The Florida Senate

Interim Project Report 2000-05 *November 1999*

Committee on Budget Senator Locke Burt, Chairman

STATE GOVERNMENT DEBT ANALYSIS

SUMMARY

A significant portion of the State's recurring revenues are required for various bonded debt obligations. In recent years, Florida's debt issuance has reached historically high levels both in absolute and relative terms. This report provides both descriptive and evaluative information regarding Florida's debt status, debt structure, and debt analysis models.

While Florida's current and anticipated debt issues appear to be manageable with current revenues, the rapid growth in State debt over the past ten years demonstrates the need to adopt some debt management principles and guidelines.

Recommendations include:

- adopting guideline ratios for overall State debt and debt service;
- using a proposed set of microanalysis questions in considering new debt proposals;
- using available cash instead of borrowing; and
- building bonding capacity reserves in certain debt service revenue streams which have proven to be insufficient for desired program expansion in past years.

BACKGROUND

A significant portion of the State's recurring revenues are required for various bonded debt obligations. This includes bonds sold for Department of Transportation projects, Public Education Capital Outlay (PECO) funds, Lottery bonds for educational facilities, various land acquisition programs such as Preservation 2000 and Save Our Coast, private prisons contracted by the Correctional Privatization Commission, port improvements administered by the Florida Ports Financing Commission, the State Office Building Program managed by the Department of Management Services, and others. In addition, there are other entities which are not state agencies, such as the water management districts and direct support organizations created within the educational institutions, which have debt obligations not met by state revenues.

Section 215.62, Florida Statutes, creates the Division of Bond Finance to provide a centralized debt management function. The Governor and Cabinet serve as the governing board of the Division. The Division of Bond Finance is responsible for issuing bonds on behalf of all State agencies, and on behalf of all State authorities unless otherwise specified in law. Bonds may be issued for State purposes only if specifically authorized by law.

Most of the major bond programs of the state are authorized in the Florida Constitution which also specifies the revenue sources to be used for debt service. Absent specific constitutional authority for a bond program, state **general obligation bonds** secured by the State's full faith and credit may not be issued without being approved by vote of the electors. **Revenue bond programs** are secured only by a dedicated revenue stream, such as the Lottery Bond Program. The remaining type of state debt is bonds **subject to annual appropriation** such as the Facilities Management Bond Program for State office buildings. The lease purchase contracts executed by the Correctional Privatization Commission (CPC) are another type of appropriated debt. Although the actual financing instruments are issued by private vendors, the CPC incurs a long-term obligation on behalf of the state to pay for the leased facilities.

In recent years, Florida's debt issuance has reached historically high levels both in absolute and relative terms. One of the objectives of this project was to summarize the State's debt programs and the amount of debt outstanding for each type of bond program. (An effort was also made to identify and quantify the amount of other debt issued by quasi-governmental entities. This will be discussed in the methodology section below.)

A second objective of this study was to provide both descriptive and evaluative analyses which would describe the growth of state debt over the last ten years. These analyses would allow the State to:

- evaluate the growth in debt with respect to the growth in funds used to pay debt service and other measures of debt capacity;
- evaluate the impact of future expected debt issuance on the relevant measures of fiscal capacity; and
- develop an approach that can be used to make decisions regarding new debt proposals and best use of available funds.

METHODOLOGY

In order to determine the information and analyses that would be most useful to legislators trying to understand the State's current debt posture and future debt proposals, this study was conducted as a joint effort with staff from the House of Representatives. In addition, staff of the Division of Bond Finance and staff of the Legislative Office of Economic and Demographic Research were consulted extensively, since they possess the greatest expertise required for this type of study. Staff from the Executive Office of the Governor also made contributions to the analysis at several of the meetings held.

During the months of June, July, and August, 1999, numerous meetings were held with the above referenced participants. Since the Division of Bond Finance was also engaged in its own debt affordability study during this period, much time was spent discussing the information they were generating contemporaneously. (Much of the information presented herein will also be presented in Division of Bond Finance's report which is expected to be released in November, 1999.)

An attempt was also made to review various debt programs created and supported by quasi-governmental agencies such as educational system direct support organizations (DSO's) and research foundations, county educational facilities authorities, airport authorities, and Water Management Districts. Debt issued by these entities may be authorized by law, but are not State obligations. Yet they may be of concern to the State if circumstances created the potential for their default. In the course of this study, it was determined that defining which entities should be included in this group is a matter of subjective interpretation. In other words, determining which entities the state would feel compelled to assist in the event of financial default is pure speculation. Further, no meaningful way to relate these entities' debt statistics to legislative decision making on State debt could be identified. Therefore, this study was limited to assessing only debt programs which are directly related to State revenue sources. It would be instructive, however, for another study to be conducted focused on defining and inventorying debt issued by quasi-governmental entities.

Because of the significant amount of information compiled with the help of the Division of Bond Finance and the Legislative Office of Economic and Demographic Research, a separate informational document was also created and is available upon request.

FINDINGS

<u>STATE DEBT HAS RISEN RELATIVELY QUICKLY IN THE LAST TEN YEARS TO $16.8 BILLION</u>

As of June 30, 1999, the Division of Bond Finance records show that state bond programs can be grouped into 21 types of programs with a total of $16.8 billion of bonds outstanding. The corresponding annual debt service totals $1.3 billion. Table 1 below shows the breakdown by program of this total outstanding debt.[1] It also distinguishes between bond programs supported by state tax revenues versus programs funded by the revenues of a specified enterprise operation, such as toll roads or college dormitories.

Table 1 shows that over half of the State's debt outstanding relates to Education programs, the largest of which is the Public Education Capital Outlay (PECO) program which by itself constitutes over 40 percent of all the State's outstanding debt. The next largest programs are Preservation 2000 (recently extended in the form of the Florida Forever program) with 13.8 percent of the total debt, and the Transportation Toll Facilities program with 11 percent of the total debt.

During the past ten years, the State's debt outstanding has grown from $5.9 billion in 1989 to $16.8 billion as of June 30, 1999. This growth represents an average annual growth rate of about 11 percent. Correspondingly, the State's annual debt service cost for all outstanding debt has risen from $686.6 million in 1989 to $1.3 billion as of June 30, 1999. This total ten year increase represents an average annual growth rate of about 6.6 percent.[2] According to Moody's Investors Service in their January 1999 analysis, **Florida increased its' debt burden more significantly than any other state from 1993 to 1998.** In large part, Florida's debt growth mirrors it's rapid economic and demographic growth. In

TABLE 1
Florida Bonds Outstanding by Program Type[1]
As of June 30, 1999
(in millions)

	Net Tax-Supported	Self-Supported
Education		
Public Education Capital Outlay	$6,808.5	
Capital Outlay & Debt Service	945.3	
Lottery	546.3	
University Bonds	204.1	263.2
Totals	8,504.2	263.2
Total all Education	**8,767.4**	
Environmental		
Preservation 2000	2,324.4	
Conservation and Recreation Lands	27.4	
Save Our Coast	206.9	
Inland Protection Finance Corp ("tanks")	195.0	
Pollution Control		2.0
Totals	2,753.7	2.0
Total all Environmental	**2,755.7**	
Transportation		
Toll Facilities		1,850.6
Expressway Authorities		1,053.8
Right-of-Way and Bridge Acquisition	884.5	
County Road and Bridge		574.4
Florida Ports Financing Commission	213.3	
Totals	1,097.8	3,478.8
Total all Transportation	**4,576.6**	
Appropriated Debt and Other		
Florida Facilities Pool (State agencies)	375.6	
Master Equipment Financing Program	23.1	
Correctional Privatization Commission	196.7	
Dept. of Juvenile Justice	20.0	
Dept. of Children and Families	38.0	
Investment Fraud Restoration Finance Corp	8.9	
Florida Housing Finance Corp.	69.0	
Totals	731.3	0.0
Total all Appropriated/Other	**731.3**	
TOTALS	13,087.0	3,744.0
TOTAL ALL BONDS OUTSTANDING	**$16,831.0**	

comparison, the State's net General Revenue Fund receipts grew from $9.9 billion in 1989-1990 to a projected $18.6 billion in 1999-2000. Total State appropriations during that same period rose from $23.2 billion to $48.8 billion. Population grew from 12.5 million to 15.3 million.

THE NET TAX-SUPPORTED DEBT OF $13.1 BILLION IS MORE RELEVANT THAN TOTAL DEBT IN AN ANALYSIS OF STATE DEBT

To better understand State debt as it relates to State resources, the analysis must focus on debt programs funded from state tax revenues. Rating agencies, credit analysts and investors likewise exclude self-supporting debt in calculating debt ratios for governmental agencies. Florida's "self-supported" debt programs, as shown in Table 1 above, include: University Bonds which relate to University Auxiliary Facility Revenue Bonds ($263.2 million); Pollution Control; Toll Facilities; Expressway Authorities; and the County Road and Bridge program. These programs all are self-supported by revenue streams outside of the State's tax sources. (Nevertheless, the Pollution Control Bonds and the County Road and Bridge Bonds still represent a form of liability to the State since they are secured by the full faith and credit of the State.)

Excluding these self-supporting programs, the State's outstanding "net tax-supported debt" has grown over the past ten years from $3.5 billion to $13.1 billion as of June 30, 1999. On an annual basis this growth averaged 14 percent. The corresponding net tax-supported debt service has grown during the same period from $314.3 million to $1.1 billion, averaging 13 percent annually.

Throughout the remainder of this report, the discussions will refer to net tax-supported debt and associated revenues. In addition, the term "general revenues" will refer to the combination of those tax revenues dedicated to specific debt obligations and the General Revenue Fund receipts.

FLORIDA'S OVERALL DEBT RATIOS ARE HIGH COMPARED TO OTHER LARGE STATES, BUT ARE CONSIDERED "MODERATE" AND "LOW" BY RATING AGENCIES

According to staff of the Division of Bond Finance, bond market and credit analysts generally evaluate states' net tax-supported debt position using three key measures: (1) debt service as a percentage of state general revenues; (2) debt per capita; and (3) debt as a percent of personal income. For Florida's net tax-supported debt these three measures have all increased significantly over the past ten years from 1989 to 1999.

- **Debt service as a percentage of general revenues has grown from 2.84 percent to 5.09 percent during the ten years ending June 30, 1999;**

- **Debt per capita has grown from $275 to $861 during the ten years ending June 30, 1999; and**

- **Debt as a percent of personal income has grown from 1.49 percent to 3.32 percent during the ten years ending June 30, 1999.**

To put these ratios in perspective, comparisons with other states have been researched by the Division of Bond Finance in their latest report on Debt Affordability. Florida's three key ratios as of 1998 were all significantly higher than the median of ratios for the ten most populous "peer group" states.

- **For debt service as a percent of revenue, Florida's 1998 ratio was 4.6 percent compared to a peer group median of 3.5 percent.**

- **For debt as a percent of personal income, Florida's 1998 ratio was 3.15 percent compared to a peer group median of 2.7 percent.**

- **For debt per capita, Florida's 1998 ratio was $787 compared to a peer group median of $679.**

In comparison with the ten most populous states, only New York and New Jersey had higher 1998 debt ratios than Florida.

While Florida's ratios may be high compared to states of similar size, they are not out of bounds in the view of the private sector analysts. The Division of Bond Finance indicates in their report that Florida's June 30, 1999 debt service/revenue, debt/personal income and debt per capita ratios are respectively considered "moderate", "moderate" and "low" by credit analysts and rating agencies (on a scale of "low/moderate/high").

The Division of Bond Finance contends that the debt service/revenue ratio is the most appropriate single measure for overall debt affordability analysis. Using this key measure, they propose that Florida would be prudent to set 6 percent as the statewide target ratio for debt service/revenue, and that 8 percent should be adopted as an upper limit. They also point out that the bond industry considers anything above 10 percent to be excessive, and would likely adjust a state's bond rating downward in such a case. Florida's current debt service to revenue ratio of 5.09 percent compares favorably to the guideline proposed by the Division of Bond Finance.

<u>FLORIDA'S UNIQUE, PROTECTED DEBT STRUCTURE IS NOT ADEQUATELY ASSESSED BY BROAD DEBT RATIOS ALONE</u>

Although the three broad key measures used by bond market analysts may provide a convenient and understandable approach to measuring a state's debt position (and for comparing the debt position of the various states' to each other), it ignores the fact that, unlike most other states, all of Florida's outstanding general obligation debt is secured from dedicated tax revenue sources established in law. For example, the PECO program is funded primarily from the gross receipts tax on telecommunications and utilities. Preservation 2000/Florida Forever are funded from statutory allocations of the documentary stamp tax receipts. The Right of Way and Bridge Acquisition program is funded from motor fuel taxes. Most of the major bond programs of the state are authorized in the Florida Constitution which also specifies the revenue **sources** to be used for debt service.

Hence, **Florida's debt capacity and risk level do not relate to the growth and stability of the total revenues as much as they do to the growth and stability of the individual revenue streams dedicated to specific debt service costs.** In their October 20, 1998 analysis of Florida's debt, Fitch IBCA, Inc., an international rating agency, states that "the legal dedication of specific taxes for each type of debt...combined with coverage requirements for issuance, largely insulate debt security from fluctuations in the condition of the general fund. **All general obligations are well protected by their pledged revenues**..." (emphasis added). Later in that same report, Fitch IBCA states, **"Overall, Florida has a favorable debt structure, and debt management through the Division of Bond Finance, is excellent"** (emphasis added). While Florida's debt structure provides greater comfort to bond analysts in the private sector, **it also points out the need for Florida's net tax-supported debt load and future capacity to be studied on a program by program basis in addition to being evaluated in summary terms.**

<u>STABILITY OF REVENUES SUPPORTING FLORIDA DEBT PROGRAMS ARE ADEQUATE, WHILE REVENUE GROWTH COMPARED TO DESIRED SPENDING VARIES</u>

Tables included in the separate informational document created along with this report show historical trends for some of the major revenue sources supporting State bond programs. Revenue trends for the largest of the net tax-supported bond programs are highlighted here.

PECO bond proceeds are used to construct public education classrooms, laboratories, parking garages, and major remodeling and roof replacements. The gross receipts tax on telecommunications and utilities, which funds the PECO program, has grown erratically during the past ten years. The receipts grew by as much as 27 percent in one year from state fiscal year 1988-89 to 1989-90, and by as little as 0.9 percent in a year from 1997-98 to 1998-99. A one percent increase in the tax rate was passed in 1990 and phased-in over the next three years, which accounts in large part for the most recent years growth. Although the average annual rate of growth in these receipts is just under 11 percent for the past ten years, it is clear that the variability in the annual growth is significant and has required adjustment to keep pace with desired spending levels.

The actual amount of the PECO bond sales possible in each year is determined by the growth in gross receipts tax collections during the 24 months prior to the date of the bond sale. Appropriations for any given year are based on the projections of this growth, but the amount of bonds that may be issued (and hence the amount that may actually be spent) is determined by actual collections, not by forecasts of collections. Small changes in actual tax collections produce very large changes in the amount of money available for appropriation. A \$1 million difference between the amount of tax collected versus the amount of forecasted tax collections will produce a \$10 to \$15 million change in the amount of funds available for appropriation. This hypersensitivity to small changes in collections is due to the leveraging effect of borrowing.

Because each year's new PECO appropriations are based on the bonding capacity of the growth increment, the variability has caused problems in several years when the desired level of funding has exceeded the available revenue from new bond issues. Yet the salient point for this study is that **these receipts have indeed increased each year, providing at a minimum a stable source to meet the debt service requirements of the bonds that have been issued.**

The same cannot be said for the documentary stamp tax receipts which support the Preservation 2000/Florida Forever environmental programs. While growing at an average annual rate of 10.2 percent over the past ten years, and while the variability from year to year may not appear as great as that of the gross receipts tax, it is notable that these receipts actually declined in two of the past ten years. In the 1994-95 fiscal year, the decline from the previous year was 10.3 percent.[3] The growth in the following year brought the documentary stamp tax receipts to barely over the receipt total from two years prior. The documentary stamp tax is highly sensitive to interest rates and the business cycle and the amount available may decline in the future in the event of a recession. Yet with regard to the debt service supported by these revenues, there is little cause for concern for the following reason.

Section 201.15, Florida Statutes, provides that 62.63 percent of the net documentary stamp tax receipts (net of the 7 percent service charge paid to General Revenue Fund) may be used to pay the Preservation 2000/Florida Forever debt service, with the remainder accruing to the General Revenue Fund. However, for the 1999-2000 fiscal year, it is estimated that the Preservation 2000 debt service will use only \$223.7 million of the \$639.5 million net documentary stamp tax revenues available for this purpose. (Note that with the advent of the Florida Forever bond program, it is projected that debt service will eventually reach 80 percent of the amount permitted under the bond indenture.) Hence, **while the total documentary stamp tax receipts may fluctuate adversely from time to time, a significant amount of the receipts dedicated to this program are deposited in the General Revenue Fund and are technically unallocated (until specifically appropriated). This provides a form of debt service "cushion" or coverage for this program.** A decline in the documentary stamp tax receipts may make less revenue available for General Revenue funded state operations, but the debt service requirements for all of the environmental bond programs are not likely to require supplemental funding because the law gives first priority to the debt service.

The third largest net tax-supported bond program, education Capital Outlay Bonds, finances capital outlay projects for school and community college districts. Such projects generally include classrooms, laboratories, maintenance facilities and parking lots. The bonds are payable primarily from the first revenues derived from the motor vehicle license taxes levied annually for the operation of motor vehicles in Florida. One hundred percent of such taxes are available for debt service on capital outlay bonds, if needed. Up to 90% of these revenues may be pledged for debt service on bonds. Growth in the revenue is steady, averaging 3 percent per year. This growth, plus the retirement of outstanding bonds, will support a sale of new bonds of about $60-$75 million per year. Again, **historically steady growth combined with a reserve requirement of 10 percent of the revenues makes for a stable source to meet the debt service obligation.**

The primary conclusion that may be drawn from a review of the specific revenue sources for the three largest net tax-supported programs is that **the various funding sources for state net tax-supported debt programs are ample, technically speaking, to meet current debt service requirements. Besides the growth in the revenues, this is ensured by either specific revenue reserves required by law, or by implicit reserves which arise when a debt program has statutory priority for funding.** However, a related observation is that a number of debt programs use funding sources which may not provide adequate ***growth*** for ***increased*** debt issuance commensurate with desired future program expansions. This raises a policy issue to be addressed by the Legislature, not one to be resolved solely by objective analysis.

<u>DECISIONS ON FUTURE DEBT REQUIRES AN IN-DEPTH, PROPOSAL-SPECIFIC MODEL</u>

As mentioned in the endnote for Table 1, the data displayed does not reflect debt authorized by law but not yet issued. According to Division of Bond Finance calculations, an estimated $9.0 billion in additional bond debt is expected to be issued under existing bond programs over the next ten years. This includes future debt only for those bond programs where reasonable projections can be made for ongoing programs (PECO bonds, Preservation 2000 and Florida Forever bonds, Lottery Bonds, Right of Way/Bridge Acquisition bonds, and several other net tax-supported bond programs.) These estimates of future debt can vary depending on the assumptions of revenue collections, interest rates and the timing of issuance.

In their Debt Affordability Study, the Division of Bond Finance adds the authorized but unissued debt to the outstanding debt, and then projects debt service as a percent of revenues over the next ten years (using revenue projections currently forecast by the Legislative Office of Economic and Demographic Research). Their model demonstrates that Florida's debt service to revenue ratio should stay within and below the proposed 6 to 8 percent target range if no new bond programs are authorized during that period. If only the currently authorized debt is issued as expected, the projected debt service to revenue ratio rises to a high of 6.2 percent in 2002 then declines to 5.3 percent by 2009.

The final step in the Division of Bond Finance's analysis is to calculate the total amount of theoretical debt capacity over the next ten years based on maintaining either a 6 percent or an 8 percent cap on the debt service to revenue ratio. The result is a range of $3.3 billion in additional debt affordable at a 6 percent ratio cap, to $12 billion in additional debt affordable at an 8 percent ratio cap.

While the Division of Bond Finance's analysis provides a strong foundation for overall debt management, there is still a need to refocus the analysis from the macro to the micro view for legislative decision making. **The Divisions's projections of increased debt capacity assume that revenue growth in the aggregate will allow the State to bond up to the debt ratio target, but that is not the case. In reality, the expected revenue growth for each individual bond program will determine Florida's true debt capacity for current programs. New debt programs will be considered based on the specific funding source's financial and political viability. In addition, any proposals which draw from General Revenue Fund receipts will be judged on the basis of the impact on state operational funding and future budget flexibility. <u>Hence, the question of how much debt the State can "afford" may perhaps be answered in theory for purposes of credit ratings, but in Florida's legislative decision making process it is not truly determinable without a specific set of proposals to consider.</u>** It could be more, or it could be less than that projected by the Division of Bond Finance.

<u>CONSIDERATION OF SPECIFIC DEBT PROPOSALS SHOULD EMPLOY A SET OF MICROANALYSIS QUESTIONS</u>

Assuming Florida maintains its current Constitutional provisions and traditional practice of creating debt programs with dedicated revenue sources, consideration of specific future debt proposals must focus primarily on the details of each proposal. Following is a list of questions that can be used to evaluate specific debt proposals:

1. Is there legal authority to borrow? Is the intended use of borrowed proceeds for state capital outlay projects?
2. Is the capital improvement or activity being financed a traditional governmental function?
3. What is the interest cost associated with the financing? If it's worth buying and funds are available, why not pay for it now? (Should the State be doing capital improvements on a "pay as you go" basis rather than borrowing the money?)
4. What will the annual debt service requirement be and for how long?
5. Is there a more cost effective method of funding the project?
6. What is the revenue stream that will be used to retire the debt? Is it reliable, particularly during recessions?
7. Is the money being diverted from the General Revenue Fund and can the General Revenue Fund afford it?
8. What impact will the long-term fixed cost of debt have on prospective budgetary flexibility?
9. Are there other bonds being supported by this revenue stream and what are the legal limitations (parity restrictions) attendant to the use of the same revenue source for other bonds?
10. Will the revenue stream and proposed financing structure result in an investment grade credit rating? How does the credit market perceive the proposed borrowing and the revenue source proposed to repay the debt? Will the proposed borrowing compromise Florida's otherwise good credit perception? How does the proposed new debt affect existing debt levels?
11. In the case of loaning the state's borrowing authority to quasi-governmental organizations or non-state entities, what control will the state have over the manner in which the debt is issued, the administration and repayment of the debt and the management of assets that may affect the repayment of the debt (e.g., private prisons, seaport improvements, dormitories, parking facilities, toll roads, etc.)?
12. What impact will the facilities constructed have on the operating budget?

<u>THERE ARE THREE VIABLE OPTIONS FOR USING AVAILABLE CASH</u>

The question of how to best use available funds to manage debt load is timely since Florida currently enjoys a growing, healthy economy. The three options to consider include:

- paying down outstanding debt early;
- paying cash instead of borrowing or in lieu of using all of the available dedicated debt service revenue streams; and
- building cash reserves.

<u>OPTION 1, PAYING DOWN EXISTING DEBT, IS NOT COST EFFECTIVE WHEN INTEREST RATES ARE RISING</u>

Paying down outstanding debt may seem intuitively prudent, since most people would think it analogous to paying off credit card debt to free up discretionary income and to avoid interest costs. However, the State's borrowing ability and investment earning ability are not at all analogous to personal debt. The State enjoys relatively low borrowing costs through issuance of tax-exempt bonds and a high credit rating. At the same time, the State Treasury earns healthy returns on funds invested at higher interest rates than are paid for State debt. While federal arbitrage laws prevent the State from earning a "profit" by investing borrowed cash, any other cash invested would earn more than could be saved if the cash were used to pay off existing debt. Rather than paying off debt, it is more cost effective for the state to invest available funds while the Division of Bond Finance refunds high cost debt as interest rates fall. (Over the past ten years, 32 percent of the $21 billion in bonds issued by the Division of Bond Finance have been old issues refunded at lower interest rates.) In reality, however, it is unlikely that the State would invest significant amounts of cash just to offset current debt costs.

A more relevant consideration is the fact that interest rates for the past decade have been at historic lows, and are now gradually rising. Given current funding needs, Florida's debt programs will continue to issue new bonds in the near future. Therefore it is not cost effective to use cash to pay off current low cost bonds while there still remains the need to issue new higher cost bonds. It is more advantageous to keep the old low cost debt and spend the cash on those programs where higher cost debt can be avoided. This raises the second option, paying cash instead of borrowing.

<u>OPTION 2, PAYING CASH INSTEAD OF BORROWING SAVES MONEY AND CAN BUILD FUTURE RESERVES.</u>

This option provides two significant benefits. First, it obviously saves long term interest costs. Second, it can build the unused capacity of a given debt service revenue stream so that it is available for unexpected future needs or for weathering economic downturns (or other causes of revenue decline). This would be particularly helpful with bond programs which have demonstrated significant fluctuations in growth over the past ten years. If some of the bondable revenue growth were not obligated in each year, then that capacity reserve could be tapped during a year when neither State cash nor dedicated revenue growth are sufficient to meet legislatively determined funding needs.

OPTION 3, BUILDING CASH RESERVES, MAY NOT BE AS COST EFFECTIVE AS AVOIDING DEBT

Building cash reserves has a drawback similar to paying down low cost debt. It may not be as cost effective to invest cash while increasing debt burden instead of avoiding new debt. Further, it is questionable whether a significant cash reserve could be maintained in the face of so many funding priorities competing for increased appropriations. Florida is fortunate to have a mandatory cash reserve protected by the State Constitution. Florida's Budget Stabilization Fund reserve equal to 5 percent of annual revenues provides not only a safety net for debt obligations (as well as other State operational costs), but also serves as a significant positive consideration by bond rating agencies.

RECOMMENDATIONS

- Florida should set broad parameters to manage total debt load as has been proposed by the Division of Bond Finance. The Legislature should determine the level of selected debt ratios that are acceptable and strive to keep total net tax-supported debt at or below those levels. This should constitute the "first level" of analysis when evaluating future debt expansion proposals, but should not be the only criteria used to consider specific debt proposals.

- Decisions on future debt proposals should be based on a program-specific microanalysis. The Legislature should use the microanalysis questions posed herein as a minimum framework for evaluating each specific proposal.

- Whenever possible, and particularly when interest rates are rising, available cash should be used to fund at least a portion of the appropriations which otherwise would be funded by new borrowing.

- For debt programs whose dedicated revenue growth has been deemed inadequate for desired program expansion in past years, available cash should be used to fund some portion of appropriations in lieu of bonding all of the available revenue growth, until a modest bonding capacity reserve has been achieved in the revenue stream.

Endnotes

1. The figures in Table 1 do not include debt issues which have been legislatively authorized but not yet issued (such as the Preservation 2000 bond issues authorized in the General Appropriations Act for 1999-2000, or the Florida Forever bonds). Neither the exact timing of these new debt issues nor the future interest rates for these issues is known in advance of the actual sale, and both of these factors determine exactly how much cash is received as bond proceeds and how much actual debt obligation is incurred. Also, Table 1 lists only those bond programs which have outstanding bonds as of June 30, 1999. Other bond programs, such as the Florida Hurricane Catastrophe Finance Corporation (the CAT Fund) and the Special Disability Trust Fund Privatization Commission could issue revenue bonds in the future, but have no bonds currently outstanding.

2. The difference between the growth in annual debt versus debt service cost can be attributed to falling interest rates during this time period as well as the Division of Bond Finance's continual refunding actions for older debt issues.

3. From August 1983 until February 1994 the 30 year mortgage rate hovered around 7 percent, producing a spike in real estate activity (mortgages and refinancings). In March 1994 mortgage rates jumped to over 7.5 percent and began an upward trend that reached 9.2 percent by year's end. This spike in interest rates dampened both new mortgage and refinancing activity in 1994-1995, leading to a significant reduction in documentary stamp tax collections.

COMMITTEE(S) INVOLVED IN REPORT ***(Contact first committee for more information.)***
Committee on Budget, 404 South Monroe Street, Tallahassee, FL 32399-1100, (850) 487-5140 SunCom 277-5140

MEMBER OVERSIGHT
Senators Burt and Sullivan