Appropriations Committee

Monday, October 23, 2017
3:30 PM – 5:30 PM
212 Knott Building

Meeting Packet

Richard Corcoran
Speaker

Carlos Trujillo
Chair

The Florida House of Representatives

Appropriations Committee

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AGENDA
Monday, October 23, 2017
212 Knott Building
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I. Call to Order/Roll Call

II. Opening Remarks by Chair Trujillo

III. Presentation on Factors Influencing Bond Ratings by Ben Watkins, Director, Division of Bond Finance

IV. Staff Presentation on Public Education Capital Outlay (PECO)

V. Closing Remarks and Adjournment

Division of Bond Finance

State of Florida
House Appropriations Committee

Credit Ratings, Pensions and Reserves

October 23, 2017

Ben Watkins, Director of Bond Finance

Florida's Credit Ratings

State of Florida General Obligation Credit Ratings	Ratings	Outlook
Standard & Poor's	AAA	Stable
Fitch Ratings	AAA	Stable
Moody's Investors Service	Aa1	Stable

- Credit ratings are integral in the municipal bond market and are one factor that affects the interest rate on State debt offerings
- Factors analyzed in assigning State's credit ratings:
  - Governance Framework
  - Financial Management
  - Budgetary Performance
  - Debt/Liability Profile
  - Economy
- ***Florida's credit ratings were affirmed during Fiscal Year 2017 and have not changed***

Florida's Credit Ratings

- The rating agencies have identified the following credit strengths and challenges:

Strengths:

- ***Strong budget, financial and debt management practices***
- ***Structurally balanced budget***
- ***Solid/good general fund reserves***
- Strong employment and population growth
- Moderate and decreasing debt burden with clear guidelines
- ***Well-funded pension system and full funding for pension contribution every fiscal year since 2014***
- Large, diverse economy that benefits from a low cost of living and favorable climate

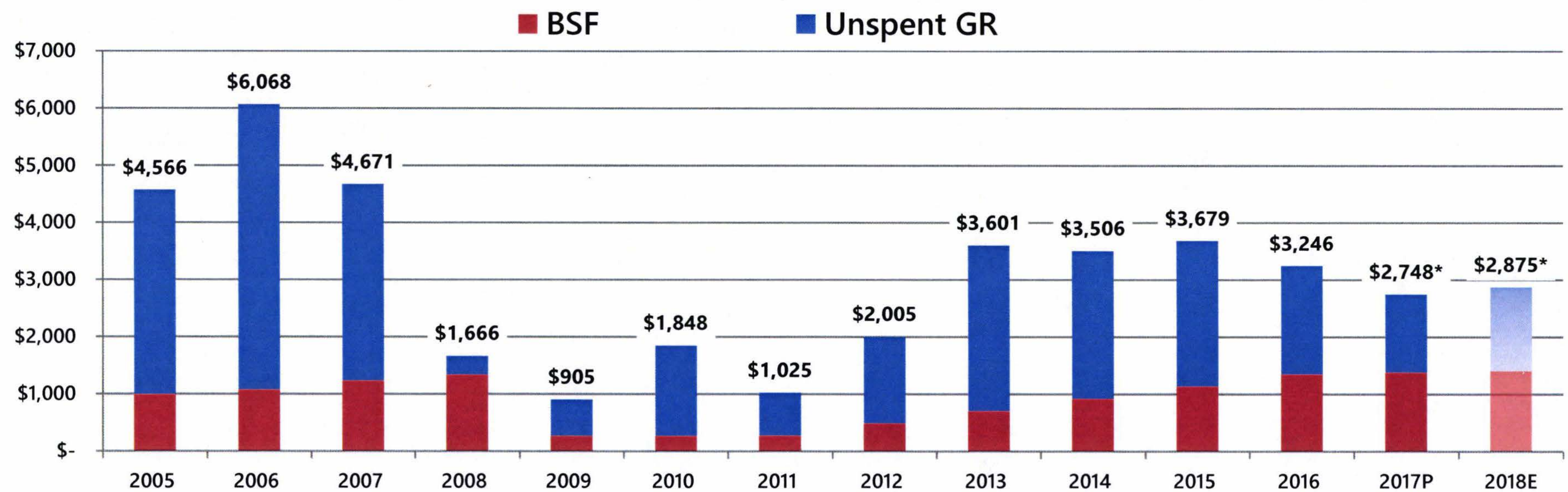
Challenges:

- Heavy dependence on economically sensitive sales taxes
- ***Maintaining adequate reserves***
- ***Maintaining structural budget balance*** while absorbing spending pressures and without overreliance on non-recurring revenues
- Mitigation of fiscal and economic risks associated with hurricane events and insurance entity debt obligations

- ***Management of the pension system and associated liabilities are increasingly important to the rating agencies credit analytics***
- There is an increasing focus on best practices and reasonableness of assumptions in calculating pension liabilities and annual contribution amounts
- Rating agencies will continue to evaluate the State's ability to meet revenue projections and maintain reserves and structural budget balance
- Rating agency models indicate that Florida is more susceptible to revenue declines in recession scenarios, making adequate reserve levels an important credit factor

Florida General Fund Reserves

($ in millions)



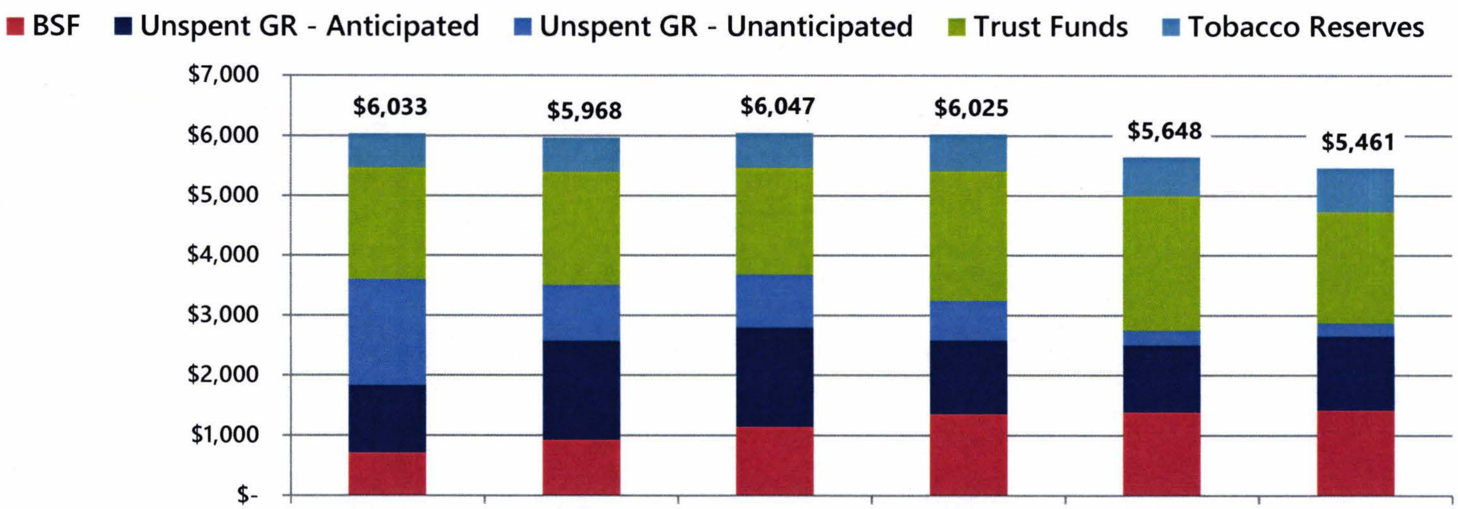
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017P	2018E
Unspent GR	$3,571	$4,990	$3,434	$321	$631	$1,573	$746	$1,509	$2,892	$2,581	$2,540	$1,892	$1,364	$1,459
BSF	$996	$1,078	$1,237	$1,345	$274	$275	$279	$496	$709	$925	$1,139	$1,354	$1,384	$1,417
Total	$4,566	$6,068	$4,671	$1,666	$905	$1,848	$1,025	$2,005	$3,601	$3,506	$3,679	$3,246	$2,748	$2,875
As % of GR	18.3%	22.5%	17.7%	6.9%	4.3%	8.6%	4.6%	8.5%	14.2%	13.4%	13.3%	11.5%	9.3%	9.3%

** Preliminary, based on the August 15, 2017 GR Outlook Statement; No adjustments for the impact of Hurricane Irma*
P = Preliminary, E= Estimated

- General Fund Reserves (Unspent GR plus BSF) of over $2.7 billion or 9.3% of GR at 6/30/17
- Targeted unspent GR remained in excess of informal policy of $1 billion
- State continues to increase the BSF balance; BSF required balance (5% of GR) is now approximately $1.4 billion
- However, over last 5 years unspent GR down by nearly $1.5 billion or 50% and complexion of General Fund Reserves predominantly comprised of BSF

Florida Total Reserves

($ in millions)

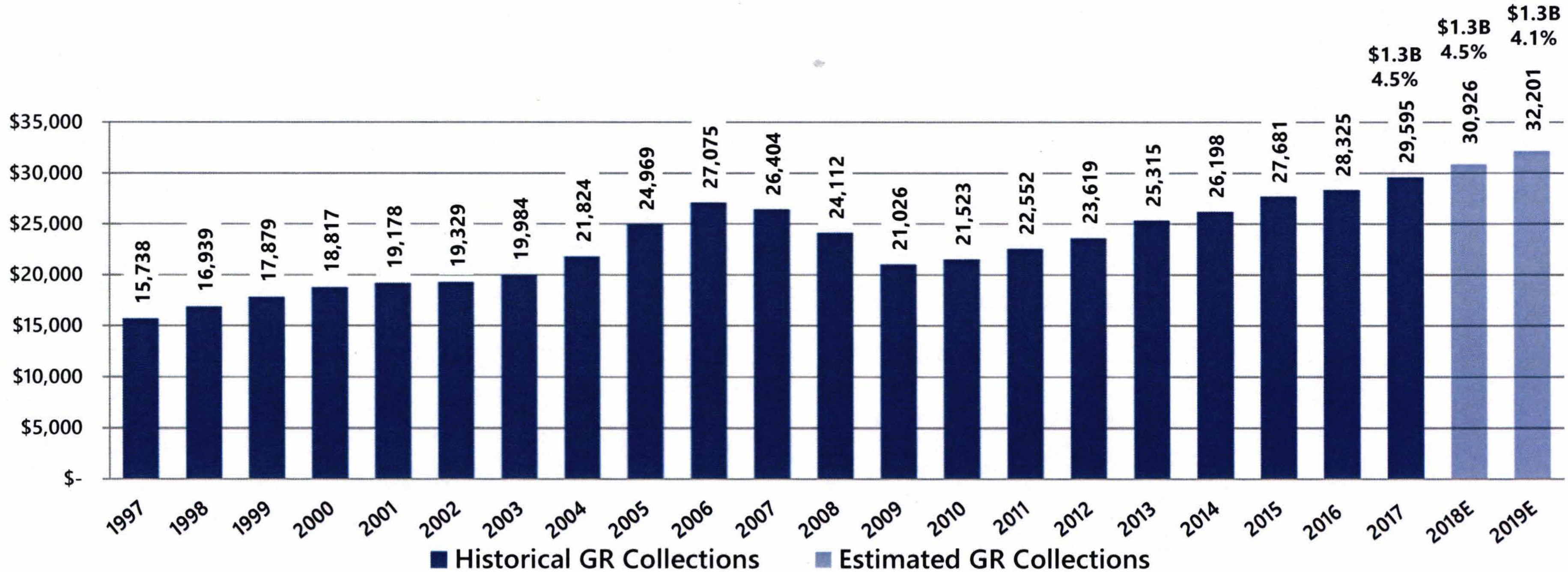


	2013	2014	2015	2016	2017P	2018E
Unspent GR – Anticipated	$1,120	$1,652	$1,652	$1,227	$1,117	$1,232
Unspent GR - Unanticipated	1,771	929	888	665	247	227
BSF	710	925	1,139	1,354	1,385	1,417
Tobacco Reserves	565	575	586	619	655	740
Other Trust Funds	1,866	1,887	1,782	2,160	2,244	1,846
Total Reserves	$6,033	$5,968	$6,047	$6,025	$5,648	$ 5,461
Total Reserves as % of GR	23.8%	22.8%	21.8%	21.3%	19.1%	17.7%

** Preliminary, based on the August 15, 2017 GR Outlook Statement; No adjustments for the impact of Hurricane Irma*
P = Preliminary, E= Estimated

- Trust Fund balances provide an additional source of reserves which have been used when needed
- Total Reserves estimated to be $5.6 billion or approximately 19.1% of GR 6/30/17
- Total Reserves estimated to decline slightly to approximately $5.5 billion or 17.7% of GR 6/30/18
- Even though dollar amount total reserves comparable ($5.6 billion vs $5.5 billion), reserves as percentage of GR down
- Estimated Fiscal Year 2018 year-end balance subject to change based on actual revenue collections and expenditures in Fiscal Year 2018
- No adjustments made for impacts from Irma on either estimated revenues or additional costs

General Revenue Collections



Source: General Revenue Estimating Conference, August 2017

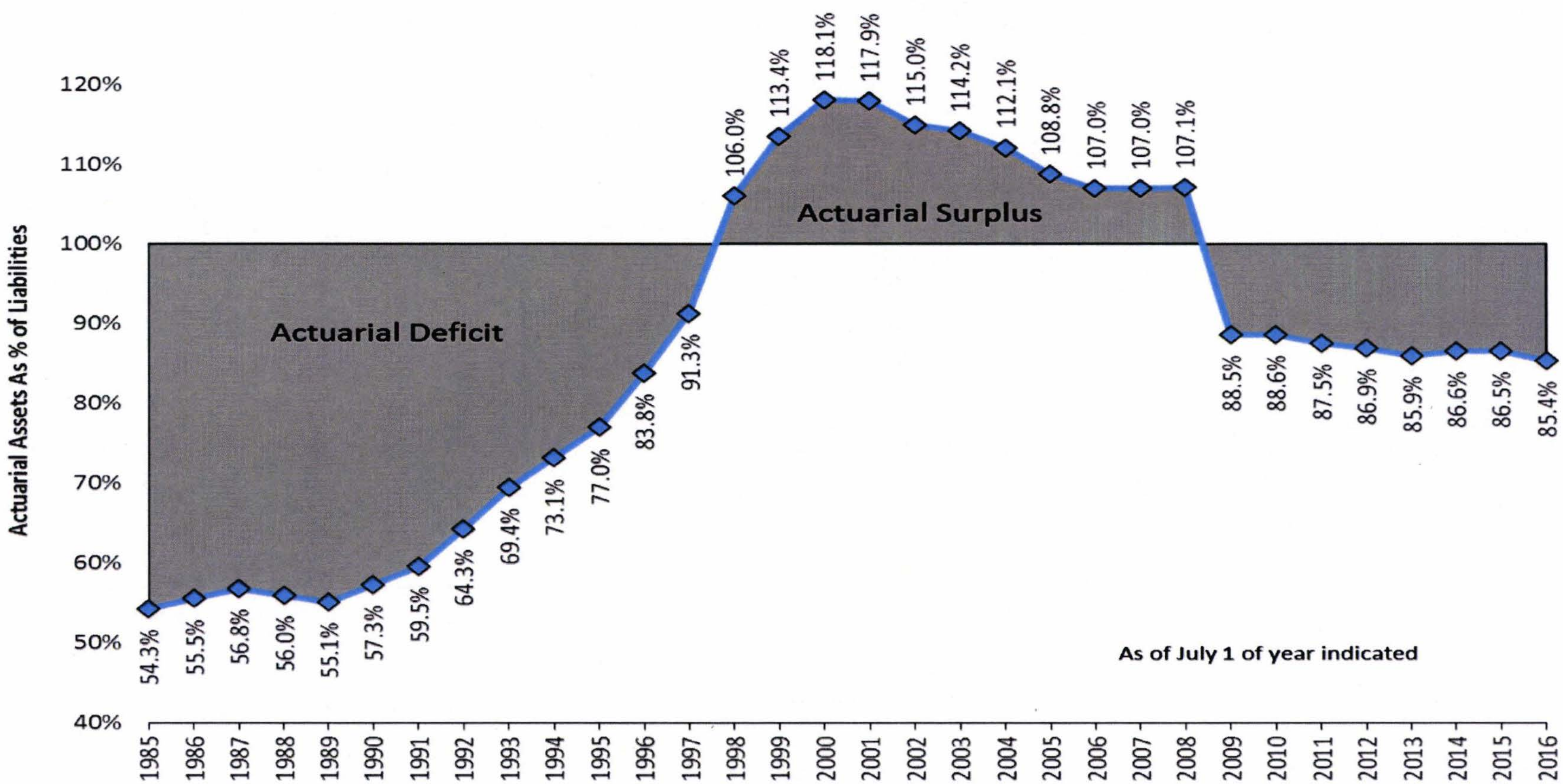
- Florida has enjoyed year-over-year revenue growth since 2009 with continued annual increases projected
- General Revenue collections grew by $1.3 billion to a new high of $29.6 billion in Fiscal Year 2017, notwithstanding tax cuts
- General Revenues are forecast to grow again by $1.3 billion in both Fiscal Year 2018 and 2019
- Although Florida's economy, revenues and budget are growing, reserves are shrinking
- Reserves provide the financial flexibility to weather unexpected events or different economic climates, mitigating budget cuts or revenue raises needed to balance the budget
- Florida dependent on economically sensitive sales taxes

Pension Funding

- Rating agencies have developed criteria and methodologies to analyze pension liabilities; most important credit issue over last 5 years
- Management of Florida Retirement System ("FRS") and unfunded pension liability is a critical part of credit analysis of the State
- FRS is strong relative to other states: funded ratio and other relevant metrics
- FRS historically managed very well; long history of legislature contributing the actuarially determined contribution ("ADC")
- Problematic pension liabilities created from underfunding required contributions (several state rating downgrades due to outsized pension liabilities)
- Funded ratio at 6/30/16 based on actuarial value of assets ($145.5 billion) and actuarial liability ($170.4 billion) was 85.4%
- Funded ratio based on market value of assets ($153.6 billion) at 6/30/17 and actuarial liability at 6/30/16 was 90.1%

Florida Retirement System

Funded Ratio History



- FRS funded ratio strong at 85.4% (June 30, 2016)
- FRS had funded ratio over 100% for a decade (1997-2007)
- Using actuarial surplus to reduce pension contributions and market losses from financial crisis weakened funded status

Pension Metric Peer Group Comparison

2016 Pension Metrics Comparison of Eleven Most Populous States

Adjusted Net Pension Liabilities ("ANPL") and Medians

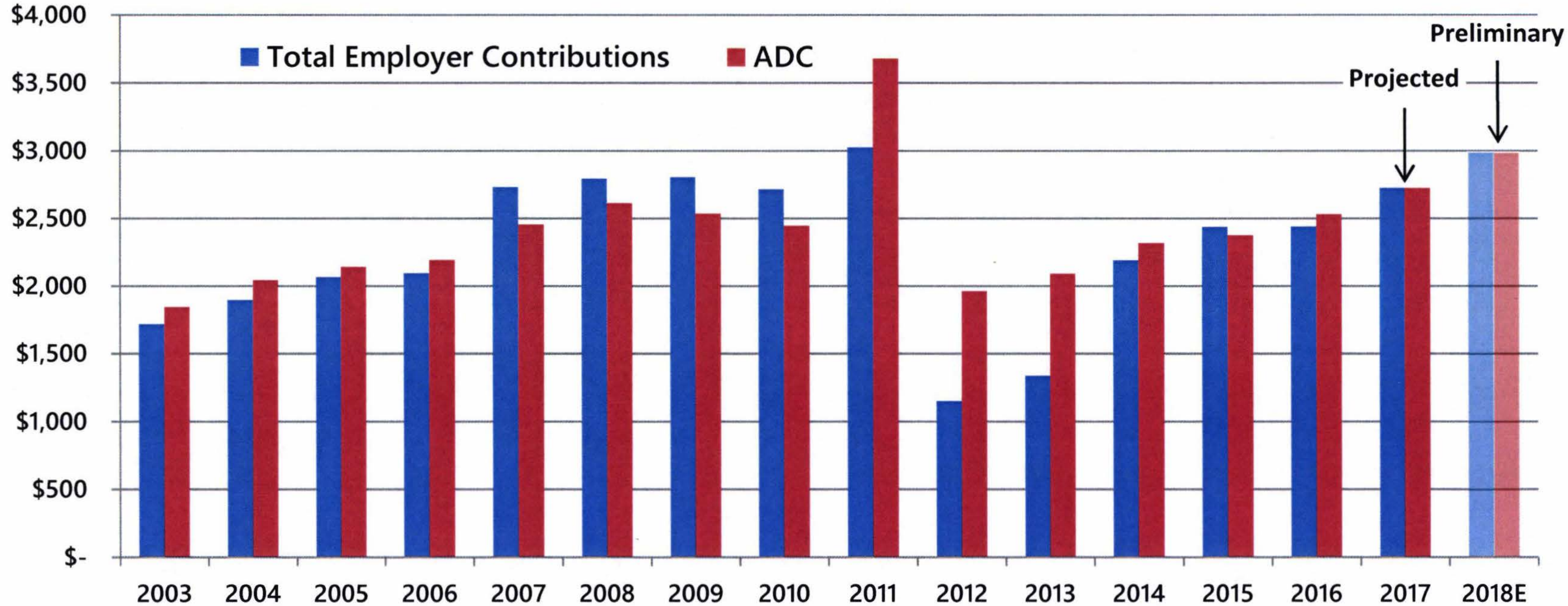
State	Rank	ANPL (in Millions)	Rank	ANPL as a % of Own-Source Revenues	Rank	ANPL Per Capita	Rank	ANPL as a % of Personal Income	Rank	ANPL as a % of State GDP
Illinois	1	$ 200,629	1	487.0%	1	$ 15,672	1	30.1%	1	25.3%
California	2	192,535	5	117.0%	4	4,905	4	8.8%	5	7.4%
Texas	3	108,619	4	162.0%	5	3,898	6	8.2%	6	6.7%
New Jersey	4	94,969	2	249.0%	2	10,618	2	17.1%	2	16.3%
Pennsylvania	5	66,598	3	164.0%	3	5,209	3	10.2%	3	9.2%
New York	6	42,914	8	47.0%	7	2,173	8	3.6%	8	2.9%
Michigan	7	36,820	6	115.0%	6	3,709	5	8.4%	4	7.6%
Georgia	8	19,679	7	82.0%	8	1,909	7	4.6%	7	3.7%
Florida	**9**	**16,531**	**10**	**35.0%**	**10**	**802**	**10**	**1.8%**	**10**	**1.8%**
Ohio	10	13,639	9	43.0%	9	1,174	9	2.6%	9	2.2%
North Carolina	11	6,709	11	24.0%	11	661	11	1.6%	11	1.3%
Median		**$ 42,914**		**115.0%**		**$ 3,709**		**8.2%**		**6.7%**
Mean		**$ 72,695**		**138.6%**		**$ 4,612**		**8.8%**		**7.7%**
National Median		**$ 9,734**		**82.0%**		**$ 2,446**		**6.0%**		**4.9%**

Source: *Moody's Fiscal 2016 Pension Medians*

- Metrics used to evaluate pension liability similar to metrics used to evaluate debt
- Florida significantly lower than peer group averages for all metrics
- Florida has the next to lowest ratio in the peer group when comparing the ANPL to revenues, personal income, per capita, and GDP.

FRS Employer Contributions versus the ADC

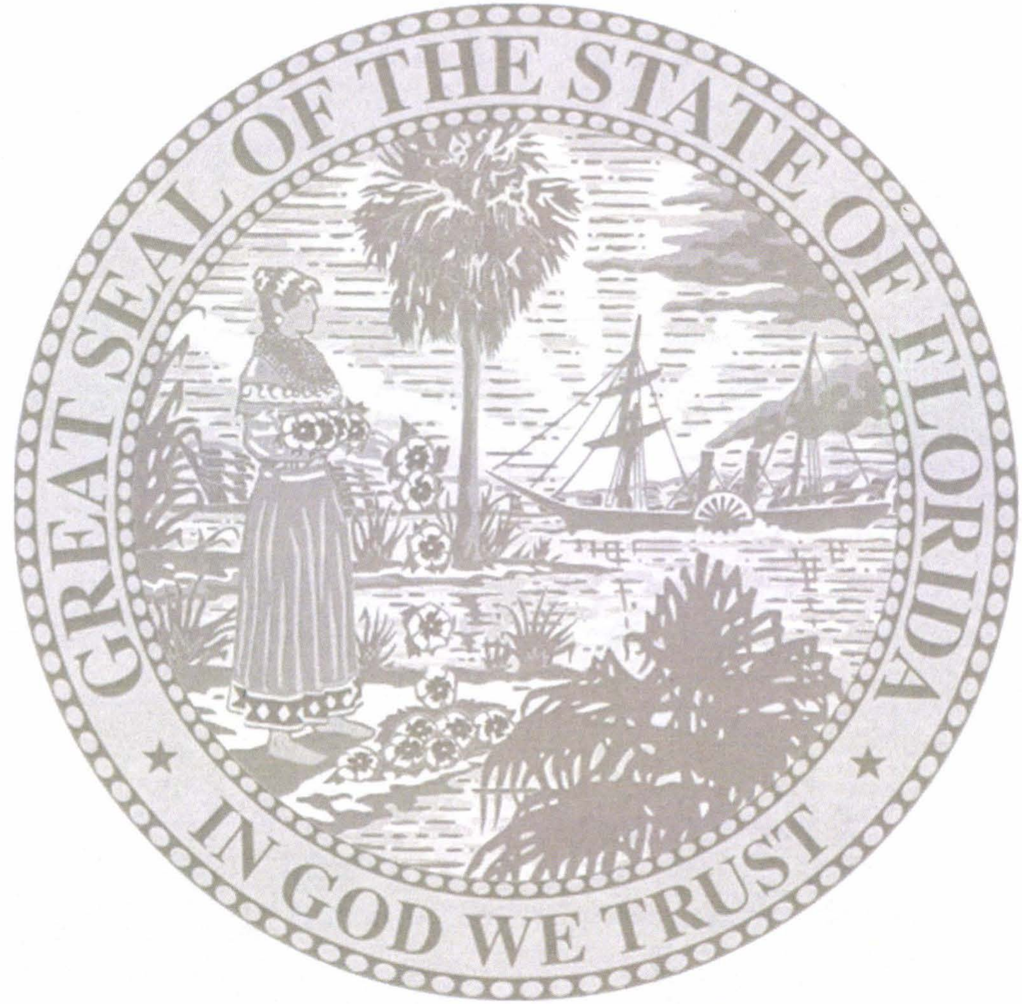
($ in millions)



- Most important element of pension funding is making required contributions
- Prior to the recession, the State was diligent about contributing the ADC to the FRS
- Pension holiday in Fiscal Year 2011, 2012 and 2013 as part of budget balancing exercise
- Pension reform (effective 7/1/12) helps constrain growing liability and pension cost
- For the last 5 years, the State budgeted contributions sufficient to fully fund the ADC based on the FRS plan assumptions
- Rating agencies now focused on reasonableness of investment return assumption and actuarial methodologies

Conclusions

- Florida has maintained strong credit ratings (AAA, AAA, Aa1)
- Credit factors within the State's control, i.e. structurally balanced budget, reserves and pension funding, are positive
- General Fund Reserves (BSF plus Unspent GR) at $2.7 billion, or 9.3% of GR, is considered good/solid at that level
- Total Reserves ($5.6 billion) has declined as a percentage of GR (19.1%) but is considered strong at current level
- Pension funding is an important element of credit analysis for states
- Although FRS funded status is strong, care should be taken to make adequate annual contributions to maintain current status


GREAT SEAL OF THE STATE OF FLORIDA
IN GOD WE TRUST

Public Education
Capital Outlay (PECO)

Public Education Capital Outlay (PECO)

October, 2017

PECO - Authorized by Article XII, Section 9, Florida Constitution

1. Provides that Gross Receipts Taxes collected shall be placed in the "public education capital outlay and debt service trust fund" (PECO TF)
2. Allows but limits bonding (no more than 90% of revenues can be used for debt service)
3. Requires that funds be for capital projects including maintaining, restoring, or repairing existing public educational facilities.

Economic and Demographic Research (EDR) - Estimating Conferences

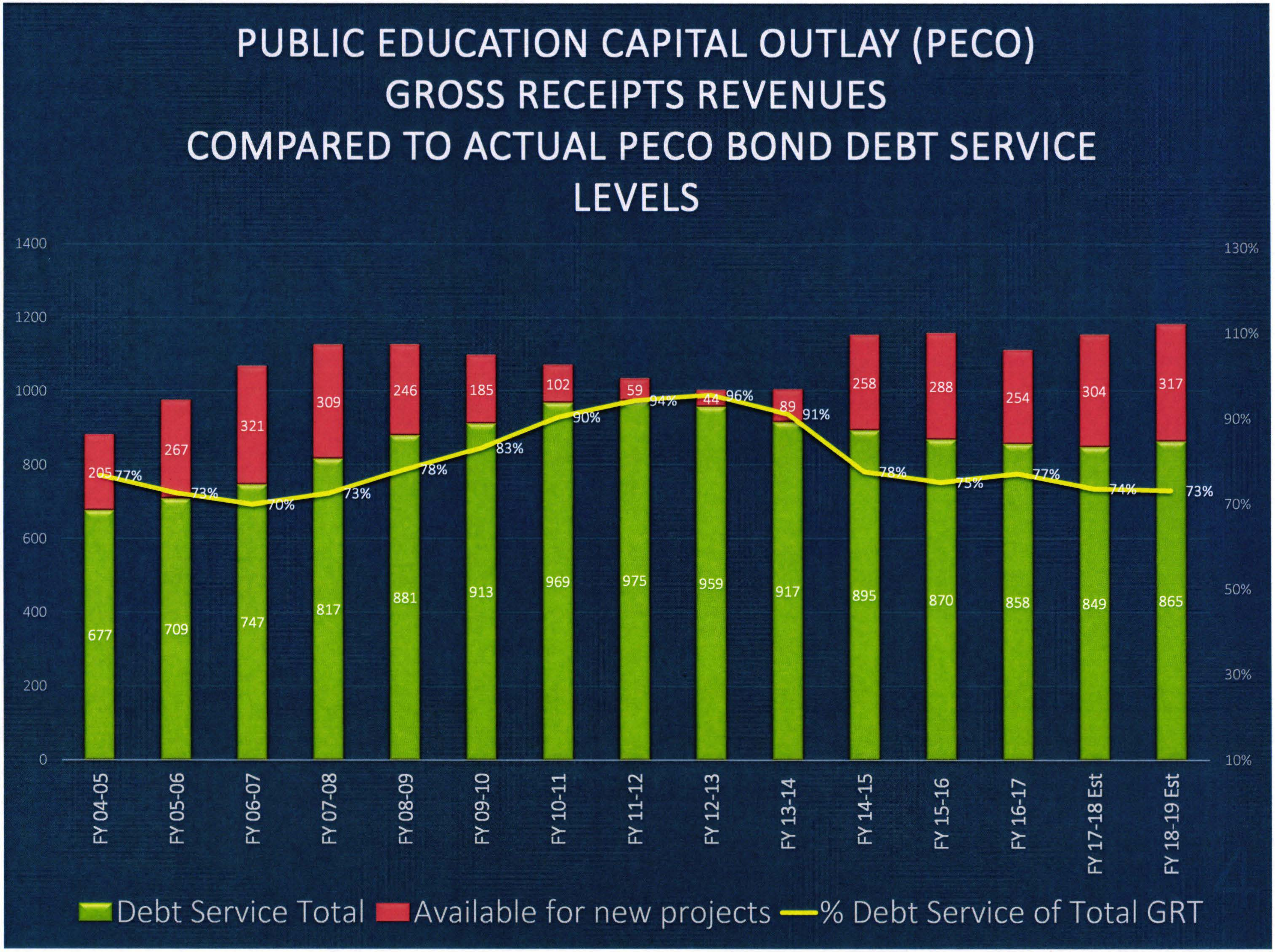
1. Gross Receipts Tax Revenue Estimating Conference - (Summer, Fall, Spring)

   Revenues are from charges on:

   - Utilities
   - Communication Services

2. Followed by PECO Appropriation estimate

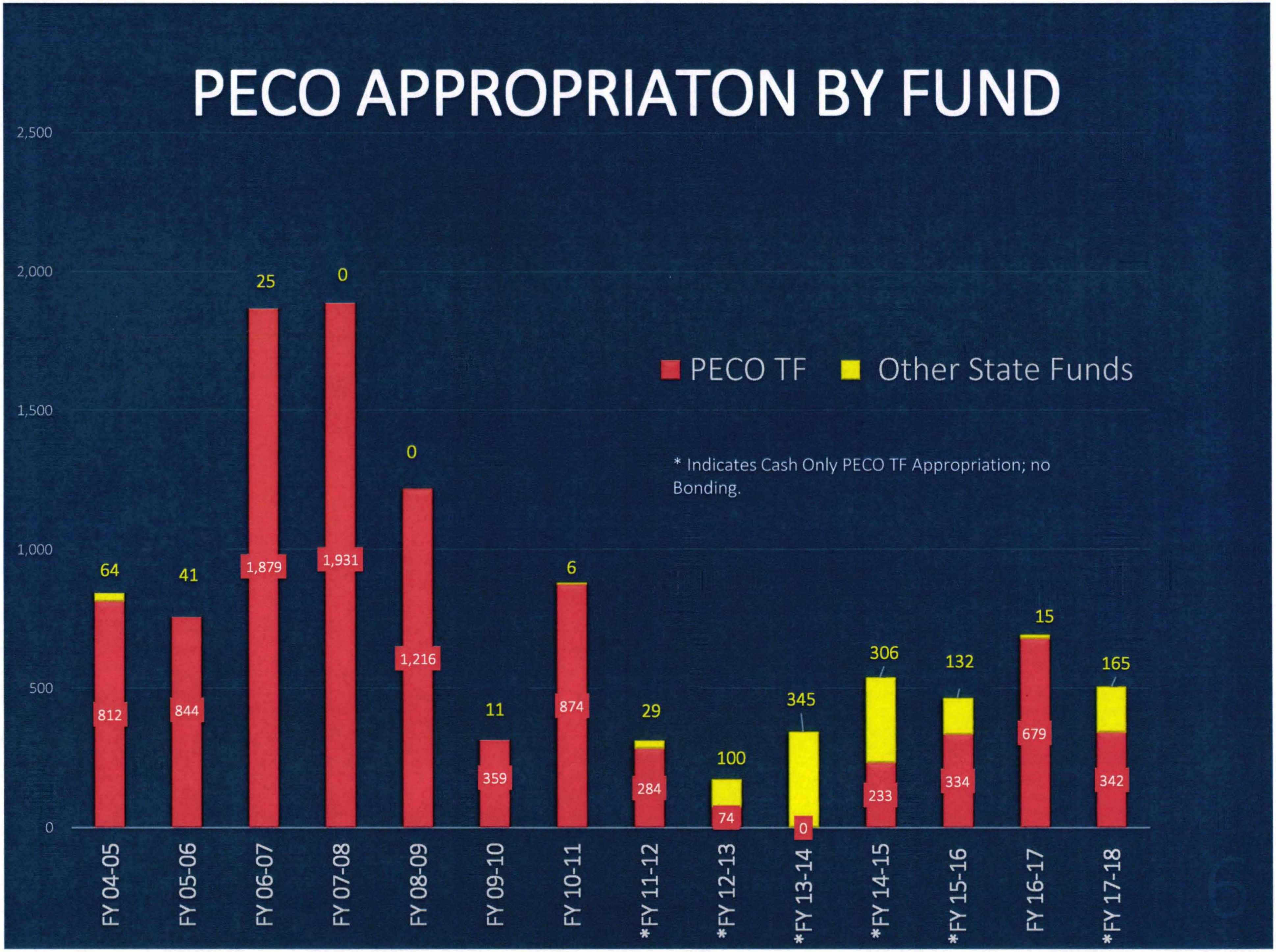
   Since FY 14-15 has included a maximum <u>Cash Only</u> Appropriation as well as maximum <u>Bonding plus Cash</u> Estimate


PUBLIC EDUCATION CAPITAL OUTLAY (PECO)
GROSS RECEIPTS REVENUES
COMPARED TO ACTUAL PECO BOND DEBT SERVICE
LEVELS
1400
1200
1000
800
600
400
200
0
130%
110%
90%
70%
50%
30%
10%
205
77%
677
267
73%
709
321
70%
747
309
73%
817
246
78%
881
185
83%
913
102
90%
969
59
94%
975
44
96%
959
89
91%
917
258
78%
895
288
75%
870
254
77%
858
304
74%
849
317
73%
865
FY 04-05
FY 05-06
FY 06-07
FY 07-08
FY 08-09
FY 09-10
FY 10-11
FY 11-12
FY 12-13
FY 13-14
FY 14-15
FY 15-16
FY 16-17
FY 17-18 Est
FY 18-19 Est
Debt Service Total
Available for new projects
% Debt Service of Total GRT

PECO Maximum Appropriation Estimates

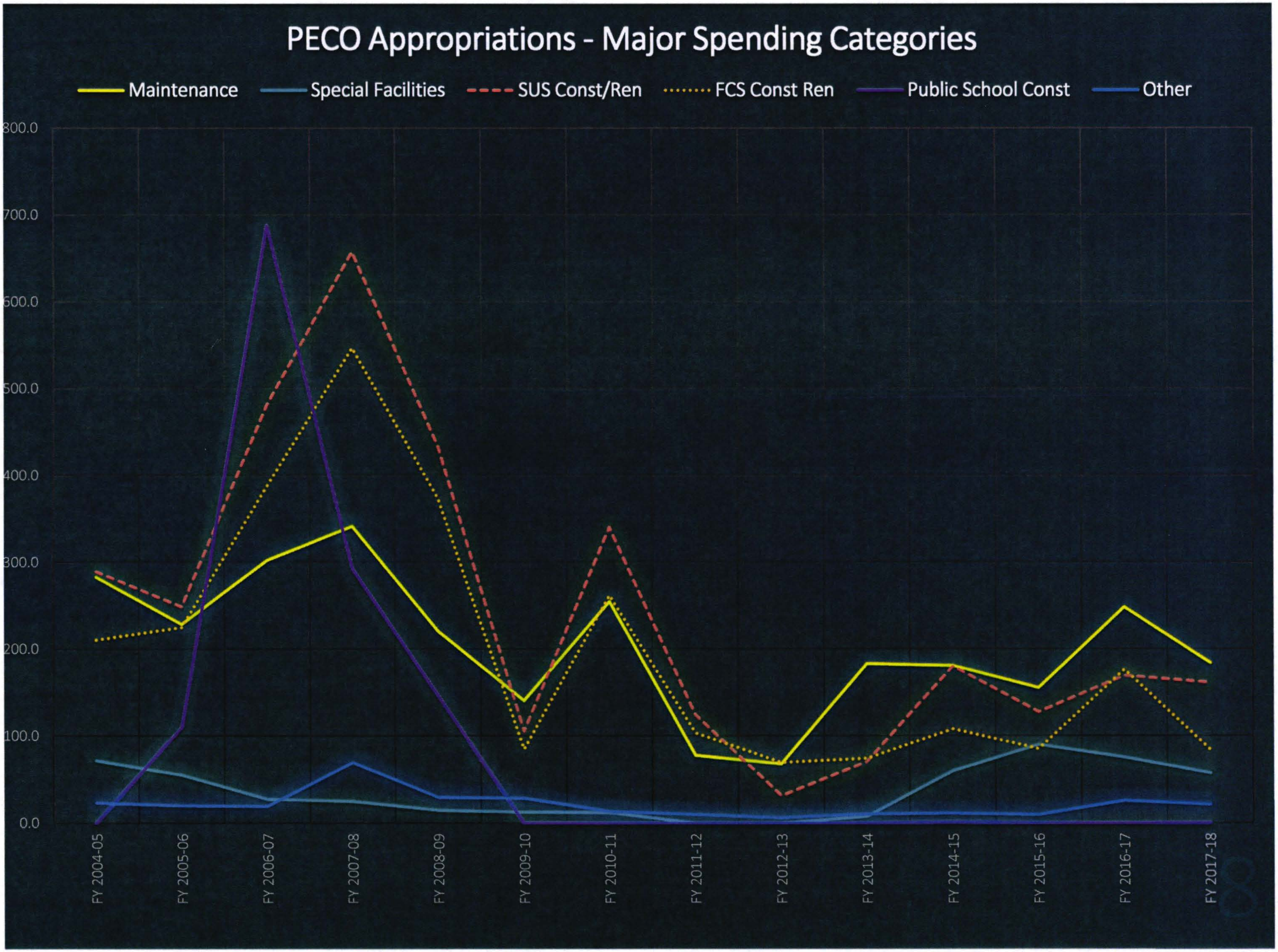
YEAR	Cash Only	Cash Plus Bonding
FY 18-19	343.5	2,636.9
FY 19-20	377.8	519.7
FY 20-21	386.8	531.8
FY 21-22	413.6	536.3
FY 22-23	471.4	1,025.5
FY 23-24	581.3	1,833.8
FY 24-25	701.0	1,543.7

(EDR – August, 2017)


PECO APPROPRIATON BY FUND
2,500
2,000
1,500
1,000
500
0
PECO TF
Other State Funds
* Indicates Cash Only PECO TF Appropriation; no Bonding.
64
812
41
844
25
1,879
0
1,931
0
1,216
11
359
6
874
29
284
100
74
345
0
306
233
132
334
15
679
165
342
FY 04-05
FY 05-06
FY 06-07
FY 07-08
FY 08-09
FY 09-10
FY 10-11
*FY 11-12
*FY 12-13
*FY 13-14
*FY 14-15
*FY 15-16
FY 16-17
*FY 17-18

Projects Typically Funded with PECO Funds – Maintenance/Renovation/Construction

1. Maintenance (Public Schools, Charter Schools, Florida Colleges, Universities)
2. Developmental Research (Lab) Schools/Florida Division of Blind Services/ Florida School for the Deaf and Blind/Public Broadcasting
3. Renovation and Construction Lists:
   - Special Facilities
   - Universities (SUS)
   - Florida Colleges (FCS)


PECO Appropriations - Major Spending Categories
Maintenance
Special Facilities
SUS Const/Ren
FCS Const Ren
Public School Const
Other
800.0
700.0
600.0
500.0
400.0
300.0
200.0
100.0
0.0
FY 2004-05
FY 2005-06
FY 2006-07
FY 2007-08
FY 2008-09
FY 2009-10
FY 2010-11
FY 2011-12
FY 2012-13
FY 2013-14
FY 2014-15
FY 2015-16
FY 2016-17
FY 2017-18

Facilities by System

System	Institutions	Number of Buildings	Square Footage
Florida Colleges	28	2,171	42,306,100
Universities	12	3,255	72,786,986
Public Schools*	3,581	156,104 (Total Classrooms)	427,704,709 (Permanent + Relocatable)

* Public School Data Source: Florida Inventory of School Houses (FISH)

Focus on Lists for Colleges and State Universities

- Commissioner of Education is required by law to develop a 3 year Allocation plan based on Available Maximum Appropriation provided by EDR

- Colleges and Universities are required by law to submit 3 year project lists (approved by Board of Governors (BOG) for the SUS and Board of Education (BOE) for the FCS) – lists are constrained by the amounts specified in the Allocation plan

- Lists are prioritized by each Board from projects that are survey recommended as required by law

SUS GUIDELINES SUMMARIZED: Projects Lists are prioritized for funding based on the following :

A. Maintenance Projects

B. System and Continuation Projects

C. Renovation Projects

D. Strategic Projects (Land, Building Acquisition, New Construction)

FCS GUIDELINES SUMMARIEZED: Projects are prioritized by a point system for five metrics.

- **Return on Investment** (Benefit Cost, Life Cycle Cost, Space Utilization) – Higher ROI scores higher

- **Program Type** (High Skill High Wage (HSHW) and Science, Technology Engineering Math (STEM) projects score higher)

- **Individual College Priority Order**

- **Age of Renovation/Remodel Project** (Older scores higher)

- **Percentage of Funding Available** (Previous State funding or local match projects score higher)

Legislative PECO Decision Making Compared to SUS/FCS Priority Lists:

The Legislature is not required to adhere to any of the statutorily required priority lists.

Funding by System for 2017-18	BOE/BOG Priority 3 YR Lists	Priorities Funded in GAA	Non Priority Projects Funded in GAA
Florida Colleges	14 Projects $167M	9 Projects $45M	17 Projects $38M
Universities	10 Projects $243M	8 Projects $73M	13 Projects $86M

PECO OUTYEAR OBLIGATIONS

Total Needed to Finish Projects Already Started (SUS $415 M, FCS $303M, Special Facilities - $25M)	$743.1
Average Annual Maintenance	$193.7
Average Cash Only PECO Appropriation next 4 years	$380.6
Average amount/Revenue Available for Construction/Renovation after Maintenance	$186.7
Years to Finish Projects Started Using only PECO TF - Assumes no New Construction/Renovation projects	4.0 Years