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PUBLIC RESOURCES ADVISORY GROUP

Revised Draft

MEMORANDUM TO: The Honorable Seth Magaziner
General Treasurer
State of Rhode Island and Providence Plantations

FROM: Public Resources Advisory Group ("PRAG")

SUBJECT: Scope of Work for Debt Affordability Study

DATE: June 29, 2016

Article 2 of the FY 2017 budget enacted a series of reforms to Treasury's management of public debt, which Treasury staff will be tasked with implementing. Among these reforms is the requirement for the Public Finance Management Board (the "PFMB") to oversee the undertaking of a debt affordability study no less frequently than every two years, which shall include recommended limits for debt capacity. As we discussed previously, measuring debt affordability is a key aspect of best practices in debt management. Article 2 specifies that the study will review the debt capacity of each state, municipal and regional authority, agency, board, commission, public and quasi-public corporation and fire district and other special districts having authority to issue revenue or general obligation bonds or notes.

Additionally, Article 2 provides the authority for the PFMB to offer non-binding advisory opinions on all aspects of debt management practices of state, municipal, and public and quasi-public corporations.

PRAG proposes to assist the PFMB in the development and implementation of the debt affordability study and development of best debt management practices. The first phase of the study should focus on the State of Rhode Island's tax-supported debt capacity, which would include State general obligation debt, State certificates of participation, State quasi agency/authority debt in which general state tax sources resources are used for repayment and/or security. Once the State's debt affordability is set, the second phase of the study can include other state-level authorities, agencies, board, commission, public and quasi-public corporations' debt that is not included in the State's tax-supported debt. The third phase would include debt affordability for municipal and regional authorities, fire districts, other special districts and any other entities not included in the first two phases. Outlined below is the proposed scope of work for the three phases and development of best debt management practices. In addition, PRAG will provide the working models developed in this study to the Office of the General Treasurer.

<u>Phase 1: State Debt Affordability Guidelines and Debt Management Best Practices</u>

A. Review debt affordability measures and determine appropriate debt/liability ratios
   1. Current PFMB Credit Guidelines
      a. Tax-supported debt to personal income (5.0% to 6.0%)
      b. Annual debt service to general revenues (<7.0%)
   2. Other debt ratios
      a. Tax-supported debt per capita
      b. Tax-supported debt to gross state product
      c. Annual debt service to expenditures
      d. Rapidity of debt repayment

3. Pension ratios
    a. Pension funding levels
    b. Unfunded pension liabilities per capita
    c. Pension Liabilities to personal income
    d. Pension liability to revenues
    e. Combined debt and pension liability to personal income
    f. Combined debt service and pension requirement to revenues
4. Debt/liability ratios used by rating agencies

B. Determine types of debt to include
    1. General Obligation
    2. Lease Participation Certificates
    3. Convention Center Authority
    4. Tax-Supported Commerce Corporation
    5. Other Tax-Supported Debt
    6. Consideration of other debt: GARVEEs, self-supporting debt, moral obligation debt

C. Develop model to analyze debt capacity under selected debt/liability ratios
    1. Assumptions for timeframe of additional debt
    2. Assumptions for term of debt, interest rate
    3. Assumptions for revenue growth, personal income, population, other economic statistics
    4. Consideration of authorized, but unissued debt (all general obligation debt and subject to appropriation debt)
    5. Sensitivity analyses

D. Prepare written debt affordability report

E. Develop debt management best practices
    1. Debt structuring and issuance guidelines
    2. Refunding policy
    3. Rating agency and investor relations efforts
    4. Other

<u>Phase II: State Public and Quasi-Public Corporations (Non-Tax Supported) Debt Affordability and Debt Management Best Practices</u>

A. Identify the types of debt outstanding
    1. General revenue pledge
    2. Lease bonds
    3. Self-supporting revenue
    4. Non-self-supporting revenue
    5. Conduit
    6. Other

B. Review bond documents for indenture requirements (rate covenant, additional bonds test)

C. Review rating agency credit criteria for types of debt

D. Recommend debt affordability measures for each public and quasi-public corporation

E. Develop debt management best practices
    1. Debt structuring and issuance guidelines
    2. Refunding policy
    3. Rating agency and investor relations efforts

F. Prepare written report on debt affordability guidelines and debt management best practices

Phase III: Municipal, Regional Authorities, Fire Districts, and Special Districts

A. Identify spectrum of issuers and available information
B. Review debt affordability measures
    1. Debt ratios
        a. Debt to full value
        b. Debt per capita
        c. Debt service to revenues or expenditures
    2. Pension ratios
        a. Pension funding levels
        b. Unfunded pension liabilities per capita
        c. Pension Liabilities to personal income
        d. Pension liability to revenues
        e. Combined debt and pension liability to personal income
        f. Combined debt service and pension requirement to revenues
    3. Debt/liability ratios used by rating agencies
C. Determine types of debt to include
    1. General obligation
    2. Appropriation
    3. Special tax
    4. Enterprise/self-supporting revenues
    5. Underlying and Overlapping debt
    6. Other
D. Develop targets of debt/liability ratios for range of issuers
    1. Targets for debt ratios
    2. Targets for combined debt and other liabilities ratios
E. Develop guidelines for debt management best practices
F. Prepare written report on guidelines for debt/liability ratios and debt management best practices

Based on this scope of work, our goal would be to complete the first phase of the debt affordability study within two months, the second phase within an additional two months and the third phase within an additional two months. For the three phases of work, we propose to work on hourly rate basis pursuant to the Municipal Financial Advisory Service Agreement with an aggregate not-to-exceed fee of $60,000, and we will submit invoices at the substantial completion of each phase. All invoices will include description of the services, personnel responsible and the hourly rate and time. We look forward to working with the Office of the General Treasurer and the PFMB on this very important aspect of debt management. Please do not hesitate to contact Janet Lee and Monika Conley at (212) 566-7800 and Tom Huestis at (610) 565-5990.