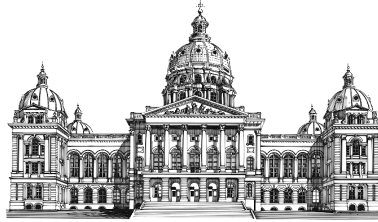


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# Iowa Legislative Services Agency Fiscal Services

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November 1, 2007

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## Outstanding Obligations of Selected State Debt

### ISSUE

This *Issue Review* provides an overview of the outstanding debt of certain bonds and lease purchase agreements of various State entities.

### BACKGROUND

The ability for states to issue debt is an important tool for financial management and may provide funds for capital improvements, without requiring tax increases, if annual tax revenues are not sufficient to support capital expenditures. Iowa has issued debt to pay for a variety of programs and projects that the State otherwise would not have been able to fund within a given fiscal year.

### DEBT POLICY

A governmental entity has several choices of debt securities, including General Obligation (GO) bonds, revenue bonds, and certificates of participation (COP). General Obligation bonds require an obligation by the governmental unit to pay the debt service from taxes and other resources. Article VII of the Iowa Constitution prohibits the State from exceeding a maximum of \$250,000 in general obligation debt without voter approval. The State does not have any outstanding GO bonds. Debt that is issued by the State is typically in the form of revenue bonds. Debt service on the revenue bonds is paid from dedicated revenue sources and does not constitute a liability against the State.

Revenue bonds may be issued with a moral obligation that includes a pledge from the Governor to request money in his annual budget to repay the debt service, if the State is unable to make its payments from the specified revenue sources. While this obligation is not legally binding, it effectively acts as binding because if the State is unable to pay its debt service it may have a negative effect on the State's bond ratings and credit quality. The State has moral obligations for Vision Iowa Bonds, School Infrastructure Bonds, and Honey Creek Resort Bonds.

In addition, bond indentures may have specific terms and requirements structured in the agreements that can affect the flexibility the issuer has within the specific capital project. For example, the specifications of the State's commitment to building the Honey Creek Resort are reflected in the indenture. If the issuer is unable to complete the requirements in accordance

with the specific terms of the bond agreement, the issuer may be considered non-compliant and considered in default, having a similarly negative effect on the issuer's bond ratings and credit quality.

### **OUTSTANDING OBLIGATIONS OF SELECTED STATE DEBT**

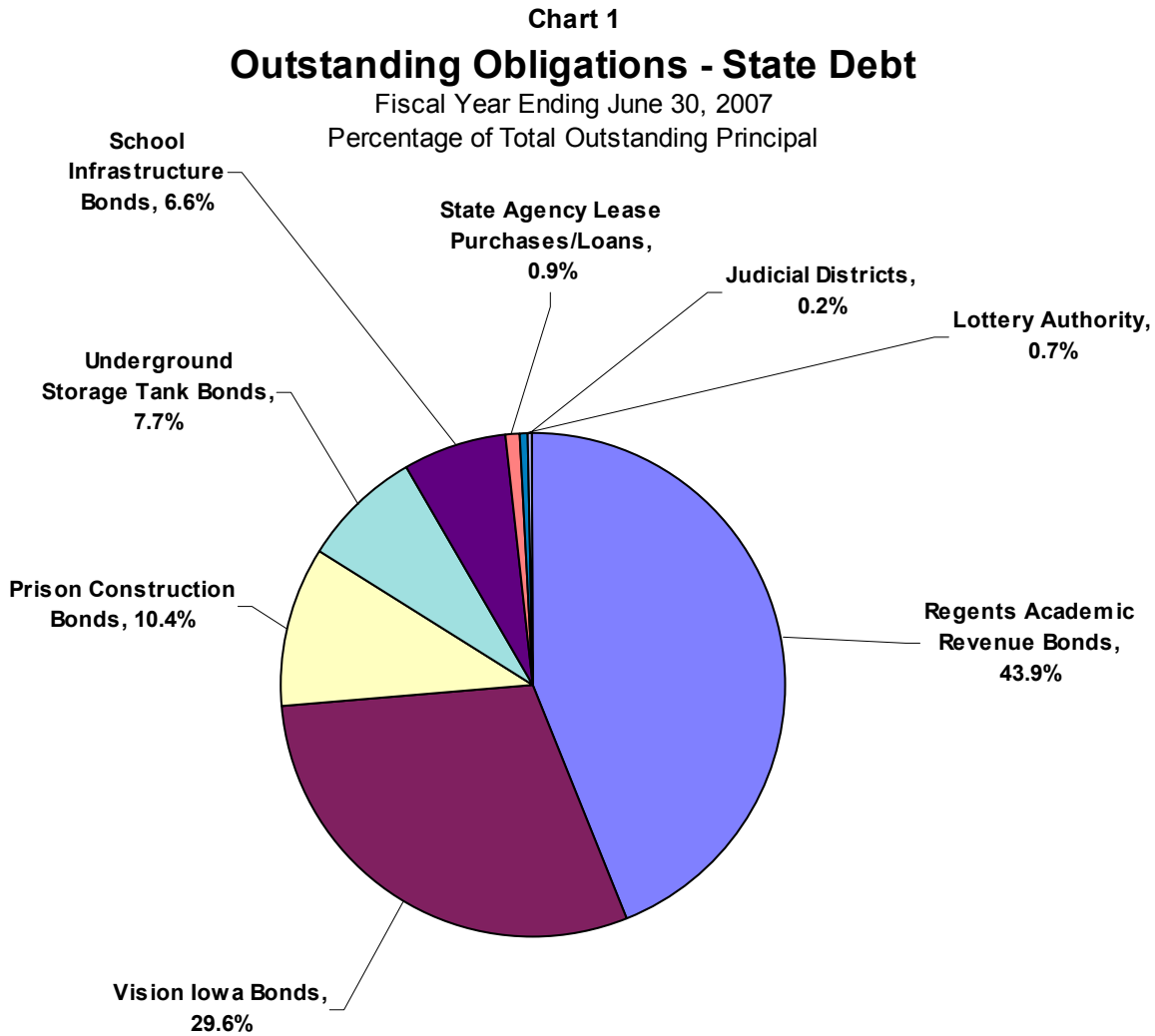
The outstanding obligations discussed in this *Issue Review* include debt that the General Assembly and the Governor have authorized and committed specific revenue sources to pay the debt service. The debt includes revenue bonds, COPs, and capital leases and loans entered into by State agencies. The debt service on the revenue bonds is paid from dedicated revenue sources that would otherwise be available for appropriation by the General Assembly. The debt service on the capital leases and COPs is typically paid from funds appropriated for the operation of various State agencies.

As shown in **Table 1**, the total outstanding principal was \$520.2 million as of June 30, 2007. Based on the current debt service schedules, the amount of interest to be paid on this debt, assuming no refinancing, will be \$207.0 million. The total amount of outstanding principal and interest is \$727.2 million.

**Table 1**  
**Outstanding Obligations by Type of Debt**  
For the Fiscal Year Ending June 30, 2007  
(Dollars in Millions)

	Principal	Interest	Total
Regents Academic Revenue Bonds	\$ 228.3	\$ 103.2	\$ 331.5
Vision Iowa Bonds	154.2	68.8	223.0
Prison Construction Bonds	54.2	13.9	68.1
Underground Storage Tank Bonds	39.8	5.4	45.2
School Infrastructure Bonds	34.4	14.1	48.5
State Agency Lease Purchases/Loans	4.8	1.1	5.9
Lottery Authority	3.5	0.4	3.9
Judicial Districts	1.0	0.1	1.1
Total	<u>\$ 520.2</u>	<u>\$ 207.0</u>	<u>\$ 727.2</u>

Chart 1 shows the distribution of debt burden for the total outstanding principal.



In FY 2007, the State paid a total of \$66.4 million in debt service for the bonds and lease purchases. **Table 2** shows the annual debt service payments by debt type for the next three fiscal years. The amount of debt service listed is not the amount the General Assembly will be required to appropriate because in some instances a portion of the debt service is paid from the interest earnings of the debt service reserve funds. For example, in FY 2007, the debt service on the Regent’s Academic Revenue Bonds was \$25.1 million, of which, \$24.3 million was appropriated by the General Assembly. The remainder was funded from reserve fund interest.

**Table 2**  
**State of Iowa Debt**  
**Annual Debt Service Payments**

(Dollars in Millions)

	FY 2008	FY 2009	FY 2010
Regents Academic Revenue Bonds	\$ 25.8	\$ 29.2	\$ 25.7
Vision Iowa Bonds	15.8	15.9	15.9
Prison Construction Bonds	8.4	8.4	8.4
Underground Storage Tank Bonds	8.9	8.9	8.9
School Infrastructure Bonds	3.5	3.5	3.5
State Agency Lease Purchases/Loans	1.4	0.8	0.6
Lottery	2.1	0.2	0.2
Judicial Districts	0.5	0.2	0.2
Total	<u>\$ 66.4</u>	<u>\$ 67.1</u>	<u>\$ 63.4</u>

**DEBT TYPES AND BUDGET IMPACT**

- Board of Regents Academic Revenue Bonds** – The General Assembly periodically authorizes the Board of Regents to issue Academic Revenue Bonds for construction, reconstruction, and renovation of facilities at the three State universities. The revenue for repayment of the bonds is derived from student tuition and fees. The General Assembly annually appropriates funds (Tuition Replacement) to replace the tuition fees in order to reimburse the universities for tuition fees used to pay the debt service on the bonds. The total outstanding principal of the Academic Revenue Bonds as of June 30, 2007, is \$228.3 million. The last bond payment is scheduled to be made by the end of FY 2029. During the 2007 Legislative Session, the General Assembly passed HF 920 (Regents Bonding Act) authorizing the Board of Regents to issue up to \$131.4 million in new Academic Revenue Bonds. As of June 30, 2007, these bonds had not been issued and are not included in the debt figures in this *Issue Review*.
- Vision Iowa Bonds** – This Program was created to provide state financial assistance in the form of grants, loans, forgivable loans, and loan guarantees to communities for the development and construction of major tourism projects. In FY 2002, the Vision Iowa Board issued \$196.4 million in bonds to fund the Program. The debt service on the bonds is paid from the State Wagering Taxes deposited into the Vision Iowa Fund, as well as Program loan repayments, and interest earnings of the Fund. Section 8.57(6)(e), Code of Iowa, allocates \$15.0 million annually from the State Wagering Tax to the Vision Iowa Fund for a 20-year period from FY 2001 to FY 2020. The debt service payments for FY 2008 will total approximately \$15.8 million. The total outstanding principal of the Vision Iowa Bonds as of June 30 2007, is \$154.2 million. The last bond payment is scheduled to be made by the end of FY 2021.
- Prison Construction Bonds** – Section 16.177, Code of Iowa, authorizes the Iowa Finance Authority to issue bonds for financing the construction of prisons. Bonds totaling \$96.1 million were issued over a three-year period (FY 1994 - FY 1996) for the construction of prisons in Clarinda, Newton, and Fort Dodge. The debt service for repayment of the bonds

is paid from the Prison Infrastructure Fund. Section 602.8108A, Code of Iowa, deposits the first \$9.5 million in court fines into the Prison Infrastructure Fund. The current annual debt service payments total \$8.4 million. The portion of the \$9.5 million not used for debt service is annually transferred to the General Fund. As of June 30, 2007, the total outstanding principal of the Prison Bonds is \$54.2 million. The last bond payment is scheduled for FY 2016.

- **Underground Storage Tank Bonds** – These bonds were issued through the Iowa Finance Authority to provide funds for the cleanup of underground fuel storage tanks. The General Assembly created a standing appropriation of \$17.0 million from the Motor Vehicle Use Tax in FY 1991 for the Underground Storage Tank Program, a portion of which is used to pay the debt service on the bonds.
- **School Infrastructure Bonds** – In FY 2002, the State issued \$48.6 million in bonds to fund the School Infrastructure Program. This Program was created to provide State financial assistance to local school districts for the construction and renovation of school buildings. The School Infrastructure Fund annually receives a \$5.0 million allocation from the State Wagering Tax to pay the debt service on the bonds.
- **Capital Leases and Loans** – State agencies have the authority to enter into lease purchase agreements for the purchase of public property. Lease purchases generally constitute shorter-term debt (three to ten years) than bonds. The agreements are primarily used by State agencies for the purchase of equipment or facility improvements. The debt service payments are paid from State agencies' operating appropriations. Section 12.28, Code of Iowa, gives the State Treasurer the authority to enter into lease purchase agreements on behalf of State agencies. The lease purchase debt information within this **Issue Review** is based on information from the FY 2006 Iowa Comprehensive Annual Financial Report.
- **Judicial Districts Certificates of Participation (COP)** – The General Assembly and the Governor authorized the Department of Corrections to issue certificates of participation in the late 1980s and early 1990s for construction of Community-Based Correctional (CBC) facilities throughout the State. Certificates of participation differ from bonds in that the title of ownership of the capital purchase is transferred upon final payment of the debt (similar to a lease purchase arrangement). However, to the investor, certificates of participation possess all of the attributes of tax-exempt bonds. The General Assembly annually appropriates funds from the General Fund to the CBC District Departments for repayment of the debt.
- **Lottery Authority** – During the 2003 Legislative Session, the General Assembly passed SF 453 (Reinvention of Government Act) establishing the Iowa Lottery Authority as an independent authority within the Executive Branch. The Iowa Lottery Authority is a public enterprise based on a corporate model. Chapter 99G, Code of Iowa, provides that the Lottery Authority is able to be self-sustaining and self-funded. The Lottery Authority issued \$8.8 million in revenue bonds for the purchase and installation of lottery ticket vending machines and for the purchase and renovation of the Lottery Headquarters building. The bonds are repaid by lottery revenue, which reduces the amount of lottery profits available to be deposited into the General Fund. For purposes of this **Issue Review**, the Lottery Authority is included in the debt figures that have an impact on the State's budget.

## OTHER BOND ISSUANCE

The State has created numerous authorities that are authorized to issue self-supporting debt for the purpose of implementing specific programs to benefit the public. The revenues used to pay down this debt are from independent revenue sources and do not constitute a liability of the State. Two examples are the Tobacco Bonds and the Honey Creek Premier Destination State Park.

- **Tobacco Bonds** –The Tobacco Settlement Authority (TSA) issued bonds that were securitized with annual payments from the tobacco industry that resulted from the 1998 tobacco Master Settlement Agreement. In 2001, the TSA issued \$644.2 million in both taxable (\$40.0 million) and tax-exempt (\$604.2 million) bonds. The net proceeds from the taxable bonds (\$39.6 million) were deposited into the Endowment for Iowa's Health Account and used primarily for health-related purposes. The net proceeds from the tax-exempt bonds were deposited into the Restricted Capital Fund and used to fund State infrastructure projects. In 2005, the TSA refinanced the tobacco bonds and issued additional bonds that generated an additional \$50.2 million in net taxable proceeds and \$100.5 million in net tax-exempt proceeds. As of June 30, 2007, the total outstanding principal of the tobacco bonds was \$1.356 billion.
- **Honey Creek Premier Destination State Park** – House File 875 (FY 2007 Infrastructure Appropriations Act) created the Honey Creek Premier Destination Park Authority and the Honey Creek Premier Destination Park Bond Fund. The Authority was authorized to issue bonds to provide net proceeds up to \$28.0 million for the development and expansion of the Honey Creek Destination Park located near Lake Rathbun. In October 2006, \$33.4 million in bonds were issued, yielding the maximum net proceeds. The first bond payment is scheduled to be made on June 1, 2009. The bonds will be repaid from the revenue generated by operations at the park. The bond indenture requires construction of the Park to include a 105-room lodge, a restaurant, an aquatic center and conference facility, an 18-hole golf course, family and group cabins, a sewer facility, a boat ramp, and docking facilities. As of September 2007, the project faces cost overruns of approximately \$9.0 million. In order to meet the requirements in the indenture, the Department of Natural Resources is requesting \$8.0 million in infrastructure appropriations for FY 2009 to complete construction of the lodge and cabins.

## CONCLUSION

The State's ability to bond has allowed it to implement numerous capital projects and economic development programs that otherwise could not have been funded within a given fiscal year. Issuing bonds provides the opportunity for the State to improve its bond ratings and the perception of how the State is managed fiscally. Debt service has risks as well, however, and the State must balance its outstanding debt and prevent default. In some cases, such as with the Honey Creek bonds, the State may have to appropriate funds in order to fulfill the requirement of the bond indenture and prevent default. Cost overruns in construction projects and other unforeseen circumstances do occur. An effective debt policy should be flexible enough to respond to the needs of the capital projects funded, while being fiscally responsible toward the annual State budget.

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