BRIEFINGS

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Center for a Competitive Florida

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Under Legislatively-Set Cap, Florida Has Limited Bonding Capacity to Meet Additional Infrastructure Demands

While Florida's Debt Position Improved Some in 2004, Implementation of the Class-Size Amendment Would Cause Our Benchmark Debt Ratio to Exceed the Target Limit

Governments often use bonding to pay for large capital public expenditures when "pay as you go" is not practical. Bonding can be a useful fiscal tool but care must be taken that debt obligations are manageable and do not put taxpayers at risk in the future, especially during slow economic periods that can limit government revenue.

The Legislature has established a 6% target and 7% cap for Florida's ratio of debt service to state revenue. When the 2003 Legislature added $600 million in bonds to reduce class size, the 6% target limit was exceeded for the first time (6.12%) in its 5-year history. While total state debt increased $817 million in 2004, stronger than expected revenue growth helped bring the benchmark ratio back below the target (5.94%). Under current estimates, the state will have no additional capacity under the 6% target until 2009. There is only $5.35 billion of capacity under the 7% cap, which can only be exceeded in case of a state emergency. While recent increases in revenue estimates should provide some additional cap room, these estimates include only currently authorized bond programs and include no additional bonds for implementing the class-size amendment. Construction costs to implement the amendment are estimated at over $9 billion.

In 1999, the Governor and Cabinet wisely established a very useful and important debt management tool—the State of Florida Debt Affordability Study. The study, conducted by the Division of Bond Finance, was meant as an analytical tool for monitoring and managing the state's debt position. It was hoped that this would integrate debt management with the capital spending decisions of the Legislature.

One of the recommendations of the report—which was the first comprehensive study of Florida's debt—was to establish benchmark guidelines for calculating debt capacity. The Governor and Cabinet adopted the study's model and the recommendation of a 6% target and 8% cap as benchmark guidelines of debt service costs (interest) as a percentage of annual revenue.

In 2000, the Legislature institutionalized the debt affordability analysis by requiring that it be prepared annually. In addition, the Legislature narrowed the benchmark guidelines range by creating a 6% target and 7% cap. To exceed the 6% target, the Legislature must determine that the additional debt issuance is in the best interest of the state. To exceed the 7% cap, the Legislature must determine the additional debt is needed to meet a critical state emergency.

Most of the data in this report comes from the 2004 Debt Affordability Study.

The need for Florida to effectively monitor and manage its debt became even more important following the passage of constitutional amendments requiring the state to reduce class size, provide universal pre-kindergarten and build a high speed rail. Although the high speed rail amendment has since been repealed, the need to maintain debt capacity has become even more apparent. Growth management has been a main concern of the 2005 Legislature and Governor Bush recently offered a plan that includes $8.5 billion in bonding for infrastructure.

Florida Has Significant Reliance on Bonding

Florida relies more heavily on bonding to pay for government expenditures than most states. Florida exceeds the national average for all three debt ratios used to evaluate a government's tax supported debt position: debt per capita; debt as a percent of personal income; and debt service as a percent of revenues. These measures are useful in translating states' debt burden into relative, comparative terms and reflect the ability of governments and taxpayers to pay for additional debt.

Florida ranks fifth in per capita tax supported debt and far exceeds the national median by 36 % ($954 vs. $701). Florida ranks fourth in tax supported debt as a percent of personal income and exceeds the national average by 34% (3.21% vs. 2.40%). National data for debt service as a percent of revenues is not available. More importantly, our state has the second highest debt service ratio of the ten most populous states (peer group).

2004 Comparison of Net Tax Supported Debt

	Debt Per Capita	Debt as % of Personal Income	Debt Service as % of Revenue
Florida	$954	3.21%	6.12%
National Median	$701	2.40%	NA
Peer Group* Median	$891	3.05%	4.35%
Peer Group* Mean	$1,194	3.56%	4.53%

** Peer Group is the nation's ten most populous states.*
Source: Florida Division of Bond Finance, December 2004

The Components of Florida's Debt

As of June 30, 2004, Florida had total debt outstanding of $21.2 billion. Of this amount, $16.9 billion is tax-supported debt and $4.3 billion is self-supporting debt, such as toll roads and university enterprises (dorms, parking, etc.)

The state's largest bond program is Public Education Capital Outlay or "PECO", which accounts for $8.4 billion of all debt. Total education debt comprises $11.4 billion, or more than half (54%) of total debt. Transportation bonds account for a quarter of all debt and environmental debt comprises 13%.

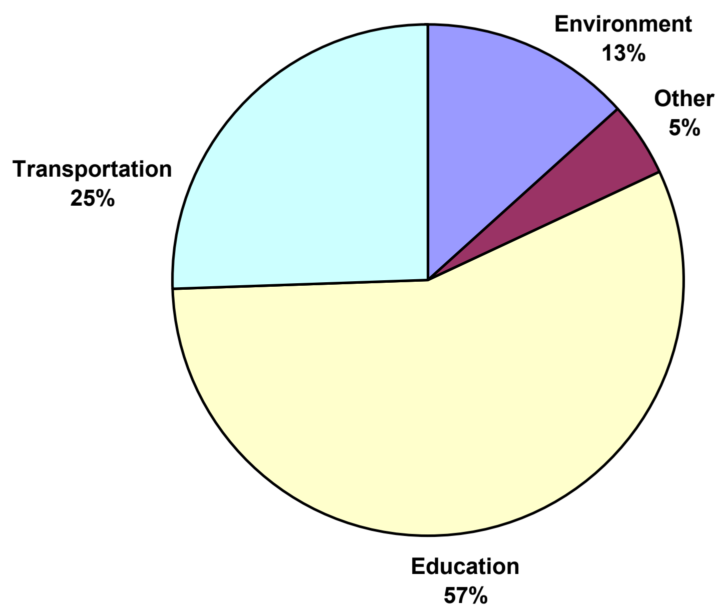
In addition, the state also has $6.3 billion of indirect debt. This debt, generally not included in the data in the debt affordability study, is the primary obligation of an entity other than the state and is not secured by state revenues. This includes bonds for the Florida Housing Finance Corporation and Shands Teaching Hospital.

Florida's total debt has more than doubled over the last ten years, rising from $9.2 billion in 1994 to $21.2 billion in 2004, an average annual increase of $1.2 billion. This 130% growth far exceeds the combined population and inflation growth of 58% over the same period.

The $16.9 billion in state tax-supported debt translates into approximately $1.5 billion a year in debt service costs. The state has spent $11.7 billion paying off debt from 1993-2002. Annual debt service payments increased over that time from $601 million to $1.552 billion. To put this in perspective, current annual debt service costs equal approximately a 0.5% sales tax increase.

Total State Debt Outstanding - $21.2 Billion

June 30, 2004

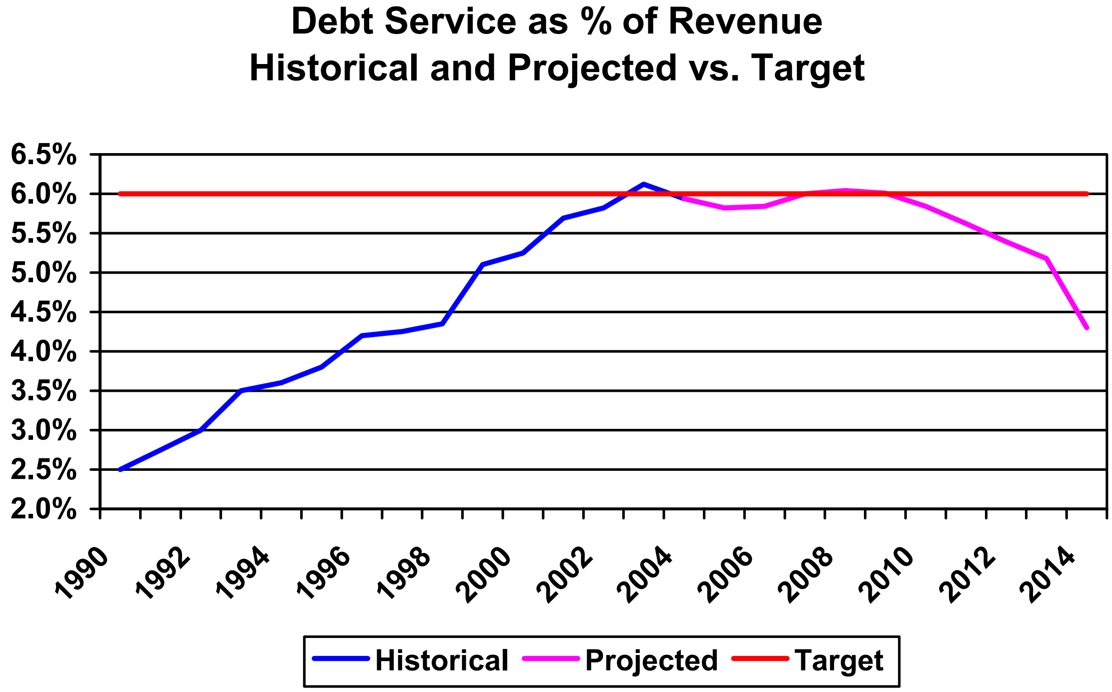


Source: Florida Division of Bond Finance, December 2004.

Current Programs Are Expected to Add $9.5 Billion to Florida's Debt

Florida's currently authorized bonding programs are expected to issue $9.5 billion in additional debt from 2005-2014. This includes $4.2 billion in PECO, $1.85 billion for Florida Forever and $1.3 billion for transportation right-of-way acquisition.

These new issues are expected to increase Florida's annual debt service requirements to almost $2.2 billion by 2013. Over the next ten years, debt service payments are projected to nearly $20 billion. Again, this is based on currently authorized bond programs only. Interest payments will exceed principal amortization until 2008 and compromise almost half of debt service payments over this period (47%). This highlights the added cost of bonding—even without any new programs, nearly $7 billion will go to pay just the interest on state debt over the next ten years.



Note: Assumes no new programs.

Source: Florida Division of Bond Finance, December 2004.

Florida's Debt Ratio Exceeds Legislatively-Set Target

As discussed earlier, the 2000 Legislature set debt ratio benchmarks for Florida based on debt service as a percent of revenues. It created a target ratio of 6% and a cap of 7%. To exceed the 6% target, the Legislature must determine that the additional debt issuance is in the best interest of the state. To exceed the 7% cap, the Legislature must determine the additional debt is needed to meet a critical state emergency.

As can be seen on the chart on this page, the state debt ratio exceeded the target of 6% in 2003 for the first time and is expected to remain near that mark for several years (based on currently authorized bond programs only.) Therefore, if the state wants to adhere to the legislatively set target, Florida has no bonding capacity available until 2009. Under the 7% cap, the state would have $5.35 billion in total legal bonding capacity over the next five years. Again, Florida faces a potential $9 billion price tag for building schools to implement the class-size amendment alone.

Good News: Florida's Bond Rating Upgraded

Despite the limited capacity under the legislatively set target, the credit rating agencies (Moody's, Standard & Poor's and Fitch) look favorably on Florida's government bonds. Florida bonds are rated Aa1, AAA and AA+, respectively. In November, Moody's announced it was raising Florida's rating from Aa2 to Aa1, the second highest rating given by the group. Only eleven other states have Aa1 and seven more have the highest ranking of Aaa. The other two rating agencies have followed suit by upgrading Florida bonds. These rankings are important in the credit market and a higher one can reduce the interest that a borrower must pay. It is expected this upgrade will save Florida millions of dollars in debt service payments.

The three rating agencies view Florida bonds as high quality and its credit outlook as stable. The state's history of conservative fiscal management, strong reserves and a formal process for evaluating the state's debt position contribute to Florida's favorable bond ratings.

Florida fared much better than most states during the last recession. While revenue collection did slow, Florida balanced its budget in both fiscal 2002 and 2003 without drawing on the Budget Stabilization Fund.

As Moody's reported, "The rating upgrade is based on the state of Florida's better than expected economic and financial performance in recent years. Florida survived the national recession in good condition, maintained healthy General Fund balances and continues to experience strong revenue growth. Florida was also one of a few states to maintain significant reserves throughout the recent recession, in keeping with the state's historically conservative budget practices. The outlook for Florida's general obligation bonds is stable."

Governor Rightly Promotes "Pay as You Go"

Although current estimates project $9.5 billion in additional debt to be issued in the next ten years, this projection is $1 billion less than last year's forecast. This decrease is due to the legislature appropriating cash in lieu of bonding for environmental programs ($300 million) and the class-size reduction program Classrooms for Kids ($100 million). Also, bonds issued for the lottery and right of way programs are not expected to be repeated.

The Governor has been a proponent of "pay as you go" and his budget recommendations for FY 2005-06 include $485.6 million in cash in lieu of issuing new debt: $300.0 million for the Florida Forever program, $100.0 million for the Save Our Everglades program, and $85.6 million for class-size reduction capital outlay. This would save an estimated $40 million annually. However, he recently proposed issuing $8.5 billion in bonds over ten years to pay for growth management.

Conclusion

While Florida's debt is considered "moderate and manageable", the now constitutionally required investment in new infrastructure and uncertain economic times could severely strain Florida's bonding capacity. The formalization of the Debt Affordability Study is a useful tool to which lawmakers should pay close attention. Each of the three major rating agencies asserts that the study is a positive factor in assigning credit ratings. However, it is the extent to which the study actually influences state debt management policies that is important.

Florida TaxWatch concurs with the recommendation of the Debt Affordability Study that the available debt capacity should be considered a scarce resource to be used sparingly to provide funding for critically needed infrastructure. The available capacity under the 7% cap should be used as a cushion against economic downturns and resultant revenue losses. Much of the improvement in our debt position is due more to increased revenue than to debt decisions. A reduction in revenue estimates could quickly put Florida back over the target benchmark ratio.

While bonding can be a useful tool to help finance needed infrastructure, Florida TaxWatch also urges lawmakers to adopt the Governor's recommendations on using cash instead of bonding when feasible and to look for additional ways to reduce debt service costs. Increasing debt--and increasing debt service—takes dollars away from other budget priorities.

Bonds Outstanding by Program – June 30, 2004

($ millions)

Tax Supported Debt

Education		
PECO	8,391.2	
Lottery	1,969.9	
Other Capital Outlay	893.7	
University System Improvements	189.7	
Total Education		**11,444.5**
Environmental		
Preservation 2000/Florida Forever	2,555.1	
Save Our Coast	115.8	
Conservation and Recreation	19.1	
Total Environmental		**2,690.1**
Transportation		
Right-of-Way and Bridge Acquisition	1,427.6	
Ports	332.0	
Total Transportation		**1,759.6**
Other		
Facilities	358.1	
Affordable Housing	278.9	
Prisons	198.4	
Lee Moffitt Cancer Center	42.0	
Children and Families	31.8	
Florida High Charter School	22.3	
Juvenile Justice	18.4	
Other	47.7	
Total Other		**997.7**
Total Tax Supported Debt		**$16,891.8**

Self Supporting Debt

Education		
University Auxiliary Facility Revenue Bonds		**539.5**
Environmental		
Florida Water Pollution Control	128.3	
Pollution Control	0.1	
Total Environmental		**128.4**
Transportation		
Toll Facilities	2,052.5	
Orlando-Orange Co. Expressway Authority	1,350.6	
Road and Bridge	234.2	
Total Transportation		**3,637.3**
Total Self Supporting Debt		**$4,305.2**
Total State Debt Outstanding		**$21,197.0**

About Florida TaxWatch

Florida TaxWatch is a private, non-profit, non-partisan research institute that over its 25 year history has become widely recognized as the watchdog of citizens' hard-earned tax dollars. Its mission is to provide the citizens of Florida and public officials with high quality, independent research and education on government revenues, expenditures, taxation, public policies and programs and to increase the productivity and accountability of Florida Government.

Florida TaxWatch's empirically sound research recommends productivity enhancements and explains the statewide impact of economic and tax and spend policies and practices on citizens and businesses. Florida TaxWatch has worked diligently and effectively to help state government shape responsible fiscal and public policy that adds value and benefit taxpayers.

This diligence has yielded impressive results: since 1979, policy makers and government employees have implemented three-fourths of Florida TaxWatch's cost-saving recommendations, saving the taxpayers of Florida more than $6.2 billion--approximately $1,067 in added value for every Florida family.

The organization enjoys a credible reputation and statewide exposure with the television, radio and newspaper media, which regularly report on its research and recommendations.

Florida TaxWatch has a historical understanding of state government, public policy issues, and the battles fought in the past necessary to structure effective solutions for today and the future. It's the only statewide organization devoted entirely to Florida taxing and spending issues.

Supported by voluntary, tax-deductible memberships and grants, Florida TaxWatch is open to any organization or individual interested in helping to make Florida competitive, healthy and economically prosperous by supporting a credible research effort that promotes constructive taxpayer improvements. Members, through their loyal support, help Florida TaxWatch to bring about a more effective, responsive government that is accountable to the citizens it serves.

Florida TaxWatch is supported by all types of taxpayers -- homeowners, small businesses, large corporations, philanthropic foundations, professionals, associations, labor organizations, retirees--simply stated, the taxpayers of Florida. The officers, Board of Trustees and members of Florida TaxWatch are respected leaders and citizens from across Florida, committed to improving the health and prosperity of Florida.

With your help, Florida TaxWatch will continue our diligence to make certain your tax investments are fair and beneficial to you, the taxpaying customer who supports Florida's government. Florida TaxWatch is ever present to ensure that taxes are equitable, not excessive, that their public benefits and costs are weighed, and that government agencies are more responsive and productive in the use of your hard-earned tax dollars.

The Florida TaxWatch Board of Trustees is responsible for the general direction and oversight of the research institute and safeguarding the independence of the organization's work. In his capacity as chief executive officer, the president is responsible for formulating and coordinating policies, projects, publications and selecting the professional staff. As an independent research institute and taxpayer watchdog, the research findings and recommendations of Florida TaxWatch do not necessarily reflect the view of its members, staff or distinguished Board of Trustees, or Executive Committee and are not influenced by the positions of the individuals or organizations who directly or indirectly support the research.

Florida TaxWatch Values:

♦ ***Integrity*** ♦ ***Productivity*** ♦ ***Accountability*** ♦ ***Independence*** ♦ ***Quality Research***

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