ANNUAL REPORT OF THE

DEBT CAPACITY ADVISORY COMMITTEE

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

HOUSE DOCUMENT NO. 50

COMMONWEALTH OF VIRGINIA
RICHMOND
1998

COMMONWEALTH of VIRGINIA

Office of the Governor

George Allen
Governor

Ronald L. Tillett
Secretary of Finance

December 31, 1997

The Honorable George Allen
Governor of Virginia
State Capitol, 3rd Floor
Richmond, Virginia 23219

The Honorable Bruce F. Jamerson
Clerk of the House of Delegates
House of Delegates of Virginia
State Capitol
Richmond, Virginia 23219

The Honorable Susan Clarke Schaar
Clerk of the Senate
Senate of Virginia
State Capitol
Richmond, Virginia 23219

Dear Governor Allen, Mr. Jamerson and Ms. Schaar:

The Debt Capacity Advisory Committee (the "Committee") held its seventh annual meeting on December 10, 1997. The Committee was established by Executive Order No. 38 in 1991 and was codified by the 1994 General Assembly (Chapter 17, Article 1.1, Sections 2.1-304.7 through 2.1-304.7). The Committee is required to review the size and condition of the Commonwealth's tax-supported debt and submit to you an estimate of the maximum amount of new tax-supported debt that prudently may be authorized for the next biennium. In addition, as a result of legislation adopted during the 1997 Session, the Committee is now required to review annually the Commonwealth's moral obligation debt and other debt for which the Commonwealth has a contingent or limited liability. We are pleased to present our seventh report.

The Debt Capacity Model

In this report, we reaffirm our use of the Debt Capacity Model as the measure of debt affordability. The Model measures tax-supported debt service as a percentage of revenues. We also reaffirm that the maximum ratio of debt service as a percentage of revenues should be no greater than 5%. In our view, 5% is the maximum ratio consistent with maintaining the current premier ratings on the Commonwealth's debt. The "tax-supported debt service as a percentage of revenues" debt affordability measure and the 5% maximum ratio are used to derive a mathematical model which produces the maximum amount of incremental debt that may be prudently issued.

The concept of debt capacity management and the 5% maximum ratio were introduced in *An Assessment of Debt Management in Virginia*, a report issued by the Secretary of Finance in December 1990. The report also recommended the creation of the Debt Capacity Advisory Committee. The Debt Capacity Advisory Committee adopted the 5% maximum measure in 1991 and has fully endorsed this ratio every year since that time. Bond rating agencies recognize the Commonwealth's efforts to foster sound debt management policies; a Moody's Investors Service report dated May 15, 1996, states that "[t]he Commonwealth's guideline of limiting expected debt service to 5% of revenues is a prudent management tool" (*Moody's Municipal Credit Report*, page 3).

The recent actions of the Governor and the General Assembly in maintaining conservative debt levels and in enacting a moratorium on new authorizations of tax-supported debt have not gone unnoticed by the rating agencies. In fact, Moody's made the following comments in its report dated August 1997, which states that:

> "[c]onservative financial management and strong oversight of debt issuance have been Commonwealth traditions that served the state well through the economic downturn of the early 1990's and continue to play an important role in the Commonwealth's creditworthiness. Both the executive and legislative branches of the state have concurred in this conservative approach. This consensus was apparent in the FY 1997 legislative session when the Governor proposed and the Legislature approved a moratorium on new debt authorizations for the remainder of the fiscal year. The Debt Capacity Advisory Committee has institutionalized the state's conservative management style" (*Moody's Municipal Credit Report*, page 6).

Model Assumptions

Department of the Treasury staff presented to us a Debt Capacity Model which made use of six variables:

- actual debt service for tax-supported debt previously issued;
- reimbursement payments for the state's share of capital costs for regional and local jails for which appropriations are currently provided;
- payments on outstanding capital leases and installment purchases;
- estimated lease payments for government facilities, which are to be financed through a capital lease and have been fully authorized by the General Assembly;
- assumed issuance of authorized but unissued tax-supported debt and associated debt service, computed using estimated interest rates based on *The Bond Buyer 11 Bond Index* for general obligation debt [9(b) and 9(c)] and a higher rate for 9(d) debt; and
- General Fund and Transportation Trust Fund revenue projections as well as ABC and Lottery profit projections and revenue equal to debt service on outstanding 9(c) debt. The General Fund revenue projections, including ABC and Lottery profit transfers, are derived from The Official and December Standard General Fund Forecast for Fiscal Years 1998-2004 prepared by the Department of Taxation. The Transportation Trust Fund revenue projections are derived from The November 1997 Forecast of Transportation Trust Fund and Other Dedicated Revenues for Fiscal Years 1998-2004 prepared by the Department of Motor Vehicles.

Recommendations

Historically, Virginia has followed a capital budgeting and approval process in which projects and the financing therefore have been approved during the even-year General Assembly Session during which a new biennial budget is adopted. The Committee therefore has provided the following amounts for the two year biennium since this report coincides with the 1998 General Assembly Session during which the 1998-2000 budget will be adopted.

Model Results:

The Committee believes that, based upon the Debt Capacity Model,

- a maximum of $445 million could prudently be authorized by the 1998 Session of the General Assembly;
- a maximum of $445 million could prudently be authorized by the 1999 Session of the General Assembly; and
- therefore, the maximum amount that could prudently be authorized over the next two years is $890 million.

This maximum amount of authorization is above and beyond the tax-supported debt currently authorized but unissued, most of which is assumed to be issued at some point in the future. The increase in debt capacity over the amounts recommended in the 1996 Report is attributable to three variables:

- increased revenues due to a strong and vibrant Virginia economy;
- the moratorium on the authorization of tax-supported debt during the 1997 General Assembly Session;
- reduced tax-exempt market interest rates that resulted in tax-supported debt being issued at lower rates than assumed in December 1996, and a reduction in approximately 30 basis points in the estimated interest rate used in the Model for future debt issuance assumptions.

The Committee recognizes that it cannot predict when interest rates may change direction or when revenue growth may decline. Therefore, while this maximum amount represents the upper limit that could be prudently authorized based on the assumptions incorporated in the Model, it does not constitute a recommendation of the Committee that such amount actually be authorized over the next biennium. In the opinion of the Committee, authorizations for debt issuance in excess of this amount could result in the Commonwealth exceeding the maximum ratio target of 5%. The Debt Capacity Model is attached as Exhibit A.

The Committee makes no recommendations as to which projects, if any, should be chosen for debt financing or how they should be prioritized. These decisions are most appropriately made through the budgetary and legislative processes.

Criteria for Determining When to Include Projects in the Model:

The Committee and Department of the Treasury staff have often struggled over determining whether debt for certain projects should be included in the Model because there are different interpretations as to whether bonds for the projects have been "authorized". The Committee developed the following criteria for determining whether obligations would be considered "authorized" for inclusion in the Model.

> To be included in the Debt Capacity Model, the issuance of obligations to fund a project(s) must be authorized by an Act of the General Assembly (either an Act specifically authorizing the issuance of debt, or Appropriation Act language) with no contingency for subsequent General Assembly approval. If obligations are authorized but will require further action by the General Assembly before they can be issued, then such obligations will not be included in the Model. The practical application of this rule will be that if debt can be issued for a project without any further action on the part of the General Assembly, such debt will be considered as authorized for issuance.

The Committee adopted these criteria for use in developing the Model. These new criteria will provide additional guidance to staff as to which projects should be included. These criteria have been applied to the current Model, with the result that the $22 million of bonds for the private 225 bed juvenile correctional center is not included in the current Model although it had been included in the past.

Consider Eliminating Authorizations Not Likely to be Issued:

The Committee endorsed the efforts of the General Assembly and the Governor in rescinding approximately $54.6 million in Virginia Public Building Authority projects and Higher Education 9(c) projects during the 1997 Session. However, Treasury staff informed the Committee that, according to the Virginia Department of Transportation, another $95 million originally authorized to finance the Route 234 Bypass in Manassas is being carried as authorized debt, but it is unlikely to be issued as this project has been undertaken using other state and federal funding. This debt has been excluded from the Debt Capacity Model but remains officially authorized.

The Committee recommends that Cabinet Secretaries work with the Secretary of Finance to identify unnecessary authorizations that could be rescinded.

Financing of Non-Traditional Lease Backed Projects:

We continue to recommend changes in the financing method used for non-traditional lease-backed projects. These projects have been financed in the past using local and special purpose authorities, such as industrial development authorities or redevelopment and regional housing authorities. These authorities are rarely regular issuers in the market with significant name recognition, which can result in their bond issues carrying higher interest costs than comparably structured financings of well-known issuers. The financing aspects of these transactions are also more costly to the Commonwealth because they do not control the procurement and issuance process. Notwithstanding the Commonwealth's lack of control over the process, the Commonwealth is responsible for debt service payments.

Additional Findings

Department of the Treasury staff presented the Committee with sensitivity analyses, taking into account the effects of changes in excess capacity, revenues and interest rates in the final Model scenario. A page summarizing these effects is attached as Exhibit B. Exhibit C contains narrative and tables which summarize information regarding the Committee and tax-supported debt.

The Committee also reviewed the outstanding moral obligation debt and other debt for which the Commonwealth has a contingent or limited liability. The Committee found that the Commonwealth is not unique in its use of moral obligation debt as a number of other state issuers utilize the moral obligation pledge. The three issuers in the Commonwealth that use the moral obligation pledge are the Virginia Housing Development Authority, the Virginia Public School Authority and the Virginia Resources Authority. Each of these issuers' outstanding moral obligation debt is within their statutory limit and none expects to request additional authorization in the 1998 Session. In addition, the Virginia Public School Authority is also the only issuer of non-tax-supported debt which utilizes a sum sufficient appropriation as an additional credit enhancement. This represents a contingent liability for the Commonwealth. This is a new program for the Authority and has received the highest double-A ratings available from each of the three major rating agencies. Information on the amount of outstanding debt, statutory limits and debt ratings for moral obligation debt and other debt for which the Commonwealth has a contingent or limited liability is shown in Exhibit D.

Finally, the Committee reviewed the current and historical debt position of the Commonwealth. Part of this review included other Authority debt not supported by taxes. Certain data included in Exhibit C summarize information considered by the Committee.

We hope this report and our recommendations are useful as we move forward together into the 1998 Session of the General Assembly. It has been our pleasure to advise you in including the concepts of debt affordability and debt capacity management into the Commonwealth's debt management programs. The Commonwealth of Virginia has become an acknowledged leader among states in the area of debt capacity management, and is repeatedly held out as an example of how the process should work.

Sincerely,

Ronald L. Tillett, Chairman

Walter W. Craigie

David T. Ralston, Jr.

Susan F. Dewey

Robert W. Lauterberg

Walter J. Kucharski

Philip A. Leone

Attachments

Exhibit A

The Debt Capacity Model

The Debt Capacity Model

General Observations and Assumptions

- Rating agencies view control of tax-supported debt as one of four key factors affecting credit quality. Other factors include economic vitality and diversity; fiscal performance and flexibility; and administrative capabilities of government.
- Virginia's goal is to maintain its triple-A ratings for general obligation debt while still meeting the capital financing needs of the Commonwealth.
- Virginia's Debt Affordability Model:
  - Debt Affordability Measure

    $$\frac{\text{Tax-Supported Debt Service}}{\text{Revenues}} \leq 5\%$$
  - 10-year issuance period
  - Incorporates currently authorized but unissued debt
  - Blended revenue growth rate
  - Term and structure:
    - 20-year bonds
    - Assumed interest rate of 5.59% for 9(b) and 9(c) General Obligation debt. 9(d) debt has an assumed interest rate of 6.09%.
    - Level debt service (except 9(b) debt)
    - 9(b) General Obligation debt is amortized on a level principal basis
  - Actual debt service of all issued tax-supported debt, including capital leases, installment purchases and regional jail reimbursement agreements.
  - Blended Revenues:
    - General fund revenues and state revenues in Transportation Trust Fund added together, plus transfers of ABC and Lottery profits, plus revenue equal to debt service on outstanding 9(c) debt.

Currently Authorized Tax-Supported Debt Issuance Assumptions*

(Dollars in Millions)

	9(b) Voter Approved	9(c) Higher Education	VPBA Projects	VPBA Jails	VCBA Equipment	VCBA 21st Century	9(d) Transportation	Other Long-Term Obligations[1]	Total
Authorized But Unissued as of December 15, 1997	$102.2	$27.2	$127.0	$169.4	$39.7	$109.8	$355.1	$26.0	$956.4
Assumed Issued[2]									
FY 1999	0.0	0.0	66.2	42.5	39.7	54.9	0.0	0.0	203.3
FY 2000	66.0	27.2	11.5	73.4	0.0	55.0	148.0	0.0	381.1
FY 2001	17.2	0.0	5.2	53.5	0.0	0.0	0.0	26.0	102.0
FY 2002-2008	0.0	0.0	17.9	0.0	0.0	0.0	112.1	0.0	130.0
Total	$83.2	$27.2	$100.9	$169.4	$39.7	$109.8	$260.1	$26.0	$816.3
Authorized Debt Assumed Unissued	$19.0	$0.0	$26.1 [4]	$0.0	$0.0	$0.0	$95.0 [3]	$0.0	$140.1

[1] Other Long-Term Obligations constitutes capital lease Project for Private 1,000 Bed Medium Security Prison.

[2] Debt is assumed issued when the first full year of debt service is paid.

[3] Transportation Contract Revenue Bonds (Rt 234)- $95 million.

[4] Represents VPBA projects to be funded with excess interest earnings on construction fund proceeds and earnings on the refunded reserve fund of VPBA Series 1992 A Bonds.

* *Numbers may not add to totals due to rounding.*

' CAPACITY MODEL
,Dollars in Millions)

Debt Capacity Maximum Ratio

Debt Service as a % of Revenue = **5.0%**

	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]
Fiscal Year	Revenues	Overall Capacity to Pay Debt Service	Annual Payments for Debt Service on Debt Issued	Annual Payments for Debt Service on All Planned Debt Issuances	Net Capacity to Pay Debt Service	Amount of Additional Debt that may Be Issued	Debt Service on the Amount of Additional Debt that may Be Issued	Remaining Capacity to Pay Debt Service	Total Debt Service as a % of Revenues
Actual 1993	$6,909.21	$345.46	$170.99	N/A	$174.47	N/A	N/A	$174.47	2.47%
Actual 1994	7,322.29	366.11	212.37	N/A	153.74	N/A	N/A	153.74	2.90%
Actual 1995	7,758.23	387.91	227.49	N/A	160.42	N/A	N/A	160.42	2.93%
Actual 1996	8,202.92	410.15	254.90	N/A	155.25	N/A	N/A	155.25	3.11%
Actual 1997	9,067.93	453.40	274.25	N/A	179.15	N/A	N/A	179.15	3.02%
1998	9,550.87	477.54	308.21	$33.40	135.93	**0.00**	0.00	135.93	3.58%
1999	10,059.01	502.95	320.84	62.66	119.44	**$445.12**	$38.57	80.87	4.20%
2000	10,628.06	531.40	314.04	100.55	116.82	**445.12**	77.144	39.67	4.63%
2001	11,197.44	559.87	312.57	107.08	140.22	**445.12**	115.716	24.50	4.78%
2002	11,840.50	592.02	302.29	117.47	172.26	**445.12**	154.288	17.98	4.85%
2003	12,493.51	624.68	280.74	117.25	226.69	**445.12**	192.860	33.83	4.73%
2004	13,176.36	658.82	276.82	107.58	274.41	**445.12**	231.432	42.98	4.67%
2005	13,887.06	694.35	256.53	107.36	330.47	**445.12**	270.003	60.46	4.56%
2006	14,641.19	732.06	251.96	107.12	372.97	**445.12**	308.575	64.40	4.56%
2007	15,439.18	771.96	248.49	106.90	416.58	**445.12**	347.147	69.43	4.55%

10 Year Average:	$400.61	Excess Capacity:	$801.22

[1] Revenues include the Official December Forecast of General Fund Revenues, transfers from the Virginia Lottery and the Alcoholic Beverage Control Board, revised as of December 19, 1997; certain revenues from the Transportation Trust Fund revised as of April 24, 1997 and revenue equal to debt service on outstanding 9(c) debt.

[2] Overall Capacity to Pay Debt Service equals 5% of the Revenues listed in Column [1].

[3] Equals the annual payments of principal and interest for all currently outstanding tax-supported debt issued through June 30, 1997 plus fiscal year 1998 issuances as of December 15, 1997.

[4] Equals the annual estimated payments of principal and interest for all currently authorized tax-supported debt planned for issuance within the next ten fiscal years. See Assumed Issuances of Currently Authorized But Unissued Tax-Supported Debt.

[5] Equals the amount of revenue available to pay debt service after principal and interest on all currently outstanding and all planned issuances of tax-supported debt has been paid. Column [2] - Column [3] - Column [4].

[6] Equals to annual amount of additional principal that may be issued without violating the parameters of the model.

[7] Equals to annual amount of principal and interest to be paid on Column [6].

[8] Equals Column [5] minus Column [7].

[9] Equals the sum of all debt service payments divided by Revenues. (Column [3]+Column [4]+Column [7])/Column [1].

DEBT CAPACITY MODEL

REVENUE DATA

(Dollars In Millions)

Fiscal Year	General Fund		Transportation Trust Fund		General Fund Growth		Transportation Trust Fund Growth		ABC Profit Transfer		Lottery Profit Transfer		Revenues Sufficient to Pay 9(c) Debt Service Outstanding	Revenues Sufficient to Pay New 9(c) Debt Service	Total Revenue (12)	Blended Revenue Growth Rate (13)
Actual 1991	$5,552.69	(1)	$420.17	(10)	-0.42%	(1)	-5.35%	(10)	$26.20	(1)	$282.00	(1)	N/A	N/A	$6,281.06	1.53%
Actual 1992	5,623.21	(2)	425.37	(10)	1.27%	(2)	1.24%	(10)	23.73	(2)	290.80	(2)	N/A	N/A	6,363.12	1.31%
Actual 1993	6,134.57	(3)	450.72	(10)	9.09%	(3)	5.96%	(10)	26.82	(3)	297.10	(3)	N/A	N/A	6,909.21	8.58%
Actual 1994	6,503.76	(4)	494.30	(10)	6.02%	(4)	9.67%	(10)	20.73	(4)	303.50	(4)	N/A	N/A	7,322.29	5.98%
Actual 1995	6,881.12	(5)	546.50	(10)	5.80%	(5)	10.56%	(10)	19.01	(5)	311.60	(5)	N/A	N/A	7,758.23	5.95%
Actual 1996	7,283.56	(6)	561.76	(10)	5.85%	(6)	2.79%	(10)	26.00	(6)	331.60	(6)	N/A	N/A	8,202.92	5.73%
Actual 1997	8,113.55	(7)	588.08	(10)	11.40%	(7)	4.69%	(10)	23.80	(7)	342.50	(7)	N/A	N/A	9,067.93	10.55%
1998	8,512.60	(8)	598.88	(10)	4.92%	(8)	1.84%	(10)	21.70	(8)	342.00	(8)	75.69	0.00	9,550.87	5.33%
1999	9,004.50	(8)	615.57	(10)	5.78%	(8)	2.79%	(10)	21.60	(8)	342.00	(8)	75.34	0.00	10,059.01	5.32%
2000	9,546.30	(8)	641.87	(10)	6.02%	(8)	4.27%	(10)	21.40	(8)	342.00	(8)	74.23	2.26	10,628.06	5.66%
2001	10,083.50	(8)	674.14	(10)	5.63%	(8)	5.03%	(10)	21.20	(8)	342.00	(8)	74.33	2.26	11,197.44	5.36%
2002	10,696.00	(8)	708.03	(10)	6.07%	(8)	5.03%	(10)	21.20	(8)	342.00	(8)	71.01	2.26	11,840.50	5.74%
2003	11,325.80	(8)	734.89	(10)	5.89%	(8)	3.79%	(10)	21.20	(8)	342.00	(8)	67.36	2.26	12,493.51	5.52%
2004	11,990.20	(8)	755.77	(10)	5.87%	(8)	3.78%	(10)	21.20	(8)	342.00	(8)	64.93	2.26	13,176.36	5.47%
2005	12,678.26	(9)	784.32	(11)	5.74%	(9)	3.78%	(11)	21.20	(14)	342.00	(14)	59.02	2.26	13,887.06	5.39%
2006	13,405.81	(9)	813.95	(11)	5.74%	(9)	3.78%	(11)	21.20	(14)	342.00	(14)	55.97	2.26	14,641.19	5.43%
2007	14,175.11	(9)	844.70	(11)	5.74%	(9)	3.78%	(11)	21.20	(14)	342.00	(14)	53.91	2.26	15,439.18	5.45%

(1) Annual Report of the Comptroller, FY 91.
(2) Annual Report of the Comptroller, FY 92.
(3) Annual Report of the Comptroller, FY 93.
(4) Annual Report of the Comptroller, FY 94.
(5) Annual Report of the Comptroller, FY 95.
(6) Annual Report of the Comptroller, FY 96.
(7) Annual Report of the Comptroller, FY 97.
(8) December Standard General Fund Forecast, December 19, 1997
(9) Derived using the average Taxation LT growth rate through years ending 2004.
(10) Department of Motor Vehicles.
(11) Derived using TTF growth rate from FY2004.
(12) Total Revenue=GF+TTF+ABC+Lottery+Existing 9(c) Revenues + Estimated 9(c) Revenues.
(13) Blended Revenue Growth Rate=(Current FY Total Revenue/Prior FY Total Rever [illegible].
(14) FY 2001-2007 based on FY 2000 forecast, (per December Standard General Fu [illegible] ast, December 19, 1997).

Annual Debt Service Requirements and Other Long-Term Obligations
As of June 30, 1997 Plus Fiscal Year 1998 Issuance To-Date
(Dollars in Thousands)

Fiscal Year Ending June 30	General Obligation Debt Sections 9(a), 9(b) and 9(c)	Other Tax-Supported Debt Section 9(d)	Capital Lease and Installment Purchases	Regional Jail Reimbursements	Other Authorized Capital Lease Projects	Debt Service on Planned Issuances	Debt Service on Unallocated Debt Capacity	GRAND TOTAL
1998	$131,700	$176,513	$23,705	$9,698	$0	$0	$0	$341,616
1999	124,489	196,355	29,878	9,782	2,253	20,750	38,572	422,079
2000	122,059	191,983	29,883	9,778	2,253	58,632	77,144	491,732
2001	120,818	191,751	29,887	9,774	2,253	65,171	115,716	535,370
2002	116,155	186,131	29,891	9,773	2,253	75,559	154,288	574,050
2003	111,135	169,605	29,889	9,783	2,253	75,325	192,860	590,850
2004	107,335	169,486	29,895	9,781	2,253	65,745	231,432	615,927
2005	100,043	156,487	29,904	9,777	2,253	65,424	270,003	633,891
2006	95,596	156,367	29,905	9,776	2,253	65,189	308,575	667,662
2007	92,132	156,353	29,912	9,774	2,253	64,957	347,147	702,528
TOTAL	$1,121,462	$1,751,031	$292,750	$97,694	$20,277	$556,752	$1,735,737	$5,575,703

The Debt Capacity Model

Parameters of the Model

(1) **Revenues** includes all general fund revenues (exclusive of transfers), ABC and Lottery profits transferred to the general fund, state tax revenues in the Transportation Trust Fund and revenue equal to debt service on outstanding 9(c) debt.

(2) **Overall Capacity to Pay Debt Service** is calculated as the product of the Debt Capacity Maximum Ratio and Revenues. It represents the maximum level of debt service allowed given the 5% debt service/revenues ratio. [Column 2 = Column 1 x .05]

(3) **Annual Payments for Debt Service on Debt Issued** is actual debt service on all tax-supported debt outstanding at the end of the most recent fiscal year and on any issuance to date since fiscal year end.

(4) **Annual Payments for Debt Service on All Planned Debt Issuances** is the estimated amount of debt service for currently authorized and unissued tax-supported debt assumed to be issued within the ten-year period.

(5) **Net Capacity to Pay Debt Service** is Overall Capacity to Pay Debt Service less Annual Payments for Debt Service on Debt Issued and Annual Payments for Debt Service on All Planned Debt Issuances. [5= 2-3-4]

(6) **Amount of Additional Debt that May Be Issued** is the amount of additional tax-supported debt (above and beyond that which is currently authorized but unissued) that may be issued in any given year without exceeding Overall Capacity to Pay Debt Service.

Commonwealth Debt

(7) **Debt Service on the Amount of Additional Debt that May Be Issued** is the estimated amount of debt service for the Additional Debt that may be Authorized and Issued.

(8) **Remaining Capacity to Pay Debt Service** is Net Capacity to Pay Debt Service less Debt Service on the Amount of Additional Debt that may be Authorized and Issued. [8=5-7]

(9) **Total Debt Service as a % of Revenues** is the sum of Annual Payments for Debt Service on Debt Issued, Annual Payments for Debt Service on All Planned Debt Issuances and Debt Service on the Amount of Additional Debt that may be Authorized and Issued, divided by Revenues. [9=(3+4+7)/1]

- Model solves for annual capacity, above and beyond authorized amounts assumed issued for the next ten fiscal years at the 5% debt service/revenues level over a ten-year period.

  $445.12 million is equal annual issuance capacity.

  - debt service/revenues ratio rises to a maximum of 4.85% in FY 2002
  - projected issuance never reaches 5% capacity due to two years excess capacity at end of ten-year period
    - two years of excess capacity is a function of conservatism

Exhibit B

The Debt Capacity Model Sensitivity Analysis

The Debt Capacity Model (continued)

Excess Capacity Sensitivity

- Model solution provides for two years of excess capacity remaining at end of the 10-year period which results in the following annual debt capacity:

2 Year Excess Capacity	**$445.12 million**

- If the model solution is altered to reduce the two years of excess capacity, the following annual debt capacity figures are produced:

1 Year Excess Capacity	**$485.58 million**
No Excess Capacity	**$534.14 million**

Revenue Sensitivity

- If the model solution is altered to change revenues, the following annual debt capacity figures are produced:

Add $100 million each year	**$471.12 million**
Subtract $100 million each year	**$419.22 million**

Interest Rate Sensitivity

- If the model solution is altered to change interest rates, the following annual debt capacity figures are produced:

Add 100 bp to rate	**$405.92 million**
Subtract 100 bp from rate	**$481.30 million**

Exhibit C

Background Information

Background

Creation of the Debt Capacity Advisory Committee was recommended in *An Assessment of Debt Management in Virginia*, December 1990. The Committee was originally created in September 1991, by Executive Order #38. The Committee was subsequently codified under Chapter 43 of the 1994 Virginia Acts of Assembly.

The Committee's mandate is to annually review the size and condition of the Commonwealth's tax-supported debt and submit to the Governor and the General Assembly an estimate of the maximum amount of new tax-supported debt that prudently may be authorized for the next biennium (Section 2.1-304.3 Code of Virginia). This estimate is advisory and in no way binds the Governor or the General Assembly.

During the 1997 General Assembly Session, the Committee's role was expanded to include the annual review of moral obligation debt and other debt for which the Commonwealth has a contingent or limited liability.

In addition, the Committee is also required to review the amount and condition of Commonwealth obligations that are not general obligations or moral obligations, and when appropriate, recommend limits on such additional obligations to the Governor and to the General Assembly.

During the 1997 General Assembly Session, two specific sports facility authorities were provided access to certain additional tax revenues. The legislation also provides that if the State Treasurer, with the concurrence of the Committee, finds that obligations issued to finance such facilities would be tax-supported debt or impact the Commonwealth's credit ratings, the obligations must be authorized by the General Assembly.

The Committee has issued 6 annual reports since its inception.

Background (Continued)

Before January 1 of each year, the Committee shall submit to the Governor and to the General Assembly the Committee's estimate of tax-supported debt which prudently may be authorized for the next fiscal year, together with a report explaining the basis for the estimate. In developing its annual estimate and in preparing its annual report, the Committee shall, at a minimum, consider:

- the amount of tax-supported debt that, during the next fiscal year and annually for the following nine fiscal years, will be outstanding and the amount of tax-supported debt which has been authorized but not yet issued;
- a projected schedule of affordable, state tax-supported debt authorizations for the next biennium;
- projected debt service requirements during the next fiscal year and annually for the following nine fiscal years based on existing outstanding debt, previously authorized but unissued debt, and projected debt authorizations;
- the criteria that recognized bond rating agencies use to judge the quality of Commonwealth bond issues;
- any other factor that is relevant to (i) the ability of the Commonwealth to meet its projected debt service requirements for the next two fiscal years; (ii) the ability of the Commonwealth to support additional debt service in the upcoming biennium; (iii) the requirements of the statewide capital plan; and (iv) the interest rate to be borne by, the credit rating on, or any other factor affecting the marketability of such bonds; and
- the effect of authorizations of new tax-supported debt on each of the considerations listed above.

Chapter 43 also requires all Commonwealth debt-issuing agencies, institutions, boards, and authorities to provide to the State Treasurer quarterly reports containing information which the Committee deems necessary for it to carry out its required duties.

Review of the December 1996 Report

The Committee issued its sixth annual report to the Governor and the General Assembly on December 13, 1996. The report addressed the following issues:

- Reaffirmed the use of debt service on tax-supported debt and related long-term obligations as a percentage of revenues as the debt affordability measure used in Virginia's Debt Capacity Model. In addition, reaffirmed a maximum ratio of debt service as a percentage of revenues of 5%.

- Concluded that the Commonwealth can issue an average of $269.7 million in tax-supported debt in each year from fiscal year 1998 through fiscal year 2006 above and beyond tax-supported debt already outstanding or authorized, while still holding the ratio to tax-supported debt service as a percentage of revenues below 5%.

- Recommended that $243 million of tax-supported debt could be prudently authorized by the 1997 and 1998 Sessions of the General Assembly, representing a maximum authorized amount of $486 million for the biennium.

- Acknowledged the Governor's request to the General Assembly to consider a one-year moratorium on any new tax-supported debt authorizations, however, noted that such policy decisions were properly left to the Governor and the General Assembly.

- Made no recommendation as to which projects, if any, should be chosen for debt financing or how they should be prioritized. Reaffirmed that this decision was most appropriately made through the budgetary and legislative processes.

Review of the December 1996 Report (Continued)

- Changed the interest rate assumption used in the Debt Capacity Model for Article X, Section 9(c) debt to the "AAA" interest rate used for 9(b) debt to allow for consistent treatment of all general obligation debt issuance.

- Recommend changes in the financing method used for non-traditional lease-backed projects previously financed by local and special purpose authorities, such as industrial development authorities or redevelopment and housing authorities. Recommended the use of financing processes which promote the lowest possible cost of funds to the Commonwealth by allowing the Treasury Board to oversee the issuance process.

- Recommended that Cabinet Secretaries work with the Secretary of Finance to develop a proposal for rescinding unnecessary authorizations for consideration in the 1998 General Assembly Session. Approximately $226 million in projects were being carried as authorized but were unlikely to be issued. The debt had been excluded from the Debt Capacity Model but remained officially authorized.

- In addition to the recommendations listed above, recommended that the 5% maximum ratio of debt service as a percentage of revenues not be codified, in order to remain sufficiently flexible to handle changes in policy, practice and general market conditions as they occur. *(January 2, 1997 letter to the Chairman and Vice Chairman of the Joint Subcommittee Studying Bonded Debt of the Commonwealth)*

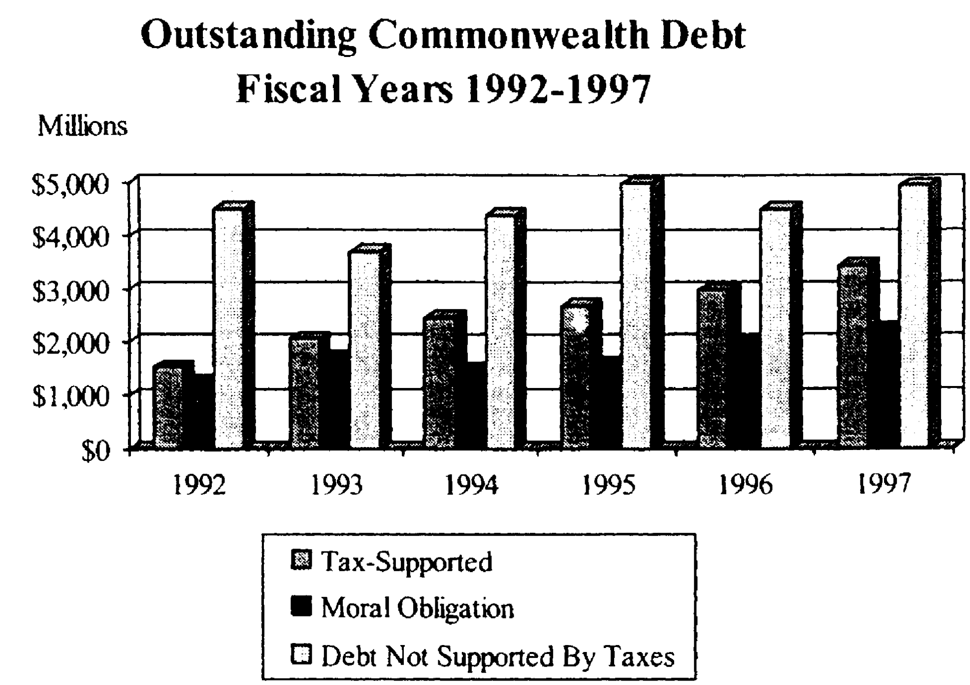
Commonwealth Debt

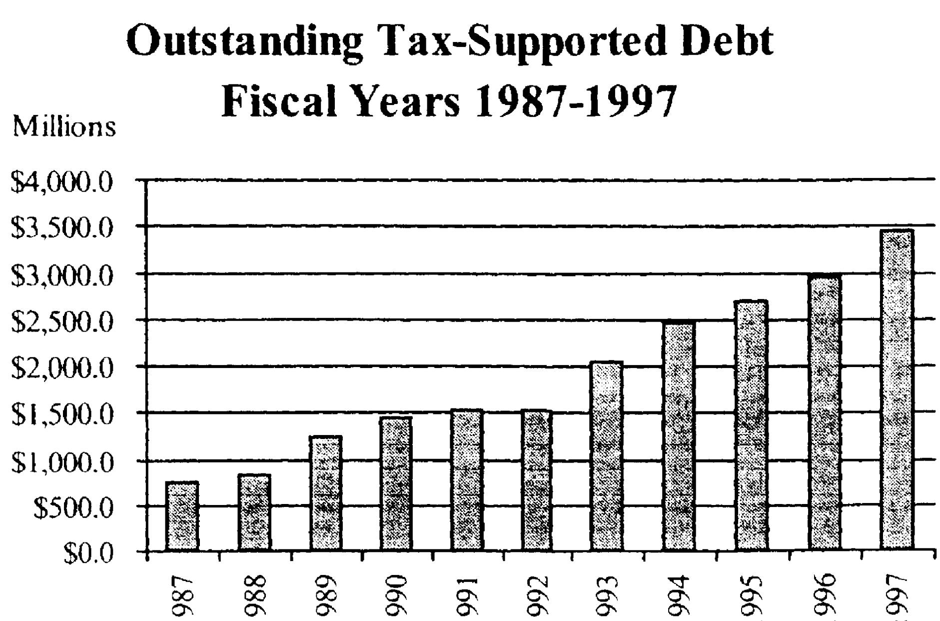
(Dollars in Millions)

	As of June 30, 1997	As of June 30, 1996
Tax-Supported Debt		
9(a) General Obligation	$70,460	$71,155
9(b) General Obligation	468,650	399,180
9(c) General Obligation - Higher Education	433,944	407,295
9(c) General Obligation - Transportation	154,948	163,265
9(c) General Obligation - Parking Facilities	12,860	13,410
Commonwealth Transportation Board	745,560	579,425
Virginia College Building Authority - Equipment	92,870	68,810
Virginia College Building Authority - 21st Century	53,160	0
Virginia Port Authority	114,025	97,180
Virginia Public Building Authority	902,604	777,731
Innovative Technology Authority	13,055	12,100
Virginia Biotechnology Research Park Authority	31,000	0
Capital Leases	120,903	115,951
Installment Purchases	37,504	31,685
Regional Jail Reimbursements	102,897	106,799
Liability for Federal Retiree Taxes	66,006	128,700
Total Tax-Supported Debt	$3,420,446	$2,972,686
Debt Not Supported By Taxes		
Moral Obligation / Contingent Liability Debt		
Virginia Resources Authority	$337,751	$323,631
Virginia Housing Development Authority	1,179,782	1,094,525
Virginia Public School Authority - 1991 Resolution	739,140	536,900
Virginia Public School Authority - 1997 Resolution	0	0
Total Moral Obligation/Contingent Liability Debt	$2,256,673	$1,955,056
Other Debt Not Supported By Taxes		
9(d) Higher Education	$334,835	$284,957
Virginia College Building Authority - Pooled Bond Program*	0	0
Virginia College Building Authority - Private College Program*	198,900	192,935
Virginia Public School Authority-1987 Resolution*	572,140	633,885
Virginia Public School Authority-Stand Alone Program	156,490	163,020
Virginia Public School Authority- Equipment Notes	84,015	36,665
Virginia Public School Authority- 1990 Insured Resolution*	27,150	28,655
Virginia Housing Development Authority	3,514,719	3,196,554
Virginia Port Authority	98,065	0
Virginia Equine Center	8,090	8,625
Medical College of Virginia Hospitals Authority	39,605	0
Hampton Roads Sanitation District	197,346	151,452
Notes Payable	15,253	57,003
Total Other Debt Not Supported By Taxes	$5,246,608	$4,753,751
Total Debt of the Commonwealth	$10,923,727	$9,681,493

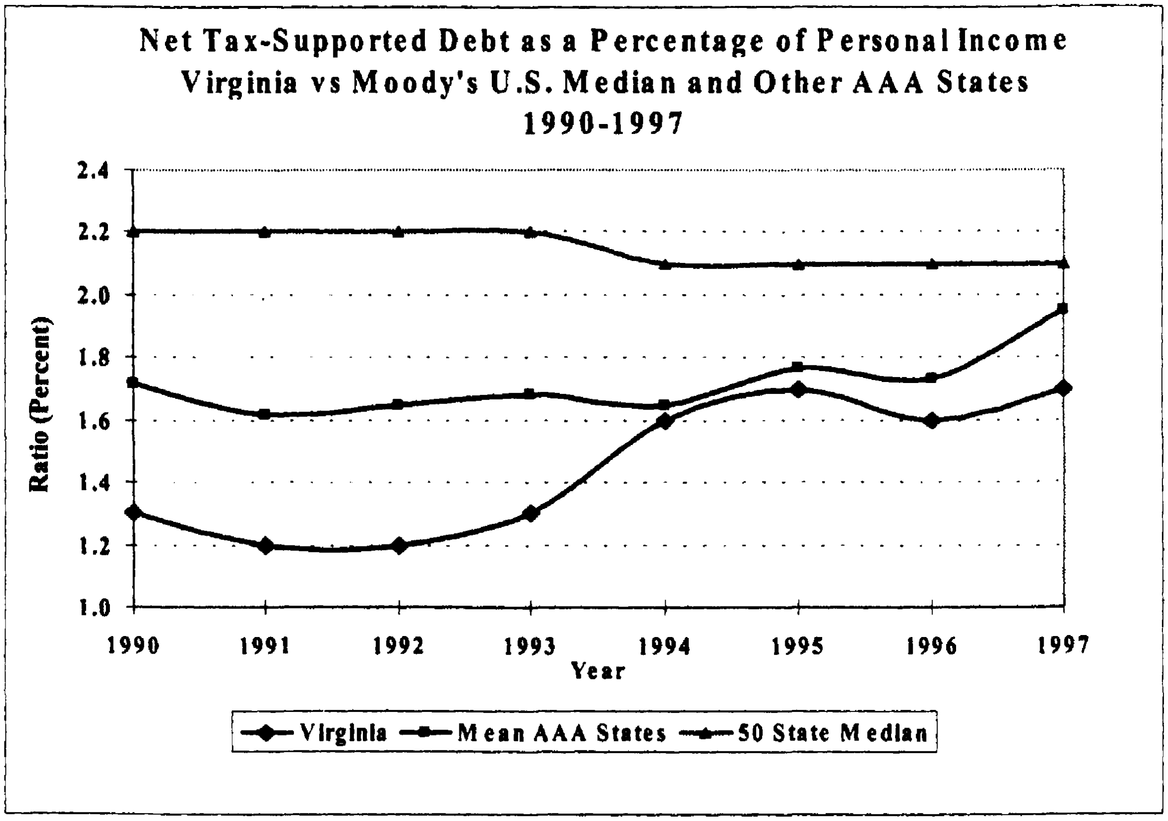
All data as reported in the Commonwealth's Comprehensive Annual Financial Report, except for items with an (*).

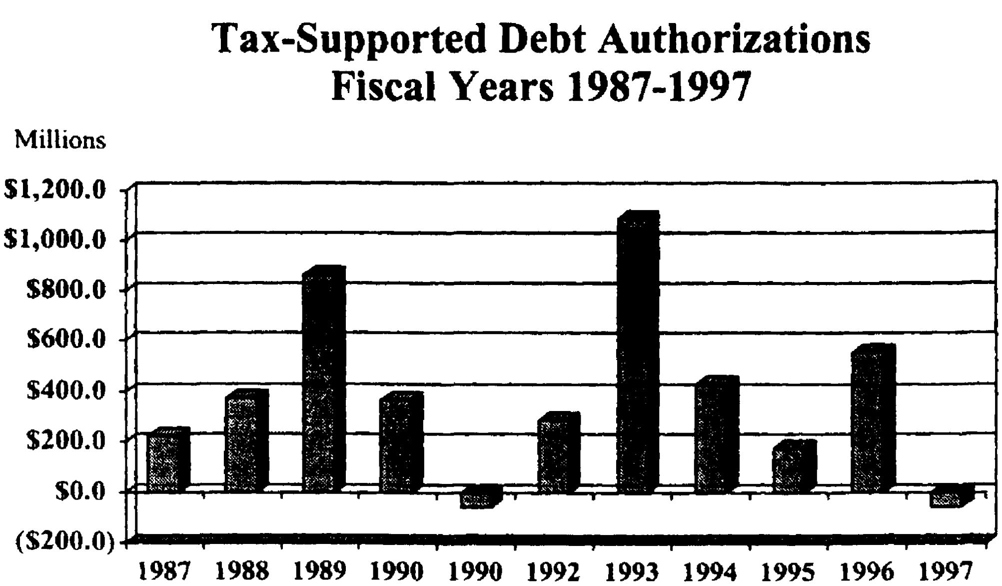
Commonwealth Debt





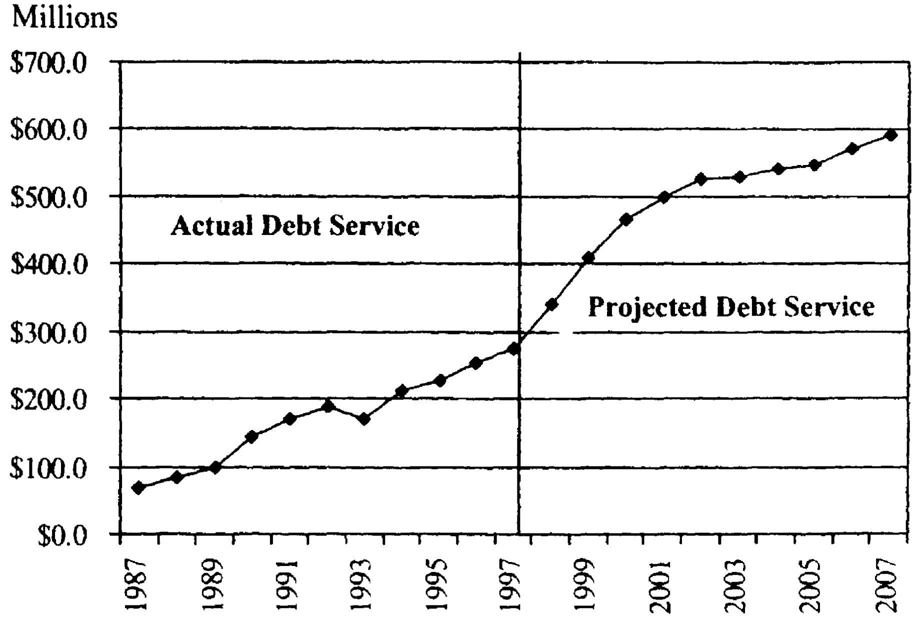
Commonwealth Debt



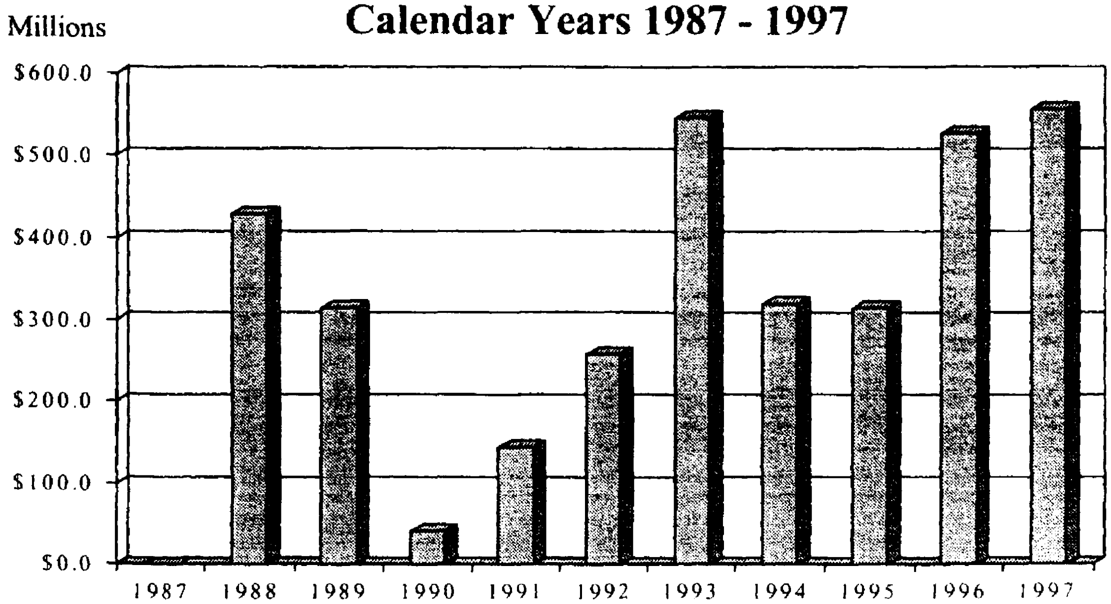


Commonwealth Debt

Tax-Supported Debt Service:Actual and Projected Fiscal Years 1987 - 2007



Trend in Tax-Supported Debt Issuance Calendar Years 1987 - 1997



The Debt Capacity Model (continued)

Breakdown of Tax-Supported Debt
As of June 30, 1997 Plus Fiscal Year 1998
Issuances through December 15, 1997*
(Dollars in Thousands)

• **9(a) Full Faith and Credit**		$ 70,460	2.0%
• **9(b) Full Faith and Credit**		$ 468,650	13.4%
• **9(c) Full Faith and Credit (Revenue)**		$ 601,752	17.3%
–Higher Education	$433,944		
–Transportation	154,948		
–Parking Facilities	12,860		
• **9(d) Debt**		$2,344,018	67.3%
–VPBA**	$902,604		
–Transportation Board	788,590		
–Port Authority	114,025		
–VCBA Equipment	92,870		
–VCBA - 21st Century Program	53,160		
–ITA	13,055		
–Biotech Authority	31,000		
–Regional Jails	102,897		
–Other Long Term Obligations ***	245,817		
TOTAL		$3,484,880	100.0%

** Does not include tax-exempt commercial paper.*
*** Net of unamortized discount.*
**** Capital Leases stated as of June 30, 1997 which includes Big Stone Gap Redevelopment and Housing Authority, Norfolk Redevelopment and Housing Authority, Brunswick County IDA, and Norfolk Industrial Development Authority and miscellaneous tax supported Capital Leases and Installment Purchases.*

Tax-Supported Debt Issuances in Fiscal Year 1998
As of December 15, 1997
(Dollars in Thousands)

Issuer	Date Issued	Amount
Commonwealth Transportation Board (Oak Grove Connector)	July 9, 1997	$ 33,075
Commonwealth Transportation Board (Revenue Refunding Bonds)	October 23, 1997	137,600
TOTAL		$ 170,675

The Debt Capacity Model (continued)

Authorized But Unissued Tax-Supported Debt As of December 15, 1997

(Dollars in Thousands)

Section 9(b) Debt:	
Higher Educational Institutions Bonds	$ 54,161
Mental Health Facilities Bonds	6,223
Park and Recreational Facilities Bonds	41,840
Subtotal 9(b) Debt:	$102,224
Section 9(c) Debt:	
Higher Educational Institutions Bonds	$ 27,200
Section 9(d) Debt:	
Transportation Contract Revenue Bonds (Rt. 28)	$ 54,092
Transportation Contract Revenue Bonds (Rt. 234)	95,000
Transportation Revenue Bonds (Rt. 58)	196,024
Transportation Revenue Bonds (Northern Virginia Transportation District Program)	10,000
Virginia Public Building Authority - Projects	126,967
Virginia Public Building Authority - Jails	169,384
Virginia College Building Authority - Equipment	39,650
Virginia College Building Authority -21st Century	109,840
Subtotal 9(d) Debt:	$800,957
Subtotal Bonded Debt	$930,381
Other Long-Term Obligations	$ 26,000*
Total	$956,381

**Capital lease project: Private 1,000 Bed Medium Security Prison-$26 million.*

Exhibit D

Moral Obligation Debt
And
Contingent Liability Debt

Moral Obligation Debt

- Definition of Moral Obligation Debt:
  - Usually applies to revenue bonds issued by state housing finance agencies or state-administered municipal bond banks.
  - Moral obligation pledge from government provides a deficiency make-up for bondholders should underlying project revenues prove insufficient.
  - Mechanics involve funding a debt service reserve fund when bonds are issued.
  - If revenue deficiency exists, reserve monies are used to pay bondholders.
  - Legislative body is informed so that reserve fund can be replenished before subsequent year debt service is due.

- Rating agencies do not include in tax-supported debt ratios as long as bonds are self-supporting.

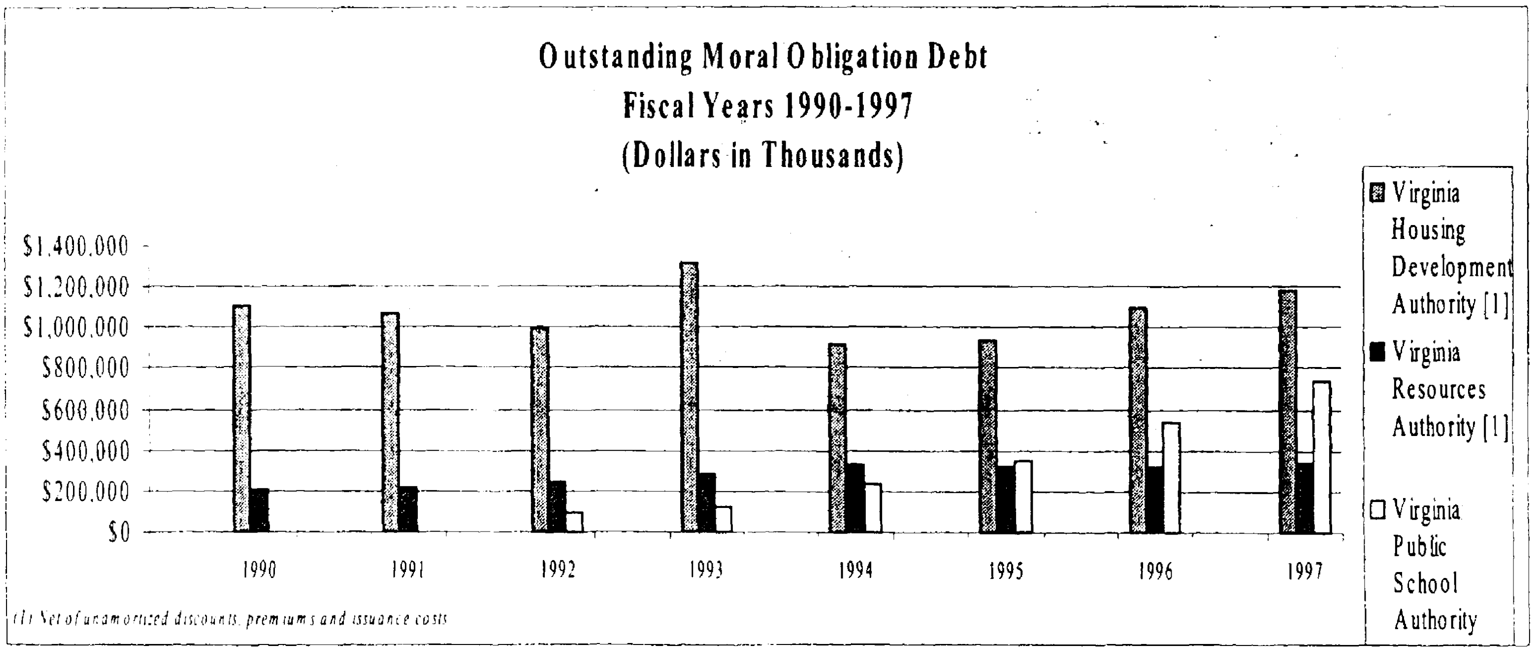
- Commonwealth Moral Obligation Debt Issuers:
  - Virginia Resources Authority
  - Virginia Housing Development Authority - Multi-Family Housing Bonds
  - Virginia Public School Authority - 1991 Resolution

Moral Obligation Debt

Outstanding Amounts as of June 30, 1997

(Dollars in Thousands)

Virginia Housing Development Authority	$1,179,782
Virginia Resources Authority	337,751
Virginia Public School Authority	739,140
TOTAL	$2,256,673



Moral Obligation Debt

Issuer	Statutory Limit	Outstanding At June 30, 1997	Available Authorization
Virginia Resources Authority	$ 550,000	$ 337,751	$ 212,249
Virginia Housing Development Authority	1,500,000	1,179,782	320,218
Virginia Public School Authority	800,000	739,140	60,860
Total	$2,850,000	$2,256,673	$ 593,327

Dates upon which issuers expect to meet or exceed statutory borrowing cap:

VHDA: June 2000 - Assumes issuance of $147 million per year.

VRA: May 2000 - Assumes normal issuance of $45 million per year plus two large projects totaling $125 million (would exceed during fiscal year 2004 without two projects).

VPSA: N/A - Has created a new bond resolution for pooled bond program. Does not expect to issue additional debt under 1991 Resolution.

Bond Ratings:	Fitch	Moody's	S&P
VHDA (Multi-Family):	N/R	Aa1	AA+
VRA:	N/R	N/R	AA
VPSA (1991 Resolution):	AA	Aa2	AA

Contingent or Limited Liability Debt

- To date, the only non-tax-supported debt obligations for which the Commonwealth has a contingent or limited liability are those which utilize a "sum sufficient appropriation" (SSA) to pay debt service included in the Appropriation Act.

- SSA used on certain revenue bonds issued by the Virginia Public School Authority under its 1997 Resolution. The Virginia Public School Authority has $224,285,000 of 1997 Resolution bonds outstanding as of December 1, 1997.

- VPSA 1997 Resolution ratings.

Fitch	AA+
Moody's	Aa1
S&P	AA+