

Report Number 662  
December 2003

### Highlights

- Utah general obligation debt grew from \$367 million in 1990 to \$1.7 billion in 2003.
- Between 1995 and 2003, 65.8% of Utah's GO bond debt was issued for transportation infrastructure. Higher Education was next, with 14.8% of GO bonds issued during that period.
- In 2003, GO debt outstanding was 66.9% of the state's constitutional limit. In 1990, GO debt outstanding was 31.9% of the constitutional limit.
- In 2000, Utah ranked 21<sup>st</sup> in the nation for total debt outstanding, 14<sup>th</sup> in GO debt outstanding and 27<sup>th</sup> in revenue debt outstanding.
- Utah is one of seven states with AAA ratings from both major bond rating agencies.
- Debt service grew from 1.48% of total state expenditures in 1991 to 2.82% in 2003.
- Utah's top-notch credit rating and reasonable debt service level are the result of thriftiness in the past. Since 1998, much of the state's capacity to absorb additional debt has been consumed.

Utah Foundation is a nonprofit, non-advocacy research organization. Our mission is to encourage informed public policy making and to serve as Utah's trusted source for independent, objective research on crucial public policy issues.

4141 Highland Drive, Suite 102  
Salt Lake City, Utah 84124  
(801) 272-8824  
www.utahfoundation.org

## State Government Debt in Utah: Rapid Growth in Recent Years

### Introduction

In 1995, Utah Foundation published two separate reports detailing the historical use of debt in the State of Utah—one that covered the use of general obligation or “GO” bonds, and another that focused on revenue bonds. At the time, the state had emerged from a period when debt was not used as a common way to fund capital projects. In fact, for much of the 20<sup>th</sup> century, this was the consistent trend for Utah. But changing times have led to different tactics, and the rapid and unprecedented growth of population seen in the past decade led to changes in methods used to fund such growth. In fact, the state greatly increased its use of debt during the 1990s to pay for infrastructure, much of which was developed to accommodate the increase in residents.

As measured by many observers, Utah has a strong record of judicious and responsible financial management. Just this year, USA Today called the Utah the best-managed state in the nation,<sup>1</sup> with particular emphasis on the way Utah weathered the recent economic downturn. Utah's AAA credit rating<sup>2</sup> from each major rating agency is another external stamp of approval on the state's financial management. This past year, the state issued \$472 million worth of bonds at an interest rate that was 5-6 basis points<sup>3</sup> lower than the rate at which the average AAA municipal bond traded at that day. Therefore, in providing facts and figures to open a public policy discussion on the state's use of debt, the authors of this report are cognizant of two things:

1. By any external measure, the State of Utah is performing remarkably well, especially when benchmarked against the rest of the nation.

2. Because the specific question of whether a certain project or investment was worth funding with debt is inherently a political one, any such judgments are left to the political arena. This report is meant to provide the public forum with a framework within which to discuss these issues on their factual merits.

The purpose of this report is to detail the use of debt in the State of Utah from the 1990s through 2003 in order to facilitate a discussion about fiscal discipline and the appropriateness of debt. After providing a brief introduction to the various tools states can use to finance capital projects and discussing the various types of indebtedness, this report will detail the historical facts concerning growth in debt and changes in the role of debt over the last decade. It will then outline a framework to evaluate the use of debt by any government entity, and examine the State of Utah with respect to the outlined criteria.

### Financing Methods

There are four primary methods that governments can use to finance projects, and these means are often used in combination to best achieve financing goals. These methods are pay-as-you-go, save-and-wait, government grants, and debt.

The pay-as-you-go method entails the government appropriating funds one year at a time to complete one portion of a particular project during that year; this funding is generally taken from tax revenue, set aside and “earmarked” to

**Debt financing permits those who will benefit from the project in the future to help assume the cost... of needs resulting from future growth.**

prevent its use for daily government operations. Under this method, whatever revenue is available to use for the project is used to complete as much as possible. At any point when funds are no longer available, the project stops and is not resumed until more funds are again available. This method avoids interest on debt by not using more funds than are available. However, under this method, completion of needed projects could be postponed due to the lack of sufficient immediate revenue. Another drawback of this financing method is the impact of inflation on funding needs over the life of the project. In addition, paying for a greater share of capital projects with current revenue may require shifting resources away from current programs—a difficult and sometimes politically untenable prospect.

The save-and-wait method builds on the pay-as-you-go method by using both current tax revenue and several years' worth of saved appropriations to completely finance a capital project. Unlike the pay-as-you-go method, however, under this method none of the funds are used until enough funds are available to completely pay for the project. This method avoids interest on debt by not using more funds than are currently available. However, under this method, completion of needed projects may be postponed due to the lack of immediately available funding. Also, depending on the government entity, there may be legal and political limitations on the quantity and timetables for saving revenue.

A third method of financing government projects is through the use of federal grants or other types of grants. Generally, this method requires the government to use some of its own funds as federal grants are often given as “matching grants.” An advantage of using federal grants is that it is “free” revenue from another source that does not need to be paid back. Although grant money comes in part from the federal taxes all Utahns pay, grants represent an infusion of capital into the local economy that wouldn't otherwise be there. To the extent that federal grants are available, they represent the best, cheapest, and easiest source of financing. One drawback to grants is that with more and more states and municipalities competing for the same federal dollars, the percentage of any one project that a state can hope to fund from grants is decreasing rapidly. For instance, the first government matching grants for UTA to build light rail were paid at 80/20, meaning the federal government assumed 80% of the bill for the project. But as more and more cities have undertaken similar capital-intensive public transportation projects, the federal allotment has fallen to 50/50—and risks falling further in the near future. Another drawback to this method is that grants require spending on projects that the grantor sees as a priority.

The fourth primary method of financing capital projects is through the use of debt. This method usually involves issuing a bond. A bond is to be repaid, with interest, by a previously set future date. Like the save-and-wait method, debt financing enables the government entity to have available at one time all the funds required to complete a project—the entire project can therefore be completed in one step, without interruption. Unlike the save-and-wait method, the funds are available to use much sooner. Although tax revenue can be used to repay the bond, and repayment of the bond may roughly be over the same time period that money would be set aside under the save-and-wait method, availability of the funds for the project more closely coincides with the time that the funds are needed.

Debt financing also permits those who will benefit from the project in the future to help assume the cost, a concept known as intergenerational equity. This seems particularly pertinent during periods of rapid growth, when capital projects are made not just to meet today's needs, but also to meet the anticipated needs resulting from future growth. Bonding also makes good

economic sense in a period of escalating construction costs as measured by inflation. If inflation is sufficiently high, the interest paid on the outstanding debt may be less than the increased costs that would be incurred by waiting to finance the project on a pay-as-you-go basis. Bonding is also justifiable when there are critical or emergency public needs that are too large to pay for out of current revenues without raising taxes. Utah's use of a bond during the Great Depression is an example of meeting critical public needs during a time when revenues were insufficient and raising taxes would have been politically or economically untenable.

Debt is certainly not without its drawbacks, as a bond is an obligation on the future revenues of the issuing entity. While issuing debt requires specific future payments, the revenues available to fund such payments are not known with complete certainty in the present; hence, risk is created. Issuing debt now decreases the ability of the state to issue debt in the future, as each liability assumed represents an increase in risk and decreases borrowing capacity.

### **Primary Instruments of Debt Financing: General Obligation and Revenue Bonding**

A general obligation (GO) bond is backed by the "full faith and credit," or the unlimited taxing power, of the government entity that issues the bond. Of all bond types, GO bonds have the lowest risk of default because the government is legally required to use its taxing power to raise additional funds to pay off its GO debts. The security of GO bonds is such that if, theoretically, every person except one moved out of the state, taxes would need to be levied on that one person's property to meet the debt obligation.

In Utah, under the provisions of the state constitution, the Legislature pledges property tax revenue to repay GO bonds. The Legislature does this even though the state does not collect a statewide property tax. All property taxes paid in Utah go to local governments, school districts, and other special districts, not the state government. However, when the state authorizes a general obligation bond, it concurrently levies property taxes sufficient to pay both principal and interest. At the same time, it abates those property taxes to the extent that other revenues are available, and other revenues have always been available. Therefore, the state does not collect any property taxes to pay off bonds because they are funded by other revenue sources. However, the state maintains the right to collect a property tax should the need exist. For example, a GO bond issued to finance highway construction is backed by the ability to collect a property tax, but the bond will actually be paid off by other revenue sources such as registration fees, motor fuel taxes, or sales taxes.

By contrast, a revenue bond is backed by a specific revenue stream associated with the purpose for which the bond was issued. Appropriate situations for use include instances in which it is both convenient and cost-effective to have users of a project pay for it. Common types of pledges for revenue bond repayment include user fees, motor vehicle fuel taxes, lease payments, income from public enterprises and mortgage payments. A revenue bond does not affect the constitutionally prescribed debt-incurring capacity of the state because it is not backed by the taxing power of the state. Revenue bonds do not require voter approval on the state level, as they do not affect property taxes; and they generally pay for themselves through user charges or fees. If financial difficulties arise and a project funded by a revenue bond fails, the state has no contractual obligation to pay off the revenue bond with funds from other sources. Revenue bonds are, therefore, considered somewhat more risky than GO bonds by investors.

**When the state authorizes a general obligation bond, it concurrently levies property taxes sufficient to pay both principal and interest. At the same time, it abates those property taxes to the extent that other revenues are available, and other revenues have always been available.**

**Figure 1****Comparison of GO and Revenue Bonds**

Characteristics	G.O Bonds	Revenue Bonds
Source of repayment	Full faith and credit (unlimited taxing power) of state	Revenues generated by specific project funded by the bond
Investor perception	Lower Risk	Somewhat higher risk
Interest Rates (Borrowing Costs)	Lower interest rate	Higher interest rate
Requires referendum if a municipality?	Yes	No
Total amount issued limited by constitution?	Yes	No
Repaid by funds directly generated by original use of bond?	No	Yes
Example of Uses	Capital investments such as highways, building projects, prison construction	Utah Housing Finance Authority (mortgages), Utah Board of Regents (student loans)

Source: Utah Foundation.

As a result, they generally carry a lower credit rating and require a higher interest rate. One notable exception to this rule is the sales tax revenue bond, which is secured by the pledge of sales taxes from the issuing entity. In most instances, sales tax revenue bonds receive similar or occasionally lower interest rates than a corresponding GO bond. Although it is theoretically possible for a state to not repay a revenue bond if the associated project were to generate insufficient revenue, in practice, the State of Utah would be very unlikely to default on any revenue bond because its overall credit rating would be in jeopardy if it were to do so.

In Utah, only a majority vote in the Legislature is required to authorize general obligation and revenue bonds. This is different than counties, cities, and special districts within the state. They must hold bond elections to authorize GO debt. The implication is that the Utah Legislature has been appointed custodian of the bonding process, and bond approval is placed in its stewardship. From the standpoint of cost, time, and general

ease of accomplishment, it is more efficient to have a majority of legislators authorize a bond than to subject it to a statewide vote. Figure 1 highlights the major differences in characteristics between GO bonds and revenue bonds as a quick reference.

**Historical Use of General Obligation Debt**

During its early history, the State of Utah rarely financed projects with general obligation debt. Utah first used general obligation debt in 1911 when it issued a \$1 million bond to help finance the building of the State Capitol. Next, the state issued a \$2 million bond in 1933 to finance needs that arose from the Great Depression. The state's first large use of general obligation debt occurred in 1965 when the state issued a \$67 million bond that was mostly used for higher education building needs. A decade later, in 1975, the Legislature approved a \$70 million bond for state building projects, including such buildings as the University of Utah Medical Center. GO bonds were also approved in 1978 and 1980.

Since 1982, the Legislature has authorized the use of general obligation bonds each year, except for the year 2000. Several major authorizations were made in 1985. That year, \$30 million in bonds were approved for prison construction, and \$81 million in outstanding debt was refunded<sup>4</sup> at a lower rate. At that point, debt service expenditures comprised approximately 9.1 percent of General Fund expenditures.<sup>5</sup>

In the early nineties, the state continued to use general obligation debt to finance the construction of various buildings. At that time, the state also started using general obligation bonds to finance highway projects to meet the state's growing infrastructure needs. By 1994, debt service as a percent of general fund expenditures had decreased to 3.7 percent. In 1994, the state dedicated one-eighth of one percent of the sales tax to water and local government roads. As the economy grew in the mid 1990s, the state experienced a revenue surplus. As a result, the state passed a \$90 million tax cut in 1995. That same year, the Legislature authorized \$44.3 million in bonds.<sup>6</sup>

To continue highway construction, the Legislature raised the motor fuel tax by five cents in 1997. In addition, \$600 million in highway GO bonds were authorized. Since that time, the state has authorized a little over a billion dollars of general obligations bonds for transportation projects.<sup>7</sup>

**The state's first large use of general obligation debt occurred in 1965 when the state issued a \$67 million bond that was mostly used for higher education building needs.**

As the state has entered the twenty-first century, its population is expected to continue growing at a strong pace. Between 1990 and 2000, Utah's population grew by 512,000, an increase of 30 percent. The growing state population necessitated a growing number of capital projects. In 2000, debt service payments reached 5.4 percent of general fund expenditures. Simultaneously, the national economic situation over the past three years has resulted in low interest rates that have lowered borrowing costs, thereby increasing the attractiveness of debt financed projects. For example, the state was able to refund some of its outstanding debt at a lower interest rate in 2002. Despite the savings gained through refinancing, debt as a percentage of total expenditures rose as the state continued to issue GO debt.<sup>8</sup>

During the 2003 General Session, the Legislature authorized \$65.3 million in GO bonds to be used for the construction of capital facilities plus \$109.5 million for transportation projects.<sup>9</sup> A breakdown of authorized projects for fiscal year (FY) 2004 can be seen in Figure 2. In the summer of 2003, the state took advantage of an extremely low interest rate of 2.83% and refunded \$150 million of outstanding bonds. In addition, it issued \$317 million in bonds for new projects, including bonds that had been authorized, but not issued, in previous years. The total issue equaled \$467 million.<sup>10</sup>

### Historical Use of Revenue Bonds

Utah first used revenue bonds in 1917. Between 1917 and 1921, \$7 million in revenue bonds were issued to raise funds for road construction. At that time, the state pledged motor vehicle registration fees to back and repay the revenue bonds. However, after this time, the Legislature was reluctant to use revenue bonds for highway construction.

The Utah Housing Corporation (UHC), formerly known as the Utah Housing Finance Agency (UHFA), was created by the Legislature in 1975 as a quasi-public agency. The UHC issues bonds to fund mortgages for low and moderate-income borrowers. These revenue bonds are in turn backed by the repayment of the mortgages. Most of the bonds issued by the UHFA are 30-year bonds. Because UHC acts like a state agency and the bonds are exempt from state and federal income tax, it can raise capital at a lower cost than private mortgage companies and banks. The savings are passed along to qualified first time homebuyers in the form of lower interest rates on home loans.

Another state agency that issues a large amount of revenue bonds is the State Board of Regents. The Board of Regents issued its first revenue bonds in 1979. At that time, the federal government encouraged states to fill the void in student loan financing, as it was no longer providing this service. The federal government still pays the interest on subsidized Stafford loans while the students are in school, pays off the loan in cases of death or default, and provides a guarantee to the loan holder. However, the bonds are mostly paid off as students repay their college debt.

Another important financial development has been the use of lease revenue bonds. The State Building Ownership Authority issues the state's lease revenue bonds. Since the early 1980s the state has built many buildings using the State Building Ownership Authority. The State Division of Facility Construction and Management, DFCM, administers this building authority.

**Figure 2**

### GO Bond Authorizations FY 2003

<b>Capital Improvements</b>	
Alterations, Repairs, and Improvements	\$4,200,000
<b>Capital Developments</b>	
Division of Archives Building	\$8,000,000
UVSC Purchase of Vinyard Elementary	\$6,600,000
Capitol Restoration	\$5,800,000
USU Library	\$40,000,000
<b>Highway Projects</b>	
	\$109,500,000
<b>Total</b>	<b>\$174,100,000</b>

Source: State of Utah Code 63b Chapter 12.

**Another important financial development has been the use of lease revenue bonds—bonds backed by the lease payments made by the state agencies that occupy these buildings.**

**Figure 3****Use of GO Bond Debt Compared to Personal Income**

Fiscal Year	Outstanding GO Debt \$million	% Change From Previous Year	GO Debt per \$1,000 of Personal Income	Constitutional GO Limit \$million
1990	367		\$10.01	\$1,151
1991	325	-8.1%	8.62	1,145
1992	436	38.5%	11.11	1,270
1993	483	14.2%	11.84	1,269
1994	491	4.2%	11.40	1,310
1995	521	9.4%	11.55	1,400
1996	487	-4.2%	10.24	1,754
1997	421	-11.1%	8.40	1,918
1998*	1,354	227.5%	25.71	2,124
1999	1,385	4.2%	25.58	2,235
2000	1,304	-3.2%	23.08	2,294
2001	1,192	-5.4%	20.93	2,377
2002	1,507	28.6%	26.35	2,502
2003	1,714	13.7%	30.28	2,562

Source: State of Utah Comprehensive Annual Financial Report (CAFR) and US Bureau of Economic Analysis (BEA).

**The Legislature amended the bond limit statute to allow certain bonds to be exempt from the statutory limitation. One reason this was done is that building more highways does not necessarily “grow the size of government” like building more government buildings does.**

Lease revenue bonds are backed by the lease payments made by the state agencies that occupy these buildings. Some lease payments come from fees collected by the occupying agencies and other payments come from legislative appropriations. These bonds usually have a maturity of about 20 years.<sup>11</sup> In 2003, the State Building Ownership Authority had about \$353 million in outstanding revenue bonds.<sup>12</sup>

### **Constitutional and Statutory Limitations**

The Utah State Constitution limits the state’s general obligation debt to 1.5 percent of the fair market value of all taxable property in the state. In 2003, the state’s outstanding general obligation debt was 1.00 percent of fair market value of the state’s taxable property. This is down from 1998, when GO

debt reached 1.29 percent of the fair market value of taxable property, the historical high.<sup>13</sup> This constitutional limit only applies to GO debt because the constitution does not consider revenue bonds to be debt.

In 1989, the Legislature passed a statutory limit on outstanding GO debt. This limit is 20 percent of the state appropriations limit. The state appropriations limit restricts increases in spending based on increases in population, personal income, and inflation. One reason that the Legislature passed the appropriations limit and statutory debt limit was to limit the growth of government. However, the state Legislature can exceed this statutory limitation with a two-thirds vote.

When the Legislature authorized \$600 million in highway bonds in 1997, this financing decision would have resulted in the state exceeding the statutory limitation for outstanding debt. To avoid this, the Legislature amended the statute to allow certain bonds to be exempt from the statutory limitation. Between 1997 and 2002, the Legislature exempted approximately \$888 million in highway GO bonds from the statutory limitation. One reason this was done is that building more highways does not necessarily “grow the size of government” like building more government buildings does. These are only statutory exemptions, so they are still governed by the overall constitutional limit.

In practice, the statutory limit on general obligation debt has served little purpose. On the few occasions a bonding authorization has risked running afoul of the statute, such as the highway bond example previously cited, it has been exempted by the Legislature, meaning the statutory limit is really no limit at all. Notwithstanding the statutory limitation, all debt issuance, including GO bonds and revenue bonds, must have full statutory approval of the Legislature.

### **GO Bond Levels Outstanding**

Outstanding general obligation debt levels grew from \$367 million in FY 1990 to \$1.7 billion in FY 2002.<sup>14</sup> This increase represents an average growth in outstanding GO debt of 12.6 percent per year. However, given the outstanding GO debt levels actually decreased in five of the 13 years in question, it seems inappropriate to talk about an average growth rate. Rather, it may be more instructive to explicitly identify the years of extraordinary growth and the projects utilizing those funds. Figure 3 shows the outstanding

GO debt levels each year between 1990 and 2003 as well as the growth, or decline, of these debt levels from year to year. Figure 4 shows the projects that were funded year by year and the percentage each category comprises of the total spent since 1990. All dollar figures have been converted to FY 2003 dollars, in order to calculate actual change rather than the effects of inflation.

To understand the implications of the growth in outstanding debt levels it is important to understand the context for the growth of debt. Debt levels have more meaning when viewed in relation to the growth of the population and the growth in income levels during the same period, or in comparison with the debt levels from similar states. For example, during the same 13-year period mentioned above, the population in Utah grew from 1.7 million to 2.3 million<sup>15</sup> and the total personal income grew from \$26 billion in FY 1990 to \$56.6 billion in FY 2003.<sup>16</sup> Figure 3 shows the outstanding debt levels per \$1,000 dollars personal income. Comparison of the outstanding GO debt and personal income levels provide a rough approximation of the growth of government debt relative to the income base.

### GO Debt Level in Context

In the late 1980s and up through 1997 the average GO debt level per \$1,000 of personal income hovered around \$10. (In 1992, for example, it stood at \$12.78.) However, due in large measure to the size of the I-15 rebuilding project, from 1998 to 2000 the state's debt level per \$1,000 personal income almost doubled, growing to \$23.08 debt per \$1,000 personal income. Thus, in spite of rapid growth in personal income in the late 1990s, GO debt grew at a rate almost twice that of the growth in personal income. In contrast, from 1992 to 2000 the average amount of GO debt per \$1,000 personal income across the United States actually dropped from \$20.06 to \$16.49. During this period, Utah's ranking of GO debt per \$1,000 personal income (ranked from largest to smallest) jumped from 29<sup>th</sup> to 14<sup>th</sup>, relative to the other 50 states. This is one of the largest changes in ranking among states from 1992 to 2000. Only New Mexico had a greater difference between its rankings, 24 slots from 37<sup>th</sup> to 13<sup>th</sup> in the nation, while Mississippi and South Carolina, like Utah, moved 15 slots.

Figure 5 shows exceptional increases in debt levels in 1998 and 2002 with 2003 showing a large increase as well, in both a table and graphical representation. Of these three years, the growth in 1998 dwarfs the growth in 2002 and 2003. Returning to the list of major projects in Figure 4,

**Figure 4**

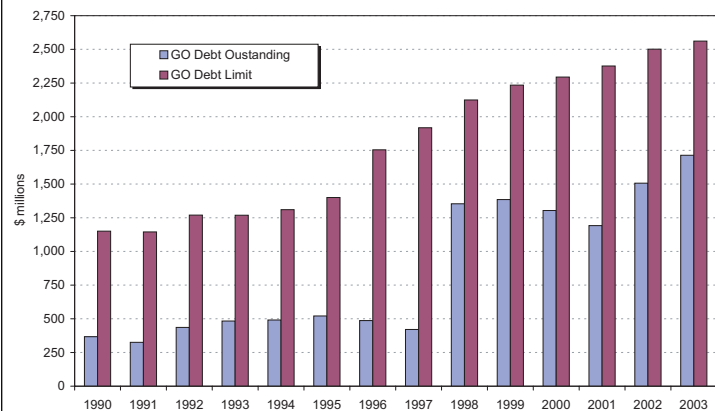
### GO Bond Debt Issued by Category

Fiscal Year	Capital		Planning/ Design		Higher Education		Admin. Services	Total
	Dev.	Imp.	Projects	Tran.	Education	Services		
1995	\$69.6	\$5.9	\$0.2	\$14.2	\$0.0	\$0.0	\$89.9	
1996	41.5	8.3	1.3	0.0	0.0	0.0	51.1	
1997	26.2	8.5	0.0	0.0	0.0	0.0	34.8	
1998	31.8	0.0	0.0	661.0	38.3	0.0	731.2	
1999	52.5	0.0	0.0	259.9	0.0	0.0	312.4	
2000	0.0	0.0	0.0	71.6	45.3	12.1	128.9	
2001	0.0	0.0	0.0	6.1	0.0	8.8	14.9	
2002	0.0	0.0	0.0	126.3	45.3	24.7	196.3	
2003	0.0	0.0	0.0	158.3	162.7	90.6	411.5	
<b>Total</b>	<b>\$221.7</b>	<b>\$22.7</b>	<b>\$1.4</b>	<b>\$1,297.4</b>	<b>\$291.6</b>	<b>\$136.1</b>	<b>\$1,971.0</b>	
<b>Category % of Total</b>	<b>11.2%</b>	<b>1.2%</b>	<b>0.1%</b>	<b>65.8%</b>	<b>14.8%</b>	<b>6.9%</b>	<b>100.0%</b>	

Source: State of Utah Budget Summaries.

**Figure 5**

### GO Constitutional Limit and GO Debt Levels Since 1990



Year	GO Debt Outstanding FY 2003 \$Millions	Constitutional GO Debt Limit FY 2003 \$Millions	Outstanding as a % of Limit
1990	\$367.27	\$1,150.53	31.9%
1991	325.41	1,145.00	28.4%
1992	436.01	1,269.67	34.3%
1993	483.35	1,268.78	38.1%
1994	491.12	1,309.93	37.5%
1995	521.30	1,400.24	37.2%
1996	487.02	1,754.33	27.8%
1997	420.76	1,918.39	21.9%
1998	1,353.71	2,124.29	63.7%
1999	1,385.14	2,234.56	62.0%
2000	1,304.11	2,294.36	56.8%
2001	1,191.93	2,376.51	50.2%
2002	1,506.81	2,501.59	60.2%
2003	1,713.76	2,561.64	66.9%

Source: State of Utah CAFRs.

the reason for 1998's unprecedented growth was a \$608 million dollar bond for highway development. From 1998 through 2001, the state saw declines in the amount of GO bonds issued relative to the constitutional limit. In 2002, the state added approximately \$315 million in debt to bring outstanding debt to 60.2 percent of the constitutional limit. In 2003, Utah added another \$207 million in debt, bringing the ratio of debt to 66.9 percent, the highest proportion during the time period studied, eclipsing the ratio achieved in 1998.

Beyond highway projects, GO debt has also been used for capital improvements, capital developments, and Administrative Services projects. Capital improvements include upgrades, remodeling, repairs, and maintenance on pre-existing facilities costing less than \$1.5 million. Capital developments include the construction or purchase of a new facility, or the remodeling of an existing building costing over \$1.5 million. The Department of Administrative Services takes on such projects as the State Capitol building, archive facilities, and information technology.

**Public activity bonds fund publicly owned and operated enterprises, such as roads, buildings, water, and other enterprise fund-type systems. Private activity bonds advance public goals but are used by privately owned and operated facilities.**

### Types of Revenue Bonds

Revenue bonds can be divided into two groups: public activity bonds and private activity bonds. Public activity bonds fund publicly owned and operated enterprises, such as roads, buildings, water, and other enterprise fund-type systems. The only requirement for revenue bonds at the state level is the approval of the Legislature. Private activity bonds advance public goals but are used by privately owned and operated facilities. Common uses of private activity revenue bonds by the state are bonds used to raise money for student loans and low to moderate-income mortgages.

As part of federal tax reform in the mid 1980s, the U.S. Treasury Department took steps to limit what it saw as excessive use of tax-exempt financing for private interests. It defined "private activity bonds" and put a cap on such bonds as figured by a formula. Utah's cap is currently \$228 million dollars a year. Before a private activity revenue bond can be sold, a certificate must be obtained from the Private Activity Bond Review Board. Utah has generally used the majority of its allotment each year for low-income mortgages and student loans.

### Current Uses of Revenue Bonds

The uses of state revenue bonds have not changed much since the 1980s. The five current uses are 1) Utah Housing Corporation, 2) State Board of Regents, 3) Colleges and University Revenue Systems, 4) Building Ownership Authority, and 5) Water Development Revolving Loans. It is important to make the distinction again between public and private revenue bonds. In the case of Utah, the two largest issuers of revenue bond debt (UHC and Board of Regents) are using private activity bonds. As both a legal and practical matter, these bonds do not count as "debt" or an obligation

for the state. The issuing entities generally operate successfully on their own with the revenue generated more than adequately covering the bonds issued. The other three issuers of revenue bonds (State Building Ownership Authority, Colleges and Universities, and

**Figure 6**  
**State of Utah Revenue Bonds**

Issuing Entity or Purpose	FY 1994		FY 2002		FY 2003	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Utah Housing Finance Agency	\$1,125,089,708	65.3%	\$1,254,400,831	38.7%	\$1,291,661,000	38.9%
Board of Regents, Student Loans	418,480,743	24.3%	1,254,359,952	38.7%	1,311,019,000	39.5%
College & Universities, Misc. Purposes	115,505,043	6.7%	377,489,803	11.6%	361,921,000	10.9%
State Building Ownership Authority	41,912,226	2.4%	354,816,153	10.9%	353,878,000	10.7%
Revolving Loans for Water Development	21,623,083	1.3%	4,225,888	0.1%	2,640,000	0.1%
<b>TOTAL</b>	<b>\$1,722,610,803</b>	<b>100.0%</b>	<b>\$3,245,292,627</b>	<b>100.0%</b>	<b>\$3,321,119,000</b>	<b>100.0%</b>

Source: Ibid.



Revolving Water Loans) issue public activity revenue bonds. As of FY 2003, these entities only accounted for 21.3 percent of all revenue bonds outstanding. Figure 6 shows the breakdown of outstanding revenue bond debt for FY 2003, 2002 and 1994.

Bonds for student loans and low-income mortgages account for 78.7 percent of the current outstanding revenue bonds as of FY 2003. The amount of outstanding loans for the UHC has only risen slightly since 1994. The amount for student loans, however, has more than doubled. At the same time, the amount outstanding for the Building Ownership Authority has almost quadrupled since 1994. The only use of revenue bonds to drop since 1994 is the Revolving Loans for Water Development. No bonding has occurred for this purpose since 1995, and that bond will be completely paid off by 2005. Overall, the total amount of outstanding revenue bond debt rose from \$1.72 billion to \$3.30 billion from 1994 through 2003.

### Revenue Debt—Comparison to Other States

Although looking at the overall increase in the amount of revenue bonds outstanding can cause concern, the real question is whether the amount of debt is appropriate and manageable. A good way to examine government debt is to compare it to the personal income of the state's citizens, since the underlying assets backing all state debt are only as good as the state's ability to benefit from its citizens' income and wealth. At the end of FY 1992, the state of Utah had \$69.87 of revenue bond debt per \$1,000 of personal income of its residents. Despite the significant increase in the overall amount of revenue bonds outstanding during the intervening eight years, the amount of revenue bond debt per \$1,000 of personal income dropped to \$50.42 by the end of FY 2000. This was due to the large increase in total personal income during the 1990s. The average across the US fell from \$56.57 to \$47.98 during the same time period. Relative to other states in 2000, Utah ranked 27<sup>th</sup> in the nation for the amount of revenue bond debt. This was a decline of seven slots since 1992. Six states saw greater relative declines in the rankings, Arizona, Louisiana, Nebraska, Nevada, South Carolina, and Wisconsin.

Figures 7 and 8 detail Revenue and GO bond debt as well as total indebtedness per \$1,000 of personal income for each state. Another interesting comparison that can be

**Figure 7**

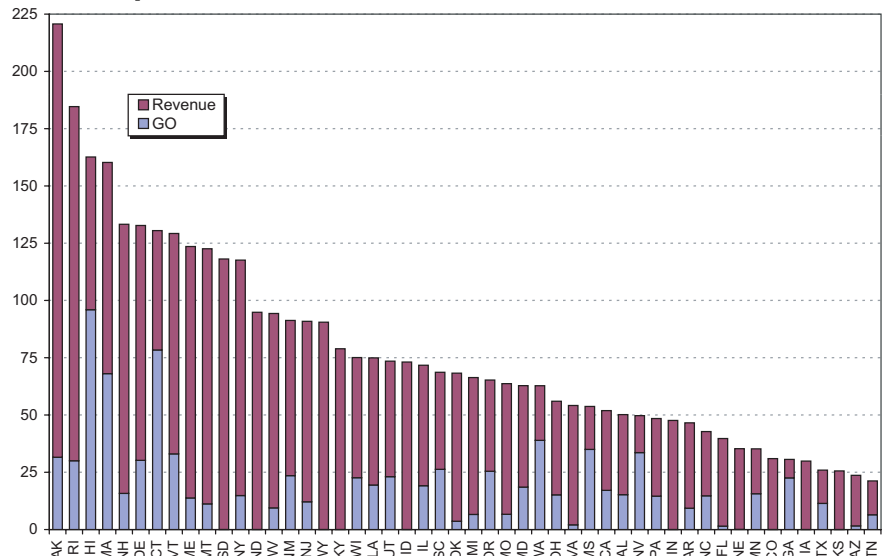
### Debt per \$1,000 of Personal Income 50 States, FY 2000

State	Total Debt	Rank	GO Bonds		Revenue Bonds	
			Amount	Rank	Amount	Rank
United States	\$64.47	NA	\$16.49	NA	\$47.98	NA
Alaska	220.70	1	31.58	8	189.12	1
Rhode Island	184.64	2	30.02	10	154.63	2
Hawaii	162.64	3	95.97	1	66.67	18
Massachusetts	160.26	4	68.05	3	92.21	11
New Hampshire	133.25	5	15.79	21	117.46	4
Delaware	132.72	6	30.21	9	102.51	8
Connecticut	130.51	7	78.39	2	52.13	25
Vermont	129.25	8	33.04	7	96.21	9
Maine	123.54	9	13.78	28	109.76	6
Montana	122.58	10	11.22	31	111.36	5
South Dakota	118.11	11	0.00	43	118.11	3
New York	117.62	12	14.86	25	102.76	7
North Dakota	94.85	13	0.00	43	94.85	10
West Virginia	94.34	14	9.48	32	84.86	13
New Mexico	91.30	15	23.55	13	67.75	17
New Jersey	90.91	16	12.11	29	78.80	15
Wyoming	90.51	17	0.00	43	90.51	12
Kentucky	78.93	18	0.00	43	78.93	14
Wisconsin	75.07	19	22.63	15	52.44	24
Louisiana	74.94	20	19.44	17	55.50	22
<b>Utah</b>	<b>73.51</b>	<b>21</b>	<b>23.08</b>	<b>14</b>	<b>50.42</b>	<b>27</b>
Idaho	73.11	22	0.00	43	73.11	16
Illinois	71.75	23	19.12	18	52.62	23
South Carolina	68.65	24	26.28	11	42.37	30
Oklahoma	68.29	25	3.62	37	64.67	19
Michigan	66.36	26	6.61	35	59.76	20
Oregon	65.28	27	25.45	12	39.83	32
Missouri	63.70	28	6.66	34	57.04	21
Maryland	62.81	29	18.53	19	44.28	29
Washington	62.80	30	38.95	4	23.85	43
Ohio	56.03	31	15.16	24	40.87	31
Virginia	54.16	32	2.07	38	52.08	26
Mississippi	53.73	33	34.99	5	18.74	46
California	51.94	34	17.10	20	34.84	37
Alabama	50.17	35	15.23	23	34.93	36
Nevada	49.71	36	33.59	6	16.12	47
Pennsylvania	48.49	37	14.61	27	33.87	38
Indiana	47.64	38	0.00	43	47.64	28
Arkansas	46.59	39	9.34	33	37.25	34
North Carolina	42.79	40	14.72	26	28.07	41
Florida	39.73	41	1.51	40	38.23	33
Nebraska	35.30	42	0.06	41	35.24	35
Minnesota	35.22	43	15.66	22	19.57	45
Colorado	30.98	44	0.02	42	30.96	39
Georgia	30.62	45	22.57	16	8.05	50
Iowa	29.88	46	0.00	43	29.88	40
Texas	25.93	47	11.43	30	14.50	49
Kansas	25.60	48	0.00	43	25.60	42
Arizona	23.67	49	1.61	39	22.05	44
Tennessee	21.24	50	6.45	36	14.79	48

Source: US Census Bureau, State Government Finance Series.

**Figure 8**

### Total Debt per \$1,000 of Personal Income 50 States, FY 2000



Source: Ibid.

gleaned from Figures 7 and 8 is Utah's position relative to its neighbors. Arizona and Colorado have the lowest debt to income ratios in the region, while Nevada and Idaho are closer to Utah. Wyoming, Montana and New Mexico all have a greater debt to income ratio, with the majority of that debt coming from revenue bonds.

## **Analysis of Performance**

Having detailed the facts concerning the growth of debt usage in the State of Utah over the past decade, we are now in a position to outline a framework for evaluating how appropriately and responsibly Utah has used debt. To facilitate this analysis, the following five criteria will be used:

1. **Cost of Capital**—debt should be used in such a way that the overall cost of borrowing money is minimized.

2. **Financial Flexibility**—in the face of disaster or extreme economic need, is the ability to borrow to meet those needs maintained?

3. **Excessive Debt and Excessive Debt Increase as Sign of Financial Distress**—if total volume of debt is rising, is there some potential underlying problem being exposed? Do ongoing revenues meet ongoing expenditures?

4. **Meeting Critical Needs**—would rigid debt-avoidance result in budget cuts adversely impacting crucial programs or resources? Are critical infrastructure concerns being addressed?

5. **Appropriate Debt Usage**—is long-term debt used for long-term projects? Is debt sometimes paid off too quickly, thus tying up revenues that could be used for ongoing state government operations? Is short-term borrowing used as a crutch to cover budget gaps?

### **Cost of Capital**

In the corporate world, sound finance principles dictate that debt should be used in order to minimize a firm's overall cost of capital. In the private sector, where issuing stock is another means of raising capital, the optimal capital structure—and thus optimal level of debt—is dictated by the idea that lower financing costs are better than higher financing costs. If a firm can add debt and simultaneously lower their overall cost of capital, it should be done. If issuing more debt will raise the firm's overall financing cost, the prudent fiscal strategy would dictate that some other mechanism be found.

In the public sector, this scenario is simplified by the absence of stock or equity, as a means to finance capital needs. Therefore, the only cost associated with securing financing above and beyond ongoing revenues is the interest rate at which debt can be secured. This is why public entities are so concerned with their credit rating. The higher a state's (or any government entity's) credit rating, the lower the interest rate it will pay on its debt. This has proven emphatically true for the State of Utah. Because of the strength of its credit, Utah has been able to borrow money at interest rates significantly below that of a single A-rated entity. This excellent credit rating has likewise allowed the state to save its schools, and taxpayers within those school districts, millions of dollars in interest expense each year through the State School Bond Guaranty Program, which enables any qualifying school district to borrow at the state's AAA borrowing cost.

Though the credit rating doesn't specifically take into account the usage of proceeds from each bond issued, it certainly puts a stamp of approval on what Moody's and S&P consider the state's willingness and ability to repay

**Though the credit rating doesn't specifically take into account the usage of proceeds from each bond issued, it certainly puts a stamp of approval on what Moody's and S&P consider the state's willingness and ability to repay its debts.**

its debts. So in one sense, bad debt may be thought of as debt that negatively impacts the credit rating provided by the rating agencies. This idea is supported by the generally held view that the credit rating agencies' job is to protect investors by giving a balanced examination of the risks associated with a certain entity's debt.

Given the rapid growth in GO bond debt since 1998, it is a little surprising that Utah has been able to maintain its AAA rating. This build-up in debt has left the state with a lot less borrowing capacity, relative to the constitutional limit, than it had prior to 1998. This may hamper future capital projects or deny the state the flexibility it needs when shifting some planned construction from pay-as-you-go to bonded projects, if there are revenue shortfalls for ongoing government expenses. When trying to balance these considerations, another important fact must be considered. Interest rates are so low that the relative importance of the AAA rating is significantly muted. The difference between the rate at which an AA+ entity and an AAA can borrow capital is smaller now than when interest rates were higher.

### Financial Flexibility

As mentioned previously, maintaining the ability to borrow to meet unexpected needs may be used as a measure of the appropriateness of current debt levels. A state may be considered somewhat fiscally irresponsible if that state does not maintain a borrowing capacity sufficient to meet and weather unexpected regional or global disasters such as flooding or periods of economic downturns.

Using this rationale and considering the economic troubles of recent years, the State of Utah seems to have done relatively well, as it has never been at risk for losing its AAA rating (termed "put on negative watch" by the rating agencies), nor had trouble in finding willing lenders. Currently only 5 other states have AAA ratings from both Moody's and Standard & Pools. Figure 9 lists the credit ratings of each of the 50 states and the District of Columbia, as rated by Moody's and Standard and Pools, the two largest credit ratings agencies in the country.<sup>17</sup>

This summer, before there was any good news regarding the economy's resurgent growth, Utah managed to sell a \$467 million dollar bond at the historically low interest rate of 2.834%. This rate is the lowest ever obtained by the state. Obviously, lenders considered the state's ability to borrow and repay any debt to be healthy.

Even without appealing to the judgment of lenders or credit rating agencies, Figure 5 shows that the state has not approached its constitutional debt limit, which leaves room for additional debt in the case of emergencies. However, as was mentioned above, that capacity has shrunk considerably in the past six years. With the accumulation of \$1.2 billion in new debt, the state now has less capacity to pay off all debt in 2003 than it did in 1992. In 1992, Utah's total outstanding debt was \$82.65 per \$1,000 of personal income, by 2003 that had climbed to \$88.94, despite the rapid growth in personal income during this time period. It is important to note that this measures the static level of outstanding debt, and the actual dollar amount being spent each year to service the debt is much smaller.

Figure 10 shows debt service expenditures as a percentage of total expenditures, general fund expenditures, and as a percentage of personal income. It is worth noting that although the outstanding GO debt level

**Figure 9**

### State Credit Ratings November 2003

State	Moody's	S&P
Alabama	Aa3	AA
Alaska	Aa2	AA
Arizona		NR
Arkansas	Aa2	AA
California	A3	BBB
Colorado		NR
Connecticut	Aa3	AA
District of Columbia	Baa1	A-
Delaware	Aaa	AAA
Florida	Aa2	AA+
Georgia	Aaa	AAA
Hawaii	Aa3	AA-
Idaho		NR
Illinois	Aa3	AA
Indiana		AA+
Iowa		AA+
Kansas	Aa2	AA+
Kentucky		NR
Louisiana	A1	A+
Maine	Aa2	AA+
Maryland	Aaa	AAA
Massachusetts	Aa2	AA-
Michigan	Aaa	AAA
Minnesota	Aa1	AAA
Mississippi	Aa3	AA-
Missouri	Aaa	AAA
Montana	Aa3	AA-
Nebraska		NR
Nevada	Aa2	AA
New Hampshire	Aa2	AA+
New Jersey	Aa2	AA
New Mexico	Aa1	AA+
New York	A2	AA
North Carolina	Aa1	AAA
North Dakota	Aa3	AA-
Ohio	Aa1	AA+
Oklahoma	Aa3	AA
Oregon	Aa3	AA
Pennsylvania	Aa2	AA
Rhode Island	Aa3	AA-
South Carolina	Aaa	AAA
South Dakota		NR
Tennessee	Aa2	AA
Texas	Aa1	AA
<b>Utah</b>	<b>Aaa</b>	<b>AAA</b>
Vermont	Aa1	AA+
Virginia	Aaa	AAA
Washington	Aa1	AA+
West Virginia	Aa3	AA-
Wisconsin	Aa3	AA-
Wyoming		NR

Source: Bloomberg.

**Figure 10**

### Debt Service as a Percent of Expenditures

FY Year	Debt Service as a Percent of:		
	Total Expenditures	General Fund Expenditures	Personal Income
1991	1.48%	3.89%	0.22%
1992	1.52%	3.73%	0.22%
1993	1.42%	3.43%	0.20%
1994	1.55%	3.70%	0.22%
1995	1.71%	3.91%	0.23%
1996	1.73%	4.00%	0.23%
1997	1.71%	4.00%	0.23%
1998	2.13%	5.06%	0.28%
1999	2.44%	5.49%	0.31%
2000	2.47%	5.45%	0.30%
2001	2.38%	5.15%	0.29%
2002	2.53%	5.13%	0.31%
2003	2.82%	5.37%	0.33%

Source: State of Utah CAFRS.

per \$1,000 personal income is approximately \$30 and the outstanding revenue bond debt level is around \$59, the state is fulfilling its debt service with the use of 2.82 percent of total expenditures.

Flexibility is demonstrated by having strong access to capital through a variety of mechanisms at affordable rates. If the state were to authorize sales tax revenue bonds in the future, they would likely receive an AAA rating. Combined with the state's AAA GO bond rating and its strong AA1<sup>18</sup> lease revenue bond rating, the state has some powerful mechanisms to access the capital markets at low cost.

### **Excessive Debt or Excessive Debt Increase**

An important factor in judging a state's use of debt is determining if there has been an excessive use of debt. Excessive use might be defined as either unnecessary or burdensome levels of debt. It appears that the state of Utah has historically been a judicious user of debt. The state's use of debt has increased recently, largely for funding transportation projects. By most standards, the improvements to the transportation infrastructure have been needed. Has the increase in debt become a burden to the state? The answer is mixed. As stated above, debt per \$1,000 of personal income has climbed since 1992 and debt service as a percentage of total expenditures has grown. Fortunately, that percentage has not yet reached the level that it was in 1985, when debt service accounted for 4.25 percent of total expenditures. However, as detailed in Utah Foundation's October report, the state has seen a large increase in the importance of federal funds and dedicated credits to the state's budget. When debt service is calculated as a percentage of state-only expenditures (all expenditures minus federal funds and dedicated credits) in 2002, Utah spent a larger percentage of these "home grown" funds to service its debt than in 1985, 3.92 percent compared to 3.84 percent in 1985.

**When debt service is calculated as a percentage of state-only expenditures (all expenditures minus federal funds and dedicated credits) in 2002, Utah spent a larger percentage of these "home grown" funds to service its debt than in 1985, 3.92 percent compared to 3.84 percent in 1985.**

Fortunately, through coincidence or planning, the increase in debt taken on by the state during the 1990s coincided with an increase in the underlying ability to pay that debt back as well as a decline in interest rates, which made borrowing more attractive. There recently has been a slowdown in the growth of personal income. The state's future use of debt should continue to take into account the burden it could face if the growth of personal income throughout the state continues to decelerate. In addition, the state must be careful to avoid the use of debt as a means to fund ongoing expenditures (e.g. the State of California). Although Utah has not specifically incurred bond debt for operating expenditures, some of the recent additions to debt loads have been used to free up previously designated cash for pay-as-you-go projects so that the cash could be utilized for operating expenditures.

### **Meeting Critical Needs**

The last fifteen years have brought great increases in population growth. This growth has brought greater needs for government services and facilities. The 2002 Winter Olympic Games also brought great needs to Utah, or at least placed greater emphasis on some needs that had been building for some time. With a growing population and "the world" coming in 2002, the State of Utah needed to significantly update its transportation systems, provide more state-of-the-art athletic facilities, and provide itself with enhanced facilities to run the state. Issuing bonds, coupled with leveraging federal grants, was the most logical answer to the question of how to finance these needs. Other, less viable, alternatives included gradually building these roads and buildings as money became available, or simply increasing

taxes.

Debt could have been avoided by simply waiting to implement these projects, or portions of these projects, until money was directly available. However, this was not very realistic. Population growth necessitated better highways, and waiting the 10 or 15 years that would have been necessary to avoid debt would have caused tremendous traffic congestion and inefficiencies in Salt Lake County. Additionally, all the facilities and commerce associated with the

Olympics were needed before 2002. The 2002 Winter Olympic Games could have been an embarrassment to the state if the infrastructure needs had not been met in a timely manner, and many officials desired to use the Olympics as an opportunity to showcase the state in order to advance economic development goals.

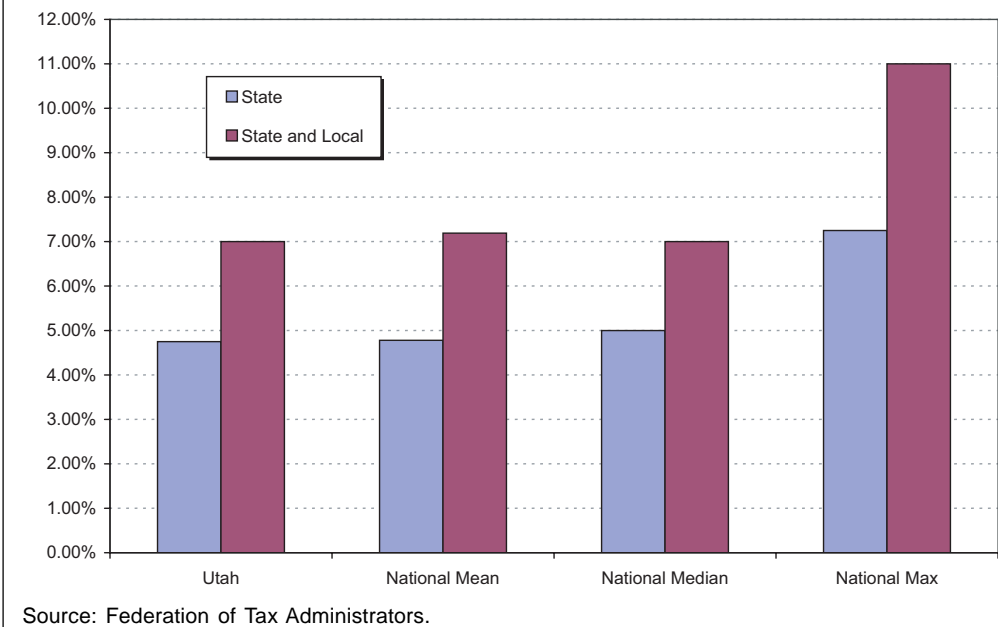
The State of Utah might have simply used taxes to directly finance its needed capital projects associated with the Olympic Games. This would have necessitated a historic increase in tax rates. Major sources of revenue for most states are sales tax and income tax. Income tax could not have been used because it is earmarked, or dedicated, to funding public education. Sales tax dollars are the primary source of revenue for the state's General Fund, while the state's gasoline tax is the primary state source of funding for transportation projects, although 1/16 of each cent of sales tax revenue does go for transportation projects.

As Figure 11 shows, Utah's state sales tax rate aligns almost perfectly with the national average for state sales tax rates of 4.75%. Additionally, local sales tax rates also align with the national average and median. It may seem out of context to consider local sales tax rates when discussing the state's capacity to raise revenue. However, when a citizen makes a purchase and pays his/her sales tax, they do not stop to consider how much is going to the state versus a locality. All they notice is the bottom line. If local sales taxes are high, it becomes difficult for state policymakers to be in a position to raise state sales tax rates.

As the data in Figure 11 seem to indicate that there is not a great difference in the amount of sales tax that Utah could collect without great political opposition, and what it is actually collecting. For this reason, Utah has done well in balancing its need for revenue with the politically conservative nature of the state. Raising the state sales tax rate to fund extremely large projects, such as the rebuilding of I-15, would be quite difficult, given its current rate.

**Figure 11**

### Sales Tax Rates as of January 2003



**Significantly raising taxes for just one or two years to fund projects that will benefit taxpayers for many years is inefficient and inequitable.**

Moreover, significantly raising taxes for just one or two years to fund projects that will benefit taxpayers for many years is inefficient and inequitable. Raising taxes to the levels necessary for such financing would likely have a negative economic impact.

Over the years, the State of Utah has used debt to finance a wide range of capital investments including the construction and remodeling of government buildings, the expansion of higher education, and the construction of prisons, water treatment facilities, and highways. In recent years the state has spent \$1.6 billion on a massive reconstruction of I-15, which included the reconstruction of over 15 miles of highway, seven major interchanges, and over 100 bridges.<sup>19</sup> Although this capital investment was funded largely via a combination of General Fund revenue monies and one-time Federal highway grants, a sizeable portion of the total expenditures was funded via general obligation bonding. GO bonds were also used in anticipation of inflows from approved government grants. As has been the case with other substantial capital projects, proponents of bonding have noted that without the use of debt financing the state would have been forced to either raise taxes or cut spending on other projects in order to fund this critical investment in transportation infrastructure.

However, it is important to remember that had the state not been cautious in the past and kept the use of bonding as a last resort, Utah would not have been in the position to take on the large amount of bond debt it incurred in 1998, 2002 and 2003. If the state were to try and pass a \$608 million highway GO bond today, Utah would only be \$200 million away from the constitutional debt limit. While a project on the scope of the I-15 renovation is not anticipated in the near future, the reduction in capacity is a concern.

### **Appropriate Use of Debt**

One of the major questions when determining the appropriateness of the use of debt is if payments match the useful life of the asset. For example, long-term debt should not be used to cover ongoing operational and maintenance expenditures. Most states, including Utah, have constitutional restrictions prohibiting such deficit financing.

Another consideration is to not pay debt off too soon. One reason to match payments with the useful life of projects is to ensure intergenerational equity. In other words, do those who benefit bear the costs? According to this criterion, Utah may have paid off some debt too soon in the past. Before the mid 1990s, the state paid off its general obligation bonds in six years. However, since that time, the state has issued bonds with maturity dates of up to fifteen years.

Beyond these two considerations, the “appropriateness” of individual projects is something that only policymakers, responding to citizen concerns, can decide. To examine each project bonded for by the state is outside the scope of this report.

### **Conclusion**

Utah has increased its use of bonds during the decade of the 1990s. In 1991, GO debt service as a portion of total state government expenditures was approximately 1.5 percent; by 2003, that had climbed to around 2.8 percent. This increase in use seems to be the result of three major factors; a rapid increase in population and income within the state, a need for infrastructure for that rapid growth and low to moderate interest rates that allowed borrowing to be economically feasible.

**Had the state not been cautious in the past and kept the use of bonding as a last resort, Utah would not have been in the position to take on the large amount of bond debt it incurred in 1998, 2002 and 2003.**

Much of debt Utah has incurred has been for transportation projects, which accounted for almost 66.0 percent of the state's total GO debt while revenue bonds have been used to fund first-time mortgages and student loans. The growth in student loan revenue bonds is quite large, until it is put into context. Utah experienced a rather large enrollment boom in higher education during the 1990s with in-state student populations increasing at an average annual percentage rate of 3.4 percent. Since government grants to low income students have been severely restricted in recent years, student loans are often the only way a low to moderate-income student has to pay for a college education. These two factors are the driving force behind the growth in the Board of Regents revenue bonds.

While it is reassuring that Utah continues to maintain its AAA rating, the rapid growth of GO bond debt since 1998 is concerning. The state is now closer to the constitutional debt limit than it has been since the start of the 1990s. This limits the state's capacity and flexibility in dealing with unknown future needs. It makes sound financial sense to borrow when interest rates are low and rates since 1998 have been so, relative to other decades.

In summary, the State of Utah enjoys the best credit rating possible, which signifies prudent use of debt financing. However, Utah would probably not enjoy such a strong credit rating if the state had not been so frugal in the past. Recent, heavy, additions to the state's debt load cannot be continued into the future without running into practical limits, whether those limits be the state's constitution, the statutory debt limit, or the desire to maintain a top-notch credit rating.

## Endnotes

<sup>1</sup> Cauchon, Dennis, "Economy not to Blame for States' Budget Woes," *USA Today*, June 23, 2003. Online at [http://www.usatoday.com/news/nation/2003-06-22-state-spending-cover\\_x.htm](http://www.usatoday.com/news/nation/2003-06-22-state-spending-cover_x.htm)

<sup>2</sup> Credit ratings are assigned by rating agencies like Moody's and Standard & Poors to assess a borrower's ability to pay back. AAA is the highest credit rating awarded and commands the lowest interest rate.

<sup>3</sup> One basis point is equal to 1/100th of a percent. Thus 6 basis points are equal to 0.06%.

<sup>4</sup> Refunding is the process of paying off existing debt with a new debt issuance, usually at a lower interest rate. It is analogous to refinancing a mortgage for a homeowner.

<sup>5</sup> One way to compare the use of debt over time is to examine the percentage of debt service expenditures to total general fund expenditures. Other methods of comparison may include ratio of debt service expenditures to expenditures of all funds, debt per capita, debt per \$1,000 of personal income, or outstanding debt to the total fair market value of taxable property. When using ratios it is important to consider all factors that may influence part of that ratio, especially to control for inflation.

<sup>6</sup> Utah Foundation Research Report, "Utah State General Obligation Debt," (Report No. 581, April 1995).

<sup>7</sup> Utah Foundation, *Financing Government in Utah: A Historical Perspective*, (Salt Lake City, 2000) pp. 177-8).

<sup>8</sup> State of Utah, *Comprehensive Annual Financial Report FY 2002*.

<sup>9</sup> State of Utah, *FY 2004 Budget Summary*, pp. 181.

**While it is reassuring that Utah continues to maintain its AAA rating, the rapid growth of GO bond debt since 1998 is concerning. The state is now closer to the constitutional debt limit than it has been since the start of the 1990s.**

We have moved. Please note our new address below. Our new phone and fax numbers are as follows:

- Phone: (801) 272-8824
- Fax: (801) 272-7711

<sup>10</sup> State of Utah, 2003A *General Obligation Bond Official Statement*.

<sup>11</sup> Utah Foundation, *Financing Government in Utah: A Historical Perspective*, (Salt Lake City, 2000) pp. 181-182).

<sup>12</sup> State of Utah, *Comprehensive Annual Financial Report FY 2003*.

<sup>13</sup> Ibid.

<sup>14</sup> State CAFRs 1990-2003

<sup>15</sup> <http://www.bea.doc.gov/bea/regional/spi>

<sup>16</sup> Bureau of Economic analysis <http://www.bea.doc.gov/bea/regional/definitions/nextpage.cfm?key=Personal%20income>

<sup>17</sup> Although the scales differ, the ratings are equivalent. For example, an A3 rating from Moody's is equal to a BBB from S&P.

<sup>18</sup> AAA is the highest bond rating available. AA1 is one "notch" under AAA and still represents an outstanding rating.

<sup>19</sup> "Utah's I-15 Design-Build Project," <http://www.fhwa.dot.gov/utdiv/projects/i15rept.htm>

This Research Report was written by Brian Baker, David Bjarnason, Brandon Bowen, Duncan Evans, Jenner Holden & Rob Schonlau, a graduate field studies team at Brigham Young University with assistance from Mark Thomas, a Director of Field Studies at BYU, under the direction of Janice Houston, Utah Foundation Director of Research. For comments, contact Ms. Houston or Steve Kroes at (801) 272-8824 or by email at [janice@utahfoundation.org](mailto:janice@utahfoundation.org) or [steve@utahfoundation.org](mailto:steve@utahfoundation.org). For more information about Utah Foundation, please visit our website: [www.utahfoundation.org](http://www.utahfoundation.org).

