THE DEBT CAPACITY ADVISORY COMMITTEE
COMMONWEALTH OF VIRGINIA
September 20, 2010

2:00 P.M.
TREASURY BOARD CONFERENCE ROOM
James Monroe Building
101 North 14th Street, 3rd Floor
Richmond, Virginia 23219

Members Present:	Richard D. Brown, Chairman William K. Butler, II Elizabeth B. Daley Manju S. Ganeriwala Walter J. Kucharski Daniel S. Timberlake Glen S. Tittermary Robert P. Vaughn David Von Moll
Members Absent:	Ronald L. Tillett
Others Present:	Evelyn R. Whitley, Department of the Treasury Tracy L. Clemons, Sr., Department of the Treasury Sherwanda Cawthorn, Department of the Treasury Janet Lee, Public Resources Advisory Group Claire Cohen, Public Resources Advisory Group Tony Maggio, House Appropriations Committee Reta Buscher, Virginia Department of Transportation John Lawson, Virginia Department of Transportation Emily O'Brien, McGuire Woods Consulting Neil Miller, Deputy Security of Finance Ty Wellford, Davenport & Company Janet A. Aylor, Department of the Treasury Jeanine Black, Department of the Treasury Debora Greene, Department of the Treasury Melissa Palmer, Department of the Treasury

Call To Order and Opening Remarks

Chairman Brown called the meeting to order at 2:08 p.m., and welcomed attendees. He stated the primary purpose of this meeting was to review and discuss the recommendations resulting from the debt capacity study that was requested at the December 2009 meeting. Chairman Brown noted that the study group, including staff from the Senate Finance Committee and House Appropriations Committee, had met several times over the last few months, and it was his expectation that recommendations resulting from the study could be incorporated into the December 2010 Report.

Mr. Brown explained that the budget bill adopted by the 2010 legislature authorized about $1 billion in additional tax-supported debt. However the bill also requires prior to the 2011 General Assembly Session, the Secretary of Finance submit a plan consistent with the recommendations of this Committee allowing for the issuance of that debt within our debt capacity limits. Secretary Brown said that over the course of the last few weeks staff worked on alternatives consisting of 1) tweaking the existing model 2) exploring substantive technical changes and policy issues and 3) consideration of changes to the content and format of the Committee's report. Secretary Brown also explained that he did not expect a vote of the Committee during this meeting. He wanted the group to get all the issues on the table for discussion during this meeting, and hopefully narrow down alternatives for the September 28, 2010 meeting. He added that if the Committee's recommendations included changes to the debt capacity model, he would first like to discuss such recommendations with the ratings agencies. Chairman Brown asked that the staff go through all alternatives before starting a question and answer period.

Public Comment Period and Approval of Minutes

Chairman Brown asked for public comments. Hearing none, the Chairman proceeded to the adoption of the minutes from the December 18, 2009 meeting. Mr. Kurchaski made a motion to accept the minutes. Treasurer Ganeriwala seconded the motion with unanimous approval by the committee.

Overview of Other States by Public Resources Advisory Group

Secretary Brown introduced Claire Cohen and Janet Lee, of Public Resources Advisory Group ("PRAG") to the committee. It was noted that PRAG serves as Financial Advisor for several programs within Treasury and also the Commonwealth Transportation Board (CTB), as well as several other states. Ms. Cohen and Ms. Lee provided an overview of what other highly rated states are doing with regard to debt capacity.

A handout of debt capacity comparison measures for highly rated states was distributed to the committee (Exhibit 1). The presentation addressed the importance of debt capacity as management tool and noted that rating agencies view having a debt management policy as a credit strength. States use a number of different ratios to measure debt capacity. Ms. Cohen noted that debt to revenue and debt to personal income are two commonly used measures. She explained that debt per capita measured the debt burden but does not measure the ability to pay debt service. Debt to property value was not used as much by states.

Ms. Cohen also stated that comparability among states was difficult since states vary as to their revenue sources and debt options. She noted that rating agencies report on debt per capita and debt to personnel income, since those measures are more consistent and are readily comparable among the states.

Virginia has used debt service to revenue ratio of 5% since 1991. Other highly rated states have debt service to revenue generally ranging from 4.5% – 8%. Ms. Cohen stated that ten percent is typically the tipping point with debt to revenue ratio. She explained that Virginia is not unique in experiencing a lack of capacity resulting from declining revenues.

Ms. Lee gave an overview of comparisons of debt capacity measures for other highly rated states. Questions were asked by committee members followed by discussion. Secretary Brown asked if there were any states that issued above their debt caps. Ms. Lee said that such caps are primarily used as a planning tool and most rating agencies recognize that.

Mr. Kucharski asked if rating agencies looked at how OPEB and pension funds are handled. Ms. Cohen stated that it was hard to get a handle on the unfunded liability piece of that analysis. A discussion ensued about the liability of unfunded pension funds. Mr. Kurcharski wanted to get a better understanding of the annual contribution rate. Ms. Cohen stated that pensions are not viewed by rating agencies in the same way as bonded debt. Mr. Von Moll asked if it might be possible to agree upon those levels of other non-bonded liabilities, and whether they should be a part of determining the overall debt capacity. Ms. Cohen indicated the rating agencies had not yet established methodology or guidance in this area. Secretary Brown proposed that the Committee monitor OPEB and pensions. He stated that he was hesitant to proceed prior to guidance from the rating agencies. It was agreed that the Committee would postpone any decisions or actions related to OPEB and pensions, relative to debt capacity prior to further guidance being established by the rating agencies.

Chairman Brown initiated a discussion of whether alternative measures, used by some of our peer states should be incorporated by the Committee. Mr. Vaughn initiated a discussion about the way in which capacity has historically presented, in terms of a year by year amount, as opposed to a longer time horizon. He emphasized that as a planning tool, a recommendation derived from a broader time horizon would be more useful in development of the 6-year capital plan. Both the plan and the recommendation could be updated with each year's subsequent recommendation, based on conditions at that time.

Presentation of Staff Workgroup Report - Exhibit 2

Ms. Whitley provided an overview of the study group's draft report to the committee (Exhibit 2) She explained that the study group had reviewed debt affordability policies and practices of other highly rated states. This group also evaluated the use of certain alternative measures of debt burden and affordability. In addition, certain technical and policy considerations related to the existing model were analyzed. She briefly reviewed several model solution scenarios illustrating the impact of each of the technical revisions, compared against the December 2009 Base Solution. Following a discussion of the scenarios and options among the members of the Committee, she concluded her overview and noted that revisions to Committee's annual report were being considered to improve the readability.

Committee Discussion of Proposed Recommendations and Options

Chairman Brown introduced Reta Buscher, Chief Financial Officer of the Department of Transportation, who explained the process used by VDOT for the CPR bonds. She emphasized that by statute, maintenance is first priority, and those needs will continue to grow unless new source of funding is found. She questioned if it might be possible to assess capacity (including CPR bonds) at 5.25%, 5.50% and 6% levels. Chairman Brown stated that he wanted to further review the authorization for CPR bonds and determine if there were alternatives for their inclusion in the model. Mr. Vaughn expressed a reluctance to change the 5% measure, but perhaps maintain the 5% exclusive to general fund debt. Ms. Lee stated that as advisor to CTB, she was reluctant to change the treatment of CPR bonds

Of the technical and policy considerations presented, Secretary Brown summarized the sense of the Committee:

1. Include the 0.25% sales tax and certain non-general fund transfers per the appropriation act.
2. Adjust for the non-General Fund Appropriated for Debt Service (Virginia College Building Authority)
3. Include debt service on Build America Bonds net of the expected subsidy.
4. Expression of Debt Capacity – Staff was directed to move forward with presenting capacity in terms of average annual capacity and retaining two-year reserve capacity.
5. Affordability Measure – Committee agreed that the supplemental information including debt per capita, debt as a percent of personal income, debt to property value and debt service as a percent of revenues can be part of the debt capacity report.
6. Handling of Transportation Debt – This option is tabled until the next meeting.
7. Integration of the debt capacity report with the six-year capital planning process – This topic will be discussed further at the September 28th meeting.
8. Usefulness of Report/Formatting Changes – The committee agreed to make revisions to the format of the December 2010 debt capacity report.

Ideas not considered by working group but recently brought to the attention of Treasury staff.

- **Include literary fund in blended revenues** – table discussion until next meeting when Mr. Tillett will be in attendance to give his intentions on how to include.
- **Interest rate used to estimate debt service on authorized and unissued debt** – Secretary Brown said he would differ to Ms. Whitley, Financial Advisor and Treasury staff to determine that most appropriate rate to use.
- **Inclusion of other debt-like obligations (OPEB)** – Secretary Brown stated that the general consensus of the Committee for this option is no; however Ms. Whitley will continue to watch for developments from the rating agencies.

Other Business

With no further business, the meeting adjourned at 5:10 p.m.