

ANALYSIS AND OVERVIEW

The State of Texas historically has had low levels of bonded indebtedness. Bonds have been issued to finance loan programs that generally are self-supportive. Regarding capital projects, the majority, such as prisons, buildings and other capital projects are financed through the general revenues of the state. Since 1986, this type of indebtedness has increased and the various types of projects financed through this mechanism have expanded.

Debt obligations supported by general revenues (not-self supportive) versus project revenues has significantly increased in recent years from just under \$400 million in 1986 to over \$3.268 billion in 2001. Texas, compared to other states still ranks low in terms of outstanding state debt per capita, however, the recent growth calls for additional review and analysis of how the approval of additional debt will impact the state's constitutional debt limit now and in future years and the potential impact this may have in obligating current and future generations of taxpayers.

Texas Demographics

Long-term demographic trends for Texas will impact infrastructure needs and debt finance. The long-term demographic outlook for Texas by the Comptroller of Public Accounts suggests a growing Texas population, but at a declining rate. The long-term population growth for Texas is expected to top 31 million in 2030, an increase of 9.7 million from our current population estimate of 21.3 million in 2001.

By age group, some major patterns emerge. Projections indicate some decrease in the under 18 year-old population (the public school population) and a flattening, yet still increasing over 65 year-old population. By 2030, one in six Texans will be age 65 or older. Should these long-term demographic patterns materialize, it may have the following effects on infrastructure development and debt issuance:

- The current building boom in public school construction could level; repair and renovation and replacement of temporary facilities with permanent facilities may become the focus of school construction;
- Colleges and universities' construction activity may decrease.
- If the existing direct relationship between crime and the teen and young-adult population continues, there may be a continuing, but declining need for new prison and detention center construction;
- Construction and debt financing for water and sewer, transportation and general purpose government facilities may continue;
- Needs for public support for low-cost student loans, affordable housing, and economic development may continue; and
- The growing number of senior citizens will need both new health-related facilities and new facilities to pursue leisure-time interests.

State Debt

Except as specifically authorized, the constitution generally prohibits the creation of debt by or on behalf of the state, with two exceptions: (1) debt created to supply casual deficiencies in revenues which do not total more than \$200,000 at any time, and (ii) debt to repel invasion, suppress insurrection, defend the state in war, or pay existing debt. In addition, the Constitution prohibits the Legislature from lending the credit of the state to any person, including municipalities, or pledging the credit of the state in any manner for the payment of the liabilities of any individual, association of individuals, corporation or municipality. The limitations of the constitution do not prohibit the issuance of revenue bonds, since the Texas courts, like most states, have held that certain obligations do not create a "debt" within the meaning of the constitution. The state and various state agencies have issued revenue bonds payable from the revenues produced by various facilities or from lease payments appropriated by the Legislature. Furthermore, obligations that are payable from funds expected to be available during the current budget period, do not constitute "debt" within the meaning of the constitution. Short term obligations, like the Tax and Revenue Anticipation Notes issued by the Comptroller, which mature within the biennial budget period in which they were issued, are not deemed to be debt within the meaning of the state constitutional prohibition.

At times, the voters of the state, by constitutional amendment, have authorized the issuance of general obligation indebtedness for which the full faith, credit, and taxing power of the state are pledged. In some cases, the authorized indebtedness may not be issued without the approval of the Legislature, but in other cases, the constitutional amendments are self-operating and the debt may be issued without specific legislative action.

Much of the outstanding general obligation bonded indebtedness of the state is designed to be self-supporting, even though the full faith and credit of the state is pledged for its payment.

Developments Affecting State Debt

In June 1999, Moody's Investors Service raised the rating on the State of Texas general obligation from Aa2 to Aa1. This upgrade affects self-supporting and non-self supporting general obligation debt issued by various state agencies. Additionally, the rating on lease revenue debt was upgraded from A1 to Aa2, affecting approximately \$640 million in lease revenue obligations.

In August 1999, Standard and Poor's Rating Services revised its outlook on Texas to stable from positive and affirmed its AA rating on the state's outstanding general obligation debt. Their rating on Texas' general obligation debt reflects, " a steadily growing and diversified economy, solid long-term economic prospects, good trends of revenue growth supporting a balanced budget and a low tax-supported debt burden. The rating outlook is returned to stable from positive due to expectation that, while revenues will continue to grow with the economy, financial reserves will be kept at modest levels."

The State of Texas has been cited by the rating agencies as having: a modest level of financial reserves, a lack of capital planning, and questions regarding the future of internet taxation. Currently, the major credit rating agencies Moody's, Standard and Poor's, and Fitch IBCA, rate Texas general obligation debt Aa1/AA/AA+, respectively. Texas' AAA rating was downgraded in 1987 due to the economic recession experienced by

the state during the 1980s. Since that time, however, there has been considerable improvement in the diversification of the state's economic base. A steady transition from a mining (oil & gas) economy to one based increasingly on services and manufacturing has expanded the state's sources of revenue.

A rating increase could potentially result in a 4 -10 basis point difference (savings) in interest rates. Hypothetically, a ratings increase could save the state \$96 million in interest costs over a 30 year term based on the approximately \$5.7 billion in general obligation debt outstanding as of 8/31/01.

Capital Project Inventory Control

Individual state agencies and institutions of higher education maintain capital inventory listings on an annual basis. The state's General Services Commission (GSC) produces "The Facilities Master Plan" on a biennial basis. This document, produced by GSC, addresses the office inventory and space needs of state agencies and takes into account current and projected needs, as well as methods for meeting those needs in a cost-effective manner. This report is also used to aid in the development of appropriation requests in the state's budget cycle. Decisions on whether facilities should be purchased, constructed, sold, renovated or leased are supported in this document. Also, capacity and best use of existing facilities determinations are rendered through this process.

The Texas Higher Education Coordination Board maintains a "Facilities Inventory" for institutions of higher education and identifies available square footage as well as the replacement value for that space. State institutions of higher education are also required to report annually to the Coordinating Board, information on planned construction projects and deferred maintenance. The Coordinating Board uses this information to produce a five-year Campus Master Plan document which guides the agency in its evaluation and approval of campus construction and land acquisition projects.

Additionally, the state maintains a complete inventory of capital assets for all state agencies, and is updated annually. The Comptroller of Public Accounts collects information provided by each reporting entity through the State Property Accounting System. The State Auditor's Office monitors agencies' inventory and asset control systems as part of its management control and performance audits.

Capital Planning Review and Approval Process

The 77th Legislature, with the passage of Senate Bill 1, Article 9, Section 9-6.38, directed the Bond Review Board to produce the state's Capital Expenditure Plan (CEP) for FY 2004-2005.

The legislation specifies that all state agencies and higher educational institutions appropriated funds by the General Appropriations Act are required to report capital planning information for projects that fall within four specific project areas. Those categories are: (1) acquisition of land and other real property; (2) construction of buildings and facilities; (3) repairs and/or rehabilitation, and (4) acquisition of information resource technologies.

The Texas Bond Review Board is responsible for a formal development process for submission of capital projects from all state agencies. Input in the development process included various state agencies including the Governor's Office of Budget and Planning, Legislative Budget Board, Texas Higher Education Coordinating Board, General Services Commission, and agency input and staff of the Bond Review Board (BRB). Through this input, the BRB developed program guidelines, instructions and a formal application process for submitting capital project requests based on the legislative mandate.

From a budgetary and capital planning standpoint, there are a number of state agencies that work together in varying degrees in coordinating the budgetary and capital reporting and approval process of state agencies. They include the Governor's Office of Budget and Planning, Legislative Budget Board, Texas Higher Education Coordinating Board, Comptroller's Office, House Committee on Appropriations, Senate Finance Committee and the General Services Commission.

Through the legislative process, the legislature defines the types of projects and cost thresholds to be reported in the CEP. The BRB coordinates the submission of capital projects through the CEP and develops the report and determines the effect of the additional capital requests on the state's budget and debt capacity. The completed plan is then forwarded to the Governor's Office of Budget and Planning and the Legislative Budget Board (LBB) for use in their development of recommended appropriations to the Legislature. The Legislature, through the processes of the House Committee on Appropriations and the Senate Finance Committee, make the final decisions on which projects will be funded.

The Legislature determines priority needs through consideration of recommendations from the two budget offices. The two budget offices, with input from the requesting agencies or universities, also assess short-term and long-term needs.

Approved capital and operating budgets are integrated into the General Appropriations Act that authorizes specific debt issuance for capital projects. The statewide capital planning process and the Legislative Appropriations Request require identification of capital and operating costs on a multi-year basis.

Through the capital budgeting process as previously defined, capital projects are approved for the two-year biennial period. However, the CEP reports on the remaining three out years (2006-2008), for identifying long-term needs of the state and for future planning purposes.

Capital Expenditure Plan for 2004-2005

In developing the Capital Expenditure Plan for fiscal years 2004-2005 with supplemental information through 2008, the Texas Bond Review Board received information from 71 state entities reported 1018 capital project request submissions totaling \$10 billion through 2008. Of this total, the

CEP reports an estimated \$3.6 billion expenditures through 8/31/2003. This leaves an estimated \$6.4 billion in capital project expenditures during the FY 2004-2008 period.

The following is reflective of new requests for project financing and represents potential obligations for FY 2004-2005:

	FY 2004	%	FY 2005	%
Current Appropriations	459,100,218	19.1	335,796,469	22.1
GO	239,552,784	10.0	175,735,989	11.6
Lease Purchase	37,437,500	1.6	25,000,000	1.6
MLPP	3,899,814	0.2	3,957,314	0.3
Gifts	344,280,066	14.3	162,365,791	10.7
Federal Funds	15,045,114	0.6	10,307,184	0.7
HEAF	4,243,636	0.2	4,406,667	0.3
Other	482,327,922	20.1	322,437,588	21.2
Revenue Bonds	813,935,760	33.9	478,009,092	31.5
Total	\$2,399,822,814	100.0	\$1,518,016,094	100.0

Principal and interest on projects that are currently debt financed or are requesting debt financing for the FY 2004-2005 biennium total **\$157.3** million and **\$172.9** million, respectively. Capital projects that are currently debt financed or are requesting debt financing during the FY 2004-2008 period total **\$7.833** billion in principal and interest.

The CEP reporting categories are as follows:

Category	Through 8/31/2003	FY 2004	FY 2005	Sum of FY 2006-2008	Total through FY 2008
Additions	\$126,183,498	\$106,269,967	\$80,007,561	\$67,309,000	\$379,770,026
Information Resources	\$341,379,091	\$264,159,282	\$235,585,872	\$136,036,977	\$977,161,222
Infrastructure	\$61,064,843	\$71,663,754	\$32,092,441	\$202,317,379	\$367,138,417
Land Acquisition	\$39,486,981	\$19,512,396	\$18,905,000	\$14,403,740	\$92,308,117
Leased Space	\$14,073,697	\$5,773,190	\$6,079,113	\$17,546,150	\$43,472,150
Renovations	\$834,466,848	\$427,423,535	\$320,645,548	\$759,582,139	\$2,342,118,070
Construction	\$2,200,459,621	\$1,505,020,688	\$826,388,056	\$1,316,804,621	\$5,848,672,986
Totals	\$3,617,114,579	\$2,399,822,812	\$1,519,703,591	\$2,514,000,006	\$10,050,640,988

Authorized but Unissued Bonds Could Add Substantially to Texas' Debt Burden

Texas continues to have a moderate amount of authorized but unissued debt on the books. This is debt that has been authorized by the Legislature, but has not been issued. As of August 31, 2002, approximately \$1.3 billion in non self-supporting bonds had been authorized by the Legislature but remained unissued. Some of these authorized but unissued bonds may be issued at any time without further legislative action, but would require Bond Review Board approval, and others would require a legislative appropriation of debt service prior to issuance.

If the state were to issue all of the authorized but unissued debt, debt service from the general revenue would increase by **\$144.8** million annually. If the above-mentioned bonds were issued, the outstanding general revenue debt would be approximately **\$4** billion.

Texas' Constitutional Debt Limit

The 75th Legislature passed House Joint Resolution 59, which limits the amount of tax-supported debt that may be issued. The resolution called for a constitutional amendment that was placed on the ballot and approved by the voters in November 1997. This legislation states that additional tax-supported debt may not be authorized if the maximum annual debt service on debt payable from general revenue, including authorized but unissued debt, exceeds five percent (5%) of the average annual unrestricted General Revenue for the previous three fiscal years. The debt limit ratio of 1.42 percent is for outstanding debt as of August 31, 2002. With the inclusion of authorized but unissued debt, the ratio increases to 2.22 percent (8/31/02).

Debt Limit Calculation

The impact on the state's debt capacity was calculated on a percentage basis of capital projects submitted requiring general revenue. The debt calculation is very conservative and does not factor in general revenue (GR) available after constitutional dedications for year-end 2002, nor does it factor in the debt that has been paid off or retired through 8/31/03. These numbers were not available to be included in the CEP report for the September 1 submission deadline. The following is a summary of the estimated impact to the state's debt capacity:

Unrestricted General Revenue	(in thousands)
GR Available After Constitutional Dedications (Year ending 8/31/97)	\$22,272,042
GR Available After Constitutional Dedications (Year ending 8/31/98)	\$23,675,662
GR Available After Constitutional Dedications (Year ending 8/31/99)	\$23,782,089
GR Available After Constitutional Dedications (Year ending 8/31/00)	\$25,362,284
GR Available After Constitutional Dedications (Year ending 8/31/01)	\$26,793,144
GR Available After Constitutional Dedications (Year ending 8/31/02)	\$26,327,248

Average Amt. Of Unrestricted GR Available for the Three Preceding F.Y.s (2000-02) \$26,077,714

Debt Limit Percentages

Debt Service on Outstanding & Authority but Unissued Debt as a % of GR after Const. Dedications: **2.22** (8/31/02)

Additional Debt Service	Percentage of GR
\$ 5,000,000	2.24%
\$ 10,000,000	2.26%
\$ 15,000,000	2.28%
\$ 25,000,000	2.32%
\$ 50,000,000	2.42%
\$ 100,000,000	2.61%

General Obligation Bond Authority

Two state agencies have requested project financing totaling \$470,229,120 through general obligation bonds. They are as follows:

Department of Criminal Justice	11 Projects	
ADA Modifications		\$4,010,918
Boiler Upgrades		\$11,222,856
Western Regional Medical Facility Expansion		\$7,874,317
Facility Repairs		\$145,825,755
Kitchen Renovations		\$8,990,028
Roofing Projects		\$24,786,793
Safety Concerns		\$11,241,755
Security Upgrades		\$102,944,548
Site Improvements		\$4,362,811
Ventilation		\$11,206,459
Water/Wastewater Projects		<u>\$27,657,280</u>

		<u>\$360,123,520</u>
Texas Building and Procurement Commission	3 Projects	
Deferred Maintenance		\$88,702,400
Deferred Maintenance		\$9,136,000
Deferred Maintenance / Compliance		<u>\$12,267,200</u>
		<u>\$110,105,600</u>
	14 Projects	<u>\$470,229,120</u>

* Projects currently financed through TPFA's Commercial Paper Program.

Aside from new voted authority, one possibility is to redirect existing appropriations of bond proceeds and debt service from one agency to another if there are unissued amounts available. Current appropriations and revenue bond authority are also alternatives.

Tuition Revenue Bond Authority

Many institutions of higher education have cited tuition revenue bond authority as the requested financing mechanism for their capital projects. Total tuition revenue bond authority remaining as of 8/31/02 is \$889 million. The breakdown is as follows:

	Authorized	Issued	Remaining Authority
Texas A&M University System			
	\$68,000,000	\$0	\$68,000,000
	\$18,700,000	\$0	\$18,700,000
West Texas State University	\$22,780,000	\$0	\$22,780,000
Texas A&M International Univ.	\$21,620,000	\$0	\$21,620,000
Texas A&M Univ. - Kingsville	\$20,060,000	\$0	\$20,060,000
Texas A&M Univ. - Corpus Christi	\$45,500,000	\$0	\$45,500,000
Texas A&M Univ. - Commerce	\$14,960,000	\$0	\$14,960,000
Texas A&M Univ. - Texarkana	\$17,000,000	\$0	\$17,000,000
TAMU Health Science Center	\$14,300,000	\$0	\$14,300,000
Texas A&M Univ. - Commerce	\$10,030,000	\$0	\$10,030,000
Texas A&M University	\$2,700,000	\$0	\$2,700,000
Texas A&M University System	<u>\$255,650,000</u>	<u>\$0</u>	<u>\$255,650,000</u>
The University of Texas System			
The Univ. of Texas at Arlington	\$16,635,945	\$0	\$16,635,945

The Univ. of Texas at Brownsville	\$26,010,000	\$4,500,000	\$21,510,000
The Univ. of Texas at Dallas	\$21,993,750	\$0	\$21,993,750
The Univ. of Texas at El Paso	\$12,750,000	\$0	\$12,750,000
The Univ. of Texas – Pan American	\$29,950,000	\$3,300,000	\$26,650,000
The Univ. of Texas at the Permian Basin	\$5,610,000	\$0	\$5,610,000
The Univ. of Texas at San Antonio	\$27,950,000	\$0	\$27,950,000
The Univ. of Texas at Tyler	\$20,910,000	\$0	\$20,910,000
The Univ. of Texas Southwestern Medical Center	\$40,000,000	\$40,000,000	\$0
The Univ. of Texas HSC at Houston	\$19,550,000	\$0	\$19,550,000
The Univ. of Texas Medical Branch at Galveston	\$20,000,000	\$0	\$20,000,000
The Univ. of Texas Health Center at Tyler	\$11,513,250	\$0	\$11,513,250
The Univ. of Texas HSC at San Antonio (Harlingen)	\$25,500,000	\$0	\$25,500,000
The Univ. of Texas M.D. Anderson Cancer Center	\$20,000,000	\$17,200,000	\$2,800,000
The Univ. of Texas HSC at San Antonio	\$28,900,000	\$3,300,000	\$25,600,000
The University of Texas System	\$327,272,945	\$68,300,000	\$258,972,945
Texas Tech Univ. HSC	\$90,530,000	\$0	\$90,530,000
Texas Southern University	\$79,000,000	\$48,065,000	\$30,935,000
Midwestern State University	\$8,967,500	\$8,967,500	\$0
Stephen F. Austin	\$14,070,000	\$14,070,000	\$0
University of Houston	\$102,056,250	\$0	\$102,056,250
University of North Texas	\$80,433,750	\$55,000,000	\$25,433,750
Texas Woman’s University	\$25,797,500	\$17,500,000	\$8,297,500
Texas State University System	\$105,398,106	\$0	\$105,398,106
Texas State Technical College System	\$10,880,000	\$0	\$10,880,000
TTU & TTU HSC	\$456,603,106	\$149,302,500	\$307,300,606
Total Tuition Revenue Bonds	\$1,039,526,051	\$217,602,500	\$821,923,551
(Excludes what has been authorized and fully issued)			