RIPEC

Comments on Your Government

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Analysis of Rhode Island's Debt Position and 2010 Bond Referenda

Introduction

In November, voters will be asked to consider three bond questions that would authorize $177.4 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 three bond questions that will be put before the voters on November 2, 2010.

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. According to State Budget documents, net tax-supported debt is anticipated to increase from 4.3 percent of personal income in FY 2010 to a 4.6 percent in FY 2012. The State Budget Office projects this amount will decline to 3.7 percent in FY 2015, assuming the capital budget is not increased.

The PMFB guidelines also state that annual debt service for tax-supported debt should not exceed 7.5 percent of general revenues. Documents from the PMFB indicate that debt service was estimated to be 6.0 percent of general revenue in FY 2009. Although this was within the PMFB guidelines, debt service as a percent of revenues is projected to increase to 7.8 percent in FY 2013 and 7.7 percent in FY 2014, outside of the Board's recommended debt service ratio of 7.5 percent, before declining to 7.3 percent in FY 2015.

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 11th highest in the country.

The economic downturn continues to have an impact on the State's ability to borrow funds at affordable levels in order to finance its capital needs. As access to capital markets continues to be strained, it is important that the State continue to preserve or improve its current rating level of Aa2 (Moody's), and AA (S&P and Fitch). Although Rhode Island has been cited for its fiscal discipline in past years, all three rating agencies have a negative outlook, in large part due to the State's significant unfunded pension liability and continued budgetary stress.

Rhode Island's Capital Budget

Overview – The FY 2011-2015 Capital Budget includes approximately $2.5 billion in revenue from current financing streams and $1.0 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 $494.1 million in general obligation debt (assuming all referenda are approved) during the five year period, including the proposed new general obligation debt in the bond referenda to be presented in 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, 2010, Rhode Island had a net tax supported debt of $1,865.8 million (see Table 1), representing a 13.0 percent increase from June 30, 2008 ($1,651.3 million). Net tax supported debt currently includes the following:

<u>Direct debt:</u> 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 $1,036 million in outstanding direct debt as of June 30, 2009 and $269.3 million authorized but unissued debt as of June 30, 2010. Direct debt increased by 3.9 percent between June 30, 2008 and June 30, 2009.

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

	2008	2009	2010
Direct Debt			
Various Purpose Bonds Outstanding	$ 982,923	$ 1,036,189	$ 972,695
Proposed General Obligation Bond Issuance	-	-	90,465
Variable Rate General Obligations	14,165	-	-
Subtotal	$ 997,088	$ 1,036,189	$ 1,063,160
Guaranteed Debt			
Subtotal	$ -	$ -	$ -
Other Debt Subject to Annual Appropriation			
Convention Center Authority Outstanding	$ 270,960	$ 263,800	$ 256,270
Projected Convention Center Authority - VMA	-	-	29,750
Econ Dev. - Transportation (motor fuel)	72,560	81,125	77,645
Public Buildings Lease Rental Bonds	24,235	6,040	-
CP - Vehicle Leases	14,395	9,400	5,425
CP - Intake Center	5,535	2,775	-
CP - Attorney General	2,230	2,030	1,745
CP - Pastore Steam Plant	22,160	21,035	19,650
CP - DLT Howard Complex	13,375	12,630	11,200
CP - Shepards Building	20,980	19,155	17,245
CP - Training School	48,370	46,470	44,500
CP - Kent County Courthouse	52,075	49,690	47,240
CP - Tribunal Court Complex	19,940	19,090	18,215
CP - Information Technology	21,000	30,500	25,935
CP - School for the Deaf	-	30,425	29,500
CP - Energy Conservation*	12,735	23,920	43,020
CP - Projeted DMV	-	-	10,066
Loan Agreement - HSTC Fund	-	150,000	135,195
Rhode Island Housing NOP	18,152	13,179	8,450
Econ. Dev. - URI Power Plant	11,494	10,759	9,995
Econ. Dev. - Masonic Temple	9,775	5,030	-
Econ. Dev. - McCoy Stadium	3,265	2,220	1,130
Subtotal	$ 643,236	$ 799,273	$ 792,176
Performance Based Agreements			
Econ. Dev. - Fleet	9,415	9,180	8,925
Econ. Dev. - Fidelity Building	19,592	18,708	17,749
Econ. Dev. - Fidelity Building II	9,766	9,514	9,244
Subtotal	$ 38,773	$ 37,402	$ 35,918
Gross Debt	$ 1,679,097	$ 1,872,864	$ 1,891,254
Less: Adjustments for Agency Payments	(27,766)	(26,617)	(25,406)
Net Tax Supported Debt	$ 1,651,331	$ 1,846,247	$ 1,865,848

* Energy Conservation - URI and DOA, Projected Pastore/Zambarano

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

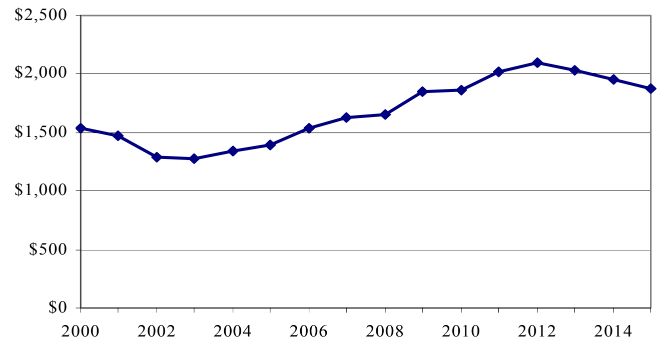
RBA - Refunding Bond Authority; CP - Certificates of Participation; HSTC - Historic Structures Tax Credit; NOP - Neighborhood Opportunities Program

As of June 30, 2010 Rhode Island had $792.2 million in this type of outstanding long-term debt. Of this amount, approximately one third ($286.0 million) was debt related to the Rhode Island Convention Center. Between June 30, 2008 and June 30, 2010, other outstanding long-term debt increased by 23.3 percent, largely due to the loan agreement for the Historic Structures Tax Credit of $150.0 million (90.8 percent of the increase and 17.1 percent of total other long-term debt). Although this component of tax supported debt has increased, it should be noted that a large portion of the State's earlier debt was related to DEPCO debt obligations which the State repaid as of August 2000. This was 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 2000 through FY 2015. 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.

Other Long-term debt: 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 2000 - FY 2015



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 2010 debt per capita, 2010 tax-supported debt was divided by 2009 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, both Connecticut (1st highest) and Massachusetts (2nd highest) ranked above Rhode Island.

As shown on Table 2, Rhode Island's 2010 net tax-supported debt per capita was $2,127. This level of per capita debt for every man, woman and child exceeds the United States median ($936) by $1,191. As a result, the Ocean State's per capita debt burden was 127.2 percent higher than the US 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 2010 ratio of debt to personal income, the 2010 tax supported debt is divided by 2008 personal income.

Table 2
Net Tax Supported Debt

Per Capita	1990	2000	2010
U.S. Median	$349	$541	$936
Connecticut	1,175	3,037	4,859
Maine	304	487	760
Massachusetts	1,435	2,957	4,606
New Hampshire	419	463	665
Rhode Island	**779**	**1,497**	**2,127**
Vermont	456	828	709
RI Rank within U.S.	8	7	9

Percent of Personal Income (2008)	1990	2000	2010
U.S. Median	2.2%	2.2%	2.5%
Connecticut	5.1%	8.1%	8.7%
Maine	2.0%	2.1%	2.2%
Massachusetts	6.9%	8.0%	9.2%
New Hampshire	2.2%	2.0%	1.6%
Rhode Island	**4.6%**	**6.2%**	**5.2%**
Vermont	3.0%	3.8%	1.8%
RI Rank within U.S.	9	5	11

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 11th highest in 2010. The debt level in the Ocean State equals 5.2 percent of State personal income compared to the U.S. median of 2.5 percent. Among the New England states, both Massachusetts (ranking 2nd) and Connecticut (ranking 3rd) ranked above the Ocean State.

Rhode Island's 1990 net tax-supported debt as a percent of personal income was 4.6 percent. That ratio increased to a high of 8.8 percent in 1994 before declining to 4.1 percent in 2006. Moody's notes that debt nationally has increased significantly since 2008 due, in large part, to low interest rates, built up demand for municipal bonds following the 2008 market disruptions, ARRA-related bonds, and the need for budgetary relief.

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

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

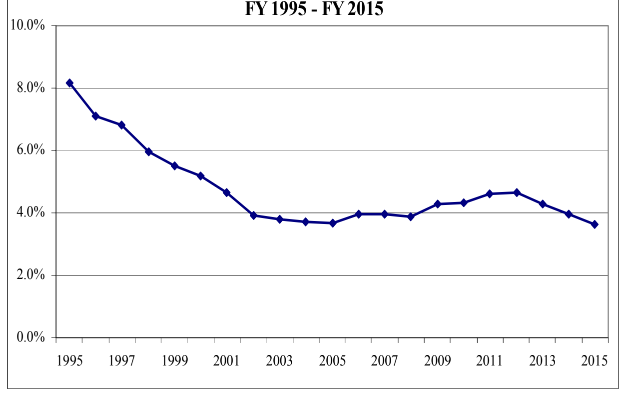
* Issuer Rating (No General Obilgation Debt)

Source: Moodys Investors Service - 2008 State Debt Medians, April 2008

As Table 3 shows, 47 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 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 Aa2. The State's current rating represents an improvement over 2009 when Rhode Island's rating was 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 will increase in FY 2011 and FY 2012, but will decline to 3.7 percent by 2015. 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 1995 - FY 2015



Debt Service and General Revenue - Based on the FY 2009 Report on Debt Management to the PMFB, debt service as a percentage of general revenues is projected to grow from 7.3 percent of general revenues in FY 2011 to 7.7 percent of general revenues in FY 2014, 0.2 percent higher than the PMFB guidelines. Net debt service obligations are estimated to increase from $219.1 million in FY 2011 to $277.9 million in FY 2014, a 6.2 percent increase.

November 2010 General Obligation Bond Proposals

Voters will be asked to approve up to $177.4 million in new general obligation bond authority on November 2, 2010. According to the 2010 Voter Information Handbook published by the Secretary of State's Office, principal and interest payments for all proposed projects are estimated to total $239.1 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 is typically not the case – the debt is issued as the projects progress). This figure includes the total amount to be borrowed if all bond proposals are approved ($177.4 million) and the interest on the amount borrowed ($131.9 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.

Higher Education – The State has proposed a $78.0 million in general obligation bonds for higher education capital projects. Of the total, $61.0 million will go to finance a new Center for Chemical and Forensic Sciences at the University of Rhode Island (URI) and $17.0 million will be dedicated to renovating and building an addition to the Art Center at Rhode Island College (RIC).

The URI project is estimated to triple the size of teaching space and double the space for research labs, increasing the student capacity by approximately 50 percent, from 1,200 to 1,900 students per semester. The proposed center will be a core education facility and will join the College of Pharmacy, the Center for Biotechnology and Life Sciences, and the College of Nursing on the North Science Quadrangle on the school's Kingston Campus.

The Arts Center renovation at RIC will support renovations to bring the building up to current code and redesign the space to support the Department of Art. The current building houses the entire Department including classrooms, studios and offices. The upgraded facility will include additional faculty offices, classrooms, studios, workshop areas, slide library, photography lab, computer lab and multipurpose presentation areas.

Questions to consider include:

- Is there high enough demand for these programs to merit the expansions?
- Will the State or schools be able to leverage these facilities to secure additional funding for research above and beyond their current capacity?
- What will be the impact on the schools' competitiveness and their students' educational needs if this initiative is rejected by the voters?
- Can or should the renovations and site improvements at RIC be funded using the State's pay-as-you-go capital program?

Transportation – The State has proposed issuing $84.7 million in general obligation debt for transportation-related projects. Of this amount, $80.0 million would be in direct and State matching funds for infrastructure improvements to Rhode Island's roads, highways and bridges. The State's general obligation bonds serve as the State's match to receive the Federal funding; it is estimated that these funds will allow the State to leverage $180 million in federal funds each year.

Major projects include replacement of the Providence Viaduct carrying Interstate 95 and the Pawtucket River bridge replacement. In addition, the funds would be used for general road resurfacing and other bridge work as a part of the State's highway improvement program.

The balance of the $4.7 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.

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?
- Are current gas tax revenues sufficient to fund debt service, particularly for RIPTA and GARVEE projects?
- How will the State's transportation infrastructure be impacted if the funds are not approved?

Open Space and Recreation – The State has proposed $14.7 million in general obligation bonds for open space and recreation initiatives including land acquisition around the former Rocky Point Park and the former Shooters nightclub, as well as renovations and repairs at Fort Adams State Park.

Of the total, $10.0 million would be used to provide funds to the Department of Environmental Management (DEM) to acquire all or a portion of the land in and around the former Rocky Point Park for the purpose of establishing the same as a public park. The land is currently in federal receivership. Part of the property was acquired in 2008 by the City of Warwick with funding assistance via the National Oceanic and Atmospheric Administration (NOAA) Costal and Estuarine Land Conservation Program.

The ballot measure also includes $3.2 million to transfer the title for the former Shooters nightclub from the Department of Transportation (DOT) to DEM, with the funds being used to reimburse the US Federal Highway Administration for the market value of the land in order to preserve the property as open space. The site was purchased in 2000 by the Department of Transportation (DOT) as part of the I-195 relocation project and is the first piece of waterfront property to be reopened for new development.

The $1.5 million balance of the bond would be to improve and make renovations to the Fort Adams State Park. The Park is a recreation facility located in Newport that receives over 500,000 visitors annually and is used as the site of a variety of special events, including the Jazz and Folk Festivals each August. Funds would go toward securing interior areas of the Fort surrounding the Parade to allow for expanded public access.

Issues for consideration include:

- What is the potential impact if the State were to not require the land for recreation/open space?
- Will the State be able to leverage additional funding if necessary?
- How will the State prioritize land acquisitions throughout the State?
- Are these sites significant economic assets that will provide a return on investment if the bond issue passes?

Table 4
Total Estimated Bond Referenda Costs

Project	Principal	Interest	Total
Higher Education Bonds	$78,000,000	$58,007,909	$136,007,909
Transportation	84,700,000	62,990,639	147,690,639
Open Space and Recreational Development Bonds	14,700,000	10,932,260	25,632,260
Total Cost	$177,400,000	$131,930,808	$309,330,808

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: 2010 Voter Information Handbook, Secretary of State