

**DEBT CAPACITY ADVISORY COMMITTEE
COMMONWEALTH OF VIRGINIA
December 19, 2018**

1:30 P.M.

TREASURY BOARD CONFERENCE ROOM

James Monroe Building
101 North 14th Street, 3rd Floor
Richmond, Virginia 23219

Members Present:

Aubrey L. Layne, Jr., Chairman
Manju S. Ganeriwala
Harold E. Greer
April R. Kees
Martha S. Mavredes
Ronald L. Tillett
Daniel S. Timberlake
Robert P. Vaughn
David A. Von Moll

Members Present Via
Teleconference:

Jody M. Wagner

Others Present:

David Swynford, Department of the Treasury
Janet A. Aylor, Department of the Treasury
Bradley L. Jones, Department of the Treasury
Sherwanda Cawthorn, Department of the Treasury
James Mahone, Department of the Treasury
Joe Flores, Deputy Secretary of Finance
Tony Maggio, House Appropriations Committee Staff
Jason Powell, Co-Director, Senate Finance Committee
Kimberly Sarte, Joint Legislative Audit & Review Commission
Matt Bowen, Bank of America

Call to Order and Opening Remarks

Chairman Layne called the meeting to order at 1:31 p.m. and welcomed the attendees, including Debt Capacity Advisory Committee (“DCAC” or the “Committee”) member Jody Wagner who was joining the meeting via teleconference. The Chairman noted the Draft DCAC Report before the Committee was based on the Governor’s Introduced Budget.

Public Comment Period

During the public comment period, Chairman Layne asked if anyone present desired to make public comments.

There were no public comments.

Approval of Minutes

Chairman Layne asked the Committee for a motion to approve the minutes of the December 19, 2017 meeting. Mr. Timberlake made a motion to approve the minutes. Ms. Mavredes seconded the motion and it carried unanimously by the members.

Review of the 2018 DCAC Report

Chairman Layne asked Mr. Jones to present the 2018 Draft DCAC Report. (Exhibit 1) Mr. Jones provided a few comments before reviewing the DCAC Report, which included: a recognition of the enactment of a structurally balanced budget; planned deposits to reserve funds; action by Standard & Poor's Global Ratings ("S&P) to return the Commonwealth's bond outlook to Stable; and a fiscal year-end 2018 revenue surplus of more than \$550 million. He noted these items provide positive momentum for fiscal year 2019.

To begin the review of the materials contained in the 2018 Draft DCAC Report, Mr. Jones directed the Committee to the section titled Potential Influencing Factors for Virginia's Fiscal Position. He noted the following positives for Virginia: Amazon's selection of Virginia for a HQ2 site; the Federal Tax Cuts and Jobs Act ("TCJA") impact on fiscal year 2018 state tax revenues and the anticipated increase of additional state tax revenues in future years assuming tax conformity; and anticipated additional internet sales tax revenues based on the Supreme Court's decision in South Dakota v. Wayfair. He noted that from a risk standpoint, Medicaid is a significant budget driver and remains a difficult variable to predict, but that based on the positives, the Commonwealth should have greater flexibility to address any increased costs. As an additional risk, he noted bond interest rates are anticipated to continue rising. He explained the market volatility experienced over the last year, along with the general increase in rates. He reminded the Committee that the DCAC Model interest rate is based on the average of the last 12-quarters of the Bond Buyer 11-GO Index rate plus 25 basis points. He noted that despite a year-over-year increase of 85 basis points in the Bond Buyer 11-GO Index rate from December 2017 to December 2018, the DCAC Model interest rate only increased five basis points to 3.40%. He explained the limited increase to the Model interest rate was due to all-time low rates experienced in 2016 still included in the rate calculation. Mr. Jones stated there is the potential for the Commonwealth's future debt issuances to exceed the interest rate assumed in the Model. He noted that there is \$5 billion of authorized and unissued debt as of June 30, 2018, which makes a potential increase in interest rates the factor that would cause the most impact to debt capacity.

During the review of the potential factors, Mr. Tillett asked if any debt related to Amazon incentives was included in the Model. It was explained to the Committee that the Model contains only actual debt service on debt issued as of June 30, 2018 and modeled debt service on debt authorized and unissued. It was reiterated that no proposed debt for Amazon or any proposed debt contained in the introduced budget was included in the base Model. Also during the review, Mr. Tillett provided comments on the financial market. In response to an issuance timing question by Mr. Vaughn, it was explained that bond issuances are not grouped together or based on projected changes in interest rates but rather are issued on an as-needed cash flow basis. Common Plan of Finance and arbitrage issues, both of which impact the timing of bond issuances, were explained. In addition, it was noted that the TCJA eliminated the ability to advance refund bonds on a tax-exempt basis; therefore, it is anticipated there will be limited opportunities to refund bonds for debt service savings.

Mr. Jones then reviewed Trends in Tax-Supported Debt. He noted that for the last ten years, outstanding tax-supported debt steadily increased. Between fiscal year 2017 and fiscal year 2018, outstanding tax-supported debt increased \$0.5 billion, which is equivalent to 2%. He attributed the fiscal year 2018 increase to 9 (d) debt and the general increase in outstanding tax-supported debt to both 9 (d) debt and pension and other post-employment benefit (OPEB) liabilities. Mr. Jones then noted the following outstanding balances as of June 30, 2018: \$1.31 billion of General Obligation (G.O.) debt; \$10.35 billion of 9 (d) debt; and \$10.22 billion of other long-term obligations. He specified that the other long-term obligations were mostly attributable to \$6.7 billion of pension liabilities and \$2.8 billion of OPEB liabilities.

Mr. Jones then reviewed additional tax-supported debt trends. He noted that during fiscal year 2018, net authorizations of tax-supported debt amounted to \$1.26 billion, while new money issuances, which exclude refundings, totaled \$1.25 billion. He also noted that of the uses of outstanding tax-supported debt over the last 10-years, higher education utilized slightly over 50% of all debt and transportation projects consisted of approximately 25%. Mr. Jones noted that annual debt service on tax-supported debt is approximately \$1 billion and is anticipated to increase to approximately \$1.2 billion without any new authorizations.

The Committee was then directed to the section titled Review of State Credit Ratings. It was again noted that S&P returned the Commonwealth's bond outlook to Stable in June 2018. It was commented by Mr. Jones that rating agencies will be watching for continued strong fiscal management and conservative budgeting practices. He also noted that rating agencies have been closely following state and local pension and OPEB liabilities. He commented that pension and OPEB liabilities, as well as resiliency efforts related to natural disaster events and sea level rise will likely remain the focus of rating agencies in the coming years.

Mr. Tillett asked Mr. Jones if he had seen any pension buyouts discussed in the news recently. Mr. Jones responded that he had not seen much on this topic beyond one state. Mr. Tillett provided comments regarding a state that had recently completed this action and another that was considering similar action.

Mr. Jones then proceeded to the section titled Review of Comparative Ratios. He stated that in the most recent Moody's Medians Report, Moody's noted slow growth in net tax-supported debt (NTSD) for the nation and that Moody's expects the trend to continue. He commented that Virginia has been opposite of the national trend. He noted NTSD per capita increased for Virginia to \$1,515, which resulted in a ranking of 19th highest. He also noted that Virginia's NTSD as a percentage of personal income remained at 2.9%; however, the Commonwealth went from 21st highest last year to 19th highest in the most recent report. He then directed the Committee to the charts and graphs in that section comparing Virginia to the 50-state median and the triple-triple A median.

Mr. Jones asked if there were any questions on the front section of the DCAC Report. Hearing no questions, he began his review of Appendix A.

Mr. Jones directed the Committee to page A-4 and noted the breakout of the planned authorized and unissued debt issuance assumptions contained in the DCAC Model. He then reviewed the Base Model Solution on page A-5. He noted that as a result of increased forecast revenues compared to last year and a fairly stable Model interest rate, the debt capacity estimate increased to \$647 million a year from \$580 million a year. He then reviewed the results of applying the Average Model Solution. He noted that if \$647 million was assumed to be authorized and issued in each year, the 5% threshold was estimated to be crossed in four of the ten years (2021-2024).

When the Model Solutions were reviewed, Mr. Vaughn had a question concerning the specifics of any new revenues included in the Blended Revenues. Mr. Jones said Blended Revenues included revenues related to the TCJA, as well as Amazon and Wayfair, but he was unable to provide any specifics regarding what Amazon revenues were included or the magnitude of the internet sales tax revenues. Mr. Vaughn and Ms. Kees expressed concern about potentially recognizing Amazon revenues too early and also the inclusion of internet sales tax revenues, given it is a policy consideration to be discussed by the General Assembly. In addition, Mr. Vaughn expressed concern regarding the inclusion of any one-time, temporary tax revenues related to tax conformity for individual income taxes. Chairman Layne noted that the revenues were provided by the Department of Taxation. It was noted that in the past, the forecasts, as presented by the Governor, have been included in the Model. Mr. Jones noted that in 2017, the Committee presented the report and cover letter with the recommendation based on the traditional forecast model, but that an additional note was included in the report and the cover letter regarding the impact on capacity should Medicaid expansion not have been passed and provider assessments not have been eligible revenue. It was suggested by Ms. Kees and Mr. Vaughn and the consensus of the Committee that one-time, temporary revenues and any policy or economic development project revenues either not be included in the Model, or those amounts should clearly be indicated as to their impact in the recommendation letter.

Mr. Jones then reviewed the Sensitivity Analysis section. He noted that of particular importance, if the Model interest rate was to be increased by 100 basis points, debt capacity is estimated to decline to \$569 million.

He then reviewed the Moral Obligation and Contingent Liability Debt section. He noted Virginia Resources Authority (“VRA”) had \$928 million of moral obligation debt outstanding as of June 30, 2018 and Virginia Public School Authority (“VPSA”) had nearly \$3 billion of sum sufficient appropriation debt outstanding. He noted that if all VRA debt was assumed into the Model, resulting capacity would decline to \$569 million a year. Similarly, he noted that if all VPSA debt was assumed into the Model, resulting capacity would decline to \$405 million annually.

Mr. Jones asked if there were any questions or further comments on the draft report. While there were no questions, Mr. Tillett provided comments about the history and the importance of the DCAC.

Mr. Jones directed the Committee to the draft cover letter to accompany the report. Mr. Vaughn and Ms. Kees again expressed concern regarding Blended Revenues reflecting potential temporary and policy related revenues. It was agreed the cover letter and report would be revised based on the discussion.

Secretary Layne asked for a motion that the Debt Capacity Recommendation Letter and Report be approved subject to the discussed changes. Mr. Vaughn moved that subject to the discussed revisions the report be adopted. Mr. Tillett seconded the motion and it carried unanimously by the members.

Other Business

Secretary Layne asked if there was any other business to be discussed. No members voiced any other business. Secretary Layne then said that subject to any mid-session General Assembly actions the DCAC might be convened again if needed.

With no further business, the meeting adjourned at 2:25 p.m.

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