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April 22, 2019

TO: Senator Tom Tiffany
Room 316 South, State Capitol

FROM: Eric Hepler, Fiscal Analyst

SUBJECT: Stewardship Reauthorization

The following paragraphs are in response to questions your office had raised on a memorandum from April 12, 2019, regarding the effects of reauthorizing the Knowles-Nelson Stewardship Program.

General Fund Structural Condition. You had inquired about the effect of a Knowles-Nelson Stewardship Program reauthorization on state general fund out-year revenues and appropriation commitments. The general fund out-year commitments are determined by: (a) base revenues, not accounting for future law changes or for economic factors that would affect state tax receipts; and (b) base appropriations established by the Legislature. Adjustments are then made for anticipated changes to each base level under laws in effect at that time. General purpose revenue (GPR) debt service, including that for the stewardship program, is one of several future appropriations commitments considered in determining the out-year commitments of the general fund for future biennia.

Annual stewardship GPR debt service attributable to reauthorization would depend on the rate at which stewardship debt is issued and the interest rate at each issuance. Annual GPR debt service for the stewardship program as a whole would depend on principal and interest payable on new debt versus the rate at which current obligations are retired. The significance of all GPR debt service in future general fund out-year commitments would depend on other general-fund-supported borrowing authorized by law, such as for the state building program. As such, it cannot be determined at this time whether or to what extent a stewardship reauthorization would affect the general fund out-year commitments.

GAAP Position. You had inquired about the effect of stewardship reauthorization on the state's year-end general fund balance under generally accepted accounting principles (GAAP). A reauthorization of the stewardship program would add to total authorized state general obligation bonding. (Outstanding state general obligation debt totaled $7.8 billion as of December, 2018.) The issuance of stewardship debt would commit the state to future repayments of principal and interest on bonds issued for the program, and debt service would likely extend past the next term of authorization. However, outstanding long-term debt obligations are not a consideration in the general fund's year-end position under GAAP, meaning additional stewardship debt issuance would not affect this figure.

Interest Rate. You had inquired about the use of a 5% estimated interest rate for bonds issued under a reauthorized program. Bonding authority that is authorized at the beginning of a stewardship term may not be committed for nearly a decade, and it is indeterminable what interest rate the future bond issuances may carry. The true interest cost of the most recent state general obligation bond issue was 3.8%. Typically, for budget projections, 5% is the standard estimate used by our office to approximate a long-term running average interest rate.

Interest Payments. You had also inquired about average weekly interest payments for the stewardship program. Based on estimated interest payments of $27,313,800 in 2018-19, interest costs would average $525,300 per week over 52 weeks. This includes interest on stewardship debt for bonding authorized since 1990.

Total Stewardship Obligations. You had inquired about the significance of the combined total of currently scheduled stewardship debt ($795.5 million) and estimated additional principal and interest payments under a reauthorization ($533.6 million). The estimate of $1.33 billion in total stewardship obligations is one approximation of all principal and interest that would be paid beginning in 2018-19 and extending through the retirement of all debt that may be issued under a succeeding program authorization. This figure assumes the conditions noted previously, including: (a) the continuation of $33.25 million in annual allocations, all of which is committed each year; (b) 20-year terms for all bonds issued for the program; and (c) a 5% annual interest rate on bonds. However, it is not expected $1.33 billion would ever be outstanding at one time. For example, the $795 million total debt service obligation scheduled currently will decrease by $165,572,900 in 2018-19 and 2019-20 before bonds under a 10-year stewardship reauthorization would be issued beginning in 2020-21. Similarly, newly authorized bonding would be issued gradually over the next stewardship term. Although the state would be authorized to incur public debt for stewardship program expenditures, no state indebtedness is incurred until bonds are issued.

I hope this information is helpful. Please contact me with any further questions.

EH/sas