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 2014 Ballot Initiatives

This RIPEC comments provides an updated look at the state's FY 2015 budget and out-years, based on the preliminary FY 2014 closing, as well as Rhode Island's current debt position. The report also summarizes the 2014 ballot initiatives. Although RIPEC does not take a position on bond initiatives, the report includes a number of questions for voter consideration.

Introduction

The preliminary, unaudited FY 2014 year-end statement, released by the State of Rhode Island Office of Accounts and Controls, shows a closing surplus of $68.0 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 2014 budget as enacted, and the preliminary closing amounts based on the State Controller's report. Revenues were higher than enacted by $20.3 million, and general revenue expenditures were $16.1 million less than enacted. After the transfer to the budget reserve, the resulting surplus was $8.7 million higher than enacted.

Although FY 2014 appears to have closed with a higher-than-anticipated surplus ($68.0 million versus the anticipated $59.2 million in the budget as enacted), out-year budget deficits are projected from FY 2016 onward. Based on recent RIPEC estimates that incorporate the FY 2014 closing, Rhode Island will have a projected surplus of $8.8 million in FY 2015. Despite this encouraging news, expenditure growth is projected to continue to outpace growth in revenues, perpetuating the state's cycle of out-year deficits. By FY 2019, the state will face a deficit ranging between $390.6 and $428.3 million.

Since the General Assembly did not fund the cost of living adjustment (COLA) in FY 2015, the modest cushion provided by a higher-than-anticipated closing surplus will likely be absorbed by COLA costs. Despite the higher-than-anticipated closing, out-year deficits will continue to hamper the state's ability to support these investments. Unless

Table 1
Preliminary FY 2014 Budget Statement ($ millions)

	Budget	Audit
Opening Surplus/Deficit	$104.1	$104.1
Reappropriated Surplus	7.1	7.1
General Revenues	3,416.0	3,436.3
Total FY 2014 Revenues	*$3,527.2*	*$3,547.5*
General Revenue Expenditures	$3,352.4	$3,336.3
Reappropriations (carried forward to 2015)	-	7.4
Excess Revenue to Retirement System	-	19.7
Total FY 2014 Expenditures	*$3,352.4*	*$3,373.3*
Balance	*$174.8*	*$174.2*
Transfer to Budget Reserve	($105.6)	($106.2)
Transfer to Depreciation Fund	($10.0)	($10.0)
Closing Surplus/Deficit	**$59.2**	**$68.0**

Source: State Controller Preliminary Audit; House Fiscal Advisory Staff "Budget as Enacted" 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.

One component of this decision is the state's capital budget and debt level. Capital investments provide both needed infrastructure improvements and can help boost 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.

This November, Rhode Island voters will be asked to consider seven ballot questions, four of which would authorize $365.0-$398.0 million in additional debt costs, including interest. Given the state's fiscal and economic outlook, 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?
- Given the current state employment outlook, is the pricing structure for these projects (including labor) optimal?

Preliminary FY 2014 Closing

Revenue Changes

Overall, FY 2014 revenues were higher than in the FY 2014 enacted budget. Table 2 provides an overview of the revised state revenues. Total FY 2014 actual revenues were $3,436.3 million – $20.3 million (0.6 percent) more than the enacted revenues of $3,416.0 million. Total tax revenue was $24.7 million (0.9 percent) higher than

Table 2
General Revenues (Preliminary-Unaudited)
for the Fiscal Year Ended June 30, 2014 ($ millions)

	Final Budget	Actual	Variance	% Variance
Personal Income Tax	$ 1,103.2	$ 1,115.5	$ 12.3	1.1%
General Business Taxes				
Business Corporations	$ 117.1	$ 115.2	$ (1.9)	-1.6%
Public Utilities Gross Earnings	108.0	101.4	(6.6)	-6.1%
Financial Institutions	13.5	22.0	8.5	62.8%
Insurance Companies	106.0	102.4	(3.6)	-3.4%
Bank Deposits	2.4	2.5	0.1	3.0%
Health Care Provider Assess.	41.8	42.1	0.3	0.8%
Sales and Use Taxes				
Sales and Use	$ 907.0	$ 916.1	$ 9.1	1.0%
Motor Vehicle	52.3	52.4	0.1	0.2%
Motor Fuel	0.5	0.5	0.0	4.8%
Cigarettes	139.1	139.5	0.4	0.3%
Alcohol	17.6	18.3	0.7	3.7%
Other Taxes				
Inheritance and Gift	$ 38.1	$ 43.6	$ 5.5	14.4%
Racing and Athletics	1.2	1.2	(0.0)	-1.9%
Realty Transfer Tax	8.0	8.0	(0.0)	-0.5%
Total Taxes	$ 2,655.8	$ 2,680.5	$ 24.7	0.9%
Departmental Revenue	$ 359.2	$ 360.3	$ 1.2	0.3%
Total Taxes and Departmentals	$ 3,015.0	$ 3,040.9	$ 25.9	0.9%
Other Sources				
Gas Tax Transfer	$ -		$ -	-
Other Miscellaneous	8.5	6.4	(2.1)	-24.6%
Lottery	380.7	376.3	(4.4)	-1.1%
Unclaimed Property	11.9	12.7	0.8	6.9%
Total Other Sources	$ 401.1	$ 395.4	$ (5.6)	-1.4%
Total	**$3,416.0**	**$3,436.3**	**$ 20.3**	**0.6%**

Source: Rhode Island State Controller

enacted. Within this total:

- Personal income tax collection actuals were $12.3 million (1.1 percent) higher than enacted, as were sales and use tax collection actuals ($10.2 million higher than enacted);
- The lower-than-anticipated revenue from insurance company, public utility gross earnings, and business corporation taxes accounted for general business tax revenue changes, as business corporation tax collections were $3.3 million lower than enacted (even though financial institution tax revenues were $8.5 million higher than anticipated, accounting for 62.8 percent of overall variance);
- Higher-than-anticipated inheritance and gift tax revenue ($5.5 million greater than enacted) accounted for 14.4 percent of overall tax revenue variance, and offset losses in other tax revenue categories such as racing and athletics and realty transfer taxes; and
- Departmental revenue was 0.3 percent, or $1.2 million higher than enacted.

Expenditure Changes

Total general revenue expenditures, based on the preliminary audited budget for FY 2014, were $3,336.3 million, or $16.1 million lower than enacted. The majority of the variance – approximately $19.1 million – was primarily due to lower-than-anticipated expenditures by general government and human services agencies ($8.0 million of which is attributable to the Executive Office of Health and Human Services).

Lower-than-anticipated spending for General Government constituted the majority of the difference between the actual and the enacted budget ($9.9 million, or 2.3 percent, less than enacted). Relative to enacted appropriations, the Legislature and the Department of Administration accounted for the majority of the variance, with expenditures of $4.2 million and $4.0 million less than enacted, respectively. However, $2.4 million of the Department of Administration's variance is attributable to money that the Department of Administration received to help other agencies support the initial 2.0 percent cost-of-living adjustment. It is important to note that this funding was spent by the individual agencies, and, therefore, should not be entirely attributable as Department of Administration spending.

Table 3
General Revenue Expenditures (Preliminary) for the FY Ended June 30, 2014 ($ millions)

	Final Budget	Actual	Variance	% Variance
General Government	$437.8	$427.9	$9.9	2.3%
Human Services	1,320.8	1,311.6	9.2	0.7%
Education	1,147.0	1,146.9	0.1	0.0%
Public Safety	410.5	413.2	(2.7)	-0.7%
Natural Resources	36.3	36.7	0.4	1.1%
Total	**$3,352.4**	**$3,336.3**	**$16.1**	**0.5%**

Source: State Controller Preliminary Audit for FY 2014

Net expenditures within Human Services were $9.2 million, or 0.7 percent, less than enacted. Relative to enacted appropriations, the Office of Health and Human Services and the Department of Behavioral Health, Developmental Disabilities and Hospitals accounted for the majority of the variance, with expenditures of $8.0 million and $3.2 million less than enacted, respectively. In contrast, the Department of Children Youth and Families spent $2.5 million more than appropriated.

Also of note are the higher-than-expected expenditures of public safety agencies, including the Department of Public Safety and the Department of Corrections ($1.8 million and $1.5 million variance, respectively). The Department of Public Safety's higher-than-expected variance was driven by Rhode Island State Police expenditures, which were $1.9 million higher than enacted. The higher-than-expected expenditures in the Department of Corrections were driven by a $2.6 million increase in the Custody and Security's total budget, relative to the final appropriation.

Budget Reserve and Cash Stabilization Fund

Rhode Island's Budget Reserve and Cash Stabilization Fund, commonly referred to as the "rainy day fund", was established in 1985. In the early 1990s, state spending was limited to 98.0 percent of estimated unencumbered general revenues for each fiscal year. Subsequently, the remaining two percent balance of general revenue that was appropriated into the Budget Reserve and Cash Stabilization account, provided that no payment into the account would increase the balance above three percent of the estimated general revenues.

Table 4
State Budget Reserve and Cash Stabilization Account
FY 2014 Preliminary ($ millions)

Opening Balance	$172.0
Calculated transfer from General Fund	106.2
Subtotal	*$278.2*
Transfer to Capital Fund	$101.2
Ending Balance	**$177.0**

Source: RIPEC calculations based on State Controller Preliminary Audit

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 on table 4, the Budget Reserve Fund had an opening balance of $172.0 million in FY 2014. The estimated transfer from the General Fund of $106.2 million resulted in a balance of $278.2 million. After transferring $101.2 million to the Rhode Island Capital Fund, a balance of $177.0 million remained. Based on statutory requirements, the plan is currently fully funded.

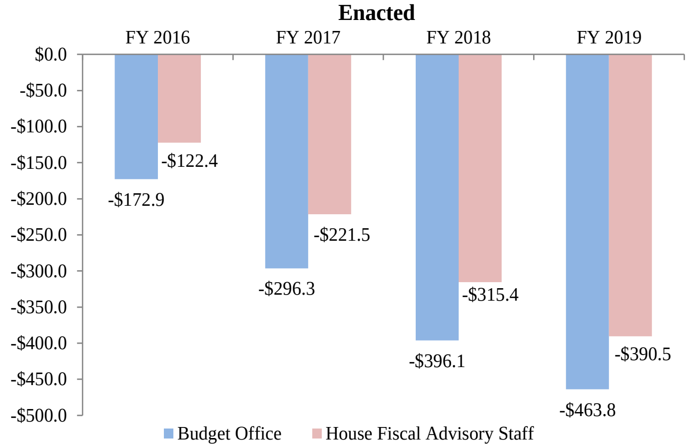
Forecast

The Budget Office's five-year financial projection, which has been updated based on the final enacted budget for FY 2015, indicates that expenditures are anticipated to exceed revenues through FY 2019. Expenditures in this projection are anticipated to increase at an average annual rate of 4.1 percent from FY 2015 to FY 2019, ultimately resulting in a FY 2019 deficit of $463.8 million.[1] The House Fiscal Advisory Staff's (HFAS) out-year forecasts, also based on the enacted FY 2015 budget,

[1] By comparison, inflation, as measured by CPI-U, is expected to grow by 2.4 percent over this time period.

indicate that expenditure growth is expected to outpace useable revenue growth for FY 2016-2019, ultimately leading to a FY 2019 projected deficit of $390.5 million. The differences in the Budget Office and HFAS projections are illustrated on Chart 1. Due to publication timing, these forecasts do not include the results of the FY 2014 preliminary audit.

Chart 1
Projected Out-Year Budget Deficits, FY 2015 Budget As Enacted



SOURCE: FY 2015 Budget As Enacted; House Fiscal Advisory Staff FY 2015 Budget as Enacted

Incorporation of the FY 2014 preliminary audit alters the anticipated out-year forecast in both the Budget Office and HFAS models. As opposed to the anticipated $0.6 million FY 2015 ending balance in the HFAS and Budget Office forecasts, the preliminary audit resulted in an anticipated $8.8 million FY 2015 closing surplus. The higher-than-expected preliminary audit surplus is also anticipated to lower the forecasted FY 2016 deficit, reducing it from $122.4 million to $114.3 million in the HFAS model and from $172.9 million to $164.4 million in the Budget Office forecast.

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 next Governor as he/she develops the FY 2016 budget.

Risks to the Forecast

Starting in FY 2016, this forecast also incorporates possible impacts of casino gaming in Massachusetts, which is just one of many policy issues that could have out-year fiscal impacts. Massachusetts's gaming law allows three Category 1 licenses: one in three specified regions of the state[2] and one slot parlor, or Category 2 license in one of the three regions. To date, the Gaming Commission has awarded the state's Category 2 slot parlor license to Penn National Gaming, which has begun construction on its facility at the Plainridge Racecourse in Plainville, MA. The Commission awarded the resort-casino license for Region B (Western Massachusetts) to MGM Springfield, and the resort-casino license for Region A (Eastern Massachusetts) to Wynn MA, LLC. The resort-casino license for Southeastern Massachusetts, or Region C, is anticipated to be awarded in August 2015. Also of note is a June 2014 Massachusetts Supreme Judicial Court ruling, which allowed a referenda initiative by anti-casino stakeholders to go on the statewide November 2014 ballot. The pending license for Region C, the results of the November 2014 ballot question, and the timing of

[2] Region A includes Suffolk, Middlesex, Essex, Norfolk and Worcester counties; Region B includes Hampshire, Hampden, Franklin and Berkshire counties; and Region C includes Bristol, Plymouth, Nantucket, Dukes and Barnstable counties.

casino openings will all determine when Rhode Island will begin to feel an impact on its state gaming revenues.

Another out-year fiscal unknown relates to the Affordable Care Act (ACA). Under the ACA, states were provided the flexibility to either join a federally facilitated marketplace, or develop their own state-based exchanges. Rhode Island, through Executive Order, created its own health benefits exchange, HealthSource Rhode Island (HSRI). To date, HSRI has been entirely funded through federal sources. Originally Rhode Island was required to fund HSRI through non-federal sources by January 1, 2015, however, the state has since received an extension of federal funds. Long-term funding sources beyond FY 2015 remain unknown, as there is no financial sustainability plan for HSRI. Funding for HSRI is not incorporated into the out-year forecast.

Moreover ACA's extension of Medicaid to adults without dependents up to 138.0 percent of the federal poverty level, will also have out-year fiscal implications on Rhode Island's budget. The ACA's Medicaid expansion is federally funded through 2016, after which the federal share declines. In January 2017, the federal Medicaid rate will decrease to 95.0 percent; 94.0 percent in 2018; 93.0 percent in 2019; and lastly to 90.0 percent in 2020 and subsequent years. Assuming no changes are made to the program, Rhode Island will begin to contribute a 10.0 percent state match in 2020. It is important to note that the out-year forecast does take into consideration changes to Medicaid under the Affordable Care Act. However, the magnitude of state participation in January 2017 could change, based on a set of variables (including Medicaid enrollment).

The third major unknown out-year budget issue relates to the Rhode Island Retirement Security Act (RIRSA) of November 2011, which reformed state pension contributions for public employees by reducing the state's unfunded liability and future payment obligations. In June 2012, a legal challenge of RIRSA was filed, and both sides were ordered into mediation in December 2012. In February 2014, the Governor, General Treasurer, and attorneys representing public employee unions and retiree coalitions challenging the pension changes announced a settlement agreement achieved through court-ordered mediation. This joint-announcement articulated that the settlement agreement proposal preserved 95 percent of the savings from RIRSA. However, in April 2014, it was announced that a small union of eligible police officers opposed the settlement agreement, and, therefore, the case will go to trial (the date of which is to-be-determined).

As announced by Moody's Investors Service in April 2014, the failure of mediation and the resulting shift towards litigation resulted in a "credit negative" for both the state of Rhode Island and local Rhode Island municipalities. Moody's provided a range of possible financial outcomes of a litigated resolution, ranging from a reversal of RIRSA (resulting in state annual contributions of $500 million for FY 2016, or approximately 14.5 percent of FY 2016 available revenues), to a court decision to uphold RIRSA, the savings of which have already been incorporated into the budget. The magnitude of the range in potential annual state costs, Moody's noted, results in a "considerable risk" to Rhode Island's already challenged economy. The out-year forecast assumes continued governance of RIRSA, and does not include funding for a potential reversal. Moreover, a reversal of RIRSA could also put municipal finances, which would further complicate the state's out-year forecasts and general fiscal health.

The annual decision the General Assembly must make regarding repayment of the Job Creation Guaranty Program's debt service associated with 38 Studios presents another out-year fiscal forecast risk. Currently, the out-year forecast assumes the annual repayment of the 38 Studios moral obligation bond debt service. The General Assembly approved the first of these eight payments ($2.4 million) in 2013, and the Governor's FY 2015 budget as enacted included $12.3 million in general revenues to make the second payment. Potential non-payment of this debt would harm the out-year deficits by likely damaging the perception of Rhode Island's creditworthiness in the market. Secondly, the state's bond rating could be downgraded in response to default. Both of these implications could increase the state's cost of borrowing. The state's lower rating may not only affect general obligation debt—it could also impact the cost of the following types of debt issuances: appropriation-backed; credit-supported; public and quasi-public; and municipal.

Rhode Island's Capital Budget & Debt Position

In contrast to state operating budgets, which usually include funding for one fiscal year, capital budgets include funding for multiple years. Capital budgets typically include projects that are:

- unique and unlikely to be repetitive;
- tangible and readily identifiable;
- of larger financial magnitude than many operating budget projects; and
- have long-term future consequences.

Table 5
Rhode Island's Net Tax-supported Debt ($ thousands)

	2012	2013	2014
Direct Debt			
Various Purpose Bonds Outstanding	$ 1,110,585	$ 1,119,450	$ 1,080,270
Proposed General Obligation Bond Issuance	-	-	60,125
Variable Rate General Obligations	-	-	-
Subtotal	$ 1,110,585	$ 1,119,450	$ 1,140,395
Other Debt Subject to Annual Appropriation			
Convention Center Authority Outstanding	$ 250,510	$ 236,960	$ 226,900
EDC-Transportation (motor fuel)	70,350	66,510	62,525
EDC-URI Power Plant	8,360	7,485	6,565
EDC-Job Creation Guaranty	75,000	81,500	73,577
CP-Equipment/Vehicle Leases	1,570	405	-
CP-Attorney General	1,145	830	505
CP-DLT Howard Complex	8,115	6,455	4,705
CP-Shepard's Building (originally EDC)	13,060	10,765	8,320
CP-Pastore Center Power Plant	16,735	15,185	13,580
CP-Kent County Courthouse	42,110	36,310	33,180
CP-Traffic Tribunal Court Complex	16,380	15,290	14,115
CP-Training School	40,290	36,575	33,825
CP-Information Technology	16,795	21,480	16,890
CP-School for the Deaf	27,410	26,320	25,185
CP-CCRI Energy Conservation	6,145	5,540	4,925
Loan Agreement-Historic Structures Tax Credit Fund	105,990	90,575	74,400
CP-DOA Energy Conservation	23,645	38,915	35,060
CP-URI Energy Conservation	20,400	18,905	17,305
CP-Division of Motor Vehicle System	8,175	6,675	5,110
Subtotal	$ 752,185	$ 722,680	$ 656,672
Performance Based Agreements			
Econ. Dev. - Fleet	$ 8,360	$ 8,045	$ 7,710
Econ. Dev. - Fidelity Building	15,586	14,364	13,038
Econ. Dev. - Fidelity Building II	8,643	8,309	7,950
Subtotal	$ 32,589	$ 30,718	$ 28,698
Gross Debt			
Less: Adjustments for Agency Payments	$ (22,780)	$ (21,353)	$ (12,013)
Net Tax Supported Debt*	$ 1,872,579	$ 1,889,895	$ 1,958,252

"CP" stands for certificates of participation; "EDC" is the Economic Development Corporation
*Totals include projections from the Governor's FY 2015 Capital Budget proposal that are not listed in this table
SOURCE: Rhode Island State Budget Office - Capital Budget, various years

Rhode Island's capital budget includes several sources of funding that include, but are not limited to, federal funding, general obligation debt, the Rhode Island Capital Plan Fund (RICAP funds), and private funding. The FY 2015-2019 capital budget enacted by the General Assembly includes capital outlays of $3,605.7 million for the five-year period. This plan is financed through $995.6 million of debt issuances and $2,610.1 million from existing revenue streams.

Credit 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, 2014, Rhode Island had a net tax-supported debt of $1,958.3 million (see table 5; total includes projections from the Governor's FY 2015 Capital Budget proposal), representing a 3.6 percent increase from 2013 ($1,889.9 million) and a 4.6 percent increase from 2012 levels ($1,872.6 million). Net tax-supported debt currently includes direct debt (e.g. general obligation bonds backed by the state), guaranteed debt, performance-based agreements, and other forms of debt such as certificates of participation.

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 $1,140.4 million in outstanding direct debt as of June 30, 2014. Direct debt decreased by 1.9 percent between June 30, 2013 and June 30, 2014.

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 master equipment lease agreements with financial institutions, revenue bonds issued by the Economic Development Corporation (EDC), and certificates of participation. As of June 30, 2014, Rhode Island had $656.7 million in this type of outstanding long-term debt. Of this amount, approximately one third ($226.9 million) was debt related to the Rhode Island Convention Center (including the Dunkin Donuts Center).

Chart 2
Rhode Island Net Tax-supported Debt ($ millions)
FY 2000 - FY 2019

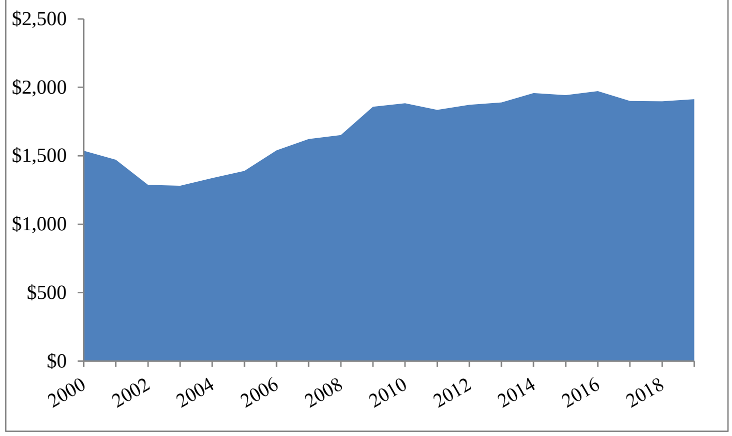


Chart 2 displays a projection of Rhode Island's net state tax-supported debt from FY 2000 through FY 2019. Net tax supported debt is projected to decrease by 2.3 percent from $1,958.3 million in FY 2014 to $1,913.6 million in FY 2019. Net debt used in these projections assumes current outstanding obligations and new debt programmed in the state's capital budget.

Overview of State Debt

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 DEPCO-related 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.

Chart 3
Net Tax-supported Debt as a % of Personal Income
FY 2000 - FY 2019

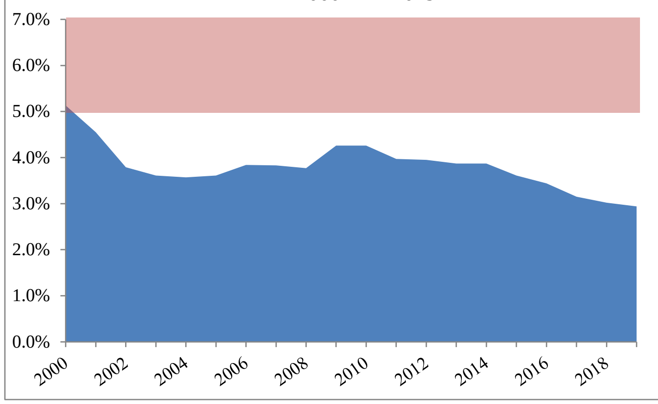
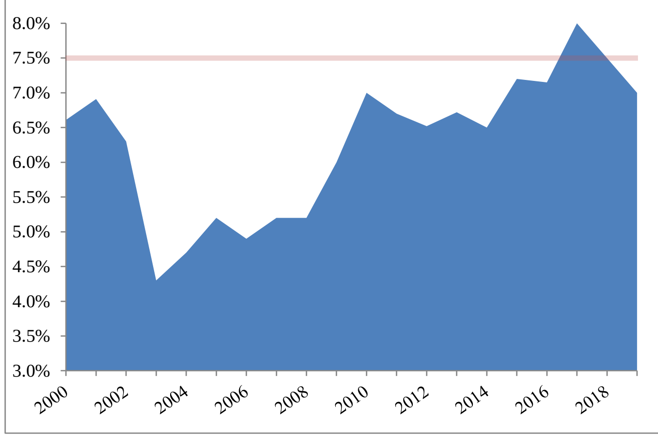


Chart 4
Debt Service as a % of General Revenues
FY 2000 - FY 2019



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. Credit guideline 1 is that tax-supported debt should not exceed the target range of 5.0 to 6.0 percent of personal income, and annual debt service for tax-supported debt should not exceed 7.5 percent of general revenues. Credit guideline 2 is 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. Lastly, the third credit guideline states that all of the guidelines may be exceeded temporarily under certain extraordinary conditions.

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. Although the state's debt as a percent of personal income was significantly above these guidelines through the mid-1990s, Rhode Island's debt burden has remained well below the PFMB guidelines since the 2000s, ranging from a low of 3.6 percent in FY 2004 to a high of 5.1 percent in FY 2000. The House Fiscal Advisory Staff projects tax-supported debt as a percentage of personal income will decline over the next few years, from 3.9 percent of personal income in 2014 to 3.1 percent in 2017 and 2.9 percent in 2019 (see Chart 3).

Debt Service as a Percent of General Revenues
The PFMB guidelines also state that annual debt service for tax-supported debt should not exceed 7.5 percent of general revenues. Based on data included in the Governor's FY 2015 Capital Budget as enacted, debt service as a percentage of general revenues is projected to grow from 6.5 percent of useable revenues in FY 2014 to 8.0 percent in FY 2017, which would exceed the PFMB guidelines for this measure. Chart 4 displays the trend of debt service increasing as a percentage of general revenues that has occurred since FY 2000.

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.

Table 6
Net Tax-supported Debt

Per Capita			
	1994*	**2004**	**2014**
U.S. Median	$399	$701	$1,054
Connecticut	2,483	3,558	5,457
Maine	469	492	951
Massachusetts	1,947	3,333	4,999
New Hampshire	639	496	864
Rhode Island	**1,779**	**1,385**	**2,064**
Vermont	846	724	878
RI Rank within U.S.	4	9	10

Percent of Personal Income			
	1994**	**2004****	**2014****
U.S. Median	2.1%	2.4%	2.6%
Connecticut	9.1%	8.4%	9.2%
Maine	2.6%	1.8%	2.4%
Massachusetts	8.2%	8.5%	9.0%
New Hampshire	2.9%	1.5%	1.8%
Rhode Island	**8.9%**	**4.4%**	**4.5%**
Vermont	4.5%	2.5%	2.0%
RI Rank within U.S.	3	12	13

*Based on estimated 1993 population
**As a percentage of 1992, 2002, and 2012 personal income, respectively
Source: Moody's Investors Service - Medians - Various Years

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 2014 debt per capita, 2014 tax-supported debt was divided by 2012 population estimates.

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 6). Among the New England states, both Connecticut (1st highest) and Massachusetts (2nd highest) ranked above Rhode Island. Rhode Island's 2014 net tax-supported debt per capita was $2,064. This level of per capita debt exceeds the United States median ($1,054) by $1,010 (95.8 percent higher than the US median).

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 2014 ratio of debt to personal income, the 2014 tax supported debt is divided by 2012 personal income.

As shown in Table 6, Rhode Island's 2014 net tax-supported debt as a percentage of personal income ranks 13th highest. The debt level in the Ocean State equals 4.5 percent of state personal income compared to the U.S. median of 2.6 percent. Among the New England states, both Connecticut (ranking 2nd) and Massachusetts (ranking 3rd) had debt levels as a share of personal income higher than the Ocean State.

Rhode Island's 1994 net tax-supported debt as a percent of personal income was 8.9

percent. That ratio declined to 4.4 percent in 2004, slightly below 2014 levels. Moody's notes that, nationally, despite low interest rates, new state borrowing grew by the smallest percentage in at least twenty years in 2013. However, overall, states' total debt service costs increased by 8.0 percent in 2013, as they began to repay the large amounts of debt incurred during the recent *Great Recession*.

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 7 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. Rhode Island is among 13 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, no state has a bond rating lower than A3. 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.

Table 7
General Obligation Bond Ratings

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

Ratings in Order of Highest to Lowest = Aaa, Aa1,Aa,Aa2,Aa3, A1,A2, A3 (NA=No GO Debt)
* Issuer Rating (No General Obligation Debt)
Source: Moodys Investors Service - 2014 State Debt Medians, May 2014

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 modestly positive general fund balances; and its narrow but improving liquidity."[3] On October 6, 2014, Moody's Investors Service upgraded Rhode Island's financial condition outlook from negative to stable, citing institutionalized governance practices, consistent funding of budget reserves, and positive trends in liquidity management as strengths to the state's outlook.

In the recent outlook upgrade, Moody's listed Rhode Island's challenges, which include "long-term economic underperformance with below-average long-term employment growth rates and very high unemployment rates; unresolved challenge to pension reforms, which has provided significant savings in recent years; above-average dependence on lottery and gaming revenues in saturated market; and recent legislative controversy regarding the state's moral obligation to appropriate debt service payments for 38 Studios economic development bonds." Moody's noted that the state's rating could go up with: stronger budget reserve levels; sustained economic improvements (specifically in metrics including job growth); and a track record of balancing budgets without significant one-time resources.

November 2014 Ballot Initiatives

When Rhode Island voters head to the polls on November 4, 2014, they will have the opportunity to vote on seven ballot initiatives. One of these initiatives would approve the convening of a state constitutional convention and two others relate to the expansion of gambling at the Newport Grand casino. The remaining initiatives would authorize the issuance of general obligation bonds, refunding bonds, and temporary notes of the state as part of Rhode Island's capital improvement plan. This section of the report provides a summary of each of the proposed referenda and comments on the financial components of each. RIPEC does not take a position on these questions, but this section will outline important questions that voters should consider when determining how they will vote.

General Obligation Bond Proposals

Voters will be asked to authorize up to $248.0 million in new general obligation bond debt on Election Day. The total cost of these proposals ranges between $365.0 million and $398.0 million, depending upon the interest rate (see Tables 8, 9 and Appendix A for more info). A summary of each bond referendum and key questions that voters should consider is included below.[4]

Question Four: Higher Education Facilities

The state has proposed issuing $125.0 million in general obligation bonds for capital projects at the University of Rhode Island. Specifically, funds would be used for Phase I of the URI College of Engineering Building Renovations project, which involves the construction of a center for the College of Engineering with modern teaching and research facilities on URI's campus as well as renovations to existing structures located around the Engineering Quad. Funds would also be used to demolish several outdated engineering buildings constructed in the 1950s and 1960s, including Crawford Hall, Gilbreth Hall, Kelly Hall and Annex, and Wales

[3] "Moody's revises Rhode Island outlook to stable and affirms Aa2 rating in conjunction with $208M GO sale." October 6, 2014. *Moodys.com*

[4] Over the course of researching these proposals, RIPEC has received detailed information on the bond proposals. Please contact RIPEC with additional questions about the proposals and their projected costs and benefits.

Hall. URI cites a 22.0 percent increase in student enrollment in the College of Engineering between 2008 and 2012 and the obsolescence of existing facilities as the main reasons why the project is necessary.

The state envisions Phase I as the first of a three-phase project designed to modernize and improve URI's College of Engineering. If the next Governor includes it in a subsequent budget proposal, Phase II of the project would tentatively include the expansion and renovation of Bliss Hall. Phase II would tentatively be paid for through an additional $25.5 million bond referendum in 2016. Phase III would involve the construction of new facilities for URI's Ocean Engineering and Oceanography programs paid for by a $38.9 million bond referendum that would potentially go before voters in 2018. If the $125.0 million bond referendum for Phase I of the project is approved, funds would be made available beginning in FY 2016.

Questions to consider include:

- Is it appropriate for the state to issue bonds for this project, or would the state be better off funding this project through a mix of funding sources, including, but not limited to, the use of the state's pay-go capital plan? Also, to what extent has the role of private fundraising for this project been considered?
- Are the demands for the associated academic programs at URI sufficient now, and projected to be sufficient in the future, to support the facility expansion?
- In what ways are the University's

Table 8
Scenarios for Estimated Bond Referenda Costs

Model	Total Principal	Total Interest	Total Lifetime
Low Estimate (4.0 percent interest)	$248,000,000	$116,962,200	$364,962,200
Medium Estimate (4.5 percent interest)	248,000,000	133,301,025	381,301,025
High Estimate (5.0 percent interest)	248,000,000	150,001,750	398,001,750

Note: Assumes a 20-year amortization with level debt service and a dated date of April 1, 2015
Source: Principal payment info from Rhode Island Secretary of State; RIPEC Calculations

Table 9
Total Estimated Bond Referenda Costs: Medium Estimate

Project	Principal	Interest	Total	Total Yearly
Higher Education Facilities	$125,000,000	$67,190,850	$192,190,850	$9,609,543
Creative and Cultural Economy	35,000,000	18,811,125	53,811,125	2,690,556
Mass Transit Hub Infrastructure	35,000,000	18,811,125	53,811,125	2,690,556
Clean Water, Open Space, and Healthy Communities	53,000,000	28,487,925	81,487,925	4,074,396
Total Cost	**$248,000,000**	**$133,301,025**	**$381,301,025**	**$19,065,051**

Note: Assumes a 4.5 percent interest rate, 20-year amortization with level debt service and a dated date of April 1, 2015
Source: Principal payment info from Rhode Island Secretary of State; RIPEC Calculations

related academic programs and proposed expansion, coordinated with broader, state-wide workforce development initiatives aimed at addressing the state's labor force challenges?

Question 5: Creative and Cultural Economy
The state has proposed issuing $35.0 million in general obligation debt to finance capital improvements and renovations at arts and cultural facilities throughout Rhode Island. $30.0 million of this total would be allocated to the Rhode Island State Council on the Arts (RISCA) to finance a new 1:1 matching grant program for public and private artistic, performance, and cultural arts centers throughout the state. The remaining $5.0 million would be used to create a program administered by the Rhode Island Historical Preservation and Heritage Commission that would provide grants to municipalities for preservation or renovation of historical or cultural sites.

Of the $30.0 million that would be used to fund the new matching grant program administered by RISCA, $23.1 million has been earmarked for the following recipients and projects:

- $4.6 million to the Trinity Repertory Company for the Lederer Theater and the Pell Chafee Performance Center for use as performance facilities, educational instruction, production, and administration, and including reimbursements of advances for up to $1.5 million for ongoing fire code compliance;
- $2.4 million to the Rhode Island Philharmonic for the Carter Center for Music Education and Performance for music teaching, learning, performance, and administration;
- $4.2 million to the Newport Performing Arts Center for the Newport Opera House for use as a multi-cultural performing arts and educational facility;
- $2.4 million to the United Theater/Westerly Land Trust for the United Theater for use as space for performing arts, fine arts showcase, arts instruction, cinema, public television station, and program administration;
- $1.1 million to the Chorus of Westerly for the George Kent Performance Hall for music and arts performance, teaching and rehearsal space, and administrative and community function space;
- $2.1 million to the Stadium Theater Conservatory in Woonsocket for set construction, costuming, rehearsal, voice, acting and dance studios, and administrative offices;
- $1.1 million to the 2nd Story Theater in Warren for performance venues, including concessions, studio and classroom space, dance studio, youth and adult education, gallery space, and artist living and working space;
- $2.1 million to AS220 in Providence for facilities used for performing arts, dance studio, youth and adult education, gallery space, and artist living and working space; and
- $3.2 million to WaterFire Providence for developing a historic warehouse for use as a headquarters, multi-use community arts center, visitor center, education center, and arts and creative industries incubator.

Questions to consider include:

- Is it an appropriate role of government to provide debt-based

funding to private arts and cultural institutions?
- Has the state explored alternate funding sources to support the projects (e.g. existing grant programs or private donations)?
- To what extent are these projects anticipated to improve economic performance, either through contributions to gross state product or labor force improvements?

Question 6: Mass Transit Hub Infrastructure
The state has proposed issuing $35.0 million in general obligation debt to improve the state's mass transit infrastructure. This would include the construction of a new transit hub located next to the Garrahy Courthouse as well as improvements to facilities in Kennedy Plaza and the Amtrak station in Providence. Other projects to enhance transit service throughout the state would also be funded through this ballot question.

Questions to consider include:
- Will the planned infrastructure projects improve the long-term accessibility and quality of transit service in the state?
- Is issuance of general obligation debt appropriate for state support of local projects?
- What are the economic, environmental and social impacts if the state were to not pursue these projects?
- Do these projects represent significant economic and social assets?

Question 7: Clean Water, Open Space, and Healthy Communities
The state has proposed issuance of $53.0 million in general obligation bonds, refunding bonds, and temporary notes for environmental and recreation programs. The $53.0 million is to be divided across six areas:
- $5.0 million would go towards the environmental remediation of brownfield sites. The funds would be used to provide matching grants of up to 80.0 percent to public, private, and non-profit entities for the cleanup, reinvestment, and reuse of former industrial sites.
- $3.0 million would go towards the design and construction of flood prevention projects such as dam repairs, improved resiliency of coastal habitats, and the restoration of river and stream floodplains.
- $3.0 million would go towards the acquisition of farmland to relieve farm owners from economic pressure to sell their land for residential or commercial development and ensure that farming can continue on the land.
- $4.0 million for municipal recreation projects through matching grants of up to 80.0 percent. Funds can be used by cities and towns for the development of sports fields, playgrounds, and other recreational facilities.
- $18.0 million would go towards improvements at Roger Williams Park and Zoo. $15.0 million of this total would be used to replace the zoo's tropical rainforest building, education center, and reptile house. The remaining $3.0 million would be used for the construction or repair of roads, bridges, sidewalks, and other infrastructure in the park.
- $20.0 million would go towards the Clean Water Finance Agency to provide funds to finance water

pollution abatement infrastructure projects.

Questions to consider include:
What resources does the state currently have to acquire and preserve open space/agricultural land, and what is the long-term goal in terms of total land to be preserved?

- Given the relatively lower cost of each of these initiatives, is general obligation bonding the appropriate financing mechanism, or should the state use pay-go financing instead?
- Are the state general obligation bonds being used to maximize other sources of revenue, to include private and federal resources?
- What roles have the private and non-profit sectors played in acquiring and preserving land in the state?

Appendix A

Total Estimated Bond Referenda Costs: Low Estimate

Project	Principal	Interest	Total
Higher Education Facilities	$125,000,000	$58,955,000	$183,955,000
Creative and Cultural Economy	35,000,000	16,505,800	51,505,800
Mass Transit Hub Infrastructure	35,000,000	16,505,800	51,505,800
Clean Water, Open Space, and Healthy Communities	53,000,000	24,995,600	77,995,600
Total Cost	**$248,000,000**	**$116,962,200**	**$364,962,200**

Note: Assumes a 20-year amortization with level debt service and a dated date of April 1, 2015
Source: Principal payment info from Rhode Island Secretary of State; RIPEC Calculations

Total Estimated Bond Referenda Costs: Medium Estimate

Project	Principal	Interest	Total
Higher Education Facilities	$125,000,000	$67,190,850	$192,190,850
Creative and Cultural Economy	35,000,000	18,811,125	53,811,125
Mass Transit Hub Infrastructure	35,000,000	18,811,125	53,811,125
Clean Water, Open Space, and Healthy Communities	53,000,000	28,487,925	81,487,925
Total Cost	**$248,000,000**	**$133,301,025**	**$381,301,025**

Note: Assumes a 20-year amortization with level debt service and a dated date of April 1, 2015
Source: Principal payment info from Rhode Island Secretary of State; RIPEC Calculations

Total Estimated Bond Referenda Costs: High Estimate

Project	Principal	Interest	Total
Higher Education Facilities	$125,000,000	$75,605,750	$200,605,750
Creative and Cultural Economy	35,000,000	21,170,750	56,170,750
Mass Transit Hub Infrastructure	35,000,000	21,170,750	56,170,750
Clean Water, Open Space, and Healthy Communities	53,000,000	32,054,500	85,054,500
Total Cost	**$248,000,000**	**$150,001,750**	**$398,001,750**

Note: Assumes a 20-year amortization with level debt service and a dated date of April 1, 2015
Source: Principal payment info from Rhode Island Secretary of State; RIPEC Calculations