Debt Capacity Policy & Model for Federal Highway Reimbursement Anticipation Notes

Barbara W. Reese
VDOT Chief Financial Officer

November 19, 2003

Virginia Department of Transportation
VDOT

We Keep Virginia Moving

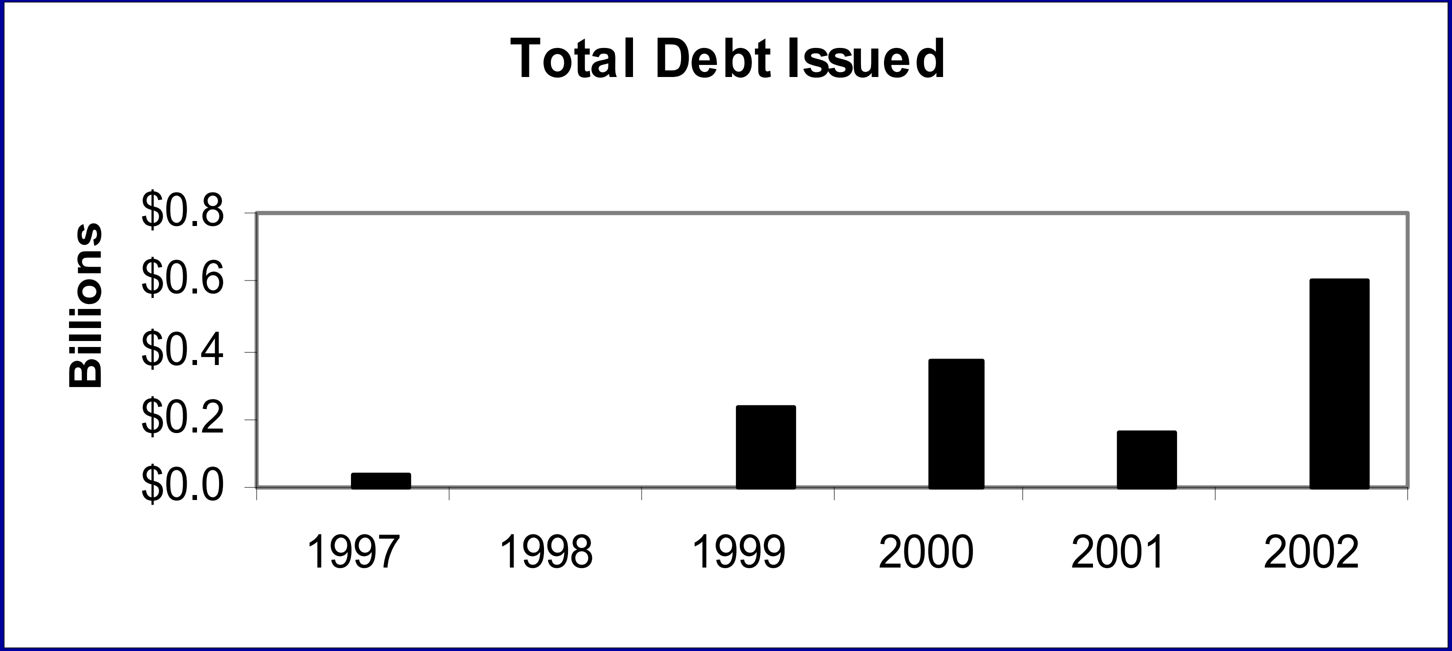
Background

- APA's July 2002 report, "Special Review of Cash Management and Capital Budgeting Practice" raised concerns about the amount of CTB-controlled revenue that had to be dedicated to debt service (9% of total revenues)

- The Governor's 2003 Transportation Reform Package requires the Board to adopt a debt management policy and model in consultation with the Department of Treasury and Debt Capacity Advisory Committee by January 2004

Background, cont'd

- In part, the concerns arose from the dramatic increase in debt over the last few years



Background, cont'd

- All CTB debt except Federal Highway Reimbursement Anticipation Notes ("FRANs") are included in Commonwealth's debt capacity model

- The model is maintained by Treasury staff and considered by the DCAC. The Governor and General Assembly consider the model's finding and DCAC policy in determining how available capacity should be used by all Commonwealth programs

FRAN Characteristics

- FRANs are different from other CTB debt programs. They are:
  - Supported by existing cash flow -- federal reimbursements
  - Short-term debt instrument (maximum term limited to 10 years by statute)

FRAN Characteristics, cont’d

- A revolving statewide debt authorization – maximum outstanding limitation of $1.2 billion – no additional General Assembly action necessary for additional debt to be issued

- While statewide, their use is controlled by a project list and by a district limitation

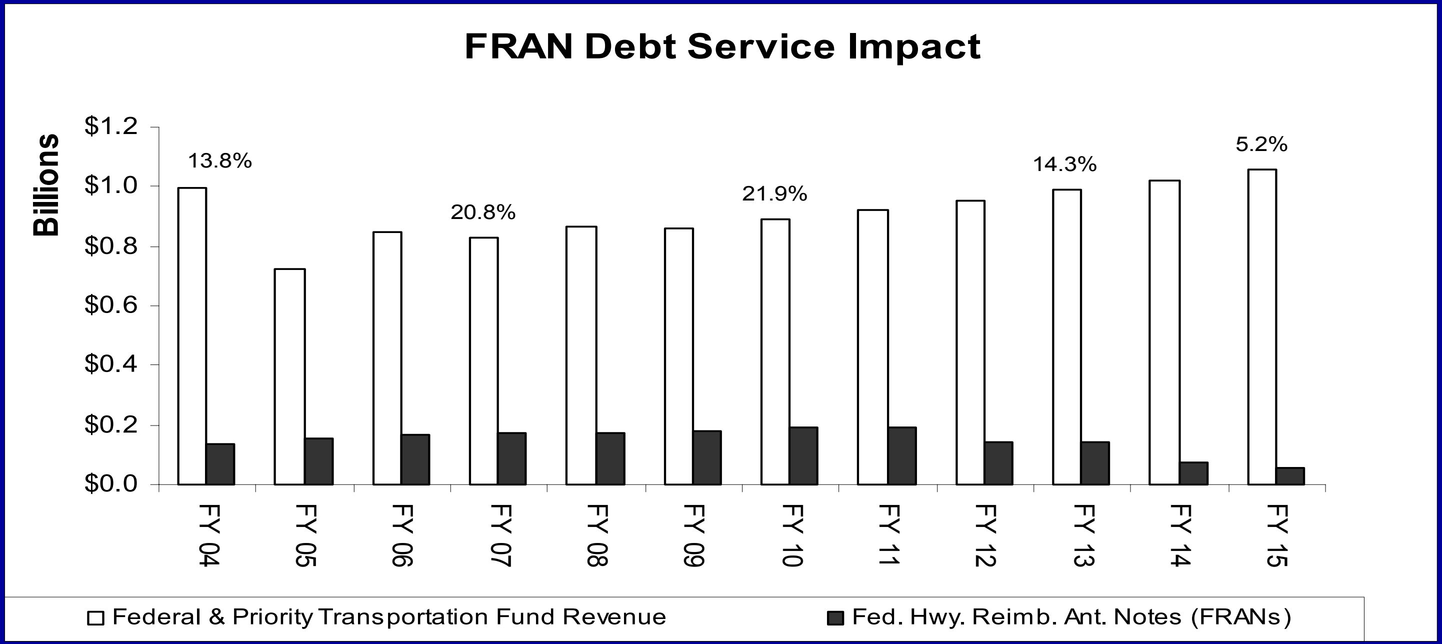
FRAN Outlook

- The CTB has issued $898.3 million in FRANs
  - $375 million in November 2000 and
  - $523.3 million in September 2002

- Current Six-Year Improvement Program assumes the following future sales:
  - FY 04 - $167.5 million FY 05 - $139.5 million
  - FY 06 - $68.0 million   FY 07 - $ 30.5 million
  - FY 08 - $127.0 million

FRAN Outlook , cont'd

- With these future sales included, FRAN debt service alone consumes almost 22% of estimated future PTF and federal revenues



Virginia Department of Transportation

We Keep Virginia Moving

FRAN Credit & Structure

- Revenue sources available to pay debt service
  1) Federal highway reimbursements received by the Commonwealth
  2) Legally available funds in the Transportation Trust Fund and
  3) Such other funds, if any, which may be designated by the General Assembly, for the payment of debt service on FRANs

Virginia Department of Transportation

We Keep Virginia Moving

FRAN Credit & Structure, cont'd

- Other credit and structure features:
  - Additional Bonds Test in the Master Indenture – the governing document for all FRAN debt issues – must have anticipated federal revenue equal to at least 3 times debt service payment
  - Short-term 10 year term
  - $1.2 billion limitation on outstanding FRANS

FRAN Debt Policy

- Commonwealth's parameter of debt service not exceeding 5 percent of revenues is not appropriate for FRANs
  - Credit and structure features already described, particularly the 10-year maturity versus 20 to 25 years used in the Commonwealth's debt capacity model
  - Revenues dedicated to FRAN debt service are for capital expenses, whereas the Commonwealth's model also includes revenues used for operating purposes

FRAN Debt Capacity Policy

- In measuring current debt capacity, outstanding FRANs need to be accounted for
  - A total of $786.6 million is currently outstanding with annual debt service of $121 million annually until 2010

- Statute currently places limitation on capacity $1.2 billion maximum

FRAN Debt Capacity Policy, cont'd

- The CTB can strengthen policy by setting debt model parameters that include:
  - a more stringent debt service as percent of revenues test (additional bonds test)
  - a federal revenue measure with which to compare debt service
  - a reasonable interest rate to use in determining future capacity
  - size and frequency of bond issues once capacity is determined

FRAN Debt Capacity Policy, cont'd

Debt service as percent of revenue

Debt Service as Percent of Revenues	Total Capacity	Amount of Additional Debt that Can be Issued Over Next Seven Years	Average Annual Revenue Available for Pay-As-You-Go (2004-2010)	Total Revenues Available for Pay-As-You Go (2004 - 2010)
33.3%	$1,645,707	$665,203	$440,333	$3,082,331
30.0%	1,482,619	502,115	451,794	3,162,560
25.0%	1,235,516	255,011	469,160	3,284,119
20.0%	988,413	7,908	486,525	3,405,678

based on Six-Year Historical Average of Revenues ($607.8 million) & 3.95% Interest Rate ($000s)

FRAN Debt Capacity Policy, cont'd

Federal revenue measure with which to compare debt service

Revenue Measure	Total Capacity	Amount of Additional Debt that Can be Issued Over Next Seven Years	Average Annual Revenue Available for Pay-As-You-Go (2004-2010)	Total Revenues Available for Pay-As-You Go (2004 - 2010)
Projected Federal Highway Revenues ($724.7 million)	$1,473,208	$492,704	$452,456	$3,167,190
Six-Year Historical Average ($607.8 million)	1,235,516	255,011	469,160	3,284,119
Fiscal Year 2001 Revenues ($535.6 million)	1,088,704	108,200	479,477	3,356,341

based on 25% Debt Service to Revenues and 3.95% Interest Rate ($000s)

FRAN Debt Capacity Policy, cont'd

Reasonable interest rate assumption to measure debt capacity

- Interest rates fluctuate, as evidenced by a true interest cost of 4.83 percent on the Series 2000 FRANs and 3.00 percent on the Series 2002 FRANs

- Based on rates as of 10/31/03 the true interest cost on a FRANs issue today would be approximately 3.15 percent

FRAN Debt Capacity Policy, cont'd

- Municipal Market Data-Line ("MMD") daily yield curves are widely used as benchmarks of municipal yields

- Using two-year average of MMD yields for double-A credit and 10-year maturity would capture interest rate fluctuations and moderate the effect of interest rate movements over any one year
  - In addition, since yield curves are generally upward sloping, using the 10-year MMD yield would be conservative

FRAN Debt Capacity Policy, cont'd

- Size and frequency of bond issues should be determined by comparing funding sources, including remaining bond proceeds, with funding and cash flow needs
  - Review funding gaps over approximately a one-year period
  - Target size of no less than $50 million and no greater than $500 million, depending on market conditions

FRAN Debt Capacity Policy, cont'd

- Recommendation for adopted policy and model components:
  - Debt service as percent of revenues – 25%
  - Revenue measure - Six-year average of federal highway receipts
  - Interest rate assumption - Two-year average of the MMD double-A, 10-year yields

FRAN Debt Capacity Policy, cont'd

- Based on these recommendations –
  - Current capacity is $1.24 billion
  - Additional capacity totals $255 million over the next seven years
  - Debt policy and model would be as outlined in the provided Public Resources Advisory Group (PRAG) analysis

Next Steps

- Recommend Board adopt resolution tomorrow that outlines this debt policy and its model

- If adopted, the policy and model will be transmitted to the Debt Capacity Advisory Committee. The Committee is scheduled to meet on December 17, 2004

- The Six-Year Financial Plan and Six-Year Improvement Program will be developed using the policy and model