COMMONWEALTH of VIRGINIA

Office of the Governor

Richard D. Brown
Secretary of Finance

P.O. Box 1475
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January 12, 2011

The Honorable Robert F. McDonnell
Governor of Virginia
Patrick Henry Building, 3rd Floor
Richmond, Virginia 23219

The Honorable Charles J. Colgan
Chairman, Senate Finance Committee
General Assembly Building, Room 626
Capitol Square
Richmond, Virginia 23219

The Honorable Lacey E. Putney
Chairman, House Appropriations Committee
General Assembly Building, Room 947
Capitol Square
Richmond, Virginia 23219

Dear Governor McDonnell, Senator Colgan, and Delegate Putney:

Item C-85 of the current Appropriation Act (Chapter 874, Acts of Assembly 2010) requires the Secretary of Finance to submit a plan for the issuance of debt for certain projects contained in that Act. The plan for issuance is to stay within the limits of debt capacity reported by the Debt Capacity Advisory Committee.

Please find attached, my report setting forth an issuance plan to meet the requirements of this provision. My plan calls for the issuance of debt during the current biennium for the full authorization for the first three priority categories of projects. These include Maintenance Reserve, Higher Education Equipment Trust Fund, and Equipment for Previously Funded Projects.

I have deferred any recommendation for issuance of debt for Priority 4 (Construction Funds for Projects with Completed Funding) and Priority 5 (Improvements: Energy Conservation) projects, as these projects continue to be reviewed by the Six-Year Capital Plan Advisory Committee. Information is being obtained on whether these projects have completed planning and on how current cost estimates compare to those originally assumed for the projects when planning funds were provided. Subsequent revisions to the plan may be necessary once this analysis is complete.

I would note that my recommendations are consistent with the actions included in the introduced budget bill which will be before the 2011 General Assembly. The introduced budget bill contains the additional debt service necessary for the issuance of these bonds.

Should you have any questions regarding this plan, do not hesitate to contact me.

Sincerely,

Richard D. Brown

Attachment

c The Honorable Martin L. Kent, Chief of Staff
Betsey Daley, Staff Director, Senate Finance Committee
Robert Vaughn, Staff Director, House Appropriations Committee

Plan for Issuance of Debt Projects
Pursuant to Item C-85, Chapter 874, Acts of Assembly 2010

Background

The current Appropriation Act (Chapter 874, Acts of Assembly 2010) requires the Secretary of Finance to prepare a plan for the issuance of debt for capital projects authorized in Item C-85 of the Appropriation Act and for projects authorized in Item C-84, Central Maintenance Reserve, Item 245 Higher Education Equipment Trust Fund and Item C-86, Improvements: Energy Projects. The plan is to include a schedule for issuance of debt to fund projects in the following priority order:

Priority 1: Maintenance Reserve
Priority 2: Higher Education Equipment Trust Fund
Priority 3: Equipment for Previously Funded Projects
Priority 4: Construction (funds for projects with completed planning)
Priority 5: Improvements: Energy Conservation

In addition, the Plan is to take into account the most recent recommendations of the Debt Capacity Advisory Committee so that the schedule for the issuance of debt for the affected projects stays within the limits of debt capacity established by the Debt Capacity Advisory Committee.

Findings of Debt Capacity Advisory Committee

The Debt Capacity Advisory Committee is required, pursuant to §2.2-2713 of the Code of Virginia to annually review the size and condition of the Commonwealth's tax supported debt and to submit to the Governor and General Assembly an estimate of the maximum amount of new tax supported debt that prudently may be authorized and issued. On December 29, 2010, the Debt Capacity Advisory Committee issued its report, which included some revisions in Virginia's established debt capacity model.

The primary changes adopted by the Committee result in the inclusion in the model of certain additional revenue and transfer items that are part of the state's official general fund forecast, and an adjustment to debt service for amounts expected to be paid from nongeneral fund sources. The determination of debt capacity, however, continues to be based on the stringent five percent measure of debt service to blended revenues. So, the basic workings of the model do not change.

Additional changes were made to alter how available debt capacity was allocated to each year within the ten-year period. Previously under our debt capacity model, debt capacity was allocated so that projected debt service costs did not exceed a five percent cap in any single year. In times when revenue grew slower in the near term than in the out years, this meant that less capacity was assigned to the earlier years and more capacity was assigned to the out years to stay within the overall five percent cap. Conversely, when revenues had greater growth in the near term than out years, there was more capacity distributed upfront and less assigned to the out years to stay within the five percent cap. Because of the fluctuations in available debt capacity among individual years under this allocation method, the results were not conducive to long-term capital planning.

Accordingly, on November 30, 2010, the Debt Capacity Advisory Committee voted to change the allocation procedure so that an average yearly amount would be assigned each year over the ten-year period. This average provides a uniform amount of debt capacity each year and eliminates the wide fluctuations found in the previous allocation scheme. This action was intended to add stability to the model and facilitated long-term capital outlay planning. It should be noted that the amount of debt capacity remains the same over the ten-year period notwithstanding the change in allocation procedure.

Based on these revised assumptions and changes, the Committee estimated that an additional $363 million in debt could be authorized in each fiscal year over the entire ten years covered by the model. This amount will cause the projections of debt service as a percent of blended revenues to exceed five percent in some years and be below that level in other years. Over the ten-year horizon, however, debt capacity stays within the prescribed five percent limit.

Analysis of Current Situation

Each year the Debt Capacity Advisory Committee updates the debt capacity model to account for all authorized tax supported debt. For debt authorizations that have yet to be issued, the Committee makes assumptions as to how that debt will be floated in the future. Even though the release of these projects (authorized by the 2010 General Assembly) is dependent on the recommendations in this report, the Committee included an assumption about how the debt for these projects would be issued in future years.

The Debt Capacity Advisory Committee assumed that $91.3 million for these projects would be issued in FY2011. This includes $65.0 million for maintenance reserve projects in Item C-84 and $26.3 million for equipment for previously funded projects specified in Item C-85 paragraph A. The Committee also assumed that $162.0 million for these projects would be issued in FY2012. This includes $50.0 million for maintenance reserve projects specified for the second year in Item C-84 and $112 million for the Higher Education Equipment Trust Fund authorizations included in for the second year Item 245.

Taken together the above assumptions mean that all of the currently authorized debt for capital projects in Priority 1: Maintenance Reserve, Priority 2: Higher Education Equipment Trust Fund, and Priority 3: Equipment for Previously Funded Projects are presently in the debt capacity model. The $363 million in additional debt capacity is over and above the assumed release of these projects. Therefore, the only projects that would need to come out of the additional $363 million would be the projects included in Priority 4: Constructions (funds for projects with completed planning) and Priority 5: Improvements: Energy Conservation. There is no specific assumption about the issuance of debt for Priority 4 and Priority 5 projects in this biennium. However, the Debt Capacity Advisory Committee did assume that starting in fiscal year 2013, at least $215 million per year would be issued to fund, in part, these projects. The $363 in additional capacity is over and above that assumed issuance.

Since the release of the Debt Capacity Advisory Committee's report, the Department of Treasury has examined how debt capacity would change assuming the 2011 General Assembly enacts all of the provisions affecting tax supported debt in the introduced budget bill. Proposed authorizations in the introduced bill include \$8.6 million for additional maintenance projects, \$44.5 million for equipment for previously funded projects and \$7.3 million to pay off obligations on a completed project and \$43.5 million for a new facility to house sexually violent predators. Assuming all of these authorizations (as well as the Governor's proposal to raise the annual cap on the 2007 transportation bonds from \$300 million to \$600 million a year) are approved, additional debt capacity per year would be reduced from \$363 million to \$353 million.

The foregoing analysis suggests that there is sufficient debt capacity to begin releasing some of the projects presently on hold pending the issuance of this report.

Recommendation on Bond Issuance Schedule

Based on the findings of the Debt Capacity Advisory Committee and the above analysis of available debt capacity, the following schedule is recommended for the issuance of debt for the affected projects in Appropriation Act within the specified priority scheme during the remainder of this biennium.

	Issuance Amount \$ in Thousands	
	FY2011	FY2012
Priority 1: Maintenance Reserve	\$65,000	\$46,540
Priority 2: Higher Education Equipment Trust Fund	0	112,106
Priority 3: Equipment for Previously Funded Projects	26,276	0
Total	\$91,276	\$158,646

[a] Does not include projects recommended for debt financing in the introduced 2011 budget bill.

As for projects in Priority 4: Construction (funds for projects with completed planning) and Priority 5: Improvements: Energy Construction, no action is recommended for issuance at this time until the Six-Year Capital Outlay Plan Advisory Committee established by §2.2-1516, Code of Virginia can more completely review these projects. As part of the review, it is anticipated that the Six-Year Capital Outlay Plan Advisory Committee will obtain complete documentation on exactly where each of these projects are in the planning cycle. Moreover, for projects that have complete detailed planning (projects ready to go to bid), information is needed on how the cost estimates derived from the detail plans compare with the original cost estimates for the projects. Once this determination is made, it is anticipated that certain of projects within these two remaining priorities could move forward within existing debt capacity constraints (provided these projects have completed planning with acceptable cost estimates).

Subsequent action to release Priority 4 and Priority 5 projects could take place as an addendum to this report (once the required analysis is in place) or the General Assembly could take action within the enacted budget to release some of these projects by specifically designating in language which projects could to go forward. Either way, more information is needed about the specifics of these projects before the issuance of debt can be scheduled. Thus, they are not addressed in terms of this issuance plan.