RIPEC

Comments on Your Government

A SPECIAL PUBLICATION OF THE RHODE ISLAND PUBLIC EXPENDITURE COUNCIL

Analysis of Rhode Island's Budget Outlook, Debt Position and 2018 Ballot Initiatives

The purpose of this RIPEC Comments is to assist voters as they consider the three bond referenda on this November's ballot. The report provides an updated look at the state's FY 2019 budget and out-years, based on the preliminary FY 2018 closing, as well as Rhode Island's current debt position. The report also summarizes the 2018 ballot initiatives, and although RIPEC does not take a position on the initiatives, it includes a number of questions for voter consideration.

Introduction

This November, Rhode Island voters will be asked to consider three ballot questions, which would authorize $589.5 million in additional debt costs, accounting for estimated interest and borrowing costs.[1] To assist voters as they consider these ballot initiatives, this report provides an updated look at the state's FY 2019 budget and out-years, based on the preliminary FY 2018 closing, as well as Rhode Island's current debt position. The report also includes a summary of the 2018 ballot initiatives, and includes a set of questions for voter consideration. The purpose is to provide voters with information regarding the current financial position of the state and other related issues, which may be helpful when deciding whether to approve the referenda.

The preliminary, unaudited FY 2018 year-end statement, released by the State of Rhode Island Office of Accounts and Controls, shows a closing surplus of $45.5 million. One should note that these year-end numbers are preliminary and subject to change in the final audit. Table 1 shows the budget statement for the FY 2018 budget as enacted, and the preliminary closing amounts based on the State Controller's report. Revenues were less than enacted by $2.1 million, and general revenue expenditures were $16.3 million less than enacted, after taking into account $10.1 million in reappropriations that will be carried over into FY 2019. After the transfer to the budget reserve, the resulting surplus was $14.3 million higher than what was assumed when the budget passed.

Although FY 2018 appears to have closed with a higher-than-anticipated surplus ($45.5 million versus the anticipated $31.3 million in the budget as enacted), out-year budget deficits are projected from FY 2020 onward. Based on RIPEC estimates that incorporate the preliminary FY 2018 closing, Rhode Island will have a projected closing surplus of $14.5 million in FY 2019,

[1] Rhode Island Secretary of State 2018 Voter Information Handbook.

though this estimate is subject to change following the November Revenue and Caseload estimating conference and the Budget Office first quarter report. Despite this potentially encouraging news, expenditure growth is projected to continue to outpace growth in revenues, perpetuating the state's cycle of out-year deficits. By FY 2023, the state will face a deficit ranging between $191.1 and $227.0 million (a more detailed review of the state's current budget position is included in the final section of this report).

Even with the higher-than-anticipated closing, out-year deficits will continue to hamper the state's ability to support long-term investments. Unless the state's structural deficit is resolved, the state will continue to have to choose between making investments in its future and relying on short-term financial fixes and one-time solutions.

Table 1

Preliminary FY 2018 Budget Statement ($ millions)

	Budget	Preliminary-Unaudited
Opening Surplus/Deficit	$61.7	$61.7
Reappropriated Surplus	10.3	10.3
General Revenues	3,910.5	3,908.4
Total FY 2018 Revenues	*$3,982.5*	*$3,980.4*
General Revenue Expenditures	$3,832.0	$3,805.7
Reappropriations (carried forward to 2019)	-	10.1
Total FY 2018 Expenditures	*$3,832.0*	*$3,815.8*
Balance	*$150.4*	*$164.6*
Transfer to Budget Reserve	($119.2)	($119.1)
Closing Surplus/Deficit	**$31.3**	**$45.5**

Source: House Fiscal Advisory Staff, FY 2019 Budget as Enacted; State Controller, FY 2018 Closing Statements - Preliminary Unaudited, Aug. 31, 2018.

One consideration is the state's capital budget and debt level. Capital investments provide both needed infrastructure improvements and boosts to the state's economy. However, how the state funds these projects – particularly with regard to increased debt – is an important consideration. Although the state has made significant improvements in debt management in recent years, it still ranks in the top half of the country for debt per capita and as a share of personal income.

Given the state's fiscal and economic outlook, RIPEC encourages taxpayers to think about the following questions when deciding whether to approve new debt in November:

- Which projects will result in investments that will strengthen the state's economy and help grow and retain jobs?
- Do some of the proposed projects represent higher priorities than others given finite resources?
- What is the "opportunity cost" of these projects if they are not approved?
- Do the benefits outweigh the costs of the project when interest costs are taken into account?
- Will these projects help the state achieve its policy goals?
- Given the current state employment outlook, is the pricing structure for these projects (including labor) optimal?
- How would approving these new bond proposals impact the state's ability to borrow for other essential capital improvement projects in the future?

Rhode Island's Capital Budget & Debt Position

As opposed to state operating budgets, capital budgets provide funding for multiple years and typically include projects that are unique and unlikely to be repetitive; are tangible and readily identifiable; involve a larger financial magnitude than many operating budget projects; and have long-term future consequences. Capital projects for FY 2019 to FY 2023 cover transportation, natural resources, public safety, education, human services, and general government functions.

The Assembly's adopted plan for the 5-year capital budget encompassing fiscal year 2019 to 2023 includes total capital outlays of $4,920.8 million, financed through the issuance of $1,251.0 million of debt and $3,669.8 million from current revenue streams (pay-go). According to the House Fiscal Advisory Staff, major funding sources include federal funding (33.6 percent), private funding (27.6 percent), the Rhode Island Capital Plan Fund (13.4 percent), and general obligation bond debt issuances (11.3 percent).[2]

Table 2
Rhode Island's Net Tax-supported Debt ($ thousands)

	2016	2017	2018
Direct Debt			
Various Purpose Bonds Outstanding	$ 1,051,810	$ 1,091,385	$ 1,159,995
Proposed General Obligation Bond Issuance	-	-	-
Subtotal	$ 1,051,810	$ 1,091,385	$ 1,159,995
Other Debt Subject to Annual Appropriation			
Convention Center Authority Outstanding	$ 203,880	$ 192,440	$ 196,360
RI Commerce Corp.-Transportation (motor fuel)	53,965	49,765	35,020
RI Commerce Corp.-URI Power Plant	4,585	3,520	2,405
RI Commerce Corp.-Job Creation Guaranty	54,866	42,455	33,000
RI Commerce Corp.-I-95 Land Sale	38,400	38,400	38,400
CP-DLT Howard Complex	930	-	-
CP-Shepard's Building (originally EDC)	2,940	-	-
CP-Pastore Center Power Plant	10,145	8,000	6,265
CP-Kent County Courthouse	30,515	27,310	23,940
CP-Traffic Tribunal Court Complex	12,510	11,320	10,085
CP-Training School	30,655	27,835	24,895
CP-Information Technology	36,195	31,255	27,725
CP-School for the Deaf	22,775	19,635	19,635
CP-CCRI Energy Conservation	3,635	2,955	2,250
CP-DOA Energy Conservation	37,785	37,497	32,267
CP-URI Energy Conservation	13,750	18,523	16,785
CP-RIC Energy Conservation	7,465	7,465	7,125
CP-Nursing Education Center	-	9,050	8,310
Projected CP-URI Energy Conservation	-	-	11,600
Projected Garrahy Courthouse Garage (Convention Center)	-	-	45,000
Loan Agreement-Historic Structures Tax Credit Fund	23,610	80,225	51,995
Subtotal	$ 588,606	$ 607,650	$ 593,062
Performance Based Agreements			
Econ. Dev. - Fleet	$ 6,950	$ 6,525	$ 6,070
Econ. Dev. - Fidelity Building	10,043	8,353	6,519
Econ. Dev. - Fidelity Building II	7,151	6,707	6,230
Subtotal	$ 24,144	$ 21,585	$ 18,819
Gross Debt	$ 1,664,560	$ 1,720,620	$ 1,771,876
Less: Adjustments for Agency Payments*	$ (9,535)	$ (8,029)	$ (6,599)
Net Tax Supported Debt	$ 1,655,025	$ 1,712,591	$ 1,765,277

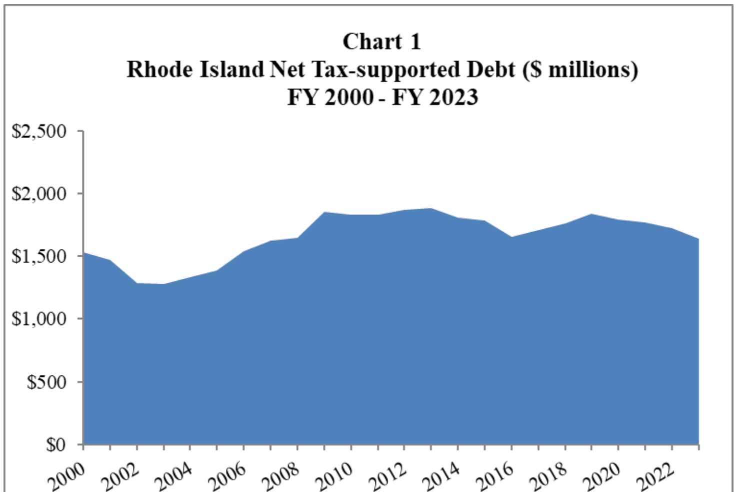
"CP" stands for certificates of participation.
* As of FY2017, the State anticipates it will be responsible for 100% of the Fidelity II debt service and thus is no longer adjusting these costs from the calculation of Net Tax Supported Debt.
Source: Rhode Island Office of Management and Budget.

When considering the state's overall debt position, credit rating agencies take into account a variety of issues, including the state's total net tax-supported debt. Net tax-supported debt refers to all debt for which an appropriation is or may be required. This includes general obligation debt, which is classified as direct debt (e.g. general obligation bonds backed by the state), guaranteed debt, contingent debt, and other obligations subject to annual appropriations. Essentially, tax-supported debt includes any debt which could be considered a future liability for the state. As of June 30, 2018 net tax-supported debt in Rhode Island totaled $1,765.3 million (see Table 2). This represents a 3.1 percent increase from 2017 ($1,712.6 million) and a 6.7 percent increase from 2016 levels ($1,655.0 million).

Direct debt is debt that is supported by the state's full faith and credit. It consists of general obligation bonds and notes that are authorized by voters in referendums. As of June 30, 2018, Rhode Island had $1,165.0 million in outstanding direct debt, a 6.3 percent increase from the prior year.

[2] House Fiscal Advisory Staff, FY 2019 Budget as Enacted.

Other long-term debt includes contractual agreements, which the state has entered into, but is subject to annual appropriation by the General Assembly. This includes master equipment lease agreements with financial institutions, revenue bonds issued by the Rhode Island Commerce Corporation, and certificates of participation. As of June 30, 2018, Rhode Island had $593.1 million of this type of long-term debt outstanding. Of this, nearly one third was in connection to the Rhode Island Convention Center, including the Dunkin Donuts Center debt.



Source: Office of Management and Budget, FY 2019 Capital Budget, Appendix B
Note: Updated data for FY 2016, 2017 and 2018 provided by Office of Management and Budget

Chart 1 shows a projection of Rhode Island's net state tax-supported debt from FY 2000 to FY 2023. Net tax-supported debt is expected to decrease by 6.8 percent from $1,765.3 million in FY 2018 to $1,644.6 million in FY 2023. These projections assume current outstanding obligations and new debt programmed into the state's capital budget.

Past practice, however, indicates that out-year debt levels are likely to be higher than these projections suggest, as new projects are added within the five-year period of the FY 2019 capital budget. This is because, in a departure from past practice, the FY 2019 capital budget does not assume any new referenda will go before the voters in November 2020 or November 2022. Historically, however, bond referenda have generally been included on the ballot for voter approval every election cycle. The average bond referenda over the past five elections was $189.3 million, and voters approved $227.5 million on the November 2016 ballot. In other words, past practice suggests that voters will be asked to approve additional borrowings in 2020 and 2022, but the impact of those future referenda is excluded from any bond or debt projections contained in the FY 2019 capital plan.[3]

Overview of State Debt

To better monitor the state's management of its debt, the Rhode Island Treasury developed legislative recommendations to strengthen debt management that were incorporated into the FY 2017 budget proposal and passed into law. The Division of Debt Management within the General Treasury's office was established in FY 2017 in order to gather information related to public debt in Rhode Island, promulgate best practices for debt management, and work with the Public Finance Management Board (PFMB) to regularly publish studies on the affordability of the state's public debt burden. In May of 2017, the Division of Debt Management and the PFMB published the first comprehensive debt affordability study for Rhode Island since the late 1990's.

[3] Ibid.

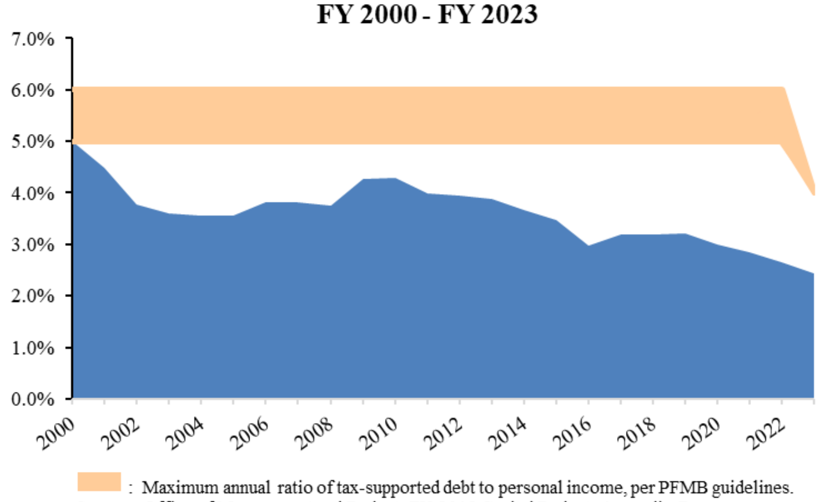
Since 1998, the PFMB has released annual reports detailing Rhode Island's debt management and providing certain credit guidelines to track state debt. The first credit guideline recommends maximum annual ratios for net tax-supported debt as a percent of personal income and annual debt service on tax-supported debt as a percent of general revenues. The second guideline states that the PFMB should monitor the total amount of tax-supported debt, state supported revenue debt, and agency revenue debt in relation to the state's personal income levels. The final guideline states that, in times of economic or financial hardship or when extraordinary infrastructure needs exist, all of the guidelines may be exceeded temporarily so long as the Governor and Legislature recommend a plan to bring debt levels below the target ranges within five years.

The PFMB's 2017 debt affordability study provided revised targets for the state's debt ratios. The new targets assert that tax-supported debt should not exceed 4.0 percent of personal income (in prior years the target range was below 5.0 to 6.0 percent), and annual debt service for tax-supported debt should not exceed 7.5 percent of general revenues from 2017-2022 and 7.0 percent every year thereafter (the prior target was below 7.5 percent).

Debt as a Percent of Personal Income

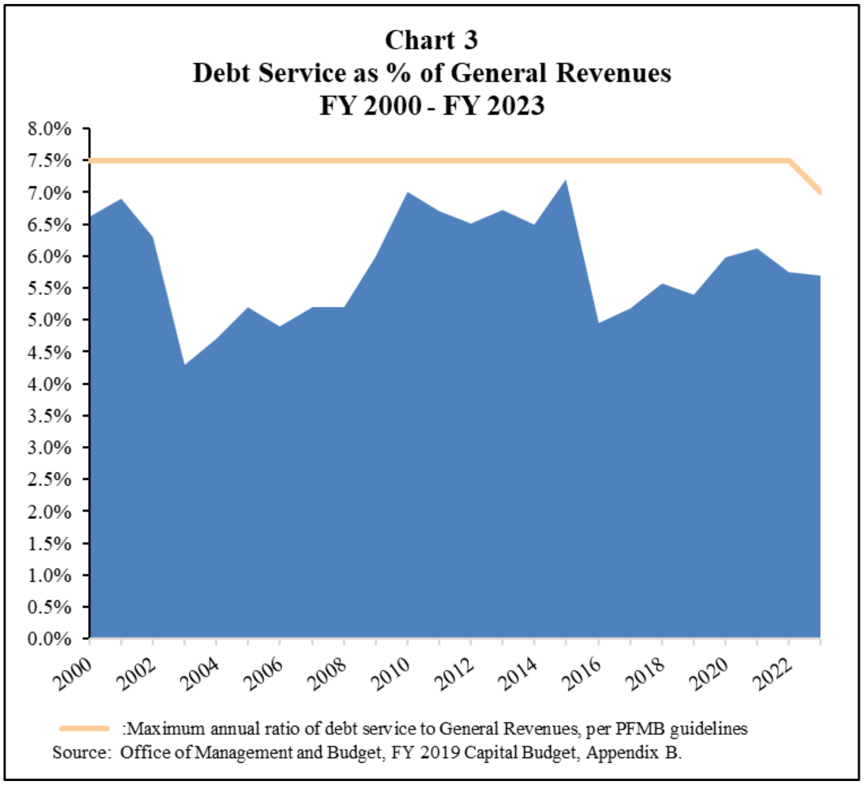
Since the adoption of Guideline 1 in 2000, net tax-supported debt levels have not exceeded the original target range of 5.0 to 6.0 percent of personal income. Net tax-supported debt levels have also remained below the updated target of 4.0 percent of personal income since 2012. The ratios have ranged from a low of 3.2 percent in FY 2017 to a high of 5.0 percent in FY 2000.

Chart 2
Net Tax-Supported Debt as a % of Personal Income
FY 2000 - FY 2023



Source: Office of Management and Budget, FY 2019 Capital Budget, Appendix B
Note: Updated data for FY 2016, 2017 and 2018 provided by Office of Management and Budget

The Governor's Fiscal 2019 Capital Budget projects that tax-supported debt as a percentage of personal income will decrease from 3.2 percent reported in FY 2017 to 3.0 percent in FY 2020 and further to 2.4 percent in FY 2023 (See Chart 2). This assumes that the capital budget is not increased over the period. However, these projections likely underestimate the ratio of tax-supported debt to personal income for the out-years, since, as previously noted, the projections do not account for the impact of any future bond referenda.



Debt Service as a Percent of General Revenues

The projected ratio of annual debt service to general revenues is less than the PFMB guideline of 7.5 percent for all the years projected. Furthermore, debt service as a percent of general revenues has remained below 7.0 percent – the new target adopted by the PFMB and set to go into effect in FY 2023 – since FY 2016. According to the Governor's FY 2019 Capital Budget, from FY 2019 through FY 2023, debt service as a percentage of general revenues is projected to range between a low of 5.4 percent in FY 2019 and a high of 6.1 percent in FY 2021. Chart 3 displays historical and projected debt service as a percentage of general revenues for the state of Rhode Island.

How Rhode Island's Debt Level Compares

The following provides an overview of the Ocean State's debt levels as compared to other states using debt per capita and debt as a percentage of personal income. It should be noted that debt ratios only provide a general picture of the state's relative debt position. Economic, administrative, and structural factors provide additional information regarding the overall financial condition of the state, illuminating issues related to debt capacities and burdens.

Debt per Capita

Tax-supported debt per capita is determined by dividing the state's tax-supported debt by the estimated population. Data comparing Rhode Island to other states shows that, while Rhode Island's tax-supported debt is estimated to be within the guidelines adopted by the PFMB, the Ocean State's net tax-supported debt per capita ranks 10th highest in the nation (Table 3). Among the New England states, both Connecticut (1st highest) and Massachusetts (2nd highest) ranked above Rhode Island.[4] Rhode Island's 2018 net tax-supported debt per capita was $2,188. This level of per capita debt exceeds the United States median ($987) by $1,201 (122.7 percent higher than the US median).

[4] Moody's State Debt Medians 2018.

Table 3
Net Tax-Supported Debt

	1998*	2008	2018
Per Capita			
U.S. Median	$446	$889	$987
Connecticut	2,962	3,698	6,544
Maine	391	618	900
Massachusetts	2,329	4,529	6,085
New Hampshire	633	499	773
Rhode Island	**1,618**	**1,766**	**2,188**
Vermont	946	707	987
RI Rank within U.S.	6	9	10

	1998**	2008**	2018**
Percent of Personal Income			
U.S. Median	1.9%	2.6%	2.3%
Connecticut	8.7%	7.3%	9.5%
Maine	1.9%	1.9%	2.1%
Massachusetts	7.8%	9.8%	9.5%
New Hampshire	2.4%	1.3%	1.4%
Rhode Island	**6.6%**	**4.7%**	**4.4%**
Vermont	4.2%	2.0%	2.0%
RI Rank within U.S.	4	13	12

Based on ranking all 50 U.S. states from highest to lowest.
*Based on estimated 1997 population.
**As a percentage of 1996, 2006, and 2016 personal income, respectively.
Source: Moody's Investors Service, State Debt Medians 2018, 2008 & 1998.

Debt as a Percentage of Personal Income
Another indicator prepared by Moody's is net tax-supported debt as a percentage of personal income. Tax-supported debt as a percentage of personal income is determined by dividing the net tax-supported debt by total personal income. There is also a lag in the data used by Moody's in this calculation. For example, to determine the 2018 ratio of debt to personal income, the 2018 tax supported debt is divided by 2016 personal income.

As shown in Table 3, Rhode Island's 2018 net tax-supported debt as a percentage of personal income ranks 12th highest. The debt level in the Ocean State equals 4.4 percent of state personal income compared to the U.S. median of 2.3 percent. Among the New England states, both Massachusetts (ranking 2nd) and Connecticut (ranking 3rd) had debt levels as a share of personal income higher than the Ocean State[5].

Rhode Island's 1998 net tax-supported debt as a percent of personal income was 6.6 percent. That ratio declined to 4.7 percent in 2008, above 2018 levels. Moody's notes that, nationally, slowed growth in state revenues and infrastructure spending, has led to 2018 being the fifth consecutive year of growth below 2.0 percent for net tax-supported debt.

State Bond Ratings

Bond ratings provide a picture of how each state's debt capacity and debt management practices impact the relative costs and risk associated with their bonds. Bond ratings are also important because they help investors determine interest rates: the higher the rating, the lower the yield and interest rates. Lower rated bonds typically have higher yields and interest rates, and, as a result, cost the issuer more in the long-run. Rating agencies (Moody's Investors Service, Standard and Poor's, and Fitch Investors Service) evaluate the economy, state debt capacity, and management practices to determine the level of risk involved in purchasing bonds.

As Table 4 shows, 49 of the 50 states currently have a bond rating from Moody's Investors Service. States that do not have general obligation debt bond ratings typically use pay-as-you-go financing

[5] Ibid

Table 4
General Obligation Bond Ratings

State	Rating	State	Rating
Delaware	Aaa	Maine	Aa2
Georgia	Aaa	Mississippi	Aa2
Maryland	Aaa	Nevada	Aa2
Missouri	Aaa	Oklahoma	Aa2
North Carolina	Aaa	**Rhode Island**	**Aa2**
South Carolina	Aaa	West Virginia	Aa2
Tennessee	Aaa	Arizona	Aa2*
Texas	Aaa	Kansas	Aa2*
Utah	Aaa		
Vermont	Aaa	Alaska	Aa3
Virginia	Aaa	California	Aa3
Indiana	Aaa*	Louisiana	Aa3
Iowa	Aaa*	Pennsylvania	Aa3
South Dakota	Aaa*	Kentucky	Aa3*
Alabama	Aa1	Connecticut	A1
Arkansas	Aa1	New Jersey	A3
Florida	Aa1	Illinois	Baa3
Hawaii	Aa1		
Massachusetts	Aa1	Wyoming	NA
Michigan	Aa1		
Minnesota	Aa1		
Montana	Aa1		
New Hampshire	Aa1		
New Mexico	Aa1		
New York	Aa1		
Ohio	Aa1		
Oregon	Aa1		
Washington	Aa1		
Wisconsin	Aa1		
Colorado	Aa1*		
Idaho	Aa1*		
Nebraska	Aa1*		
North Dakota	Aa1*		

Ratings in Order of Highest to Lowest = Aaa, Aa1,Aa,Aa2,Aa3, A1,A2, A3, Baa1, Baa2, Baa3 (NA=No GO Debt)

* Issuer Rating (No General Obligation Debt Outstanding)

Source: Moody's Investors Service, State Debt Medians 2018, April 24, 2018.

or other methods to fund capital projects. Rhode Island is among 8 states that have a rating of Aa2. The state’s current rating represents an improvement over 2009 when Rhode Island’s rating was Aa3. Currently, Illinois is the only state with a bond rating lower than Baa1. Although interest rates are favorable for borrowing, it is of paramount importance that the state preserve or improve its current rating level of Aa2 (Moody’s), and AA (S&P and Fitch) to ensure continued access to capital markets.

According to Moody’s, the state’s rating “incorporates the state's strong financial management practices, including multi-year financial planning, consensus revenue forecasting and consistent maintenance of reserves resulting in positive general fund balances; and its improving liquidity.”[6]

On March 7, 2018 Moody’s Investors Service determined Rhode Island’s financial condition outlook was stable, citing “the state's success in shoring up its finances through maintenance of adequate available reserves, improved liquidity, stabilizing demographic and economic trends; and careful preparation for the impact on state revenues of gaming expansion in Massachusetts.”

In the outlook, Moody’s listed Rhode Island’s factors that could lead to an upgrade, including further reductions in the state’s overall liability levels and sustained economic improvement at least in line with the national average. Moody’s noted that the state’s rating could also go down with: “deterioration of state's liquidity position accompanied by worsening reserve and balance sheet position; [and a] return to budgeting practices that rely on significant nonrecurring resources.”

[6] Moody’s Investors Service, " Moody's Assigns Aa2 to Rhode Island's 2018 Series A & B GO Bonds; Outlook Stable,” March 19, 2018.

November 2018 Ballot Initiatives

In the upcoming election, on November 6, 2018, Rhode Island voters will be asked to vote on three ballot initiatives. The first initiative would authorize the state to issue general obligation bonds to fund public school construction and repairs over the next five years. The second initiative relates to authorizing the state to issue general obligation bonds funding renovations for two higher education facilities: University of Rhode Island Narragansett Bay Campus and the Rhode Island College School Horace Mann Hall. The final initiative is a compilation of 10 different projects collectively titled the Green Economy Initiative. This section delivers an outline of each of the referenda questions and their financial components as well as important questions voters should consider when voting on these proposals. RIPEC does not take a position on any of these questions.

General Obligation Bond Proposals

Voters will be asked to authorize up to $367.3 million in the issuance of 20-year bonds for capital projects totaling roughly $589.5 million in borrowing costs. For more information see Table 5. A summary of each bond referendum is provided below.[7]

Table 5
Total Estimated Bond Referenda Costs

Project	Principal	Interest	Total
Rhode Island School buildings	$250,000,000	$151,212,936	$401,212,936
Higher Education Facilities	70,000,000	42,339,622	112,339,622
Green Economy and Clean Water	47,300,000	28,609,487	75,909,487
Total Cost	**$367,300,000**	**$222,162,045**	**$589,462,045**

Note: Assumes a 20-year amortization with level debt service at 5.0% interest, as of October 12, 2018
Source: Principal payment info from Rhode Island Secretary of State 2018 Voter Information Handbook

Question One: Rhode Island School Buildings
The state has proposed issuing $250.0 million in general obligation bonds over the period of five years in order to fund public school construction and repairs. The release of the Department of Elementary and Secondary Education's 2017 State of Rhode Island Schoolhouses report revealed $2.2 billion in deficiencies across 306 public schools. This report led to Governor Raimondo establishing the Rhode Island School Building Task Force through executive order, led by the General Treasurer and the Commissioner of Elementary and Secondary Education. After several meetings in fall 2017, the task force developed a set of recommendations which include putting $250 million in bonds for authorization on the November 2018 and 2022 ballots (for a total of $500 million) and various oversight measures to ensure efficient spending.

[7] Detailed information on the bond proposals can be found in the Rhode Island 2018 Voter Information Handbook, the Office of Management and Budget FY 2019 Capital Budget, and the HFAS FY 2019 Budget as Enacted.

The FY 2019 budget also includes a number of new, time-limited bonuses that would increase the state's share of the total cost of eligible school construction projects, thereby reducing the cost of the project for the local school district. These bonuses would only be authorized if the voters approve the school construction bond referendum, and would only apply to projects started by 2023. The intent of the bond and the additional bonuses is to incentivize school districts to move forward with needed capital improvements by offering a time-limited increase in state reimbursements for such projects, and by using the state's borrowing power to provide upfront resources to help pay for the surge of activity. It is important to note that the school construction program works as an entitlement, meaning that the state is obligated to pay for its share of any eligible projects that are proposed by the school districts. This means that if demand from the school districts exceeds the bond, the state would make up the difference through the operating budget.

The project would have an issuance limit of $100 million per year (over a period of five years), though the capital budget assumes issuance of $50.0 million each year from FY 2020 through post-FY 2023. Assuming a 5.0 percent interest rate and a 20-year amortization, the annual debt service is estimated at $20.7 million and the total debt service is estimated to be approximately $401.4 million. The budget does not assume any new referenda will go before the voters in November 2020 or November 2022.

Questions to consider include:

- How would the timing and length of construction and renovations affect the academic environment of students?
- How would Rhode Island students and the state be impacted if this referendum is not approved in November?
- What are the costs and benefits associated with the state issuing debt to fund some portion of school construction projects, as opposed to the model Rhode Island has been operating under (whereby each municipality takes on the debt for the entire cost of the school construction project and the state reimburses the municipality for some portion of those costs)?
- Given that this proposal represents a change from the existing system for funding the construction and improvement of public school buildings, what are the impacts of the state taking on general obligation debt to fund school construction? How would approving this proposal impact the state's borrowing capacity moving forward? Will it impact the state's access to credit to fund future capital improvement projects?
- How is the responsibility of building maintenance after renovations/construction going to be delegated?

Question Two: Higher Education Facilities

The state has proposed a total of $70.0 million general obligation bond authorization to pay for construction projects affiliated with the University of Rhode Island (URI) and with Rhode Island College (RIC). Specifically, $45.0 million would go towards the renovation and replacement of buildings, laboratories and infrastructure of URI's Narragansett Bay Campus to support the educational and research needs of the Graduate School of Oceanography, the College of

Engineering, and the College of Environment and Life Sciences. In addition, improvements would be made to the waterfront research vessel dock, roadways and walkways. Assuming a 5.0 percent interest rate and a 20-year term, annual debt service would be approximately $3.6 million and total debt service is estimated to be $73.5 million for the life of the borrowing. The remaining $25.0 million would go towards renovations to RIC's Horace Mann Hall, which houses the School of Education and Human Development. Annual debt service for this project is estimated to be $2.0 million per year, for a total of $40.9 million over the life of the borrowing, using the same assumptions mentioned earlier.

Questions to consider include:

- Is it appropriate for the state to issue bonds to finance this project, or should alternative funding sources be utilized? For example, how and to what extent has private fundraising for this project been considered?
- How would the quality of the facilities at the URI and RIC be altered without the additional funding?
- Is there sufficient demand for these educational programs to warrant further expansion and renovations at URI and RIC?
- To what extent will the development of these higher-education programs improve the state's economic performance through job creation and workforce development?
- How will the state's education system provide ongoing support for these facilities?

Question Three: Green Economy and Clean Water

The state has proposed the authorization of $47.3 million in general obligation bonds for environmental and recreational purposes to be distributed over ten different projects:

- *Coastal Resiliency and Public Access Projects: $*5.0 million would go towards matching grants (up to 75.0 percent) to public and non-profit entities supporting the restoration and resiliency of vulnerable coastal habitats and restoring river and stream floodplains. The intention of supporting these entities is to improve community resiliency and public safety in the event of increased flooding, major storm events, and environmental degradation. The annual debt service is estimated at $0.4 million and total debt service is estimated to be $8.2 million, assuming a 5.0 percent interest rate and a 20-year term.
- *Capital for Clean Water and Drinking Water*: $7.9 million would be allocated for clean water and drinking water infrastructure improvements. Examples of these projects include: wastewater treatment upgrades and storm water quality improvements to combine sewer overflow abatement projects. Using the same assumptions mentioned before, annual debt service would be $0.6 million and the total debt service would be $12.9 million.
- *Wastewater Treatment Facility Resiliency Improvements*: $5.0 million is intended for matching grants (up to 50.0 percent) for wastewater treatment facility resiliency improvements for those vulnerable to flooding, storm events, and environmental degradation. Using the same assumptions mentioned before, annual debt service would be $0.4 million and the total debt service would be $8.2 million.
- *Dam Safety:* $4.4 million is proposed for repairing or removing state-owned dams. Annual debt service would be $0.4 million and total debt service would be $7.2 million.

- *Providence River Dredging:* $7.0 million would go towards the dredging and analysis of downtown Providence's rivers. Specifically, dredging and analysis would occur in: the Woonasquatucket River from I-95 north of Providence Place Mall to its confluence with the Providence River, the Moshassuck River from Smith Street to its confluence with the Providence River, the Providence River from Steeple Street to Point Street, and dredging a sediment basin upstream of the Providence Place Mall and I-95 for approximately six hundred feet. Using the same assumptions mentioned before, annual debt service would be $0.6 million and total debt service would be $11.4 million.
- *State Bikeway Development Program*: $5.0 million would go towards design, repair and construction of bikeways. Annual debt service would be $0.4 million and total debt service would be $8.2 million.
- *Brownfield Remediation and Economic Development:* $4.0 million would be allocated for matching grants (up to 80.0 percent) to public, private and non-profit entities for brownfield remediation projects. Annual debt service would be $0.3 million and total debt service would be $6.5 million.
- *Local Recreation Projects:* $5.0 million is intended for grants (up to 80.0 percent) to municipalities for recreation development and acquisition projects. Annual debt service would be $0.4 million and total debt service would be $8.2 million.
- *Access to Farmland:* $2.0 million would be allocated to protect the state's working farms through the Farmland Access Programs and the purchase of development rights by the Agricultural Lands Preservation Commission. Annual debt service would be $0.2 million and total debt service would be $3.3 million.
- *Local Open Space:* $2.0 million would be allocated for matching grants (up to 50.0 percent) to municipalities, local land trusts, and non-profit organizations to preserve open space in Rhode Island. Annual debt service would be $0.2 million and total debt service would be $3.3 million.

These environment and recreation investment projects are expected to begin in fiscal year 2020 and conclude by fiscal year 2025. The Department of Environmental Management estimates the useful life of the revitalized recreational, bikeway, resiliency, dam safety and water infrastructure to be between 25 and 50 years, while the useful life of the local open space, farmland preservation and brownfields restoration to be permanent. The Coastal Resources Management Council estimates the useful life of dredging the Downtown Providence Rivers to be approximately 20 years.

Questions to consider include:

- How will these enhancements and renovations impact social and environmental well-being?
- In what ways are private and non-profit entities involved in the funding of environmental preservation projects such as these?
- To what extent have alternative funding sources, such as federal grants or the state pay-go financing, been considered?
- What is the estimated demand for these projects?
- How have prior bonds for these types of projects been utilized in the past? Have all funds that were previously authorized for such projects been spent?

Preliminary FY 2018 Closing

Revenue Changes

Overall, actual FY 2018 revenues were lower than anticipated in the final FY 2018 budget. Table 6 provides an overview of the revised state revenues. In total, actual FY 2018 revenues were $3,908.4 million – $2.1 million (0.1 percent) less than the final enacted revenues of $3,910.5 million. Total tax revenue was also $2.1 million (0.1 percent) less than enacted.

Within this total:

- Actual personal income tax collections were $11.9 million (0.9 percent) less than enacted, while actual sales and use tax collections were $9.1 million (0.7 percent) greater than enacted;
- General business tax collections were $2.1 million greater than enacted. Higher-than-anticipated collections from public utilities gross earnings and financial institutions were enough to offset the lower than anticipated collections in all of the other categories;
- Other tax collection actuals were $1.5 million less than enacted due to lower than anticipated collections in the inheritance and gift category ($0.8 million less than enacted) and the realty transfer tax ($0.7 million less than enacted);
- Departmental revenue was 0.3 percent, or $1.1 million, higher than enacted.

Table 6
General Revenues (Preliminary-Unaudited)
for the Fiscal Year Ended June 30, 2018 ($ millions)

	Final Budget	Actual	Difference	% Difference
Personal Income Tax	$ 1,357.2	$ 1,345.3	$ (11.9)	-0.9%
General Business Taxes				
Business Corporations	$ 139.5	$ 127.7	$ (11.8)	-8.5%
Public Utilities Gross Earnings	$ 100.0	$ 109.6	$ 9.6	9.6%
Financial Institutions	$ 21.7	$ 29.2	$ 7.5	34.5%
Insurance Companies	$ 132.0	$ 130.3	$ (1.7)	-1.3%
Bank Deposits	$ 2.7	$ 1.6	$ (1.1)	-39.3%
Health Care Provider Assess.	$ 44.4	$ 44.1	$ (0.3)	-0.7%
Sales and Use Taxes				
Sales and Use	$ 1,051.5	$ 1,057.2	$ 5.7	0.5%
Motor Vehicle	$ 20.8	$ 20.8	$ 0.0	0.1%
Motor Fuel			$ -	
Cigarettes	$ 143.1	$ 146.9	$ 3.8	2.6%
Alcohol	$ 20.3	$ 19.9	$ (0.4)	-1.8%
Other Taxes				
Inheritance and Gift	$ 52.2	$ 51.4	$ (0.8)	-1.5%
Racing and Athletics	$ 1.1	$ 1.1	$ (0.0)	-1.7%
Realty Transfer Tax	$ 13.5	$ 12.8	$ (0.7)	-4.9%
Total Taxes	$ 3,100.0	$ 3,097.9	$ (2.1)	-0.1%
Departmental Revenue	$ 396.5	$ 397.6	$ 1.1	0.3%
Total Taxes & Departmentals	$ 3,496.5	$ 3,495.5	$ (1.0)	0.0%
Other Sources				
Gas Tax Transfer	$ -	$ -	$ -	
Other Miscellaneous	$ 38.5	$ 37.1	$ (1.4)	-3.6%
Lottery	$ 364.6	$ 365.0	$ 0.4	0.1%
Unclaimed Property	$ 10.9	$ 10.9	$ 0.0	0.0%
Total Other Sources	$ 414.0	$ 412.9	$ (1.0)	-0.2%
Total	**$ 3,910.5**	**$ 3,908.4**	**$ (2.1)**	**-0.1%**

Source: State Controller, FY 2018 Closing Statements - Preliminary Unaudited, Aug. 31, 2018.

Expenditure Changes

Total general revenue expenditures, based on the preliminary unaudited closing statements for FY 2018, were $3,805.7 million, or $26.3 million lower than enacted. The majority of the difference – approximately $24.0 million – was due to lower-than-anticipated expenditures by General Government and Human Services agencies.

Lower-than-anticipated spending for Human Services constituted nearly 63.0 percent of the difference between actual expenditures and the enacted budget ($16.5 million, or 1.1 percent).

Table 7
General Revenue Expenditures (Preliminary)
for the FY Ended June 30, 2018 ($ millions)

	Final Budget	Actual	Difference	% Difference
General Government	$462.1	$454.5	$7.6	1.6%
Human Services	$1,467.7	$1,451.2	$16.5	1.1%
Education	$1,386.2	$1,386.2	$0.1	0.0%
Public Safety	$473.2	$471.0	$2.2	0.5%
Natural Resources	$42.8	$42.8	$0.0	0.0%
Total	**$3,832.0**	**$3,805.7**	$26.3	**0.7%**

Source: State Controller, FY 2018 Closing Statements - Preliminary Unaudited, Aug. 31, 2018.

Within Human Services, the Executive Office of Health and Human Services Medicaid spending accounted for the majority of the difference between the final budget and actual expenditures, with expenditures of $23.1 million less than enacted. In contrast, the Department of Children, Youth and Families spent $7.7 million more than appropriated.

Actual expenditures within the General Government agency were $7.6 million, or 1.6 percent, less than enacted. Relative to final appropriations, the legislature accounted for the majority of this difference, with expenditures of $7.9 million less than enacted. On the other hand, the Department of Labor and Training spent $3.9 million more than enacted.

Education, Public Safety, and Natural Resources combined expended $2.3 million less than appropriated, accounting for less than 10.0 percent of the total $26.3 million difference between final appropriations and actual expenditures.

Budget Reserve and Cash Stabilization Fund

Table 8
State Budget Reserve
and Cash Stabilization Account
FY 2018 Preliminary ($ millions)

Opening Balance	$192.6
Calculated transfer from General Fund	119.1
Subtotal	*$311.7*
Transfer to Capital Fund	$113.2
Ending Balance	**$198.5**

Source: State Controller, FY 2018 Closing Statements - Preliminary Unaudited, Aug. 31, 2018; RIPEC calculations.

Rhode Island's Budget Reserve and Cash Stabilization Fund, commonly referred to as the "rainy day fund," was established in 1985. Resources from this fund can only be used if there is a general revenue shortfall. Budgetary appropriations are made based on the amount of revenue that the state estimates it will collect in a given fiscal year. If, after the third quarter of the fiscal year, actual revenue collections are anticipated to fall below the estimates upon which the current appropriations were made, the "rainy day fund" can be used only to fill the gap. In other words, the amount that can be used from the fund cannot exceed the difference between the original revenue estimates that were used to make the current appropriations, and the most recent revenue projections from the latest state revenue estimating conference.[8]

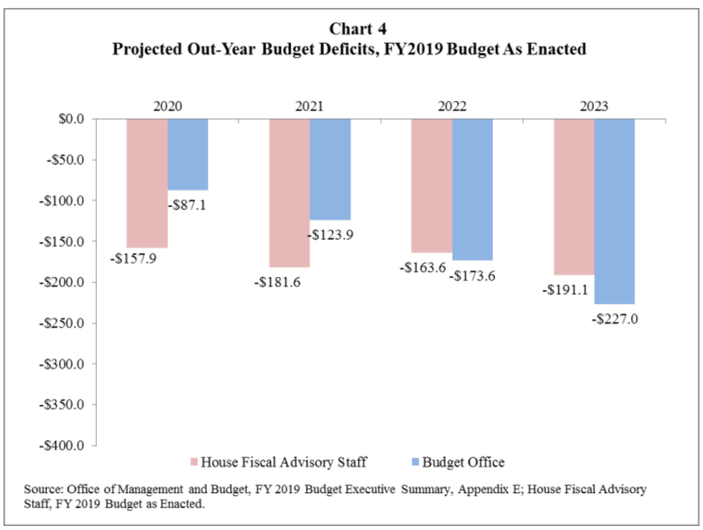
[8] RIGL §35-3-20.

In the early 1990s, state spending was limited to 98.0 percent of estimated unencumbered general revenues for each fiscal year. Subsequently, the remaining 2.0 percent balance of general revenue was appropriated into the Budget Reserve and Cash Stabilization account, provided that no payment into the account would increase the balance above 3.0 percent of the estimated general revenues.

In the early 1990s, a constitutional amendment created the Rhode Island Capital Plan Fund (RICAP) to pay for capital projects, debt reduction, or debt service. As part of this change, appropriations in excess of the cap on the "rainy day fund" now flow primarily into the RICAP fund. In addition to limiting the use of excess reserve funds to capital projects only (as opposed to debt reduction or debt service), a 2006 amendment increased the cap on the budget reserve fund from three percent of general revenues to five percent beginning in FY 2013. This amendment reduced the amount of revenues that can be spent from 98.0 percent of revenues to 97.0 percent of revenues by FY 2013.

As shown in Table 8, the Budget Reserve Fund had an opening balance of $192.6 million in FY 2018. The estimated transfer from the General Fund of $119.1 million resulted in a balance of $311.7 million. After transferring $113.2 million to the Rhode Island Capital Fund, a balance of $198.5 million remained. Based on statutory requirements, the state's "rainy day fund" is currently fully funded.

Forecast



The Budget Office's five-year financial projection, based on the Governor's proposed budget submitted in January 2018, indicates that expenditures are anticipated to exceed revenues through FY 2023. Expenditures in this projection are anticipated to increase at an average annual rate of 2.7 percent from the FY 2018 base to FY 2023,[9] ultimately resulting in a FY 2023 deficit of $227.0 million. The House Fiscal Advisory Staff's (HFAS) out-year forecasts, based on the enacted FY 2019 budget, indicate that expenditure growth is expected to outpace useable revenue growth for FY 2020 and FY 2021, ultimately leading to a FY 2023 projected deficit of $191.1 million. The differences in the Budget Office and HFAS projections are illustrated on Chart 4. Due to publication timing, these forecasts do not include the results of the FY 2018 preliminary audit.

[9] Office of Management and Budget, FY 2019 Budget Executive Summary.

Based on the Governor's recommended FY 2019 budget, the Budget Office forecast anticipates a FY 2019 ending balance of $0.9 million,[10] while the HFAS forecast, based on the enacted FY 2019 budget, anticipates a $0.7 million ending balance for FY 2019. [11] Again, the differences between the Budget Office and HFAS forecasts are due to the fact that the Budget Office's numbers are based on the Governor's FY 2019 recommended budget, submitted in January, while the HFAS numbers are based on the enacted FY 2019 budget, adopted in June – in addition to timing, the enacted budget includes modifications and changes to the Governor's proposed budget. Furthermore, the projections are based on different revenue and expenditure projections – the Governor submits her budget based on the November estimates, while the enacted budget is based on updated estimates adopted in May. It should also be noted that the Controller's preliminary unaudited report states that the ending surplus balance for 2018 is $14.3 million higher than the enacted. An audited report from the Controller could change these projections.

The November Caseload Estimating Conference will provide an update on projected caseloads and expenditures for TANF/RIWP, child care, SSI disability, general public assistance (GPA), and Medicaid spending. The Revenue Estimating Conference will also update projected revenues based on the economic conditions in the state and current and projected revenue from taxes, departmental revenue, and other sources. The information from the November conference will represent the first official projections and will be used by the Governor as she or he develops the FY 2020 budget.

Risks to the Forecast

FY 2019 general revenue growth is projected to decrease from 4.6 percent in FY 2018 to 2.5 percent. The general revenue growth rate is expected to decline even further, to 1.9 percent annually, from FY 2020 to FY 2023. This decline is due, in part, to a one-time realization of personal income tax and business corporation tax revenue in FY 2019 that helped drive up the FY 2019 general revenue growth rate. The decline is also partly attributable the projected impact on state revenues of competition from Massachusetts and Connecticut gaming facilities. After the Governor's recommendation to legalize sports betting in FY 2019, lottery transfers to the state general fund are projected to grow initially before declining in FY 2022. It is worth noting, however, that the delay in the implementation of sports betting may cause a shortfall in current-year revenues – the forecast assumed nine months of revenues from sports betting in FY 2019, but due to delayed implementation, the state will have, at most, seven months of collections. The opening of a new hotel at Twin River Casino in Lincoln and a new gaming facility in Tiverton is expected to mitigate the competitive effects of the new Massachusetts facility opening fall of 2018. However, the forecast does project a decline in lottery transfers beginning in FY 2022, due to the opening of two additional casinos in Connecticut and Massachusetts in FY 2021 and FY 2022, respectively.[12]

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[10] Office of Management and Budget, FY 2019 Budget Executive Summary.
[11] House Fiscal Advisory Staff, FY 2019 Budget as Enacted.
[12] Office of Management and Budget, FY 2019 Budget Executive Summary, Appendix E.

Another out-year fiscal risk is medical services inflation, utilization, and technological change. Medical costs remain a significant driver of expenditure growth, and these costs have been accelerating. Rising medical costs drive up state expenditures by increasing the cost of state employee health insurance and the cost of providing services to the state's clients. The state budget office assumes that growth in the cost of state employee health benefits will average 5.0 percent annually through FY 2023, and that average state employee cost sharing will cover 20.0 percent of medical premiums throughout the five-year forecast period.[13]

Demographic changes also represent a risk to the forecast. In particular, Rhode Island's aging population will likely increase demand for enhanced and expanded infrastructure for elderly care in the later years of the five-year forecast. This, in addition to uncertainty regarding the status of the Affordable Care Act at the federal level, will impact state expenditures for medical services to Medicaid-eligible and other citizens. [14]

Additionally, the required state contribution rate to the state employee retirement system will increase from 26.3 percent in FY 2019 to 29.0 percent projected for 2023, largely due to recent changes in investment return assumptions (from an assumed 7.5 percent return to a 7.0 percent return). Based upon projected payroll growth and retirement contribution rates, state general revenue funded contributions for state employees are projected to increase by an average of 3.0 percent a year, from $107.1 million in FY 2019 to a projected $126.8 million by 2023. Total personnel and operating costs continue to rise at an annual rate of 3.0 percent, with an estimated increase of $144.0 million total by 2023.[15]

The House Fiscal Advisory Staff Budget as Enacted estimates an imbalance between expenditure growth and revenue growth from FY 2019 to FY 2023, with expenditures growing at a faster rate on average. Factors that contribute to the expansive growth in expenditures include medical and other assistance programs, including Rite Share, Rite Care, cash assistance, and tuition assistance programs. Other factors driving the out-year budget deficits include the use of one-time items to resolve current-year budget gaps and growth in local aid from the on-going phase-out of the car tax.[16]

[13] Ibid.
[14] Ibid.
[15] Ibid.
[16] House Fiscal Advisory Staff, FY 2019 Budget as Enacted.