RIPEC

# Comments on Your Government

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## Analysis of Rhode Island's Debt Position and 2008 Bond Referenda

### Introduction

In November, voters will be asked to consider two bond questions that would authorize $89.7 million in new general obligation debt. This issue of *RIPEC Comments* summarizes the proposed referenda and key facts concerning public debt in the Ocean State. In addition, the report compares Rhode Island's debt level and bond ratings to those in other states as well as national mean and median levels. It also comments on measures of affordability and discusses the two bond questions that will be put before the voters on November 4, 2008.

RIPEC has traditionally not taken positions on bond referenda questions. However, RIPEC encourages taxpayers to consider the following questions when deciding whether to authorize 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?
- What impact will new capital projects have on the cost of operating state government?
- What will be the impact of the current credit situation on the availability and cost of borrowing?

Rhode Island has made significant progress in managing its debt over the past 20 years as a result of conservative debt management practices. For example, the State paid-off the DEPCO debt twenty-two years ahead of schedule - eliminating a considerable portion of the State's debt burden. The State allocated $295.6 million of the net tobacco proceeds to defease existing, non-callable general obligation debt – thereby freeing up approximately $343.5 million in net debt service payments through FY 2012.

The State created a pay-as-you-go asset protection program in the late 1980s to preserve the State's public infrastructure without incurring additional debt. The voters protected the program by amending the constitution in 1992, and again in 2006 when they limited its use for projects and increased its funding.

To monitor the State's progress, the Rhode Island Public Finance Management Board (PFMB) adopted guidelines for managing certain elements of the State's debt. The PFMB recommended that annual debt as a percentage of personal income should be no greater than a range of 5.0 to 6.0 percent and that annual debt service for tax-supported debt should not exceed 7.5 percent of general revenues.

According to State Budget documents, FY 2009 net tax-supported debt would grow from 4.0 percent of personal income in FY 2007 to an estimated 4.2 percent in FY 2009. Assuming the capital budget is not increased, the State Budget Office projects this amount will decline to 3.5 percent in FY 2013. Debt service was estimated to be 5.3 percent of general revenue in FY 2007, and is projected to decline to 4.6 percent by the end of the decade. Based on these anticipated debt levels, it appears that the State will remain within the PFMB's guidelines through FY 2013.

At the same time, data comparing Rhode Island to other states show that while Rhode Island's tax-supported debt is estimated to be within the guidelines adopted by the PFMB, the Ocean State's debt per capita ranks 9th highest in the Nation and debt in relation to personal income ranks 13th highest in the country.

Recent market events will have an impact on borrowing requirements for the State. While ratings methodologies for state and local governments are being reviewed nationally, Fitch Investors Service recently downgraded Rhode Island's general obligation debt rating from AA to AA-, noting weakness in revenue collections and the State's faltering economy. However, Standard and Poor's currently rates Rhode Island's general obligation debt at AA while Moody's Investor Service currently rates Rhode Island at Aa3.

With the current challenges in the debt market, it is unclear what impact the current market volatility will have on the state's ability to access the market and at what cost.

## Rhode Island's Capital Budget

*Overview* – The FY 2009-2013 Capital Budget includes nearly $2.4 billion in revenue from current financing streams and $1.6 billion in debt issuance over the five year period. This level of capital investment reflects expenditures from all sources of funds, including general obligation bond proceeds, higher education resources, federal funds and third party funding. The financing plan includes approximately $470.9 million in general obligation debt (assuming all referenda are approved) during the five year period, including the referenda proposed this November.

*State Debt* - Bond rating agencies consider a number of issues when analyzing the State's overall debt position, including the State's total net tax supported debt. Net tax supported debt refers to all debt in the State that requires an appropriation.

As of June 30, 2008, Rhode Island had a net tax supported debt of $1,716.1 million (see Table 1), representing a 5.8 percent increase from June 30, 2007 ($1,622.4 million). Net tax supported debt currently includes the following:

Direct debt: Direct debt is debt supported by the State's general fund for which the State has pledged its full faith and credit. It consists of general obligation bonds and notes issued in anticipation thereof. This type of debt requires approval by the voters. Rhode Island had $913.5 million in outstanding direct debt as of June 30, 2007 and $275.0 million authorized but unissued debt as of June 30, 2008.

**Table 1**
**Rhode Island's Net Tax Supported Debt ($ thousands)**

| | 2006 | 2007 | 2008 |
|---|---|---|---|
| **Direct Debt** | | | |
| Various Purpose Bonds Outstanding | $ 822,881 | $ 897,119 | $ 983,658 |
| Variable Rate General Obligations | 19,665 | 16,365 | 14,165 |
| Subtotal | $ 842,546 | $ 913,484 | $ 997,823 |
| **Guaranteed Debt** | | | |
| Narragansett Bay District Commission Bonds | $ - | $ - | $ - |
| Subtotal | $ - | $ - | $ - |
| **Other Debt Subject to Annual Appropriation** | | | |
| RI Refunding Bond Authority - Direct | $ - | $ - | $ - |
| RI Refunding Bond Authority - Narragansett Bay Commission | - | - | - |
| Convention Center Authority Outstanding | 287,185 | 279,935 | 270,960 |
| Economic Development - Transportation (motor fuel) | 79,920 | 76,290 | 72,560 |
| Public Buildings Authority Lease Rental Bonds | 60,320 | 42,710 | 24,235 |
| Certificates of Participation - Vehicle Leases | 13,580 | 19,790 | 14,395 |
| Certificates of Participation - Intake Center | 10,655 | 8,160 | 5,535 |
| Certificates of Participation - Attorney General | 2,795 | 2,575 | 2,230 |
| Certificates of Participation - Pastore Steam Plant | 23,440 | 22,360 | 23,290 |
| Certificates of Participation - DLT Howard Complex | 17,150 | 15,970 | 13,375 |
| Certificates of Participation - Shepards Building | 23,655 | 22,135 | 21,420 |
| Certificates of Participation - Training School | 51,985 | 50,205 | 48,370 |
| Certificates of Participation - Kent County Courthouse | 56,685 | 54,405 | 52,075 |
| Certificates of Participation - Tribunal Court Complex | 21,565 | 20,765 | 19,940 |
| Certificates of Participation - Information Technology | - | 23,490 | 21,000 |
| Certificates of Participation - School for the Deaf | - | - | 31,250 |
| Certificates of Participation - Energy Conservation | - | 12,735 | 12,735 |
| Certificates of Participation - Division of Motor Vehicle System | - | - | 13,000 |
| Certificates of Participation - Innovation Technology | - | - | 13,410 |
| Rhode Island Housing/Travelers Aid | 18,754 | 15,502 | 23,002 |
| Economic Development - URI Power Plant | 12,869 | 12,194 | 11,494 |
| Economic Development - Masonic Temple | - | 14,280 | 9,775 |
| Economic Development - Dow Chemicals Corp | - | - | - |
| Economic Development - Fidelity Building | 21,154 | 20,402 | 19,592 |
| Economic Development - Alpha Beta Corporation | - | - | - |
| Economic Development - McCoy Stadium | 5,245 | 4,275 | 3,265 |
| Economic Development - Fleet | 9,830 | 9,630 | 9,415 |
| Economic Development - Fidelity II | 10,000 | 10,000 | 9,766 |
| Subtotal | $ 726,787 | $ 737,808 | $ 746,089 |
| **Gross Debt** | $ 1,569,333 | $ 1,651,292 | $ 1,743,912 |
| Less: Adjustments for Agency Payments | (29,662) | (28,848) | (27,766) |
| **Net Tax Supported Debt** | $ 1,539,671 | $ 1,622,444 | $ 1,716,146 |

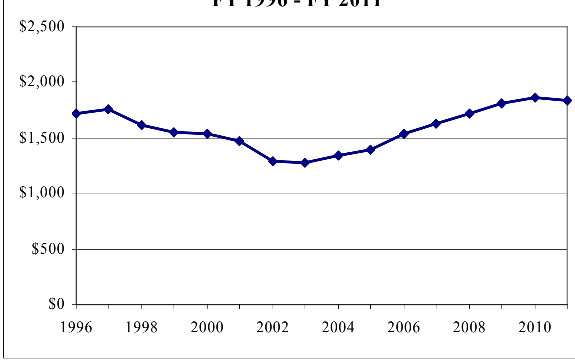
Source: Rhode Island State Budget Office - Capital Budget, various years

As of June 30, 2008 Rhode Island had $746.1 million in this type of outstanding long-term debt. Of this amount, nearly one half ($287.2 million) was debt related to the Rhode Island Convention Center. Recently, another component of other long-term debt has been DEPCO debt obligations. The State has repaid all DEPCO debt obligations as of August 2000. It should be noted that this is a significant reduction in the State's debt levels - at one point the State had approximately $510.0 million in DEPCO debt.

Chart 1 displays a projection of Rhode Island's net State tax supported debt from FY 1996 through FY 2011. Net tax supported debt is projected to increase by 2.5 percent from FY 2007 to FY 2011. Net debt used on these projections assumes current outstanding obligations and new debt programmed in the State's Capital Budget.

<u>Other Long-term debt:</u> Other long-term debt includes State obligations related to revenue bonds from State agencies or commissions, third party financing arrangements and other contracts entered into by the State. Examples include capital leases with the Rhode Island Refunding Bond Authority (formally the Rhode Island Public Buildings Authority), master equipment lease agreements with financial institutions, revenue bonds issued by the Economic Development Corporation and certificates of participation.

**Chart 1**
**Rhode Island Net Tax Supported Debt ($millions)**
**FY 1996 - FY 2011**



## 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 where the State's relative debt position stands. Economic, administrative and structural factors often provide information regarding the overall financial condition of the State, therefore 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. It should be noted that Moody's Investors Service calculation of debt per capita has a time-lag in the data. For example, to determine 2008 debt per capita, 2008 tax-supported debt was divided by 2007 population estimates. Over time, this measure is affected by changes in population among the states and by changes in the amount of tax supported debt in each state.

Net tax supported debt per capita in Rhode Island ranked 9th highest in the United States according to Moody's. Among the New England states, Massachusetts (ranking 1st) and Connecticut (ranking 2nd) both ranked above Rhode Island.

As shown on Table 2, Rhode Island's 2008 net tax-supported debt per capita was $1,766. This level of per capita debt for every man, woman and child exceeds the United States median ($889) by $877. As a result, the Ocean State's per capita debt burden was 98.7 percent higher than the U.S. median. A portion of this level of debt may be explained in part by having Rhode Island fund some capital projects that might be funded locally in other states as well as the age of the State's infrastructure.

*Debt Per $1,000 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 2008 ratio of debt to personal income, the 2008 tax supported debt is divided by 2006 personal income.

**Table 2**
**Net Tax Supported Debt**

| Per Capita | 1998 | 2003 | 2008 |
|---|---|---|---|
| U.S. Median | $505 | $606 | $889 |
| Connecticut | 3,131 | 3,440 | 3,698 |
| Maine | 418 | 471 | 618 |
| Massachusetts | 2,436 | 3,298 | 4,529 |
| New Hampshire | 620 | 485 | 499 |
| **Rhode Island** | **1,670** | **1,508** | **1,766** |
| Vermont | 953 | 861 | 707 |
| RI Rank within U.S. | 5 | 7 | 9 |

| Percent of Personal Income (2006) | 1998 | 2003 | 2008 |
|---|---|---|---|
| U.S. Median | 1.9% | 2.2% | 2.6% |
| Connecticut | 8.7% | 8.2% | 7.3% |
| Maine | 1.9% | 1.8% | 1.9% |
| Massachusetts | 7.8% | 8.5% | 9.8% |
| New Hampshire | 2.4% | 1.4% | 1.3% |
| **Rhode Island** | **6.6%** | **5.0%** | **4.7%** |
| Vermont | 4.2% | 3.0% | 2.0% |
| RI Rank within U.S. | 4 | 8 | 13 |

Source: Moody's Investors Service - Medians - Various Years

As shown on Table 2, Rhode Island's net tax-supported debt as a percentage of personal income ranks 13th highest in 2008. The debt level in the Ocean State equals 4.7 percent of State personal income compared to the U.S. median of 2.6 percent. Among the New England states, both Massachusetts (ranking 2nd) and Connecticut (ranking 4th) ranked above the Ocean State.

Rhode Island's 1990 net tax-supported debt as a percent of personal income was 4.6 percent. As a result of DEPCO and the Rhode Island Convention Center project, that ratio jumped to 8.9 percent in FY 1994. The decline in debt burden since 1997 was due in part to growth in personal income, the policy to repay DEPCO debt early, and the defeasance of debt through the use of tobacco securitization proceeds.

*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. There are several rating agencies, such as Moody's Investors Service, Standard and Poor's and Fitch Investors Service. Each evaluates the economy, state debt capacity and management practices to determine the level of risk involved in purchasing bonds.

**Table 3**
**General Obligation Bond Ratings**

| State | Rating | State | Rating |
|---|---|---|---|
| Delaware | Aaa | Arizona | Aa3* |
| Georgia | Aaa | Connecticut | Aa3 |
| Maryland | Aaa | Illinois | Aa3 |
| Missouri | Aaa | Maine | Aa3 |
| North Carolina | Aaa | Michigan | Aa3 |
| South Carolina | Aaa | Mississippi | Aa3 |
| Utah | Aaa | New Jersey | Aa3 |
| Vermont | Aaa | New York | Aa3 |
| Virginia | Aaa | Oklahoma | Aa3 |
| | | **Rhode Island** | **Aa3** |
| Florida | Aa1 | West Virginia | Aa3 |
| Indiana | Aa1* | Wisconsin | Aa3 |
| Iowa | Aa1* | | |
| Kansas | Aa1* | California | A1 |
| Minnesota | Aa1 | Louisiana | A2 |
| Nevada | Aa1 | | |
| New Mexico | Aa1 | Colorado | NA |
| Ohio | Aa1 | Nebraska | NA |
| Tennessee | Aa1 | South Dakota | NA |
| Texas | Aa1 | Wyoming | NA |
| Washington | Aa1 | | |
| Alabama | Aa2 | | |
| Alaska | Aa2 | | |
| Arkansas | Aa2 | | |
| Hawaii | Aa2 | | |
| Idaho | Aa2* | | |
| Kentucky | Aa2* | | |
| Massachusetts | Aa2 | | |
| Montana | Aa2 | | |
| New Hampshire | Aa2 | | |
| North Dakota | Aa2* | | |
| Oregon | Aa2 | | |
| Pennsylvania | Aa2 | | |

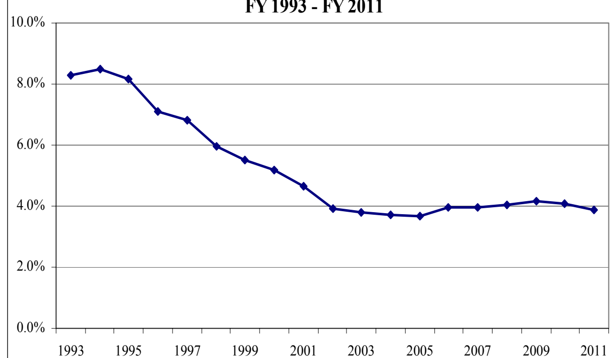
Ratings in Order of Highest to Lowest = Aaa, Aa1,Aa,Aa2,Aa3, A1,A2 (NA=No GO Debt)
* Issuer Rating (No General Obilgation Debt)
Source: Moodys Investors Service - 2008 State Debt Medians, April, 2008

As Table 3 shows, 46 of the 50 states currently have a bond rating from Moody's Investors Service. Four states do not have general obligation debt bond ratings. These states typically use pay-as-you-go financing or other methods of funding capital projects. The states are sorted from the highest bond rating of Aaa to A3. Rhode Island is among 12 states that have a rating of Aa3.

*Debt as a Percent of Personal Income* – The PFMB set a guideline that net tax supported debt levels should not exceed 5.0 to 6.0 percent of personal income. The State Budget Office projected tax supported debt as a percentage of personal income would decline over the next five fiscal years to 3.4 percent by 2013. The enacted budget decreases that to 3.2 percent in FY 2013 due, in part, to the lowered amount of debt approved by the General Assembly in FY 2009 in an effort to maintain control of the State's debt burden.

It should be noted that this projection is calculated differently than Moody's analysis noted earlier in the report due to the use of different dates for net debt and personal income.

**Chart 2**
**Net Tax Supported Debt as a Percent of Personal Income**
**FY 1993 - FY 2011**




*Debt Service and General Revenue* - Based on the FY 2009 Enacted budget, the Capital Budget, and Budget Office projections, debt service as a percentage of general revenues is projected to be approximately 6.0 percent in both FY 2009 and FY 2013. Net debt service obligations are projected to increase from $206.9 million in FY 2009 to $235.8 million in FY 2013 – a 12.5 percent increase during this period.

**November 2008 General Obligation Bond Proposals**

Voters will be asked to approve up to $89.7 million in new general obligation bond authority on November 4, 2008. According to the 2008 Voter Information Handbook published by the Secretary of State's Office, principal and interest payments for all proposed projects are estimated to total $156.4 million over the 20-year payback period. The estimates are based on a 6.0 percent interest rate on the bonds, and assume that the State issues all the bonds at once (which it never does – the debt is issued as the projects progress). This figure includes the total amount to be borrowed if all bond proposals are approved ($89.7 million) and the interest on the amount borrowed ($66.7 million).

RIPEC has traditionally not taken positions on specific bond questions. Therefore, the following highlights each bond referendum placed on the ballot and provides examples of questions taxpayers might consider when voting.

**Transportation –** The State has proposed $87.2 million in State general obligation bonds to support State transportation initiatives including $80.0 million in direct and State matching funds for infrastructure improvements to Rhode Island's roads, highways and bridges.

In addition to infrastructure improvements, $3.6 million of the funds will be used to match available federal funds and provide direct funding for the development of commuter rail. The project aims to extend the commuter rail line from Boston to Warwick and North Kingstown and includes funds to construct stations and tracks, purchase right-of-way rights, trains, and other rail infrastructure needed to support a passenger rail service.

The balance of $3.6 million will be for purchase and rehabilitation of RIPTA buses. This is part of a multi-year program to replace buses and other revenue vehicles that have exceeded, or are about to exceed, their useful life.

The State's highway improvement program for FY 2009 – FY 2013 includes an estimated $1.0 billion in federal highway matching funds. The general obligation bonds, coupled with potential proceeds from the sale of real estate, municipal contributions, and other "soft matches", serve as the State's match for federal highway funding.

Questions to consider include:

- How will the State finance scheduled projects if funds are not approved and made available to match federal dollars?
- What is the future impact on State transportation projects due to the Federal Highway Trust Fund deficit?
- What effects will decreased gas tax revenues have on debt financing and debt service, particularly for RIPTA and GARVEE projects?
- What other obligations will the State incur for the commuter rail project?
- How will the State's transportation infrastructure be impacted if the funds are not approved?

**Open Space** – The State has proposed $2.5 million in general obligation bonds to provide funding assistance to the Department of Environmental Management (DEM) for the purchase or permanent protection of open space and other public land including, but not limited to, State forests, conservation easements and agriculture lands. These funds are to be combined with federal, non-profit, and municipal funds to purchase real estate and coordinate preservation projects.

The federal government, through the U.S. Department of Agriculture and the Natural Resources Conservation Service (NRCS), provides matching funds at a 1:1 ratio. The NRCS estimates a FY 2009 allocation of federal farmland protections funds to Rhode Island of 3.7 million. Passage of the measure, combined with leveraged non-profit and other funds would be used to secure the federal match.

Issues for consideration include:

- Are the State general obligation bonds being used to maximize other sources of revenue, to include private and federal resources?

- How will the State prioritize land acquisitions throughout the State?

- Should the State consider other financing mechanisms given the size of the issue and the State's current fiscal limitations?

**Table 4**
**Total Estimated Bond Referenda Costs**

| Project | Principal | Interest | Total |
|---|---|---|---|
| Transportation | 87,215,000 | 64,861,023 | 152,076,023 |
| Open Space and Recreational Development Bonds | 2,500,000 | 1,859,228 | 4,359,228 |
| Total Cost | $89,715,000 | $66,720,251 | $156,435,251 |

Principal and Interest include cost of issuance; Interest is based on a rate of 6.0 percent over 20 Years (May vary when issued); Assumes level payments

Source: 2008 Voter Information Handbook, Secretary of State

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