017, the General Fund made debt services payments totaling $340 million, of which 34% was paid towards interest. By comparison, in FY 2016, the General Fund debt service payments totaled $326 million, of which 36% was paid towards interest.

Laws 2017, Chapter 328 establishes the University Capital Investment Program, which provides annual General Fund appropriations from FY 2019 – FY 2043 for new university research facilities, building renewal, or other capital construction projects. The universities may use these monies for debt service on infrastructure long-term-financing, with debt issued under this program not to exceed $1.0 billion.

Because this report summarizes the state's debt and lease-purchase obligations during FY 2017, there is no financing related to the University Capital Investment Program displayed in this report, as no debt was issued under the program as of the end of FY 2017.

Table 1 below gives a brief summary of the report.

Table 1

State Debt and Financing Summary
(As of FY 2017)

Total Outstanding Balance	$ 8.72 B
Total Outstanding Balance (excludes Payment Deferrals)	$ 7.79 B
General Fund Outstanding Balance	$ 2.33 B
FY 2017 General Fund Debt Service	$ 340 M
Interest as a % of General Fund Debt Service	34%
Total Outstanding Balance Per Capita	$ 1,110

Table 2

Per Capita State Debt Historical Summary

Fiscal Year	Outstanding Principal (Total Funds - $ in B)	Per-Capita Outstanding	% Change from Prior FY
2008	5.96	949	19.7%
2009	7.29	1,150	21.2%
2010	8.33	1,299	13.0%
2011	8.64	1,335	2.8%
2012	8.71	1,329	(0.4)%
2013	8.60	1,296	(2.5)%
2014	8.26	1,227	(5.3)%
2015	8.07	1,194	(2.7)%
2016	7.91	1,141	(4.4)%
2017	7.79	1,110	(2.7)%

Table 3

Lease-Purchase and Bonding Summary 1/

LEASE-PURCHASE SUMMARY	Overall Balance 2/	GF Balance 2/	Overall FY 17 Payment 3/	FY 17 Principal Payment 3/	FY 17 Interest Payment 3/	FY 17 GF Payment 4/	FY 17 GF Principal Payment 4/	FY 17 GF Interest Payment 4/
State Buildings								
2008A Issuance (ADC Prisons Expansions/DHS Forensic Hospital)	$43,360,000	$43,360,000	$14,202,200	$12,040,000	$2,162,200	$14,202,200	$12,040,000	$2,162,200
2013A Issuance (DHS Building Refinance)	20,445,000	0	1,909,000	990,000	919,000	1,145,400	594,000	551,400
2013B Issuance (Health Lab Refinance/ADC Prison Issuance Refinance)	16,395,000	6,525,000	5,099,100	4,175,000	924,100	3,069,700	2,513,400	556,300
2015 Issuance (2008A ADC and DHS)	107,515,000	107,515,000	5,304,900	0	5,304,900	5,304,900	0	5,304,900
2015 A Issuance (PLTO Refinance - Capitol Mall)	50,560,000	50,560,000	6,004,300	3,555,000	2,449,300	1,893,000	381,700	1,511,300
2016 Issuance (ADC Kingman Refinance)	113,030,000	113,030,000	9,419,100	6,850,000	2,569,100	9,419,100	6,850,000	2,569,100
Subtotal - ADOA	*351,305,000*	*320,990,000*	*41,938,600*	*27,610,000*	*14,328,600*	35,034,300	22,379,100	*12,655,200*
ABOR Building System								
Arizona State University	299,594,500	142,316,700	28,432,500	15,458,200	12,974,300	10,850,500	5,899,200	4,951,300
Northern Arizona University	53,040,000	52,845,000	4,445,500	1,945,000	2,500,500	1,696,600	742,300	954,300
University of Arizona	309,018,900	131,809,300	45,885,900	30,673,700	15,212,200	17,511,100	11,705,800	5,805,300
Subtotal - ABOR	*661,653,400*	*326,971,000*	*78,763,900*	*48,076,900*	*30,687,000*	*30,058,200*	*18,347,300*	*11,710,900*
Other								
Phoenix Convention Center 5/	260,124,400	260,124,400	20,449,000	0	20,449,000	20,449,000	0	20,449,000
Subtotal - State Building System	***$1,273,082,800***	***$908,085,400***	***$141,151,500***	***$75,686,900***	***$65,464,600***	***$85,541,500***	***$40,726,400***	***$44,815,100***
Operating Shortfall								
2010 Sale/Leaseback A/B Issuance	802,100,000	802,100,000	84,097,300	43,180,000	40,917,300	84,097,300	43,180,000	40,917,300
School Facilities Board								
New School Construction - FY 2008 - FY 2009	85,190,000	85,190,000	44,852,000	39,370,000	5,482,000	44,852,000	39,370,000	5,482,000
2010 Qualified School Construction Bonds	55,317,700	55,317,700	9,938,100	5,028,900	4,909,200	9,938,100	5,028,900	4,909,200
2010 Refinance (FY 2011)	58,785,000	58,785,000	2,449,800	0	2,449,800	2,449,800	0	2,449,800
2013 Refinance	21,905,000	21,905,000	24,779,700	23,220,000	1,559,700	24,779,700	23,220,000	1,559,700
2014 Refinance	145,455,000	145,455,000	76,446,500	73,565,000	2,881,500	76,446,500	73,565,000	2,881,500
2015 Refinance	257,835,000	257,835,000	11,465,800	0	11,465,800	11,465,800	0	11,465,800
Subtotal - SFB	*624,487,700*	*624,487,700*	*169,931,900*	*141,183,900*	*28,748,000*	*169,931,900*	*141,183,900*	*28,748,000*
TOTAL - Lease-Purchase	***$2,699,670,500***	***$2,334,673,100***	***$395,180,700***	***$260,050,800***	***$135,129,900***	***$339,570,700***	***$225,090,300***	***$114,480,400***

Table 3 (Cont'd)

	Overall Balance 2/	GF Balance 2/	Overall FY 17 Payment 3/	FY 17 Principal Payment 3/	FY 17 Interest Payment 3/	FY 17 GF Payment 4/	FY 17 GF Principal Payment 4/	FY 17 GF Interest Payment 4/
Bonding Summary								
School Facilities Board								
Deficiencies Correction:								
Proposition 301	$185,595,000	$0	$64,142,500	$60,290,000	$3,852,500	$0	$0	$0
State Land Trust	22,190,000	0	23,296,000	21,130,000	2,166,000	0	0	0
Subtotal - SFB	*207,785,000*	*0*	*87,438,500*	*81,420,000*	*6,018,500*	*0*	*0*	*0*
Department of Transportation 6/	1,565,100,000	0	160,828,100	86,625,000	74,203,100	0	0	0
ABOR Building System								
Arizona State University	1,362,610,000	0	97,188,200	34,083,500	63,104,700	0	0	0
Northern Arizona University	526,925,000	0	38,730,100	12,800,000	25,930,100	0	0	0
University of Arizona	1,090,805,000	0	82,474,000	33,080,000	49,394,000	0	0	0
Subtotal - ABOR	*2,980,340,000*	*0*	*218,392,300*	*79,963,500*	*138,428,800*	*0*	*0*	*0*
Operating Shortfall								
Lottery Revenue Bonds 7/	333,610,000	0	37,501,500	20,065,000	17,436,500	0	0	0
TOTAL - Bonding	***$5,086,835,000***	***$0***	***$504,160,400***	***$268,073,500***	***$236,086,900***	***$0***	***$0***	***$0***
TOTAL - Lease-Purchase & Bonding	**$7,786,505,500**	**$2,334,673,100**	**$899,341,100**	**$528,124,300**	**$371,216,800**	**$339,570,700**	**$225,090,300**	**$114,480,400**
TOTAL - Payment Deferrals	**$930,727,700**	**$930,727,700**						
TOTAL ALL OBLIGATIONS	**$8,717,233,200**	**$3,265,400,800**	**$899,341,100**	**$528,124,300**	**$371,216,800**	**$339,570,700**	**$225,090,300**	**$114,480,400**

1/ Pursuant to A.R.S. § 41-1277, all information listed is from the FY 2017 Arizona Department of Administration Bonded Indebtedness Report, except where noted. The Arizona Department of Administration report does not delineate between General Fund and non-General Fund financing. While most issuances have a distinct financing source, in circumstances where this source was unclear the table estimates the GF/Non-GF split using historical averages.

2/ Represents outstanding principal on the respective lease-purchase agreement or debt issuance, including the portion paid from a General Fund source, which is represented in the "GF Balance" column. Balances are displayed as of the end of FY 2017.

3/ Represents total FY 2017 lease-purchase or debt service payments from all fund sources, along with the portions of the payments consisting of principal and interest costs.

4/ Represents lease-purchase or debt service payments paid from a General Fund source in FY 2017, along with the portions of the payments consisting of principal and interest costs.

5/ Phoenix Convention Center financing was not included in the Arizona Department of Administration Bonded Indebtedness Report as the issuance was made by the City of Phoenix. However, the state's portion of the financing is displayed above as the payments are long-term obligations of the state.

6/ Excludes Regional Area Road Fund (RARF) Bonds which are paid from the local Maricopa County regional transportation sales tax.

7/ Debt service for the Lottery Revenue Bonds is paid for with Lottery profits which would have otherwise been revenues deposited into the General Fund.

Table 4

Payment Deferral Summary

Agency	Overall Deferral Balance	Original Due Date(s) of Deferral	Interest Paid to Date for Deferral	Interest Paid in FY 17	Interest to be Paid in FY 18
Department of Education	930,727,700 1/	$273 M in FY 2008, $330 M in FY 2009, and $350 M in FY 2010. $21.9 M paid in FY 2013.	2,400,100 2/	0	0
Total	**$930,727,700**		**$2,400,100**	**$0**	**$0**

1/ Laws 2013, 1st Special Session, Chapter 1 reduced the outstanding payment deferral by $(21,900,000) by eliminating the deferral for school districts with less than 600 pupils.
2/ Interest was paid for the ADE payment deferral in FY 2008 - FY 2010.

Explanation of Issuances

Lease-Purchase Summary

State Buildings

ADOA Building System – Lease-Purchase

2008 A – Laws 2007, Chapter 261 authorized 4,000 new public prison beds through a $200.0 million lease-purchase agreement. Laws 2007, Chapter 257 authorized a $39.0 million lease-purchase agreement for the following 2 projects: $32.2 million for a new forensic hospital unit at the Arizona State Hospital and $6.8 million for water supply projects at 4 prison complexes.

The total $239.0 million in agreements was issued in April 2008; the prison beds have a 20-year term while the forensic unit and water projects have a 15-year term. While Chapter 261 authorized 4,000 beds, the department was able to construct and open 5,000 beds in FY 2011 - 1,250 beds at Perryville SPC, 1,250 beds at Tucson SPC, and 2,500 beds at Yuma SPC.

The 2015 lease-purchase agreement refinanced a portion of the outstanding 2008A ADC lease-purchase financing. *(Please see the 2015 section below for more information)*. In 2017, the remaining 2008A issuance that was not part of the 2015 lease-purchase agreement was refinanced. The new lease-purchase agreement was favorably reviewed by JCCR in June 2017. The refinancing of $31.6 million in outstanding principal obligations is estimated to result in a total savings of $1.6 million through FY 2028.

2013 A – Issued in January 2013, the 2013 A lease-purchase transaction refinanced the privatized lease-to-own (PLTO) agreement (executed in 2001) which had initially funded the DHS office building at 150 North 18th Avenue. The refinancing transaction reduced the existing payment schedule for the building by approximately $(330,000) annually through FY 2029. While a PLTO agreement usually requires a private entity to maintain the building until the life of the agreement is complete, the conversion of this agreement into a traditional lease-purchase has been accompanied by an agreement with a private entity that will continue to be responsible for the maintenance of the DHS building through the end of the issuance in FY 2029.

2013 B – Issued in January 2013, the 2013 B transaction refinanced the 2 existing lease-purchase transactions (2002 A and 2004 B). The refinancing transaction reduced the existing payment schedule for these buildings by approximately $(390,000) annually through FY 2019.

2015 – Issued in July 2015, the 2015 transaction refinanced a portion of the 2008 A transaction. The refinancing transaction reduced the existing payment schedule for these buildings by approximately $(950,000) annually through FY 2028.

2015 A – Issued in July 2015, the 2015 A lease-purchase transaction refinanced the privatized lease-to-own (PLTO) agreement (executed in 2005) which had initially funded the 2 office buildings on the Capitol Mall. The 2 buildings house ADOA and the Department of Environmental Quality. The refinancing transaction reduced the existing payment schedule for the building by approximately $(480,000) annually through FY 2028. While a PLTO agreement usually requires a private entity to maintain the building until the life of the agreement is complete, the conversion of this agreement into a traditional lease-purchase has been accompanied by an agreement with a private entity that will continue to be responsible for the maintenance of the DHS building through the end of the issuance in FY 2029. As a result of the refinanced ADOA and ADEQ buildings, the state currently has no active PLTO agreements.

2016 – Issued in November 2016, the 2016 issuance refinanced the Arizona Department of Corrections (ADC) Kingman private prison. This generated a net savings of $8.8 million. The state will now make direct debt service payments. Prior to the refinancing, the payment was included in the overall funding amount for a private vendor.

<u>ABOR Building System – Lease-Purchase</u>

Arizona Board of Regents (ABOR) – Laws 2003, Chapter 267 appropriated $34.6 million from the state General Fund to the universities to be used to finance lease-purchase payments from FY 2008 to FY 2031 for research infrastructure project agreements entered into prior to July 1, 2006. These projects include science and technology buildings and the debt service payments are made from annual General Fund appropriations. Laws 2016, Chapter 130 modified statute to reflect long-term debt service savings from the refinancing of research infrastructure projects and specified appropriations through the end of the debt service in FY 2031.

<u>Other</u>

Phoenix Convention Center – While not a state building, the Phoenix Convention Center represents a state obligation. Laws 2003, Chapter 266 authorized the state to make distributions to provide for the debt service related to the financing of certain convention center projects, provided that the state funding would account for no more than 50% of the total project cost and would not exceed $300 million. Funding of the Phoenix Convention Center project was approved by Phoenix voters in 2001, and the renovation and expansion of the center subsequently qualified as an eligible project. In 2005, the City of Phoenix issued $600 million of bonds, 50% of which were to be paid from the state share of funding, with payments beginning in FY 2012 for a term of 33 years. The state distribution occurs according to a statutory schedule, which was modified by Laws 2011, Chapter 28. The Convention Center expansion was completed in 2009.

Operating Shortfall

2010 State Building Sale/Leaseback – FY 2010 budget legislation (Laws 2009, 3rd Special Session, Chapter 6 and Laws 2010, 6th Special Session, Chapter 4) authorized the Arizona Department of Administration (ADOA) to enter into sale/lease-back agreements for 22 existing state-owned facilities, requiring the funds to be deposited to the General Fund to subsidize state operating expenses. ADOA sold the issuances in 2 series (January 2010 and June 2010) at a tax-exempt yield of approximately 4%. These issuances range up to 20 years in period of time.

The transaction generated $1.04 billion of up front proceeds, in exchange for annual lease payments through the term of the agreements. While the titles of the buildings were used as collateral for the financing, the state maintains operational control of the facilities. Upon the expiration of the agreements, the legal titles to the buildings will be transferred back to the state.

When the financing was originally issued, the state agreed to the Working Capital Surplus Limitation, which would have required certain cash reserves to be used for mandatory repayment of the financing. Given the concerns about the mandatory repayment, the state converted to the Investment Yield Restriction in May 2014. The selection of this limitation is irrevocable for the duration of the financing. Because the state is no longer subject to the mandatory repayment requirements of the Working Capital Surplus Limitation, the operating financing is not subject to prepayment by the state until FY 2020. *(Please see the FY 2017 JLBC Baseline Summary for more information on these requirements.)*

School Facilities Board – Lease-Purchase

SFB – The School Facilities Board (SFB) is responsible for providing capital funding for K-12 school districts within the state. A.R.S. § 15-2004 authorizes SFB generally to enter into lease-purchase financing agreements in order to provide funding for the agency's New School Facilities program. However, these transactions have been prohibited since May 2006, except in cases of specific legislative authorization. SFB has entered into 6 broad types of lease-purchase financing agreements.

- **New Construction Financing 2008 - 2009** – This group of financing was issued as traditional tax-exempt Certificates of Participation. While in some years SFB New Construction has been paid for with cash financing, in certain years the Legislature has authorized SFB to enter into lease-purchase agreements. In FY 2008/2009, SFB entered into a lease-purchase agreement with a principal amount of $580.0 million for a term of 15 years.

- **2010 Qualified School Construction Bonds** – Authorized by Laws 2010, 3rd Special Session, Chapter 12, SFB entered into $91.3 million worth of lease-purchase financing through a federal program known as Qualified School Construction Bonds. This type of financing entitles the state to interest rate subsidy from the federal government, which amounts to 4.86% of the 6.0% due on the bonds, leaving the state with an effective interest rate of 1.14%. Beginning in FY 2014, the subsidy was reduced due to federal budget reductions.

- **2010 SFB Refinance** – Authorized by Laws 2010, 7th Special Session, Section 20, SFB entered into a refinancing agreement whereby $58.8 million of new financing was issued, and the cash proceeds were used to lower the agency's FY 2011 debt service obligations to achieve one-time savings. Through FY 2018, the state will pay approximately $2.4 million of interest annually, until the principal amount is paid in installments during both FY 2019 and FY 2020.

- **2013 SFB Refinance –** Authorized by Laws 2013, 1st Special Session, Chapter 3, SFB entered into a refinancing agreement whereby $79.6 million of new financing was issued, and the cash proceeds were used to refinance a portion of the outstanding 2003 and 2004 agreements and lower the agency's FY 2014 and FY 2015 debt service obligations to achieve non-recurring savings of $1.4 million in FY 2014 and $3.8 million in FY 2015.

- **2014 SFB Refinance** – Authorized by Laws 2013, 1st Special Session, Chapter 3, SFB entered into a second refinancing agreement whereby $226.1 million of new financing was issued, and the cash proceeds were used to refinance a portion of the outstanding 2005 agreements and lower the agency's debt service obligations to achieve non-recurring savings of $9.4 million in FY 2015 along with approximately $100,000 annually between FY 2016 and FY 2020.

- **2015 SFB Refinance** – Authorized by Laws 2015, 1st Special Session, Chapter 15, SFB entered into a refinancing agreement whereby $263.5 million of new financing was issued, and the cash proceeds were used to refinance a portion of the outstanding 2008 agreements and lower the agency's debt service obligations to achieve debt service savings of approximately $1.7 million annually through the end of the issuance in FY 2024.

Bonding Summary

<u>School Facilities Board</u>

In addition to the agency's general lease-purchase authority, SFB was authorized to issue revenue bonds, to be paid for with a dedicated source of funding:

- **Proposition 301 Bonds (State School Improvement Revenue Bonds)** – Proposition 301, approved by voters in 2000, authorized SFB to issue up to $800 million of revenue bonds to finance its Deficiencies Correction program which made school repairs statewide. The bonds were issued in this amount during FY 2001 – FY 2003, and are paid from the 0.6% sales tax enacted by the ballot measure. The term of the bonds runs through FY 2021, which coincides with the expiration of the measure's sales tax, at which point the entire issuance will have been retired.

- **State Land Trust Bonds (School Trust Revenue Bonds)** – Laws 2003, Chapter 264 authorized SFB to issue $246.6 million of State School Trust revenue bonds to provide further funding for the Deficiencies Correction program. Debt service on the bonds is paid from expendable earnings of the state's land trust, which consists of monies received from the sale or lease of state school trust lands and investment earnings in the fund. Earnings from this fund are first used to fund payments related to the SFB trust revenue bonds, with any excess funds above this amount transferred to the Department of Education. The bonds were issued with a term of 15 years, and are scheduled to be retired in FY 2018.

Department of Transportation

Financing largely consists of 2 broad categories:

- Highway User Revenue Fund (HURF) bonds are used to finance the State Transportation Board's 5-year construction program. HURF consists of monies received in the state from transportation-related licenses, taxes, fees, penalties and interest, such as the motor vehicle fuel tax, vehicle license tax, vehicle registration, driver's license, and others. In order for the department to issue subordinate HURF bonds, State Highway Fund revenues must exceed 3 times the maximum annual debt service on current outstanding debt. The State Highway Fund is the source of debt service for HURF bonds.

- Grant Anticipation Notes (GAN) allow ADOT to issue debt secured by future federal aid for the purposes of accelerating or advancing mostly large highway construction projects. Federal Funds are the source of debt service for GANs.

ABOR Building System

A.R.S. § 15-1683 allows each state university to incur a projected annual debt service for bonds and certificates of participation of up to 8% of each institution's total projected annual expenditures. Universities fund revenue bond debt service payments with university system revenues. While tuition represents the primary source of these revenues, they may also be directly related to the capital project. For instance, the debt service payments for renovations to a student recreation center may be paid for with student recreation fees.

Laws 2008, Chapter 287, as amended by Laws 2009, 1st Special Session, Chapter 6 and Laws 2009, 3rd Special Session, Chapter 9, authorized ABOR to enter into lease-to-own and bond transactions up to $800 million to pay for building renewal projects and new facilities with university lottery bonds (also known as SPEED bonds). ABOR is required to allocate $376.0 million of the $800.0 million for the Phoenix Biomedical Campus. Of the remaining $424.0 million in proceeds, ABOR allocated $16.0 million to ASU's School of Construction and $136.0 million to each of the 3 universities for building renewal, deferred maintenance, and new construction projects. Under Chapter 287, the annual debt payments are comprised of up to 80% lottery revenues and at least 20% university system revenues. *(Please see the Arizona Board Regents Building Systems narrative pages in the FY 2019 JLBC Baseline for more information.)*

Laws 2017, Chapter 328 established the University Capital Investment Program, which provides General Fund appropriations from FY 2019 – FY 2043 for new university research facilities, building renewal, or other capital construction projects. The law appropriates $27,000,000 to the universities in FY 2019 and increases the appropriation each year thereafter by 2% or the rate of inflation, whichever is less. The universities may use these monies for debt service on infrastructure long-term-financing and for cash construction costs. New debt issued under this program may not exceed $1.0 billion. Each university will match any General Fund contributions that are used for debt service payments at a 1:1 rate. There is no financing related to Chapter 328 displayed in this report, as no debt had been issued under the program as of the end of FY 2017.

Operating Shortfall

Lottery Revenue Bonds – FY 2010 budget legislation (Laws 2010, 6th Special Session, Chapter 4) authorized the department to issue Lottery revenue bonds, which generated $450 million of up front proceeds for the state, in exchange for fixed payments over a 20-year term. Under A.R.S. § 5-572, the funds necessary to make debt service payments relating to the lottery revenue bonds receive the first priority in the distribution of lottery profits, and are taken from monies that would have otherwise been transferred to the General Fund.

When the Lottery Revenue Bonds were originally issued, the state agreed to the Working Capital Surplus Limitation, which would have required certain cash reserves to be used for mandatory repayment of the issuance. Given the concerns about the mandatory repayment, the state converted to the Investment Yield Restriction in May 2014. The selection of this limitation is irrevocable for the duration of the financing. Because the state is no longer subject to the mandatory repayment requirements of the Working Capital Surplus Limitation, the Lottery Revenue Bonds are not subject to prepayment by the state until FY 2020. *(Please see the FY 2017 JLBC Baseline Summary for more information on these requirements.)*

Attachment A

Report on State Debt and Lease-Purchase Financing

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Debt Overview

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Statute Requires JLBC to Annually Report on State Debt and Other Obligations

- Outstanding principal on State debt, along with principal and interest payments in the prior fiscal year (FY 2017)
- Summary of payment deferrals ("rollovers") by budget unit and the cost of these deferrals
- Information on per-capita State debt and other long-term obligations
- A 10-year history of State debt and long-term financing based on available data

Arizona Constitution Limits General Fund Backed Debt to $350,000

- This limit has been interpreted as applying to debt secured by General Fund revenues
- This interpretation does not apply to debt secured by non-General Fund revenues
  - State has outstanding bonds supported by transportation, lottery and University revenues
- Lease-purchase financing has also been viewed as not applying to the limit

Lease-Purchase Financing vs. Bonds

- Lease-purchase financing has no pledged source of repayment
  - Lease agreements typically have language that payments are “subject to annual appropriation by the State Legislature” and are not “a general obligation or indebtedness of the State”
  - Non-payment would terminate lease and cause loss of property/project
- Bonds have a dedicated funding source and are secured by non-General Fund source, such as:
  - Lottery Revenue
  - Highway User Fees
  - University Tuition

Arizona's Credit Rating Was Upgraded in May 2015

- In May, 2015, both major credit rating agencies upgraded AZ's credit rating (S&P: AA- to AA; Moody's: Aa3 to Aa2)
  - Outlook from both agencies is stable

- In comparison to other states, 32 states have a higher rating, 10 states have the same rating, and 7 states have a lower rating or are not rated due to a lack of state level debt

Uses For State Debt and Lease-Purchase Financing

- State owned capital facilities/uses
- School Facilities Board to fund local new school construction
- During budget shortfalls, financing has been used for operating expenses

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State Used Operating Financing For $1.5 B of Solutions To Budget Shortfalls in 2010

- $1.0 B from the sale and leaseback of 22 state properties
  - Building titles transferred to 3rd party – transfers back after 20 years of lease payments
  - Sale/Leaseback financing paid off in FY 2030
- $450 M from the issuance of lottery revenue bonds
  - Debt service paid from General Fund portion of lottery revenues – represents foregone revenues
  - Lottery financing paid off in FY 2029

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Debt Balance and Payment Information

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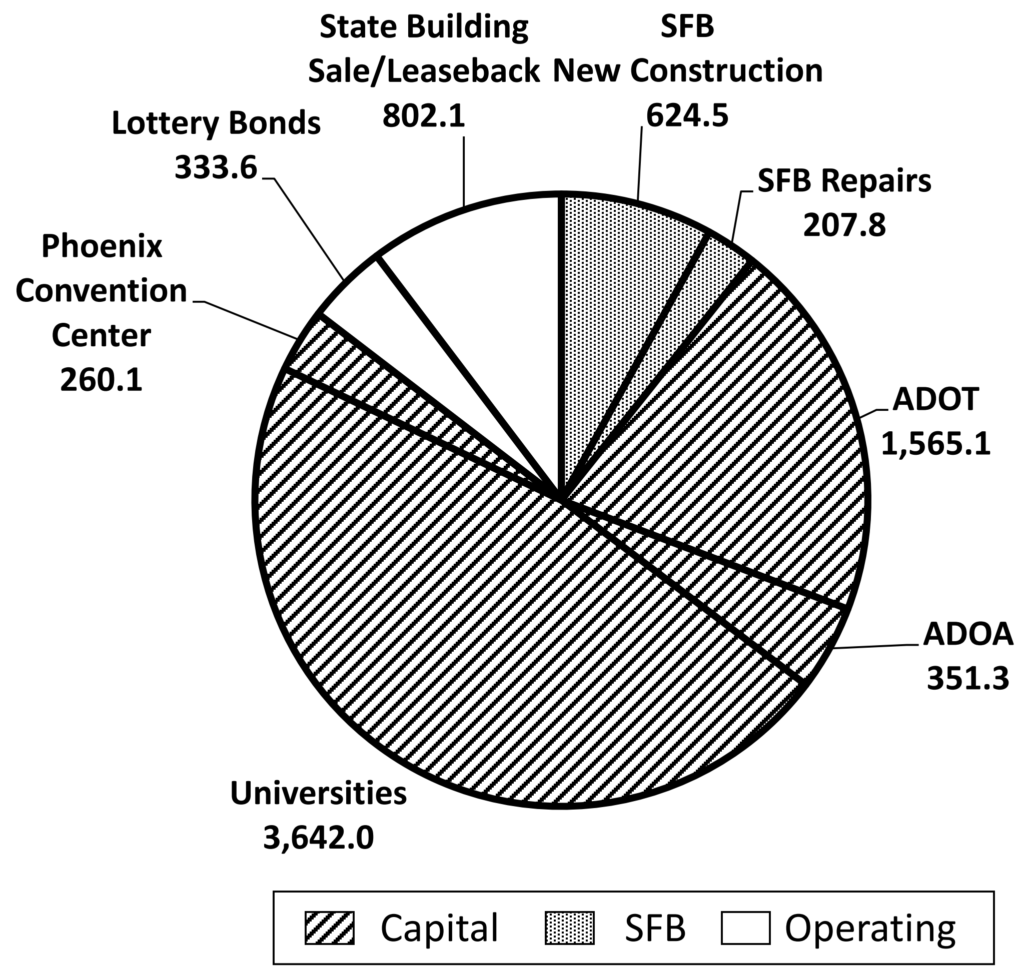
Total Outstanding State Debt/Lease-Purchase Financing is $7.8 Billion

- Reflects Multiple Payment Sources

Outstanding Balances

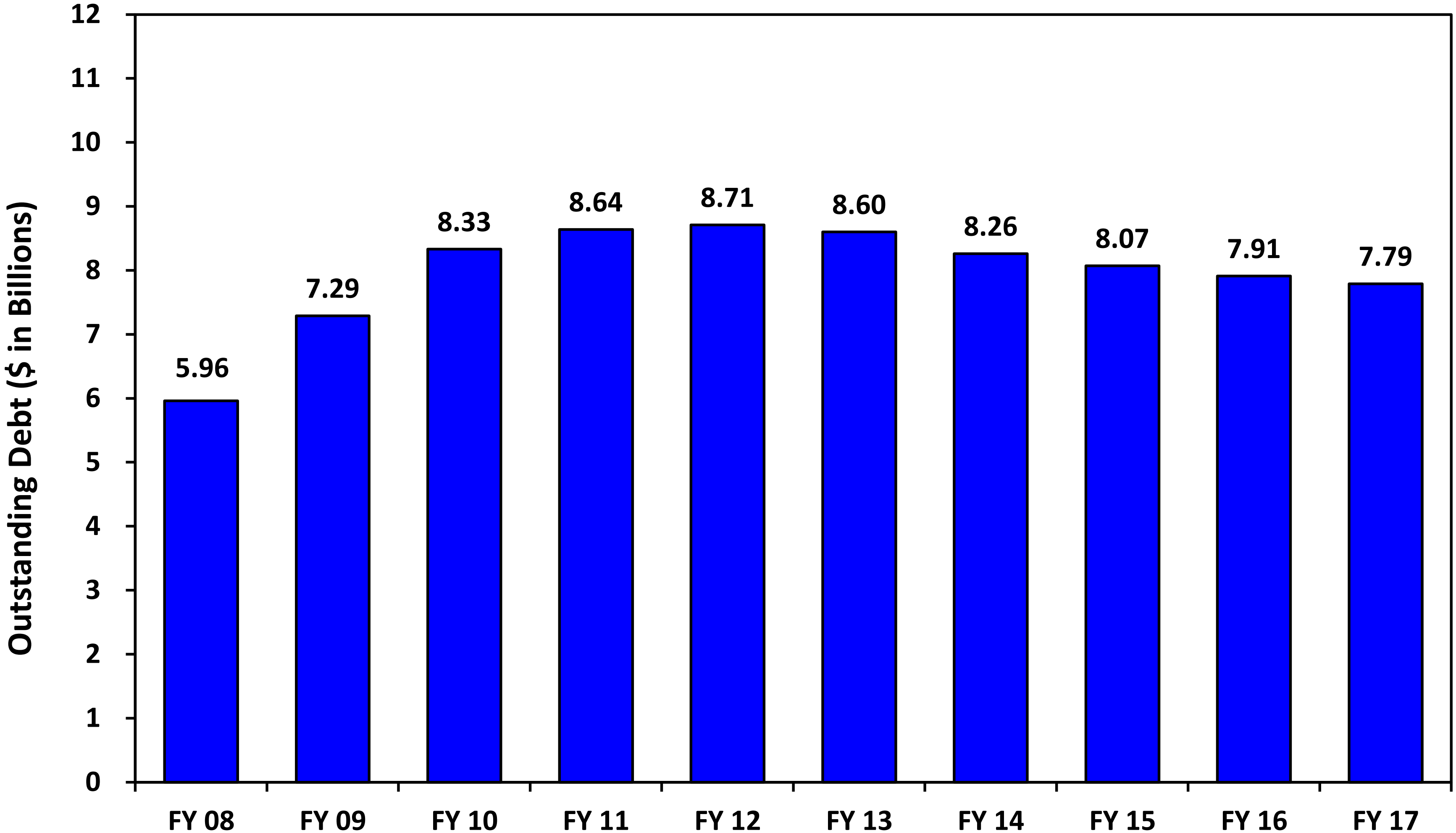
Capital Facilities/Uses	$ 5.9 B
School Facilities Board	$ 0.8 B
Operating	$ 1.1 B



End of FY 2017 - $ in Millions

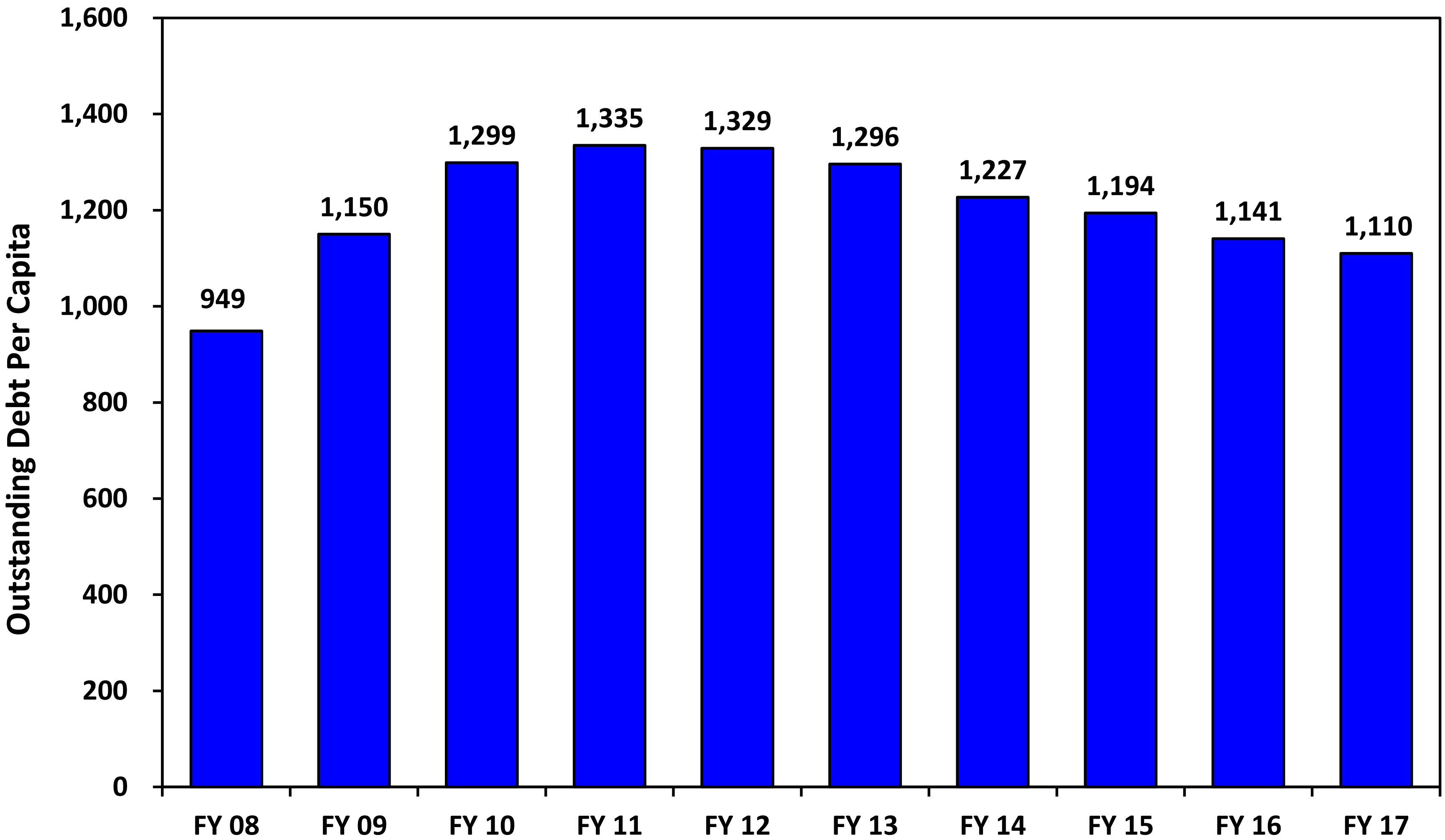
JLBC

Arizona Overall Debt Obligations Peaked in '12



JLBC

Arizona Per Capita Debt Obligations Since '08



JLBC

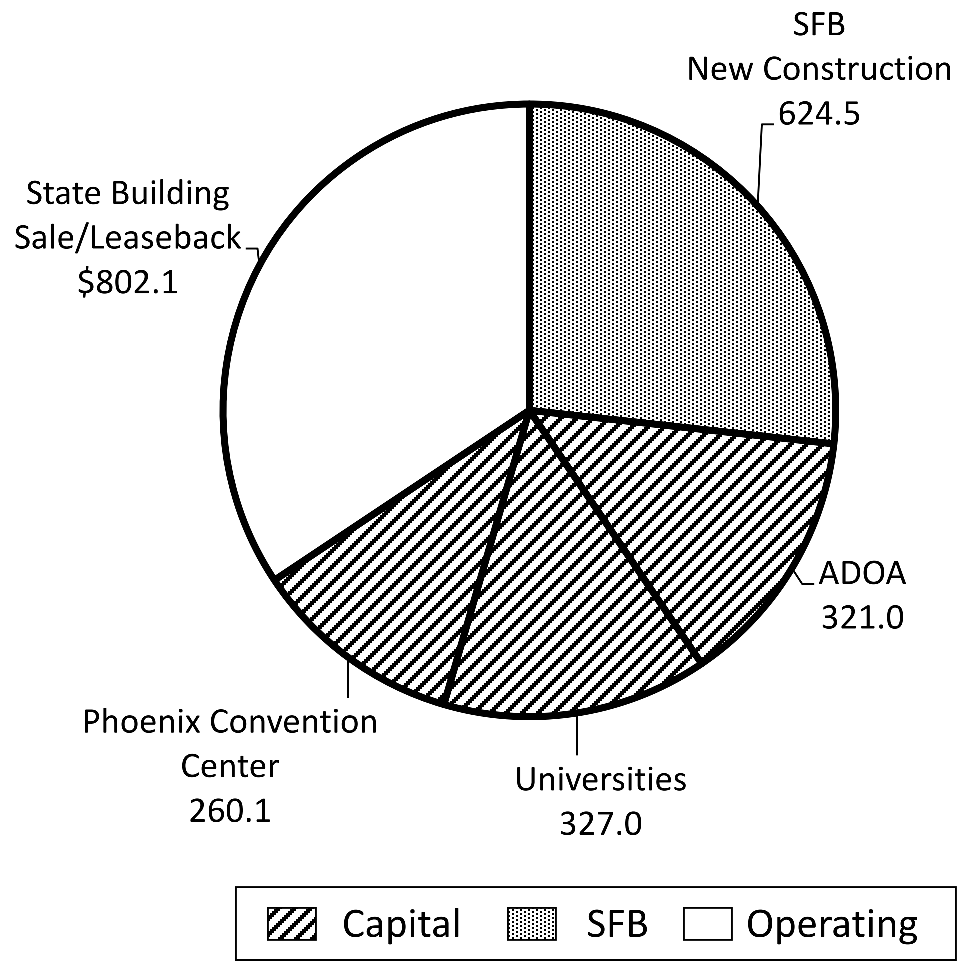
State Defers $931 M of K-12 Payments Annually
- Interest Is Not Paid By the State For Rollovers

- Used for one-time solutions during recent years with significant budget shortfalls – at its highest, the state had $1.3 B of active rollovers in FY 2011
- Only K-12 rollover now remains

General Fund Share of Outstanding Balances Is $2.3 B

Outstanding Balances

Capital Facilities/Uses	$ 0.9 B
School Facilities Board	$ 0.6 B
Operating	$ 0.8 B



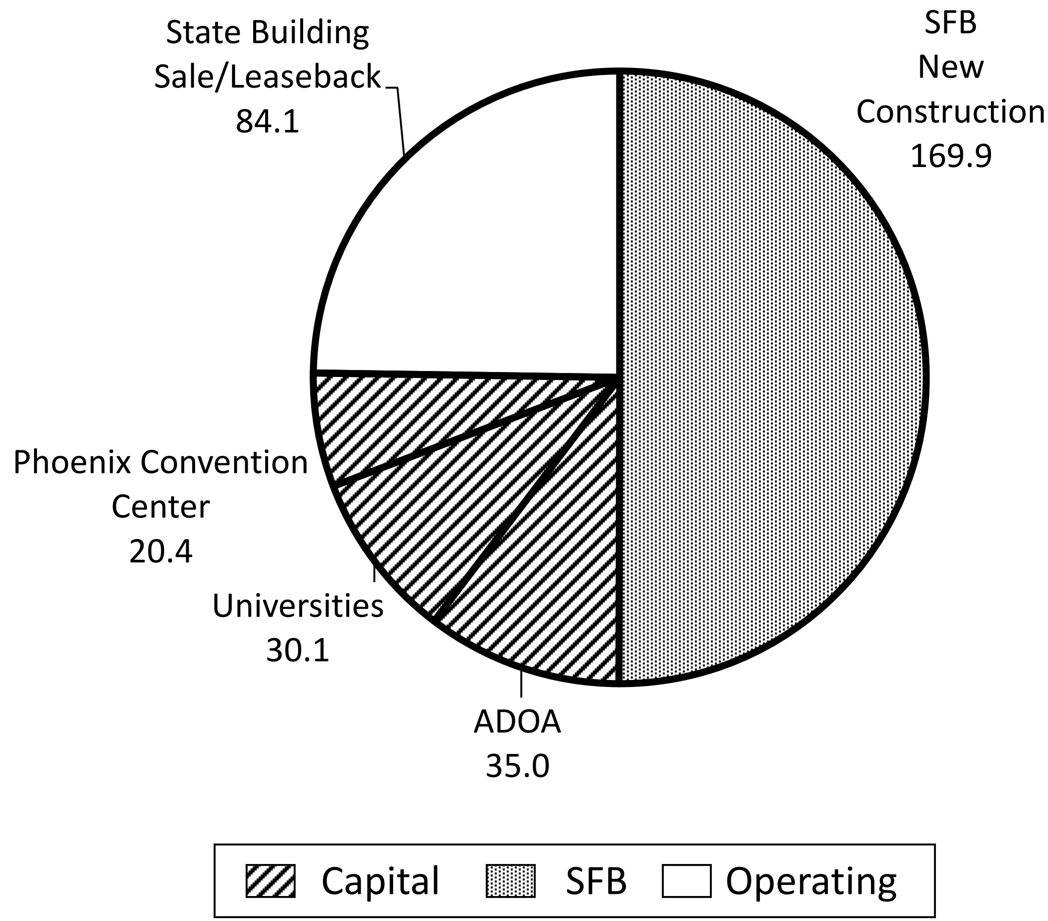
End of FY 2017 - $ in Millions

JLBC

General Fund Debt Service Cost $340 M
- Would Be Equivalent of 7th Largest Budget Unit

Annual Payments

Capital Facilities/Uses	$ 86 M
School Facilities Board	$ 170 M
Operating	$ 84 M



FY 2017 - $ in Millions

JLBC

Annual General Fund Debt Service Decreases in '19

$ in Millions			
	'17	**'18**	**'19**
Capital Facilities/Uses	86	100	103
School Facilities Board	170	170	134
Operating	84	84	84
Total	**$340 M**	**$354 M**	**$321 M**

- '19 General Fund debt service decrease mostly related to School Facilities Board debt service

JLBC

Potential Issues for Debt Retirement

- Laws 2013, Chapter 99 created an annual report from ADOA on debt retirement options
  - 2017 Report estimated that $100 M debt retirement would generate future total debt service savings of $48 M through FY 2030
- Variety of factors when selecting issuances to retire early
  - Call date – Most financing agreements have a time period where the state is prohibited from paying off the outstanding balance, typically 10 years from issuance
  - Principal amount/interest rate – Both of which affect the level of annual debt service
  - Length of term – As financing period become longer, the state generates more savings from avoided payments
- Transaction costs may affect whether debt retirement occurs in one transaction or over several years