



STATE DEBT OBLIGATIONS

INFRASTRUCTURE GENERAL GOVERNMENT APPROPRIATIONS SUBCOMMITTEE
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ISSUE BRIEF

SUMMARY

When a discussion on state debt occurs, the focus of the conversation typically centers on General Obligation debt – debt issued by the state based on the state’s “full faith and credit” and ability to raise taxes if needed to pay off obligations. While General Obligation debt is likely the most important type of debt held by the state, there exist many other types of debt obligations incurred by the state and its subdivisions. This Brief attempts to identify and classify the majority of those obligations. The Analyst calculates that approximately \$8 billion of outstanding state-related debt exists.

CATEGORIES OF STATE DEBT

In order to facilitate discussion of a complicated subject the Analyst classifies debt obligations into three categories:

1. Legal Obligations
2. Credit Obligations
3. Non-State Obligations

Legal obligations require the State of Utah to pay all outstanding debt no matter the circumstance. Credit obligations, while not legally binding to the State, nevertheless may significantly affect the credit of the state because of the perceived responsibility of the State to guarantee payment. Non-state obligations are debt incurred by entities that are both legally separate and do not involve the State’s credit.

For legal and credit obligations the Analyst makes a further distinction between direct and indirect state obligations. Direct obligations consist of debt incurred by entities that are directly attributable to the state. Indirect obligations consist of debt obligations that are only loosely related to the state. The table below summarizes these categories. A description of each category and sub-category follows along with examples and financial information related to each.

	Direct State Obligations	Indirect State Obligations
Legal Obligations	General Obligation Debt	Public School Debt Guaranty
Credit Obligations	State Building Ownership Auth.	Higher Education revenue bonds
Non-State Obligations	Housing Authority; Student Loans; Cities, Towns, and Counties	

Table 1

LEGAL OBLIGATIONS

Legal obligations require the state to pay the debt no matter what happens. In the event that the state could not meet a debt service appropriation for a legal debt, the state would have to levy a property tax sufficient to meet the obligation.

Direct – General Obligation Bonds

General Obligation (GO) bonds pledge the “full faith, credit and resources of the state.” The state uses its own credit to issue these bonds and must levy an annual tax on real and personal property sufficient to pay the debt service on the bonds when and if annual appropriations to debt service funds do not cover the obligation (U.C.A. 63B-1a-303). Each year the state appropriates an amount sufficient to pay GO principal, interest, and fees so as to avoid levying a state property tax. In FY 2013 the state will pay off \$296 million of principal and pay \$142 million of interest on general obligation bond debt.

As of June 30, 2011 the State of Utah owes \$3.3 billion of General Obligation bond principal to investors. This does not include additional Legislative authorizations that have not yet been issued of approximately \$575 million.

Indirect – School Bond Guaranty

In 1996 voters passed a referendum recommended by both the Constitutional Review Commission and the Legislature to amend the State Constitution to guarantee the debt of school districts (Article X, Section 5). The Utah School Bond Guaranty Act (U.C.A. 53A-28-201) governs the program and pledges the full faith and credit and unlimited taxing power of the state to ensure full payment of eligible public education debt. The Act requires the State Treasurer to determine whether the financial affairs of a particular school district would allow eligibility in the guaranty program. If eligible, the Treasurer issues the district a certificate of eligibility good for one year. The certificate may be used when issuing the school's bonds to receive the state's credit (currently AAA) and more favorable interest rates.

Several provisions of the Utah School Guaranty Act help mitigate the risk to the state of the guaranty program. A school district desiring to incur debt must first receive authorization from the voters to issue a general obligation bond. Then, each school board must transfer sufficient funds to make debt service payments at least 15 days before the due date to its paying agent. If sufficient funds are not transferred within 10 days before the due date, the paying agent must notify the State Treasurer who discharges the obligation. If the Treasurer makes a payment for a school district, the Treasurer must intercept any payment from the Uniform School Fund or other state funds to that district and use those funds to reimburse the state for payments made. The Treasurer may also assess a penalty on the district of up to five percent of the amount paid by the state. If the Treasurer is unable to collect sufficient funds through the intercept mechanism within one year of the date of payment, the Treasurer must pursue legal action against the school board including the compulsion to levy a property tax to repay the state.

The State Treasurer currently tracks outstanding debt and debt payments by the Utah school districts. The total principal outstanding at the end of FY 2011 was \$2.5 billion. To date all districts are current with their payments and there have been no defaults. Even though the state legally guarantees public education debt, the chance that the state would be called upon to actually pay that debt is extremely small. The built-in mechanisms give an incentive to school districts to pay their debt.

CREDIT OBLIGATIONS

Unlike legal obligations, credit obligations do not guarantee payment of debt service. A credit obligation lends the credit of the state to an entity without a legal liability to the state; thereby creating a credit liability to the state. The state's credit rating would likely be affected by a default on a credit obligation.

Direct – SBOA Lease Revenue

In 1979 the Legislature created the State Building Ownership Authority (SBOA) as a political and corporate entity to finance the construction of facilities through the issuance of lease revenue bonds (U.C.A 63-1-304 and 305). The Authority pays debt service on outstanding bonds with rental payments received from state agencies that in turn receive appropriations for such by the Legislature. State statute specifically excludes the state from legal liability or general obligations arising from debts issued by the SBOA.

To get the highest bond rating and in order to avoid the requirement of funding a debt service reserve fund to secure the bonds (and unnecessarily tie up cash in restricted accounts), the SBOA cross-collateralizes all of the 68 buildings owned by the Authority. The cross-collateralization gives bond holders "right, title and interest in all the facilities" should any debt service payment not be made. Since the Authority does not have the "full faith and credit" of the state and therefore has no taxing power, the Authority receives a lower credit rating (AA+ as opposed to AAA).

Even though the state does not directly issue SBOA lease revenue bonds the Authority is a creation of the state and the state appropriates funds for lease payments to pay off the bonds. As opposed to moral obligation bonds, credit agencies directly associate the Authority's lease revenue bonds with the state's credit. Any default by the Authority would directly affect the credit rating of the State of Utah.

The State Building Ownership Authority owes approximately \$380 million in outstanding principal and is scheduled to pay approximately \$23 million in principal and \$17 million in interest in FY 2013.

Indirect – Moral Obligations

Certain entities may issue revenue bonds secured by a pledge that each year a state official will certify to the Governor by December 1 the amounts necessary to restore any shortfall in a debt service reserve fund. This pledge constitutes a moral obligation of the state to fund the debt service even though no legal obligation exists. The Governor is not obligated to budget the debt service in his or her budget nor is the Legislature obligated to appropriate funds to cover the shortfall. The moral obligation allows the entity to receive a higher credit rating based on the state's credit and thereby issue bonds at lower interest rates. Currently, three entities may issue moral obligation bonds: entities listed under the State Financing Consolidation Act, the Utah Communications Network, and the State Board of Regents.

The State Financing Consolidation Act (U.C.A. 63B-1b) provides bonding authority for revolving loan funds such as water resources. There are currently \$61 million of revenue bonds outstanding under this authority. The Utah Communications Network (U.C.A. 63C-7-301) issued bonds to create a state communications network and currently has approximately \$4 million outstanding.

The State Board of Regents issues bonds in behalf of Utah institutions of higher education to finance buildings and in behalf of the Higher Education Assistance Authority. Buildings financed by Board bonds are repaid from pledged revenues from the operation of buildings, student fees, or proprietary activities. The Regents must first receive authorization from the Legislature before they issue any bonds for buildings. Not all of those bonds are secured with the pledge that would make them moral obligation bonds. Of the Regents' current outstanding debt for capital projects of \$647 million, about \$565 million is a moral obligation. Likewise, the Board issues some debt using the credit of the Utah Higher Education Assistance Authority (see next section) for student loans. However, \$1.2 billion of the \$1.9 billion currently outstanding bonds for student loans is moral obligation debt. The most recent issuance of student loan bonds received a 'AAA' rating as a result of the moral obligation pledge.

Credit agencies view a moral obligation as an indication that the state will contribute in the event of a default; hence a higher credit rating. Inaction by the state to stand behind a moral obligation pledge would likely negatively impact the credit rating of the state.

NON-STATE OBLIGATIONS

Non-state obligations rely on the credit rating of the entity rather than the credit of the State of Utah. Defaults of obligations by these entities would probably not affect the state. The State of Utah created three entities that may issue debt under their own authority, which does not constitute legal or moral obligations of the state: the Utah Housing Authority, student loans of the Utah Higher Education Assistance Authority, and the State Charter School Finance Authority. Utah counties, cities, and towns also fall under this category.

Housing and Student Loans (Asset Backed)

Asset backed entities rely on the value of owned assets as a source of collateral and credit. The credit of these entities improves as the assets grow and as the entities pay off obligations.

The Utah Housing Corporation (U.C.A. 9-4) gives Utah residents access to affordable housing through mortgage loans funded by the issuance of bonds. When first created, the Corporation may have issued moral obligation bonds using the state's credit; however, the Corporation currently operates independently of the state and is responsible for its own credit. The repayment of mortgage loans to the Corporation acts as collateral for the bonds issued and is the source of credit to the Corporation. The Corporation currently has \$1.7 billion of bonds outstanding; however, of that amount \$375 million is conduit debt for multi-family construction using the credit of private builders. Therefore, the total outstanding obligation of the Corporation is approximately \$1.3 billion.

Statute authorizes the Utah State Board of Regents (U.C.A. 53B-13-104) as the Utah Higher Education Assistance Authority (U.C.A. 53-12) to issue bonds in order to raise capital to make loans to students attending institutions of higher education in the state. The Authority issues bonds using the state's moral obligation (see previous section) and using its own credit. Bonds issued using its own credit do not convey any recourse to appropriated funds to cover a default. The Authority alone holds responsibility for the bonds and these bonds are rated based on the credit history, worthiness, and assets of the Authority. The repayment of student loans to the Authority acts as collateral for the bonds issued and is the source of

credit to the Authority for these revenue bonds. Of the \$1.9 billion of student loan debt currently outstanding, approximately \$648 million was issued using the Authority’s own credit.

Charter School Finance Authority

The State Charter School Finance Authority Act (U.C.A. 53A-20b-104) authorizes the State Charter School Finance Authority to issue bonds in order to finance charter school facilities. The approximately \$220 million of outstanding debt incurred by the Authority does not constitute legal or moral obligations of the state (U.C.A 53-20b-105).

Counties, Cities, Towns

The Utah State Constitution allows counties, cities, towns, school districts, and political subdivisions to issue debt with certain limitations (Article XIV, Sections 3 and 4). The Constitution further stipulates that the state will not assume any part of the debt of these entities except as provided by the School bond Guaranty (Article XIV, Section 6). Even though these entities are subdivisions of the state, the Constitutional provisions limit both the legal and credit risk to the state sufficiently that their obligations have no impact on the state’s credit rating. The amount of outstanding debt in Utah’s 29 counties and 243 cities is beyond the scope of this Brief.

CONCLUSION

The State of Utah currently holds an “AAA” rating from all three credit rating agencies for its General Obligation bonds. As discussed in the sections above, obligations other than General Obligations may impact this rating. The state currently appropriates sufficient funds to cover all General Obligation and SBOA lease revenue debt service. The State Treasurer actively monitors the Utah School Bond Guaranty program to ensure that school districts meet their outstanding debt payments and statutory controls so that the state assumes a minimal credit risk. Entities that contract moral obligations in the name of the state self-monitor their debt obligations knowing that any default would likely ruin any hope of future debt issuance. Non-state obligations should not affect the state’s credit rating and are actively monitored to a much lesser extent. Table 2 below contains an estimate of all outstanding debt, as discussed previously in the brief.

Principal Outstanding (billions) as of June 30, 2011				
	Direct State Obligations		Indirect State Obligations	
Legal Obligations	General Obligation Debt	\$3.3	Public School Debt Guaranty	\$2.5
Credit Obligations	State Building Ownership Auth.	\$0.4	Higher Education Student Loans	\$1.2
			Board of Regents Building Rev. Bonds	\$0.6
Total State Legal and Credit Obligations				\$8.0
Non-State Obligations	Housing Authority	\$1.3		
	Charter School Finance Authority	\$0.2		
	Student Loans	\$0.7		
			\$2.2	

Table 2