Overview of State Debt and Lease-Purchase Financing

September 27, 2011

Appropriations Subcommittee on Debt

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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 – unlike bonds, there is no dedicated source of repayment

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Lease-Purchase Financing vs. Bonds

- Lease-purchase financing has no dedicated 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

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Uses For State Debt and Lease-Purchase Financing

- State owned capital facilities/uses
- School Facilities Board to fund local new school construction
- Financing has recently been used for operating expenses

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In The Past Two Fiscal Years, State Has Used Debt/Lease-Purchase Financing For $1.5 B Worth of Budget Solutions

FY 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
- $450 M from the issuance of lottery revenue bonds
  - Debt service paid from General Fund portion of lottery revenues – represents foregone revenues

FY 2011

- $60 M from the refinancing of outstanding SFB lease-purchase agreements

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State Building Sale/Leaseback Used Over $1.0 B Of Properties As Collateral For Transaction

- During lease-purchase transaction, properties serve as collateral for potential non-payment
- Investors required the State to transfer titles of properties with a replacement value of at least $1.0 B to be held by trustee
- When the outstanding lease principal falls below the value of the buildings, properties may be released from the transaction and no longer serve as collateral – they are "bought back".

State Building/Property	Replacement Value
State Capitol/Exec. Tower	$81 million
State Prison Complexes	$265 million
State Hospital	$180 million
State Fair Coliseum	$84 million
Other State Buildings	$519 million
Total	**$1.1 billion**

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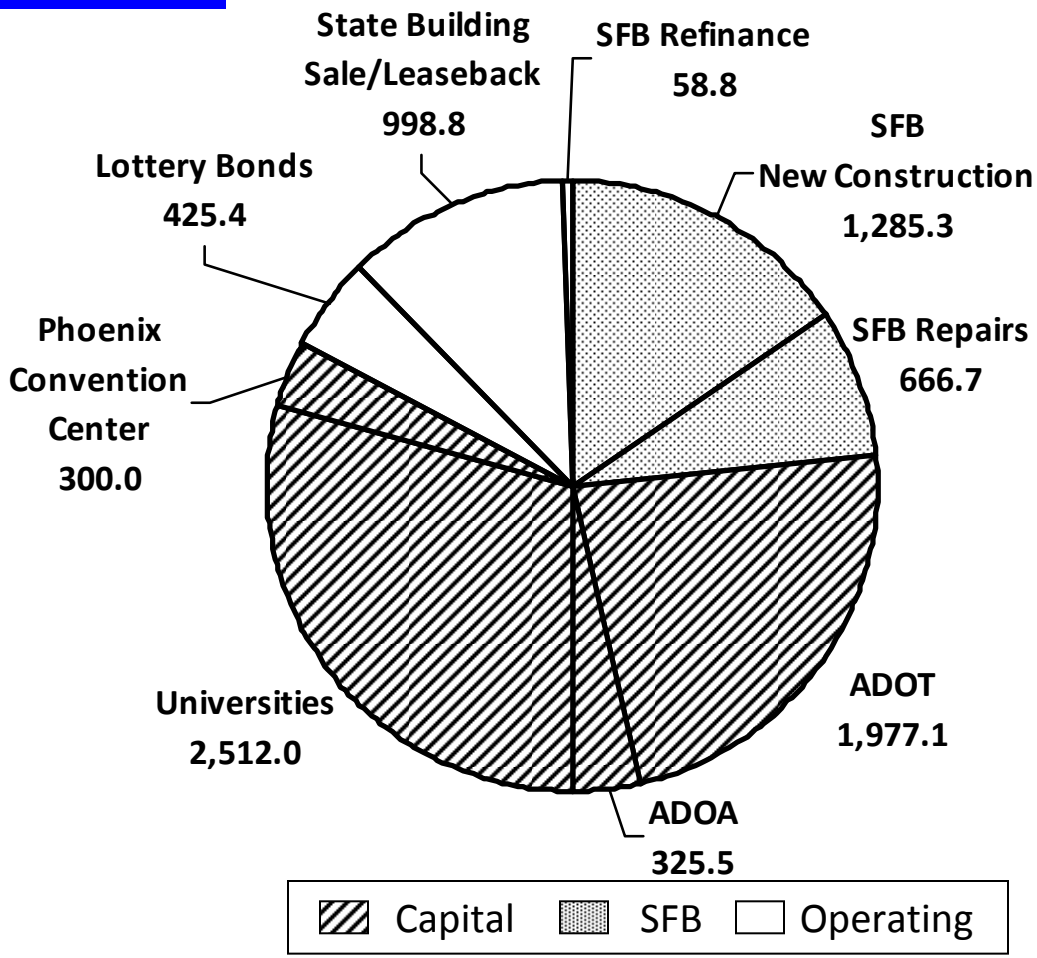
Total Outstanding State Debt/Lease-Purchase Financing is $8.5 Billion

- Reflects Multiple Payment Sources Including the State General Fund, Highway User Fees, Lottery Proceeds and University Tuition

Outstanding Balances	
Capital Facilities/Uses	$ 5.1 B
School Facilities Board	$ 1.9 B
Operating	$ 1.5 B



$ in Millions

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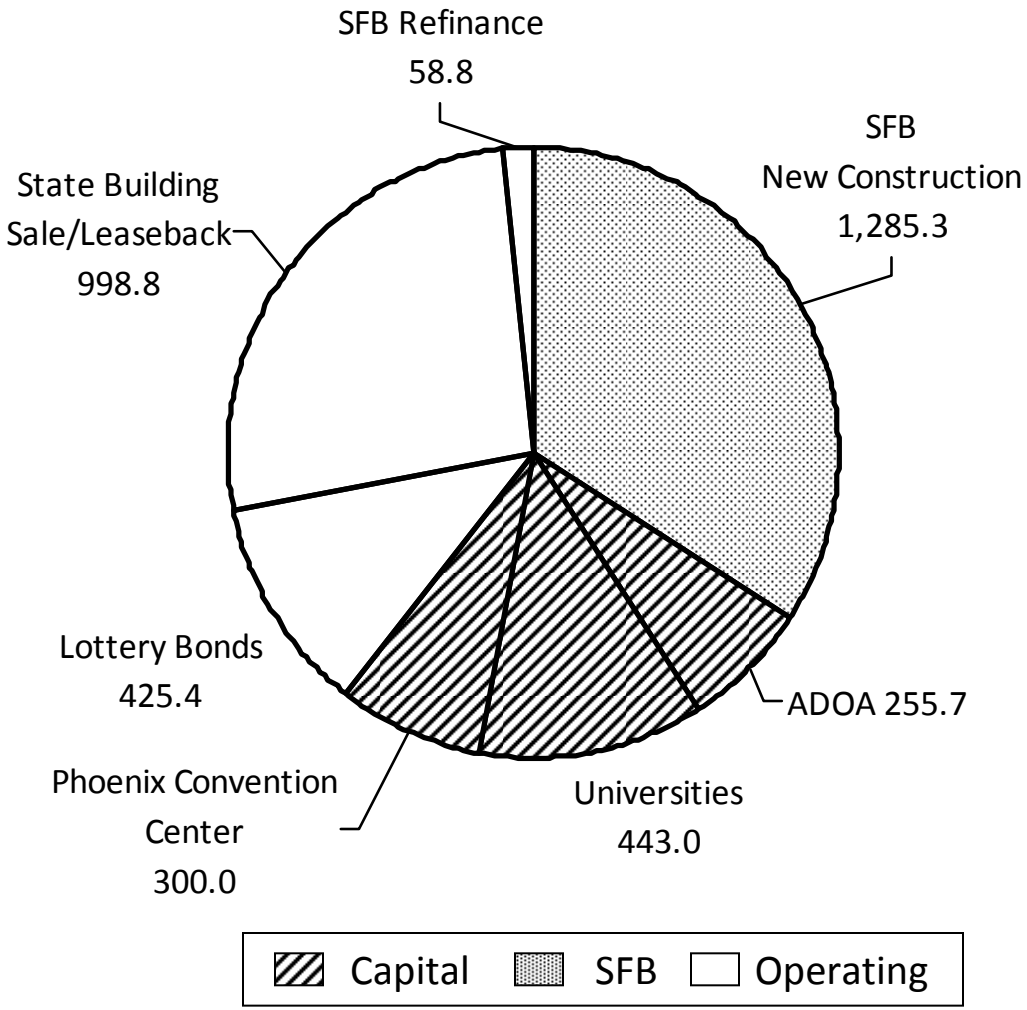
Total Outstanding General Fund Debt/Lease-Purchase Financing is $3.8 Billion

Outstanding Balances	
Capital Facilities/Uses	$ 1.0 B
School Facilities Board	$ 1.3 B
Operating	$ 1.5 B



$ in Millions

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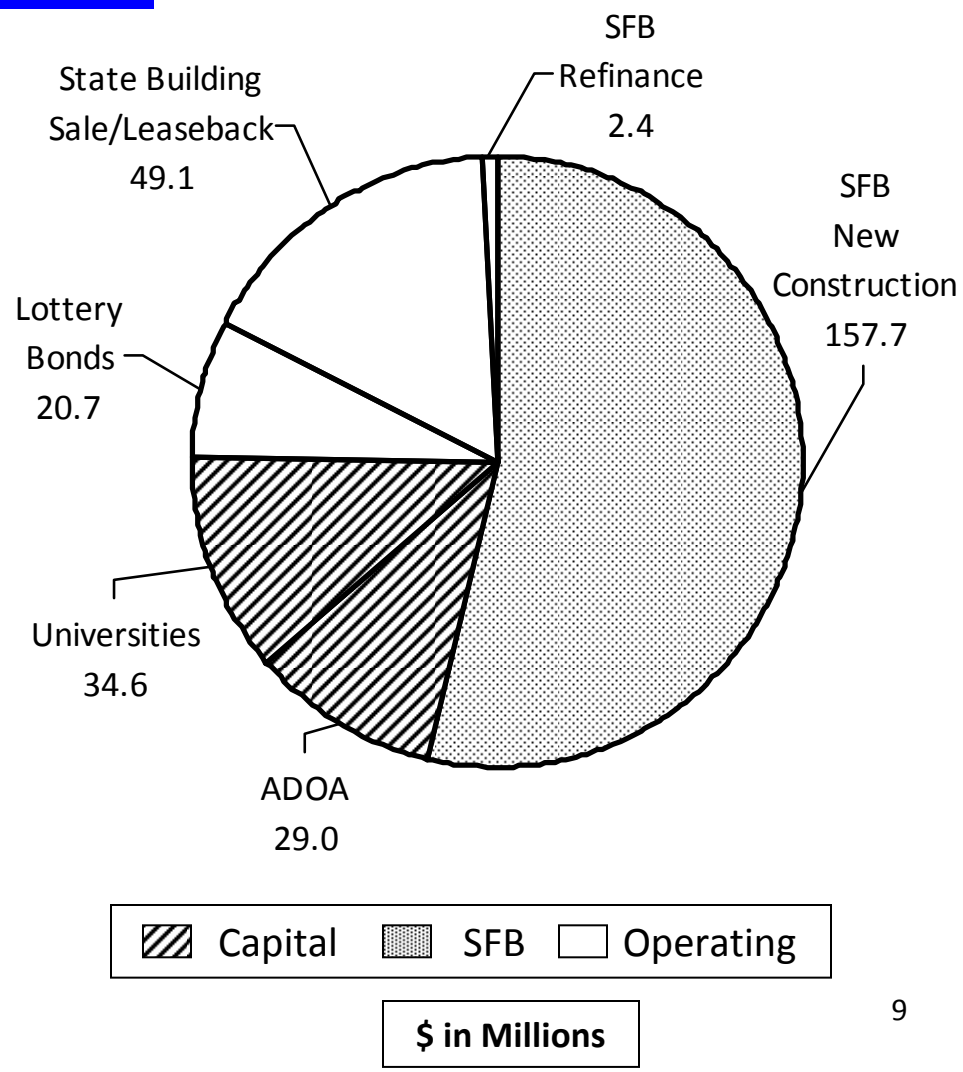
General Fund Debt Service/Lease-Purchase Financing Will Cost $293 M in FY '12

- Represents 7th Largest Budget Unit

Annual Payments	
Capital Facilities/Uses	$ 63 M
School Facilities Board	$ 158 M
Operating	$ 72 M



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State Retired $17 M of Outstanding General Fund Lease-Purchase Financing in FY 2011

- Final payments were made on 6 state buildings in FY ’11
- In FY ’12, several other state buildings have their final scheduled payment, some of which declined from the prior year
- In total, the FY ’12 budget includes $16.5 M of net savings related to the retiring of state office building lease-purchase agreements

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Levels of State Debt Can Impact Amount of Local Debt As Well

- Significant amount of State debt relates to K-12 capital facilities – financing has funded both repairs and new schools
- Changes in State funding can affect the amount of local funds used for facilities
- Statute allows school districts to issue "Class B" bonds to finance capital needs
  - Require voter approval
  - Amount of outstanding district bonds limited by property values

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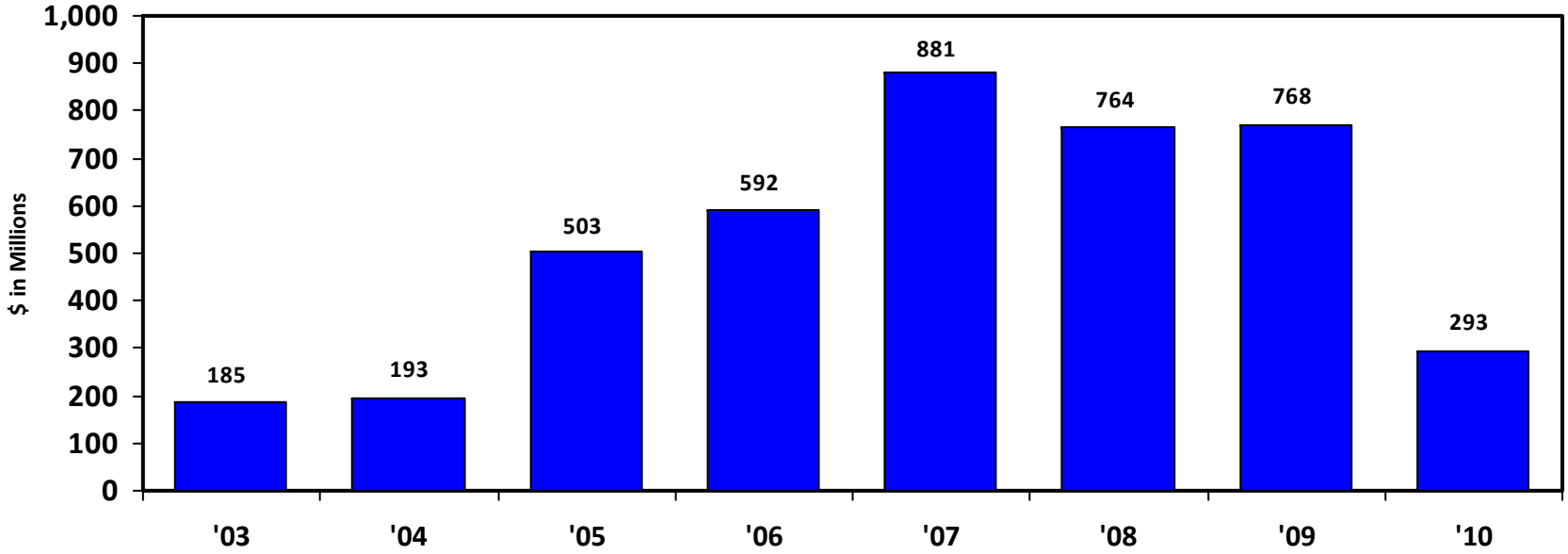
School Districts Have Issued Significant Amount of Class B Bonds Over The Last Decade

- School districts have issued $4.2 B of Class B Bonds since FY 2003 – excludes refinancing



- Of the 168 bond elections held since FY 2003, 155 or 92% of issuances were approved. District voters have approved the sale of approximately $5.0 B in bonds (includes refinancing)

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State Fiscal Policy As Measured By Its Credit Rating - Rating is Lower Than Most Other States

- Still Investment Grade – 4th highest level (out of 10) but only 2 states have lower Moody's rating
- Last downgrade in July 2010 due to:
  - Economic and financial weakness
  - Structural imbalance and reliance on one-time solutions
  - Constitutional limits on raising revenues and reducing spending
- But outlook remains "negative" reflecting:
  - Continued economic weakness and concerns about housing sector
  - Uncertainty regarding implementation of enacted FY '12 budget reductions

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The Impact of the Federal Downgrade On Arizona Is Uncertain At This Time

- Shortly after the August federal deficit reduction legislation was approved, Standard & Poor's (S&P) downgraded the United States' credit rating from AAA to AA+. The other major credit rating agency (Moody's) lowered its outlook on the U.S. credit rating to negative.
- It is difficult to predict what impact these events may have on Arizona's budget – analysts have suggested states with a high proportion of Medicaid spending or economic activity dependent on federal spending may experience pressure on their credit ratings and budgets due to future deficit reduction activity.