GOMB

KEY BUDGET DRIVER FRAMEWORK

Infrastructure: Debt Obligation

Maintaining Utah's competitive edge and quality of life requires that we proactively manage and address the multiple demands being placed on limited resources—the taxpayer dollar. Utah's growing and changing population along with new dynamics in our revenue streams places an increased demand on everything from infrastructure to education and the state's natural resources to our correctional system. Reacting to new demands and changes within the economy without a proactive approach to budget design and strategy could potentially leave Utah vulnerable to a diminished future prosperity.

For Utah, there are six key elements that drive approximately 80 percent of expenditures: Corrections, Employee Compensation and Liabilities, Higher Education, Infrastructure (transportation, buildings, and debt), Medicaid, and Public Education. The ability to develop sound planning strategies and to resolve the challenges within these key areas is fundamental to a thriving economy. These planning strategies, or what we in GOMB refer to as ***key budget drivers****, have been developed in consultation with subject-matter experts and key stakeholders.*

Overview of Debt Obligation Budget Driver

A significant share of Utah's budget expenditures covers the development and maintenance of the State's buildings and roads. The size of these capital projects can be so large that it is difficult to fund them without considering the use of general obligation bonds. The current general obligation bond debt level in Utah is high by historical standards—currently at $3.3 billion. As the amount of debt increases, so does the service of that debt, which creates a constraint on available revenue for future needs. Current debt service (principal and interest payments) is approximately $450 million annually and accounts for a significant share of the state's expenditures.

Objectives of Debt Obligation Policy and Budget Decisions

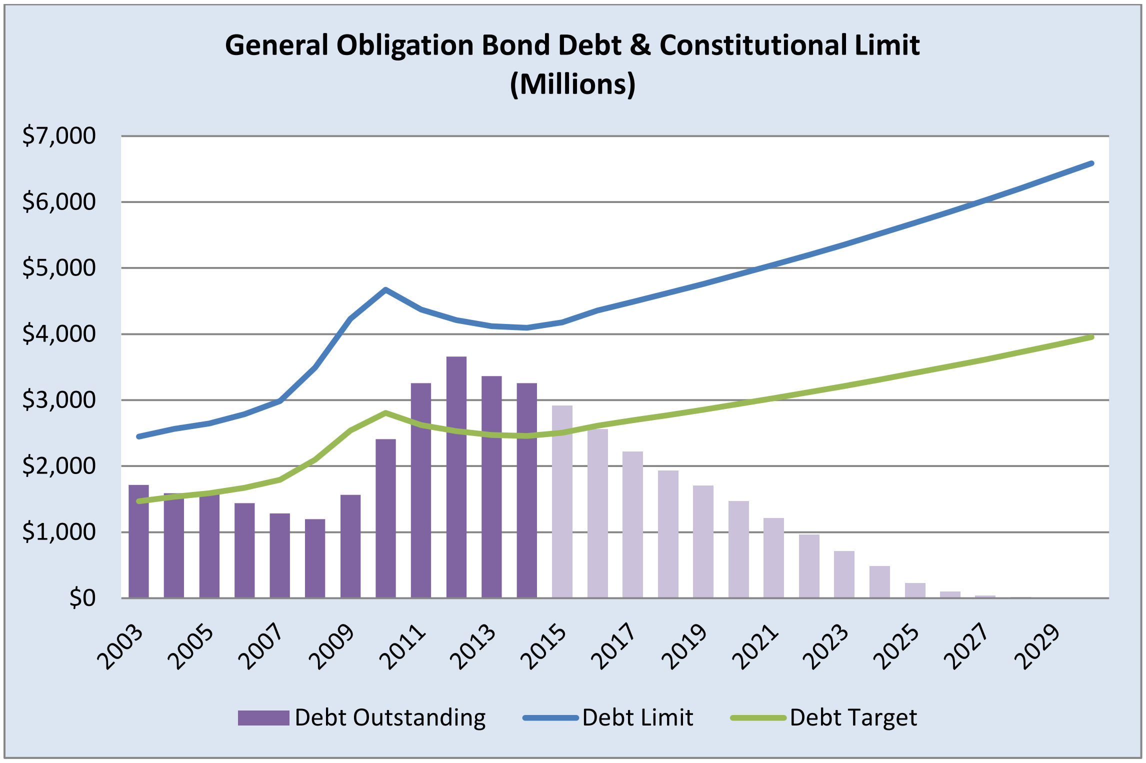
Ultimately, the goal for capital improvement projects should be to use a suitable mix of current revenues and debt—keeping debt at an appropriate and sustainable level. Appropriate and sustainable levels will vary with the needs and economic conditions in place at any given time.

Significant Issues, Potential Challenges and Risks

The State of Utah Constitution limits the total general obligation indebtedness to an amount equal to 1.5 percent of the value of total taxable property as shown by the latest assessment previous to incurring the additional debt. For FY 2014, final assessment values for tax year 2012 of the Utah Property Tax Annual Statistical Report are the basis of the calculation. Total market value of taxable property for 2012 was $273 billion. Applying the 1.5 percent constitutional limit results in a maximum indebtedness of $4.1 billion. Current net general bond debt (which includes premiums, discounts, and deferred amounts on refunding) is $3.3 billion—leaving an additional $733 million in bonding capacity.

By practice, current legislative debt policy keeps Utah's general obligation debt below 85 percent of the constitutional debt limit. This provides the flexibility to respond to unforeseen circumstances such as natural disasters and declines in property tax values. Property tax values peaked in tax year 2008 at $225 billion and over the last four years has fallen 10.4 percent to $201 billion. As a result of increased debt in 2010 and a large decline in property tax values, the outstanding general obligation debt in FY 2012 was 87 percent of the constitutional limit. The state treasurer recently recommended a debt target of 60 percent of the constitutional limit to ensure that Utah's outstanding debt return to lower levels. The following chart shows historical and forecasted net general obligation bond debt, the 1.5 percent constitutional limit, and the target level of 60 percent on a fiscal year basis.

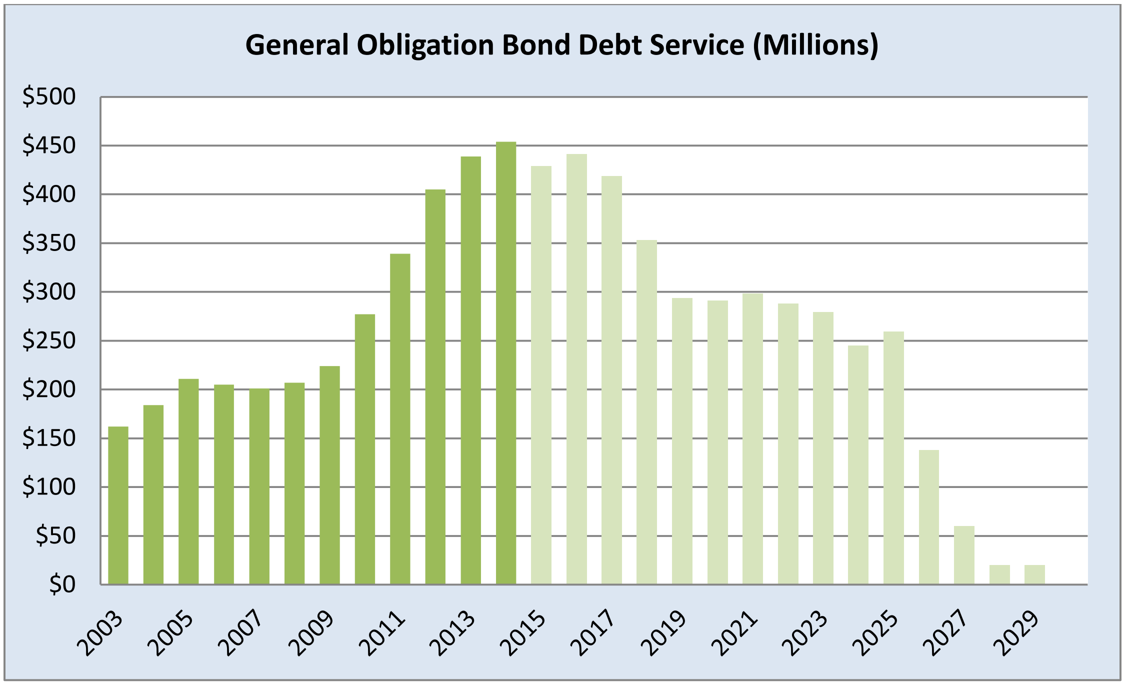
Constitutional Debt Limit



The decline in property tax values is illustrated in the drop in the constitutional debt limit (blue line) and the target level (green line). After four years of decline, property tax values are estimated to increase in tax year 2013—resulting in a higher constitutional debt limit for FY 2015. The dark purple bars indicate actual net general obligation bond debt for FY 2003 to 2014. During FY 2010 to 2012, the State of Utah issued just under $1 billion in additional debt to take advantage of historically low interest rates and to ease highway and building project budget constraints. For FY 2015 and beyond, the light purple bars represent the repayment of the $3.3 billion in existing debt. Assuming no additional debt, a 2 percent growth in property tax values in FY 2015, a 4.3 percent growth in FY 2016, and a 3 percent growth thereafter, it is estimated that the 60 percent debt target level will be reached by FY 2016.

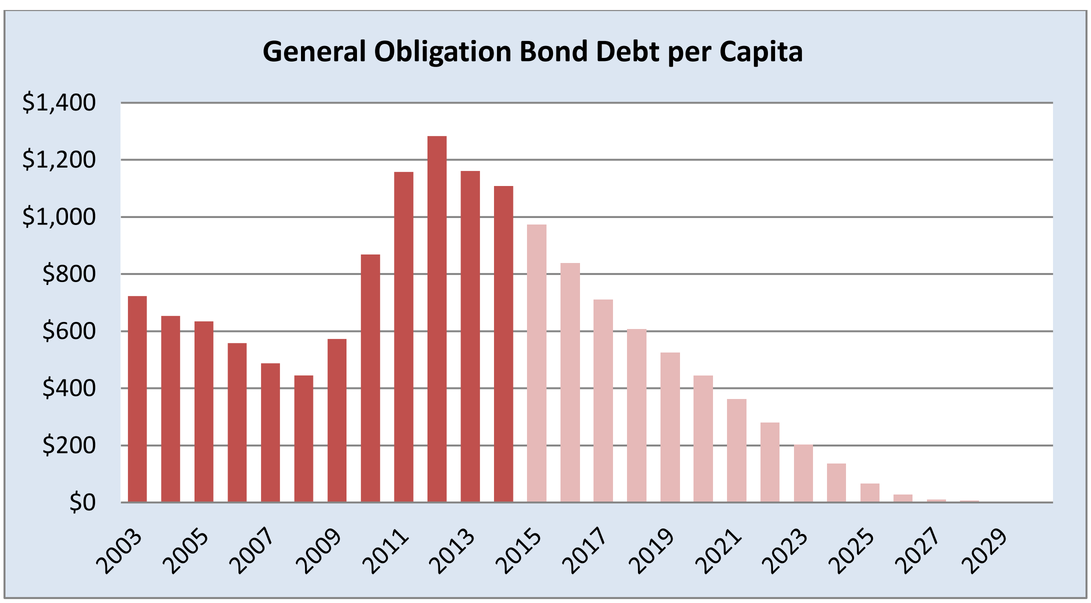
Debt Service

The chart below displays historical and forecasted debt service levels based on current repayment schedules for FY 2003 to FY 2029 when all existing general obligation bond debt is paid off. For FY 2014, the state paid approximately $454 million in principal and interest for general obligation bond debt. Debt service will remain above $400 million for the next three fiscal years, dropping below $300 million in FY 2019. The average debt payment from 2003 to 2010 was approximately $209 million.



Debt per Capita

Debt per capita represents the amount of outstanding debt associated with each Utah resident at a given point in time. The chart below displays historical and forecasted debt per capita from FY 2003 to 2019 using the Governor's Office of Management and Budget population estimates. The dark red bars represent actual debt amounts and the light red bars estimate debt amounts assuming no additional debt incurred. In FY 2008, debt per capita debt was $445. In FY 2012, the amount more than doubled to $1,283. The 2003 to 2009 average was $582. Based on population projections and no additional debt, debt per capita will not return to this level until 2019. Bond rating agencies track debt per capita so returning to lower debt levels is important for Utah to retain its AAA bond rating.



Guiding Principles for Debt Obligation Budget and Policy Decisions

Debt should be kept at an appropriate and sustainable level which may vary with economic conditions, infrastructure needs, and other budgeting priorities. Given Utah's current economic and budgetary climate, the state treasurer's target level of 60 percent is worth pursuing in order to maintain Utah's AAA bond rating.

Areas Requiring Additional Research and Consideration

Utah should identify and prioritize future capital development projects well in advance in order to adequately plan for future expenditures and reduce debt levels.