Capital Debt Affordability Committee

Treasurer Nancy K. Kopp, Chair
Treasury Building Assembly Room
80 Calvert St.
Annapolis, MD

September 22, 2010
1:00 PM

Work Group Report

Review the impact of public-private partnership agreements on the total amount of new State debt that prudently may be authorized for the next fiscal year

In compliance with Chapter 641 of the Laws of 2010 and as part of the CDAC recommendation for the authorization of general obligation bonds

Projected Affordability Assumptions and Ratios

Projected Status of the Annuity Bond Fund

Discussion of Recommendations:

General Obligation Bond Authorization

- Recommendation of total amount of new State debt that prudently may be authorized for the next fiscal year and the annual increase for future years.

Academic Facilities Bonds Authorization

- Recommendation of amount of new bonds for academic facilities for the next fiscal year by the University System of Maryland, Morgan State University, St. Mary's College of Maryland and the Baltimore City Community College.

Follow-up - Public Private Partnerships and the University System

Jim Sansbury, Associate Vice Chancellor, Administration and Finance

Work Group Report

Report of the 2010 Work Group
of the Capital Debt Affordability Committee

Scope, Members and Meeting Dates

The Committee at its June 2010 meeting requested staff to comprehensively discuss during the summer of 2010 the following topics:

1. Debt issuance constraints for tax-supported debt
2. Comparison of bonds vs. leases for financing Energy Performance Contracts
3. H.B 1370 - Oversight of Public-Private Partnerships
4. Operating and Capital Leases
5. Energy Performance Contract (EPC) Leases
6. Assumptions for Affordability Analysis
    - Assumptions for Future Authorizations
    - Coupons
    - Premium
    - Financing plans for video lottery terminals and discussion of possible alternatives
    - Garage at State Center
7. Proposed Legislation
    a) P3 Legislation (H.B. 1370)
    b) Expansion of the use of QZAB proceeds
    c) Exclusion of energy leases from CDAC affordability analysis

The members of the Work Group who met in July, August and September are as follows**:**

State Treasurer's Office	Bernadette Benik, Steve Vanderbosch, Patti Konrad, Cindy Reese
Comptroller's Office	David Roose
MDOT	David Fleming, June Hornick, Linda Williams
DBM	Chad Clapsaddle and Amber Teitt
DLS	Patrick Frank, Matt Klein, Jaclyn Hartman

Other Attendees:

DGS	Julia Davis and Scott Walchak

Discussion and Recommendations:

1. Debt issuance constraints for tax-supported debt:

In 1987, the CDAC acknowledged that the two affordability criteria (debt outstanding as a percent of personal income and debt service as a percent of revenues) were originally established for General Obligation Bonds. “These criteria … were adopted by the Committee solely for the analysis of general obligation debt.”[1] However, the Committee’s analysis expanded to encompass all tax-supported debt and included not only General Obligation Bonds, but also Transportation Bonds, capital leases and Stadium Authority Bonds. (This was codified by Chapter 241, Laws of Maryland, 1989) The Committee recognized that ultimately they would need to develop techniques to insure that major components of tax-supported debt are in appropriate balance. In the 1987 report the Committee stated, “At the present time, the Committee is not prepared to recommend a set of principles for allocating the comprehensive affordability limit.”

Because both affordability measures are at or near their thresholds, the work group reviewed the constraints for each component of tax-supported debt in Chart 1 on page 8 and discussed how to allocate available debt capacity.

Recommendation

The group recommends that the Department of Budget and Management coordinate debt capacity issues among the various components of tax-supported debt.

2. Comparison of bonds vs. leases for financing Energy Performance Contracts

The work group reviewed the advantages and disadvantages of issuing tax-exempt bonds in lieu of financing energy performance contracts with lease-purchase agreements. While the cost of capital is expected to be lower using bond financing compared to lease financing, there were disadvantages that the group noted; particularly that the use of general obligation bonds would bind the State’s full faith and credit. Lease financing is secured by the property and is subject to appropriation. Other questions arose in the discussion regarding how the financing would be authorized and budgeted.

The State can use its $6.5 million Qualified Energy Conservation Bonds’ (QECBs) federal allocation by financing energy projects in the schools or other State facilities. These projects have been authorized in MCCBLs and, consequently, the State expects to issue GO bonds in February 2011 for these bonds which have a 70% interest subsidy from the US Treasury.

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[1] 1987 CDAC Report, page 31

Recommendation

The work group recommends proceeding with issuing general obligation bonds for energy projects that are already included in MCCBLs and that can use proceeds of QECBs. The group further recommends that the State continue financing energy performance contracts with leases instead of general obligation bonds. While there may be a lower cost of capital if energy projects are financed with bonds instead of capital leases, there are significant disadvantages using the State's full faith and credit, and authorization and budget challenges if bonds are issued.

3. Public-Private Partnership "P-3" Legislation

Chapter 641 of the Laws of 2010 requires the Capital Debt Affordability Committee to analyze and report on the aggregate impact of Public-Private Partnership agreements on the total amount of new State debt that prudently may be authorized for the next fiscal year. The work group focused this analysis on tax-supported State leases and discussed the classification of leases as capital or operating.

Currently capital leases are considered debt of the State by financial analysts, rating agencies and under generally accepted accounting principles (GAAP). According to GAAP, leases that are in essence a vehicle for financing assets must be "capitalized" – i.e., reflected on the balance sheet as both an asset and debt and the annual payments are considered as debt service. Operating leases, on the other hand, are not recorded as debt and the annual payments are recorded as operating expenses. The Capital Debt Affordability Committee currently considers tax-supported capital leases ***but not operating leases*** in its affordability analysis. Consequently, the determination of whether a proposed lease is capital or operating is critical to determine the impact of the lease on CDAC limits.

State Center

Since the enactment of this law in 2010, the State has entered a Public-Private Partnership for the development of State Center and the State Treasurer analyzed the impact of this P3 on the State's Capital Debt Affordability limits after consulting with the State's accounting professionals and requesting an opinion by the State's auditor on the classification of the State Center occupancy lease.

As pointed out in a letter from the Treasurer to the Budget committees on July 23, 2010, this analysis only gives us an indication of the lease classification as of July 2010. The auditor's letter emphasized that "the calculation to determine whether the lease would be an operating or capital lease would occur when the State actually enters into the lease." If the assumptions used in July 2010 are different from the actual terms of the lease, if the discount rate is less than 7% at the time the lease is entered into, or if the estimated fair value of the project is different from the actual amounts, the calculation may result in a different conclusion.

As a result, the Treasurer concluded and recommended that the State Center occupancy lease ***not*** be considered a capital lease in CDAC's affordability analysis.

Recommendation

In summary, because the State Center leases approved by the Board of Public Works on July 28, 2010 currently meet the criteria for an operating lease, the work group concluded that they have no impact on the total amount of new State debt that may be authorized for the next fiscal year. However, on the advice of the State's auditor, the final determination of the classification of the occupancy leases at State Center should be done at the time the State actually enters into the leases, which is expected to be fiscal year 2014 for Phase 1.

Charles County Courthouse

As noted above, public private partnership agreements require the Treasurer to evaluate the impact of the agreement on the CDAC's debt affordability. However, only agreements between the State and a private entity are included. In the case of the Charles County Courthouse, the agreement is between the State and Charles County. Therefore, the agreement is not subject to the review by the State Treasurer's Office for affordability consideration prior to submission of the lease to the Board of Public Works.

This lease will begin in fiscal year 2011 and the General Accounting Division (GAD) will review the terms of the financing and advise the State Treasurer's Office of the classification of the lease when they prepare the 2011 financial statements. If they determine it is a capital lease, the lease will be included in the CDAC analysis in the next report. The State Treasurer's Office reconciles the capital leases reported in the CDAC report with GAD to ensure that all capital leases are properly accounted for in the affordability analysis.

4. Accounting Standards for Capital and Operating Leases

Review of FASB (Financial Accounting Standards Board) and GASB (Governmental Accounting Standards Board)

On March 19, 2009, the U.S. Financial Accounting Standards Board and the International Accounting Standards Board released a joint paper on accounting by lessees in operating lease arrangements. The contemplated changes, which are not expected to be finalized before 2011, would require all lease arrangements to be reported on the balance sheet. Consequently, all leases would be considered debt. The State's financial statements conform to GASB which may not necessarily follow FASB or its timetable for the implementation of any accounting changes.

The State's 2009 CAFR reports that the State's governmental funds pay for office space under various agreements that are accounted for as operating leases. Rent expenditures for operating leases for the year ended June 30, 2009 were approximately

$63,939,000. Clearly, if there is a change to the accounting standards and operating leases are capitalized in the future, an adjustment to the CDAC affordability ratios may be necessary.

Rating Agency Guidance

The State's Financial Advisor has reported that Fitch and Moody's will not focus on any possible accounting change for leases until a change is formally adopted and incorporated by GASB. The rating agencies include the capital leases reported in the State's CAFR in their financial ratios.

Recommendation

Since the outcome of any GASB lease accounting change is so uncertain, the work group recommends that the 2010 CDAC report should not include operating leases in its affordability analysis. The work group recommends that CDAC continue to monitor this accounting issue at its meetings in the future and that CDAC review the affordability benchmarks if the accounting standards change.

5. Energy Performance Contract (EPC) Leases

The work group examined the energy leases financed for higher education institutions to determine if they should be considered tax-supported debt and, consequently, included in the debt affordability analysis. The State has financed $36.2 million of leases for the University System and St. Mary's College and has $50.7 million in projected new leases. In 2009, these energy leases were not included as tax-supported debt. This treatment of the System's energy leases was discussed by the work group.

Recommendation

Since State tax revenues are used to provide support for higher education institutions, EPC capital leases for those institutions should be included in the tax-supported debt considered by CDAC. SF&P 8-104(c) states "tax-supported debt" includes "…debt of…units of State government which, in the opinion of the Committee, are supported directly or indirectly by State tax revenues."

6. Assumptions for Affordability Analysis

The Work Group reviewed the following assumptions for the affordability analysis on September 15 at its final meeting. The assumptions are discussed in Section V of the CDAC Report and in materials distributed at the September 22 CDAC meeting.

- Future Authorizations
- Revenues
- Interest Rates
- Premium
- Financing plans for video lottery terminals and discussion of possible alternatives
- Garage at State Center

7. Proposed Legislation

a) P3 Legislation (H.B. 1370)

Chapter 641 of the Laws of 2010 (H.B. 1370) requires that the State Treasurer analyze the impact of each public-private partnership agreement on the State's Capital debt affordability limits. To be able to do this the Treasurer must consult with GAD and with the State's auditor to determine if the lease is capital or operating.

Recommendation

The Work Group recommends that the process include a determination by the Comptroller of the classification of the lease prior to the debt affordability analysis by the Treasurer.

b) Qualified Zone Academy Bond (QZAB) Proceeds

The US Treasury subsidizes 100% of the QZAB interest so it is in the State's financial interest to issue and use the proceeds of these bonds which are issued annually. Planned issuances in FY11, FY 12, and FY 13 are $4.5 million, $15.9 million and $15.3 million respectively.

Federal legislation also requires that QZAB proceeds meet strict draw down timetables. Chart 2 on page 9 depicts the spend-down of the State's proceeds as of August 31, 2010. Representatives from the Department of Budget and Management, the State Treasurer's Office, the Department of Legislative Services, and the Interagency Committee on School Construction have met and will continue to meet quarterly to monitor the use of QZAB proceeds. The work group discussed options to accelerate the expenditure of QZAB proceeds and restructure how future QZABs are utilized.

Recommendation

The work group recommends the continued monitoring and quarterly review of the QZAB program including progress on options to maximize the State's QZAB allocation and to spend-down proceeds in a timely manner. No legislation is recommended at this time.

c) Exclusion of energy leases from CDAC affordability analysis

Capital leases authorized under §8-405 are required to be included in the tax-supported debt considered by the Capital Debt Affordability Committee. The work group discussed whether this provision should be amended so that energy leases with guaranteed savings would be excluded as tax-supported debt and therefore not counted in the debt affordability analysis.

A survey was sent to other states with the following results:

- North Carolina " Energy Performance Contracts not included where such obligations are guaranteed … and not supported by separate appropriations"
- Vermont excludes EPC leases from CDAC analyses because of a guarantee by the contractor and because budgeted energy savings, not tax dollars, are providing for the lease payment
- Virginia includes energy leases in tax supported debt

Recommendation

There is not a separate appropriation for debt service on these energy leases; instead, the payment is made from the agency's utility budget. The work group recommends that capital leases for energy performance contracts funded with energy savings be excluded from tax-supported debt. If this legislation passes, the work group does recommend that future CDAC reports include a summary of the amount outstanding of these leases and the current year's debt service along with the justification for not including them in the affordability analysis.

CHART 1
Debt Issuance Constraints for Tax-Supported Debt
as of September 15, 2010

Type of Tax-Supported Debt	Limit
General Obligation Bonds	CDAC Affordability Analysis and Recommendation Legislative Authorization
Department of Transportation Bonds	Transportation statute §3-202 limit is $2.6 billion Lower limit for FY 11 is $1,791,000,000 Bond Covenants: No additional bonds unless: (1) the excess of Transportation Trust Fund revenues over Department of Transportation operational expenses in the preceding fiscal year is equal to at least twice the maximum amount of debt service for any future fiscal year, including debt service on the additional bonds to be issued; and (2) total proceeds from taxes pledged to debt service for the past fiscal year equal at least twice such maximum debt service or, conversely, total debt service cannot exceed 50% of taxes pledged using the debt service divided by revenues convention.
Capital Leases	Approval by Legislative Policy Committee MDOT limit of non-traditional debt is $663,340,000 for FY 11 * Non-traditional debt is anything other than a Consolidated Transportation Bond or GARVEE bond. Per discussion with MDOT, DLS and AGs, MDOT energy leases are not included as non-traditional debt.
GARVEE Bonds	Transportation Statute §3-601 and §4-321 limited issuance to $750 million
Maryland Stadium Authority	Economic Development Statute §10-628 has a maximum limit by project. MSA can issue bonds up to that limit.
Bay Restoration Bonds	Environment Statute §9-1607 limits issuance to an amount where fee revenue is sufficient to cover debt service.
Revenue Bonds	If revenues are insufficient and taxes are needed to support debt service. For example, debt service on the Port's paper warehouse was originally covered by rental revenues from the tenant. Since the property is now vacant and if other paper revenues are insufficient, the TTF may have to cover the debt service.

* MDOT will be increasing the nontraditional debt limit for FY2011 (as allowed after notice to the Budget committees) by approximately $32 million to allow for the issuance of bonds to finance the State Center Garage. MDOT will (most likely) give notice in early Fall. The timing of the bonds is not determined.

CHART 2
EXPENDITURES OF QZAB BOND PROCEEDS THROUGH AUGUST 2010

	Proceeds	Interest Income through 8/31/10*	Proceeds Plus Interest through 8/31/10	Expenditures through 8/31/10*		Unexpended Balance 8/31/10	% Expended through 8/31/10
2001 QZAB	$18,097,984	$1,320,875	$19,418,859	$19,319,816	**	$99,043	99.49%
2004 QZAB	$9,043,000	$939,975	$9,982,975	$7,499,518		$2,483,457	75.12%
2006 QZAB	$4,378,000	$320,772	$4,698,772	$1,059,443		$3,639,328	22.55%
2007 QZAB	$4,986,000	$122,814	$5,108,814	$2,489,638		$2,619,176	48.73%
2008 QZAB***	$5,563,000	-$18,095	$5,544,905	$2,027,963		$3,516,942	36.57%
2009 QZAB***	$5,563,000	$5,114	$5,568,114	$2,016,601		$3,551,513	36.22%
TOTALS	**$47,630,984**	**$2,691,455**	**$50,322,440**	**$34,412,980**		**$15,909,460**	

* from 8/31/10 R*STARS Reports

** $593,868 of the expenditures for QZAB 2001 were spent on non-qualified projects. This amount must be deducted from expenditures for federal compliance purposes, therefore reducing percentage expended to 96.43%.

*** QZABs issued after October 3, 2008, therefore requiring 100% of proceeds spent within 3 years of issuance.

Projected Affordability Assumptions and Ratios

Affordability Assumptions

Assumptions
for
Affordability Analysis
Capital Debt Affordability Committee Meeting
September 22, 2010

ASSUMPTIONS AND ANALYSES ARE AS OF SEPTEMBER 22, 2010

Because the affordability ratios are near or at the benchmarks, any variation to the assumptions for revenues, personal income, interest rates, and expected activity in tax-supported debt would impact directly the amount of future general obligation authorizations and issuances.

PROJECTED AUTHORIZATIONS:

The authorizations in the chart below result in debt service to revenues at 7.92% in 2017 and 7.84% in 2018 as of September 2010. There are many authorization options that could be used to achieve adherence to the CDAC affordability criteria. The chart below reflects one plan.

The motion to adopt the recommendation of $925 million in general obligation bond authorizations to the 2011 Session specifically recognizes that authorization levels proposed in the Governor's 2012 capital budget could be adjusted to reflect up-to-date economic and fiscal information and the Board of Revenue Estimate's December revenue estimates. Accordingly, the Capital Debt Affordability Committee will review this recommendation of $925 million in December 2010 and make any necessary modifications to its recommendation.

Leg. Session	**(in millions)**
2009 (Actual)	$1,110
2010 (Actual)	$1,140
2011	$925
2012	$925
2013	$925
2014	$935
2015	$945
2016	$955
2017	$1200
2018	$1,240
2019	$1,280
2020	$1,320

Assumptions (cont.)

PROJECTED ISSUANCES

The issuances in the chart below are predicated on the authorization levels in the prior table.

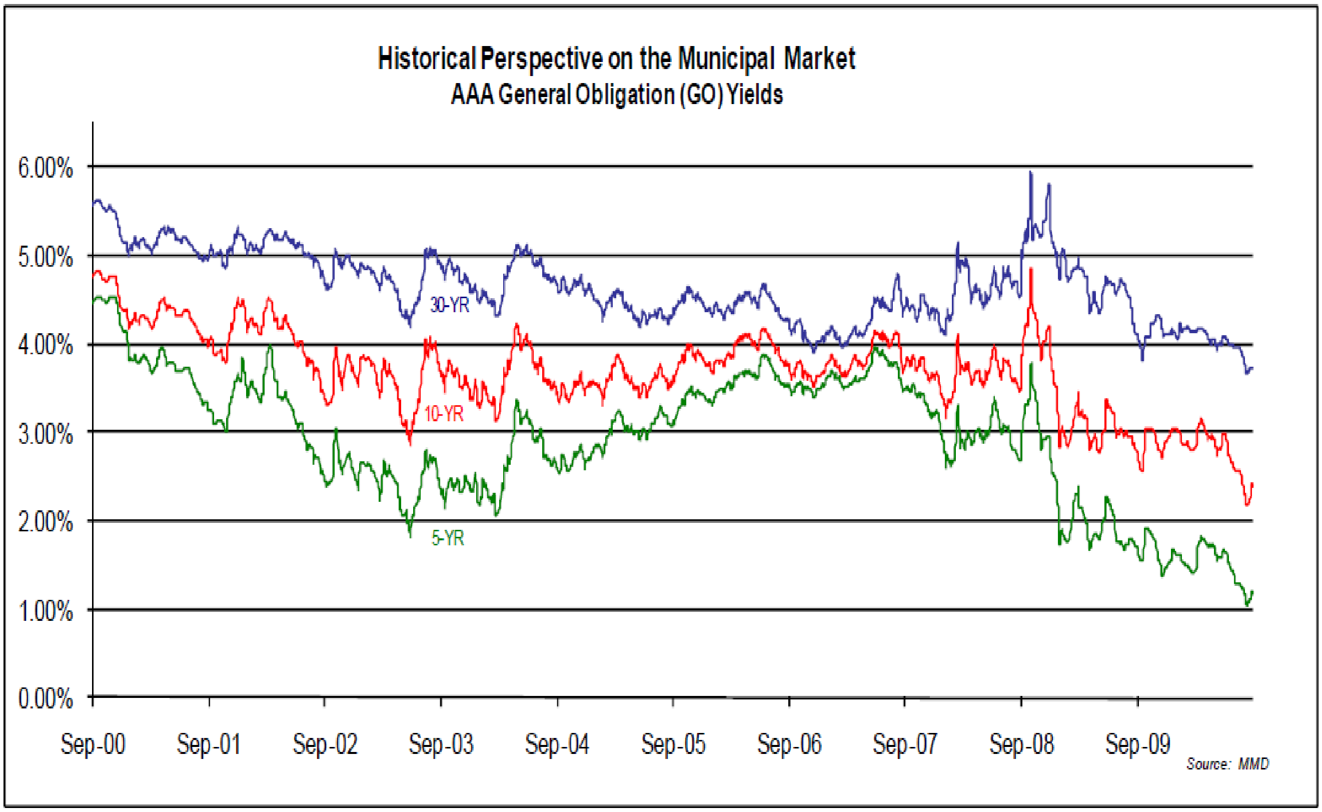
Projected Bond Issuance in Fiscal Years	**GO Issuances (in millions)**
2009 (Actual)	$845.6
2010 (Actual)	$1,141.9
2011	$970
2012	$960
2013	$945
2014	$940
2015	$935
2016	$940
2017	$940
2018	$1,020
2019	$1,100
2020	$1,175

INTEREST RATES

The State Treasurer's Office, the Department of Budget and Management, and the State's financial advisor reviewed historical indices for municipal debt including the Municipal Market Data (MMD) for 15 year, AAA general obligation bonds. This index had daily rates from 1993 through September 2010. For this time period, the average rate was 4.53% and the median was 4.66%.

The following graphs depict the historical trends for 5 year and 10 year AAA bonds.

Assumptions (cont.)



Raymond James' Municipal Bond Investor Weekly
September 17, 2010

Based on this review and after consideration for future trends in rates, 5% was the assumed rate for all future issues.

PREMIUM

Premium net of costs of issuance is deposited into the Annuity Bond Fund and is used to pay debt service. It supplements property taxes for the payment of debt service and reduces possible dependence on the general fund for debt service. It is also included as revenue in the debt service to revenues calculation on Appendix A-2 in the CDAC report. **Because of the volatility of premiums, only actual receipts are included in the calculations, and they are not included in future projections.**

Assumptions (cont.)

CAPITAL LEASES

<u>INCLUDED IN THE CDAC PROJECTIONS AS OF SEPT. 2010</u>

Garage at State Center – estimated at $31,550,000
Projections for a capital lease for this project **are** included in the affordability analysis.

Equipment Leases (tax-exempt)

Agency Surveys indicates $15 million per year
Interest rate assumption is 2% for 3 year and 5 year leases.

Energy Leases (tax-exempt)

DGS indicates $80 million in tax-supported leases in FY 11 and none thereafter. (Included as tax-supported are energy leases for Higher Education and for a portion of the projected MAA energy lease)
Interest rate assumption: 5.50%

VLTs financings: 5 year ***taxable*** leases

$29,000,000 – Penn National – closing of financing on 1/15/2011
$12,500,000 – Ocean Downs – closing of financing on 2/15/2011
First Payment due 7/1/11
Interest rate assumption: 5.35% for 15 year leases

$68,000,000 – Anne Arundel Co.
First Payment due 1/1/12 – closing of financing 6/15/11
$66,300,000 – Anne Arundel Co.
First Payment due 1/1/13 – closing of financing 7/15/12
Interest rate assumption: 5.35%

<u>NOT INCLUDED IN THE CDAC PROJECTIONS AS OF SEPT. 2010</u>

VLTs financings – Baltimore City ($110 million) and Rocky Gap ($45 million)

Charles County Courthouse – estimated at $15,516,000
This lease will begin in 2011, and the General Accounting Division (GAD) will review the terms of the financing and advise the State Treasurer's Office of the classification of the lease when they prepare the 2011 financial statements. If it is deemed to be a capital lease, it will have to be counted in the CDAC analysis as tax-supported debt.

DHMH Lab – estimated at $181,570,000
The projections for the DHMH lab were received on September 21 – after the agenda was set and the CDAC analysis was completed for the Committee's last summer meeting. §12-204 of the State Finance and Procurement article states that CDAC must certify to the Governor and

Assumptions (cont.)

General Assembly that the total amount of new State debt to be incurred as a result of the DHMH lease may be prudently authorized. As noted above, CDAC is planning to meet in December 2010 to review the September recommendation to the 2011 Session for general obligation bond authorizations. A presentation on the DHMH lease will be included in the December agenda and CDAC will have the opportunity to review the affordability projections with the proposed DHMH lease.

REVENUES AND PERSONAL INCOME

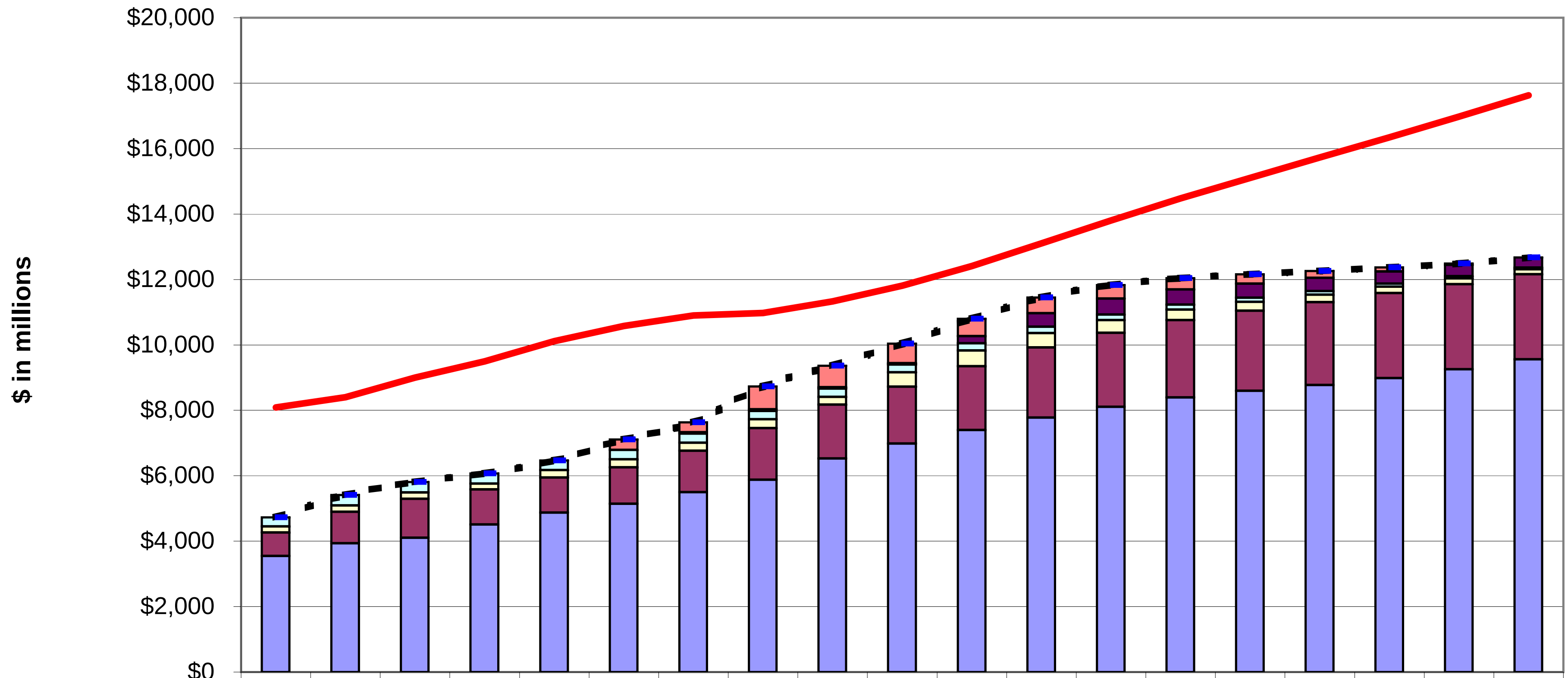
Revenues were updated after the Board of Revenue Estimates meeting on September 16, 2010. See sources of data and assumptions at bottom of page A-1 and A-2.

OTHER TAX-SUPPORTED DEBT

Assumed issuances are at the bottom of Table 1.

Debt Outstanding to Personal Income
As of September 2010

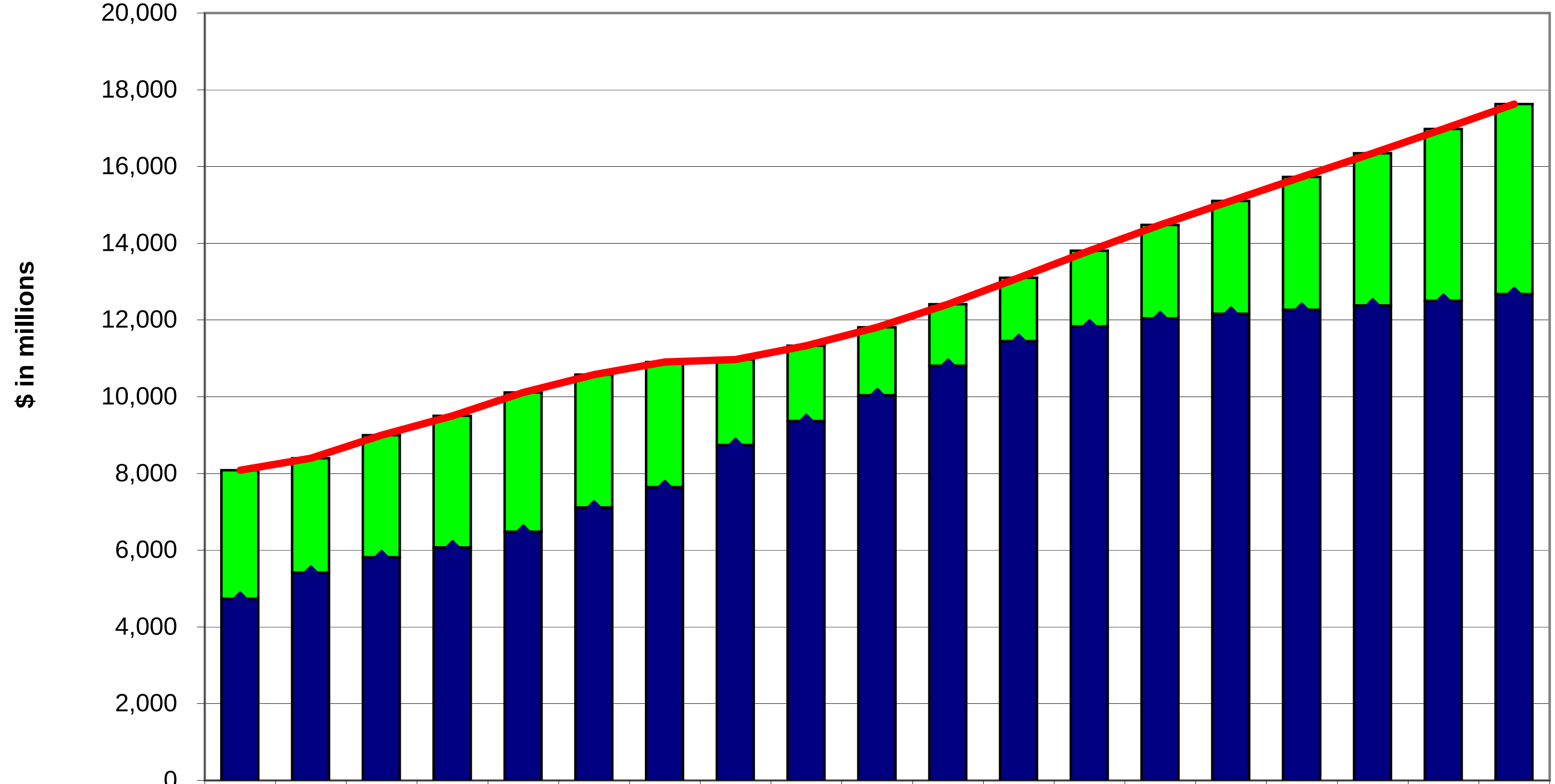
Tax Supported Debt Outstanding to Personal Income
as of SEPTEMBER 2010



	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Garvee	0	0	0	0	0	325	301	704	652	597	539	479	416	349	280	207	130	49	0
Bay Restoration	0	0	0	0	0	0	50	47	44	42	219	413	487	461	434	405	375	343	310
Stadium Authority	278	323	321	309	297	283	272	256	252	234	214	193	171	148	129	111	91	70	47
Capital Leases	186	193	199	175	227	248	247	267	243	443	484	444	386	327	264	229	194	175	157
Total DOT	717	964	1,187	1,071	1,078	1,111	1,269	1,583	1,645	1,742	1,949	2,140	2,265	2,358	2,447	2,531	2,597	2,597	2,600
General Obligation	3,544	3,932	4,102	4,512	4,868	5,142	5,494	5,874	6,523	6,978	7,396	7,777	8,105	8,394	8,598	8,775	8,985	9,256	9,556
4.0% Benchmark	8,086	8,399	9,001	9,501	10,111	10,575	10,902	10,973	11,329	11,812	12,411	13,100	13,807	14,477	15,106	15,726	16,345	16,976	17,632
Total Tax Supported Debt	4,726	5,413	5,809	6,067	6,471	7,109	7,632	8,730	9,359	10,036	10,802	11,446	11,830	12,038	12,153	12,257	12,371	12,490	12,670

Source: Table 1 as of September 2010

Available Debt Capacity Using the 4.0% Criterion
as of SEPTEMBER 2010



	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Remaining Capacity	3,360	2,986	3,192	3,434	3,641	3,465	3,269	2,243	1,970	1,776	1,609	1,654	1,977	2,438	2,953	3,469	3,974	4,486	4,962
Tax Supported Debt	4,726	5,413	5,809	6,067	6,471	7,109	7,632	8,730	9,359	10,036	10,802	11,446	11,830	12,038	12,153	12,257	12,371	12,490	12,670
4.0% Benchmark	8,086	8,399	9,001	9,501	10,111	10,575	10,902	10,973	11,329	11,812	12,411	13,100	13,807	14,477	15,106	15,726	16,345	16,976	17,632
Total Tax Supported Debt	4,726	5,413	5,809	6,067	6,471	7,109	7,632	8,730	9,359	10,036	10,802	11,446	11,830	12,038	12,153	12,257	12,371	12,490	12,670

source: Table 1 as of September 2010

TABLE 1

STATE TAX SUPPORTED DEBT OUTSTANDING
COMPONENTS AND RELATIONSHIP TO PERSONAL INCOME

($ in thousands)

Sep-10

Fiscal Year	General Obligation Bonds	Department of Transportation: Consolidated Transportation Bonds	Department of Transportation: County Transportation Bonds (b)	Department of Transportation: Total DOT	Capital Leases	Stadium Authority	Bay Restoration Bonds	Garvee Bonds	Total Tax Supported Debt Outstanding	Fiscal Year
	(a)				(c) (d)					
2002	$3,544,178	$714,150	$3,155	$717,305	$186,238	$277,995			$4,725,716	2002
2003	$3,932,493	$961,245	$2,440	$963,685	$193,136	$323,240			$5,412,554	2003
2004	$4,102,278	$1,185,650	$1,675	$1,187,325	$198,585	$320,955			$5,809,143	2004
2005	$4,511,826	$1,069,945	$865	$1,070,810	$175,062	$309,195			$6,066,893	2005
2006	$4,868,471	$1,078,475	$0	$1,078,475	$226,898	$296,820			$6,470,664	2006
2007	$5,142,154	$1,111,050	$0	$1,111,050	$247,939	$283,090		$325,000	$7,109,233	2007
2008	$5,493,830	$1,268,815	$0	$1,268,815	$247,427	$271,570	$50,000	$300,655	$7,632,297	2008
2009	$5,873,643	$1,582,605	$0	$1,582,605	$266,757	$256,013	$46,825	$704,365	$8,730,208	2009
2010	$6,523,222	$1,645,000	$0	$1,645,000	$242,636	$251,940	$44,185	$651,795	$9,358,779	2010
2011	$6,978,303	$1,742,000	$0	$1,742,000	$442,947	$233,871	$41,560	$596,915	$10,035,596	2011
2012	$7,396,124	$1,949,000	$0	$1,949,000	$484,298	$214,183	$218,820	$539,355	$10,801,780	2012
2013	$7,776,824	$2,140,000	$0	$2,140,000	$443,697	$193,196	$412,962	$479,035	$11,445,714	2013
2014	$8,105,304	$2,265,000	$0	$2,265,000	$385,601	$170,832	$487,399	$415,775	$11,829,911	2014
2015	$8,393,891	$2,358,000	$0	$2,358,000	$327,139	$148,357	$461,493	$349,440	$12,038,321	2015
2016	$8,598,128	$2,447,000	$0	$2,447,000	$264,497	$129,447	$434,201	$279,780	$12,153,053	2016
2017	$8,774,822	$2,531,000	$0	$2,531,000	$228,517	$110,763	$405,474	$206,590	$12,257,166	2017
2018	$8,984,654	$2,597,000	$0	$2,597,000	$193,690	$90,785	$375,224	$129,680	$12,371,032	2018
2019	$9,255,804	$2,597,000	$0	$2,597,000	$175,323	$69,864	$343,371	$48,865	$12,490,227	2019
2020	$9,555,754	$2,600,000	$0	$2,600,000	$156,746	$47,483	$309,707	$0	$12,669,689	2020

State Tax Supported Debt Outstanding as a Percent of Personal Income
(Affordability criteria standard = 4.0%)

Fiscal Year	General Obligation Bonds	Consolidated Transportation Bonds	County Transportation Bonds	Total DOT	Capital Leases	Stadium Authority	Bay Restoration Bonds	Garvee Bonds	Total Tax Supported Debt Outstanding	Fiscal Year
2002	1.75%	0.35%	0.00%	0.35%	0.09%	0.14%			**2.34%**	2002
2003	1.87%	0.46%	0.00%	0.46%	0.09%	0.15%			**2.58%**	2003
2004	1.82%	0.53%	0.00%	0.53%	0.09%	0.14%			**2.58%**	2004
2005	1.90%	0.45%	0.00%	0.45%	0.07%	0.13%			**2.55%**	2005
2006	1.93%	0.43%	0.00%	0.43%	0.09%	0.12%			**2.56%**	2006
2007	1.95%	0.42%	0.00%	0.42%	0.09%	0.11%		0.12%	**2.69%**	2007
2008	2.02%	0.47%	0.00%	0.47%	0.09%	0.10%	0.02%	0.11%	**2.80%**	2008
2009	2.14%	0.58%	0.00%	0.58%	0.10%	0.09%	0.02%	0.26%	**3.18%**	2009
2010	2.30%	0.58%	0.00%	0.58%	0.09%	0.09%	0.02%	0.23%	**3.30%**	2010
2011	2.36%	0.59%	0.00%	0.59%	0.15%	0.08%	0.01%	0.20%	**3.40%**	2011
2012	2.38%	0.63%	0.00%	0.63%	0.16%	0.07%	0.07%	0.17%	**3.48%**	2012
2013	2.37%	0.65%	0.00%	0.65%	0.14%	0.06%	0.13%	0.15%	**3.50%**	2013
2014	2.35%	0.66%	0.00%	0.66%	0.11%	0.05%	0.14%	0.12%	**3.43%**	2014
2015	2.32%	0.65%	0.00%	0.65%	0.09%	0.04%	0.13%	0.10%	**3.33%**	2015
2016	2.28%	0.65%	0.00%	0.65%	0.07%	0.03%	0.11%	0.07%	**3.22%**	2016
2017	2.23%	0.64%	0.00%	0.64%	0.06%	0.03%	0.10%	0.05%	**3.12%**	2017
2018	2.20%	0.64%	0.00%	0.64%	0.05%	0.02%	0.09%	0.03%	**3.03%**	2018
2019	2.18%	0.61%	0.00%	0.61%	0.04%	0.02%	0.08%	0.01%	**2.94%**	2019
2020	2.17%	0.59%	0.00%	0.59%	0.04%	0.01%	0.07%	0.00%	**2.87%**	2020

(a) Reflects presumed authorizations as follows:

General Assembly Session:	2010	2011	2012	2013	2014
Fiscal Year:	**2011**	**2012**	**2013**	**2014**	**2015**
For Capital Program ((in millions)	$1,140	$925	$925	$925	$935

(b) Net of sinking funds or debt service reserve funds.

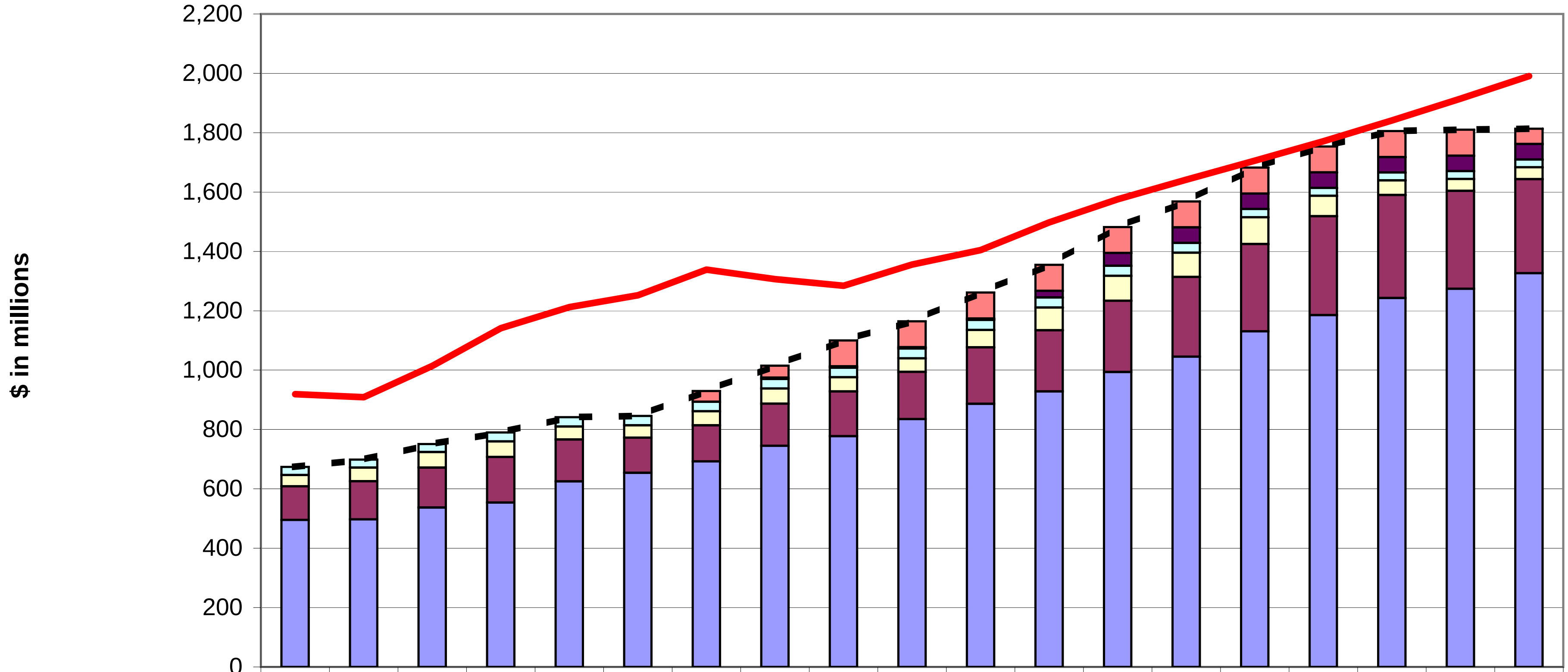
(c) Includes financings for multi-agency office buildings in St. Mary's and Calvert Counties, district court facilities in Baltimore and Prince George's Counties, headquarters building for MDOT, shuttle buses at BWI, water and waste water facility at ECI, the state office parking facility, and State Center garage.

(d) Equipment leases including video lottery terminals and energy leases including energy performance contracts for higher education facilities.

Issuance Assumptions: ($ in millions)	**2011**	**2012**	**2013**	**2014**	**2015**
G.O. issues (Includes 2009 Program Open Space)	$970	$960	$945	$940	$935
Qualified Zone Academy Bonds (QZAB's)	$4.5				
DOT issues	$180.0	$310.0	$300.0	$260.0	$250.0
Stadium Authority issues	$0.0	$0.0	$0.0	$0.0	$0.0
New Capital Leases - Equip. & EPC	$95.0	$15.0	$15.0	$15.0	$15.0
New Capital leases - VLTs	$109.5	$66.3			
Garvee Bond Issues	$0.0	$0.0	$0.0	$0.0	$0.0
Bay Bonds Issues	$0.0	$180.0	$205.0	$95.0	$0.0
Personal Income (billions) (Appendix A-1)	$295.3	$310.3	$327.5	$345.2	$361.9

Debt Service to Revenues
As of September 2010

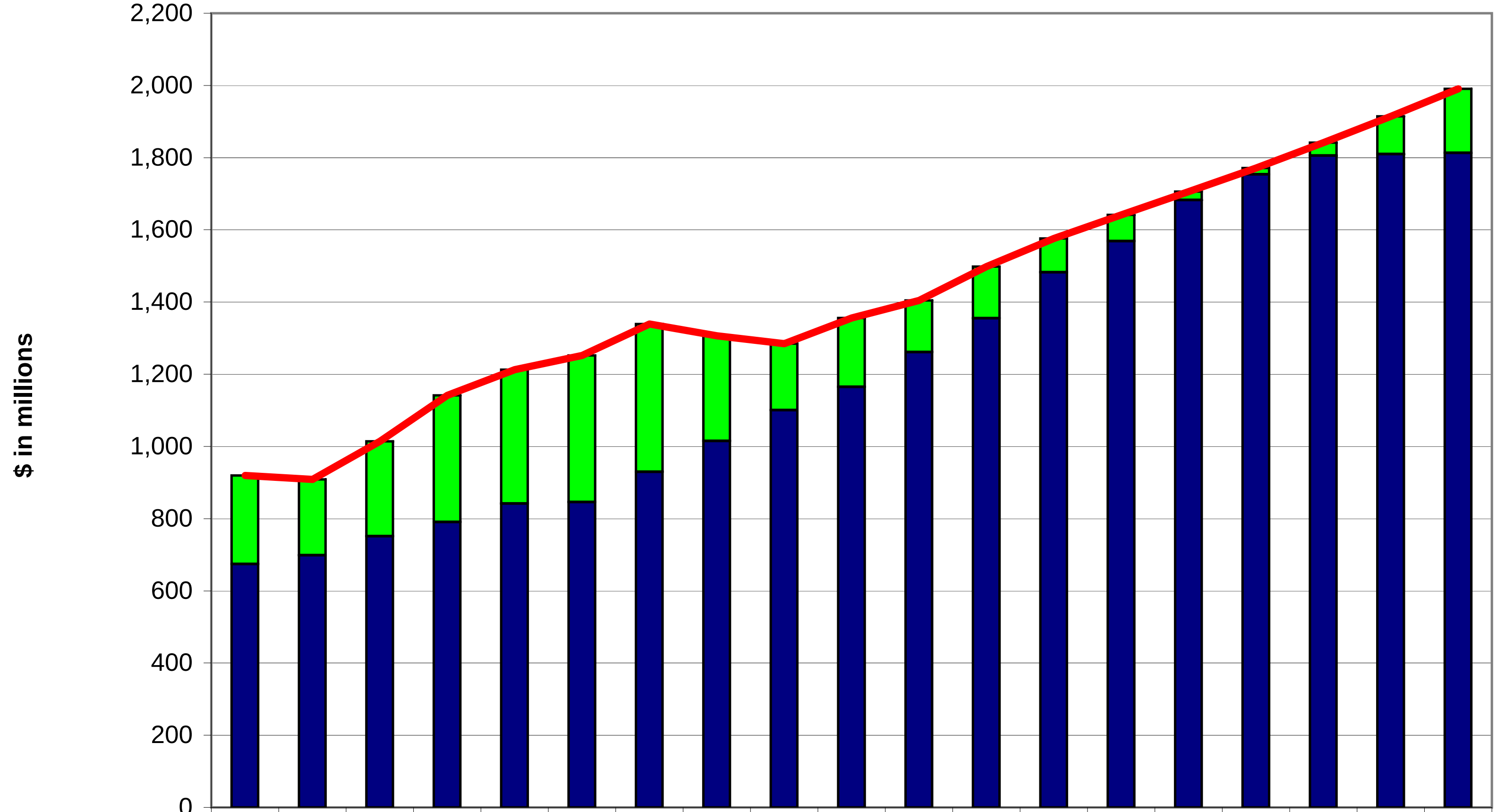
Tax Supported Debt Service to Revenues
as of SEPTEMBER 2010



	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Garvee Bonds							36	40	87	87	87	87	87	87	87	87	87	87	51
Bay Restoration Bonds								5	5	5	5	23	43	52	52	52	52	52	52
Stadium Authority	27	27	27	30	32	32	32	32	32	33	34	34	34	33	28	26	26	26	26
Capital Leases	38	46	52	52	44	42	47	51	47	46	59	76	84	82	90	69	49	40	40
DOT Consolidated Bonds	113	129	135	154	141	118	121	142	151	159	190	206	240	269	294	333	347	330	317
General Obligation Bonds	495	497	537	554	625	654	693	745	778	835	887	928	994	1,045	1,131	1,186	1,243	1,274	1,327
8.0% Benchmark	919	909	1,014	1,141	1,212	1,252	1,339	1,307	1,284	1,356	1,405	1,498	1,576	1,642	1,706	1,771	1,841	1,915	1,991
Total Tax Supported Debt Service	674	699	751	790	842	846	929	1,015	1,100	1,165	1,261	1,355	1,482	1,568	1,682	1,754	1,805	1,810	1,813

Source: Table 2A as of Sept 2010

Available Debt Service Capacity Using the 8.0% Criterion as of SEPTEMBER 2010



	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Remaining Debt Service Capacity	245	210	263	351	371	406	409	292	184	191	143	143	94	73	23	18	36	105	177
Total Tax Supported Debt Service	674	699	751	790	842	846	929	1,015	1,100	1,165	1,261	1,355	1,482	1,568	1,682	1,754	1,805	1,810	1,813
8.0% Benchmark	919	909	1,014	1,141	1,212	1,252	1,339	1,307	1,284	1,356	1,405	1,498	1,576	1,642	1,706	1,771	1,841	1,915	1,991

Source: Table 2A as of Sept 2010

TABLE 2A

STATE TAX SUPPORTED DEBT SERVICE
STATE TAX SUPPORTED DEBT SERVICE AS A PERCENT OF REVENUES
(Affordability criteria standard = 8%)
($ in thousands)

as of September 2010

Fiscal Year	General Obligation Bonds	DOT Consolidated Bonds	Capital Leases	Stadium Authority	Bay Restoration Bonds	Garvee Bonds	Total Tax Supported Debt Service	Total Revenues	Total Tax Supported Debt Service as a % of Revenues	Fiscal Year
	(a)	(b)	(c) (d)					*(Appendix A-2)*		
2002	$495,217	$113,178	$37,979	$27,383			$673,757	$11,489,682	**5.86%**	2002
2003	$496,870	$128,694	$46,152	$27,035			$698,751	$11,357,434	**6.15%**	2003
2004	$536,819	$134,910	$52,117	$27,333			$751,179	$12,676,056	**5.93%**	2004
2005	$553,783	$153,655	$52,239	$30,480			$790,157	$14,265,771	**5.54%**	2005
2006	$625,208	$141,172	$43,532	$31,713			$841,625	$15,155,236	**5.55%**	2006
2007	$654,055	$118,424	$41,636	$31,725			$845,840	$15,651,623	**5.40%**	2007
2008	$692,539	$121,390	$47,357	$32,108		$36,091	$929,484	$16,734,909	**5.55%**	2008
2009	$744,799	$142,355	$50,783	$31,935	$4,655	$40,364	$1,014,892	$16,334,382	**6.21%**	2009
2010	$777,523	$150,954	$47,460	$32,054	$4,710	$87,458	$1,100,158	$16,054,708	**6.85%**	2010
2011	$835,079	$159,000	$45,593	$32,954	$4,616	$87,455	$1,164,697	$16,946,266	**6.87%**	2011
2012	$886,583	$190,000	$58,836	$33,832	$4,614	$87,457	$1,261,321	$17,558,413	**7.18%**	2012
2013	$928,368	$206,000	$76,429	$33,836	$22,550	$87,451	$1,354,634	$18,723,337	**7.24%**	2013
2014	$993,650	$240,000	$84,154	$33,915	$42,970	$87,458	$1,482,146	$19,697,238	**7.52%**	2014
2015	$1,045,073	$269,000	$81,805	$32,683	$52,436	$87,454	$1,568,451	$20,520,950	**7.64%**	2015
2016	$1,130,717	$294,000	$90,127	$27,720	$52,434	$87,450	$1,682,448	$21,319,603	**7.89%**	2016
2017	$1,185,523	$333,000	$68,935	$26,382	$52,405	$87,452	$1,753,696	$22,140,802	**7.92%**	2017
2018	$1,242,993	$347,000	$49,212	$26,422	$52,364	$87,457	$1,805,447	$23,017,410	**7.84%**	2018
2019	$1,273,909	$330,000	$40,213	$26,079	$52,322	$87,452	$1,809,975	$23,931,854	**7.56%**	2019
2020	$1,326,593	$317,000	$39,715	$26,097	$52,434	$51,365	$1,813,204	$24,882,994	**7.29%**	2020

Assumptions: See Table 1

(a) Payments for 2001, 2004, 2006, 2007, 2008, and 2009 Qualified Zone Academy Bonds (QZAB's) have been included for fiscal years 2002 through 2020.
(b) Does not include debt service on county transportation bonds. Highway user revenues from counties exceed debt service requirements.
(c) Includes debt service on financings for multi-agency office buildings in St. Mary's and Calvert Counties, district court facilities in Baltimore and Prince George's Counties, headquarters building for MDOT, shuttle buses at BWI, water and waster water facility at ECI, the state office parking facility, and State Center garage.
(d) Debt service on equipment leases including video lottery terminals and energy leases including energy performance contracts for higher education facilities.

Projected Personal Income and Revenues
As of September 2010

MARYLAND PERSONAL INCOME AND POPULATION

Historical Data through 2009
Projections 2010-2020

Updated September 2010,
Subject to Change

Calendar Year	Personal Income ($ in millions)	% Change	Population (thousands)	% Change
2000	$ 184,174	8.80%	5,342	1.66%
2001	$ 194,986	5.87%	5,408	1.23%
2002	$ 202,148	3.67%	5,470	1.14%
2003	$ 209,974	3.87%	5,521	0.93%
2004	$ 225,023	7.17%	5,564	0.79%
2005	$ 237,522	5.55%	5,599	0.63%
2006	$ 252,781	6.42%	5,623	0.43%
2007	$ 264,368	4.58%	5,646	0.40%
2008	$ 272,542	3.09%	5,676	0.54%
2009	$ 274,326	0.65%	5,726	0.89%
2010	$ 283,227	3.24%	5,793	1.16%
2011	$ 295,296	4.26%	5,836	0.74%
2012	$ 310,266	5.07%	5,870	0.59%
2013	$ 327,488	5.55%	5,902	0.54%
2014	$ 345,176	5.40%	5,932	0.52%
2015	$ 361,917	4.85%	5,962	0.50%
2016	$ 377,660	4.35%	5,992	0.50%
2017	$ 393,145	4.10%	6,022	0.50%
2018	$ 408,634	3.94%	6,051	0.49%
2019	$ 424,408	3.86%	6,080	0.48%
2020	$ 440,790	3.86%	6,109	0.47%

4.97% Average rate of personal income growth for 10 year period 2000 through 2009
5.07% Median rate of personal income growth for 10 year period 2000 through 2009

Sources: Personal Income
1999-2008 Bureau of Economic Analysis, U.S. Dept. of Commerce
2009 - 2014 BRE
2015-2020 BRE from growth rates of Economy.com September 2010 forecast

Population
1999-2009 Census Bureau, U.S. Dept. of Commerce
2009-2020 Forecast: Economy.com September forecast

MARYLAND STATE REVENUE PROJECTIONS
($ in millions)

updated September 2010

Fiscal Year	General Fund Revenue	% Growth of GF	Property Taxes	% Growth of Prop. Taxes	Use of Premium and Misc. ABF Receipts	US Treasury Subsidy - Build America Bonds	Educational Trust Fund (VLT revenues)	Program Open Space	Total	Transportation Revenues	Stadium Related Revenues	Garvee Bonds	Bay Restoration Fund	Total Revenues	Percent Change of Total Revenues
1999	$8,524.0	5.9%	$246.9		$11.0				$8,781.9	$1,462.6	$24.5			$10,269.0	6.11%
2000	$9,220.0	8.2%	$250.8		$12.6				$9,483.4	$1,568.4	$21.2			$11,073.0	7.83%
2001	$9,802.0	6.3%	$257.1		$11.4				$10,070.5	$1,615.0	$27.6			$11,713.1	5.78%
2002	$9,504.0	-3.0%	$270.0		$25.5				$9,799.5	$1,663.0	$27.2			$11,489.7	-1.91%
2003	$9,409.8	-1.0%	$286.0		$36.7				$9,732.5	$1,603.0	$21.9			$11,357.4	-1.15%
2004	$10,204.3	8.4%	$468.4		$97.2				$10,769.8	$1,884.0	$22.2			$12,676.1	11.61%
2005	$11,548.0	13.2%	$516.5	10.3%	$94.5				$12,159.1	$2,085.0	$21.7			$14,265.8	12.54%
2006	$12,390.3	7.3%	$575.1	11.3%	$46.4				$13,011.8	$2,122.0	$21.4			$15,155.2	6.23%
2007	$12,940.2	4.4%	$552.7	-3.9%	$37.6				$13,530.4	$2,100.0	$21.2			$15,651.6	3.28%
2008	$13,545.6	4.7%	$625.7	13.2%	$37.1				$14,208.4	$2,009.0	$21.5	$441.3	$54.7	$16,734.9	6.92%
2009	$12,900.0	-4.8%	$698.6	11.6%	$79.2				$13,677.7	$2,142.0	$20.0	$441.3	$53.3	$16,334.4	-2.39%
2010	$12,587.1	-2.4%	$762.4	9.1%	$65.2	$0.9	$11.0		$13,426.5	$2,113.0	$20.0	$441.3	$53.9	$16,054.7	-1.71%
2011	$13,127.6	4.3%	$790.4	3.7%	$49.0	$9.1	$114.0	$149.9	$14,240.1	$2,200.0	$19.0	$432.8	$54.4	$16,946.3	5.55%
2012	$13,606.5	3.6%	$774.9	-2.0%	$2.2	$10.8	$145.0	$169.2	$14,708.7	$2,343.0	$19.0	$432.8	$55.0	$17,558.4	3.61%
2013	$14,390.3	5.8%	$795.5	2.7%	$2.2	$10.8	$372.0	$176.2	$15,747.0	$2,469.0	$19.0	$432.8	$55.5	$18,723.3	6.63%
2014	$15,102.1	4.9%	$801.4	0.7%	$2.2	$10.8	$479.0	$190.8	$16,586.4	$2,603.0	$19.0	$432.8	$56.1	$19,697.2	5.20%
2015	$15,806.4	4.7%	$801.8	0.0%	$2.2	$10.8	$523.0	$201.3	$17,345.5	$2,667.0	$19.0	$432.8	$56.6	$20,521.0	4.18%
2016	$16,517.8	4.5%	$821.9	2.5%	$2.2	$10.8	$533.5	$208.4	$18,094.6	$2,716.0	$19.0	$432.8	$57.2	$21,319.6	3.89%
2017	$17,261.0	4.5%	$842.5	2.5%	$2.2	$10.8	$544.1	$213.6	$18,874.2	$2,757.0	$19.0	$432.8	$57.8	$22,140.8	3.85%
2018	$18,037.7	4.5%	$863.5	2.5%	$2.2	$10.8	$555.0	$219.0	$19,688.3	$2,819.0	$19.0	$432.8	$58.3	$23,017.4	3.96%
2019	$18,849.4	4.5%	$885.1	2.5%	$2.2	$10.8	$566.1	$224.4	$20,538.1	$2,883.0	$19.0	$432.8	$58.9	$23,931.9	3.97%
2020	$19,697.7	4.5%	$907.2	2.5%	$2.2	$10.1	$577.4	$230.0	$21,424.7	$2,947.0	$19.0	$432.8	$59.5	$24,883.0	3.97%

General Fund:
- 1999 - 2010: Bureau of Revenue Estimates
- 2011 - 2015: BRE
- 2016 - 2020: Projected at growth rate of 4.5%

Property Tax and Use of Premium Revenues:
- 1999 - 2009: State Budget Books
- 2010 - 2020 : Dept. of Budget and Management, STO, Department of Assessments and Taxation

US Treasury Subsidy - Build America Bonds
- actual subsidy for 2009 2nd, 2009 3rd, 2010 1st and 2010 2nd Series

Educational Trust Fund (slots revenues)
- through 2015 - 90 Day Report, A Review of the 2010 Legislative Session, page A-15
- 2016 through 2020, projected at 2% growth

Transportation Revenues:
- 1999-2020: Department of Transportation, Office of Finance, updated September 2010
- Revenues consist of Taxes and Fees, Operating Revenue, Other Revenue, (including investment revenue) and federal funds for operations; MdTA transfers are deducted.

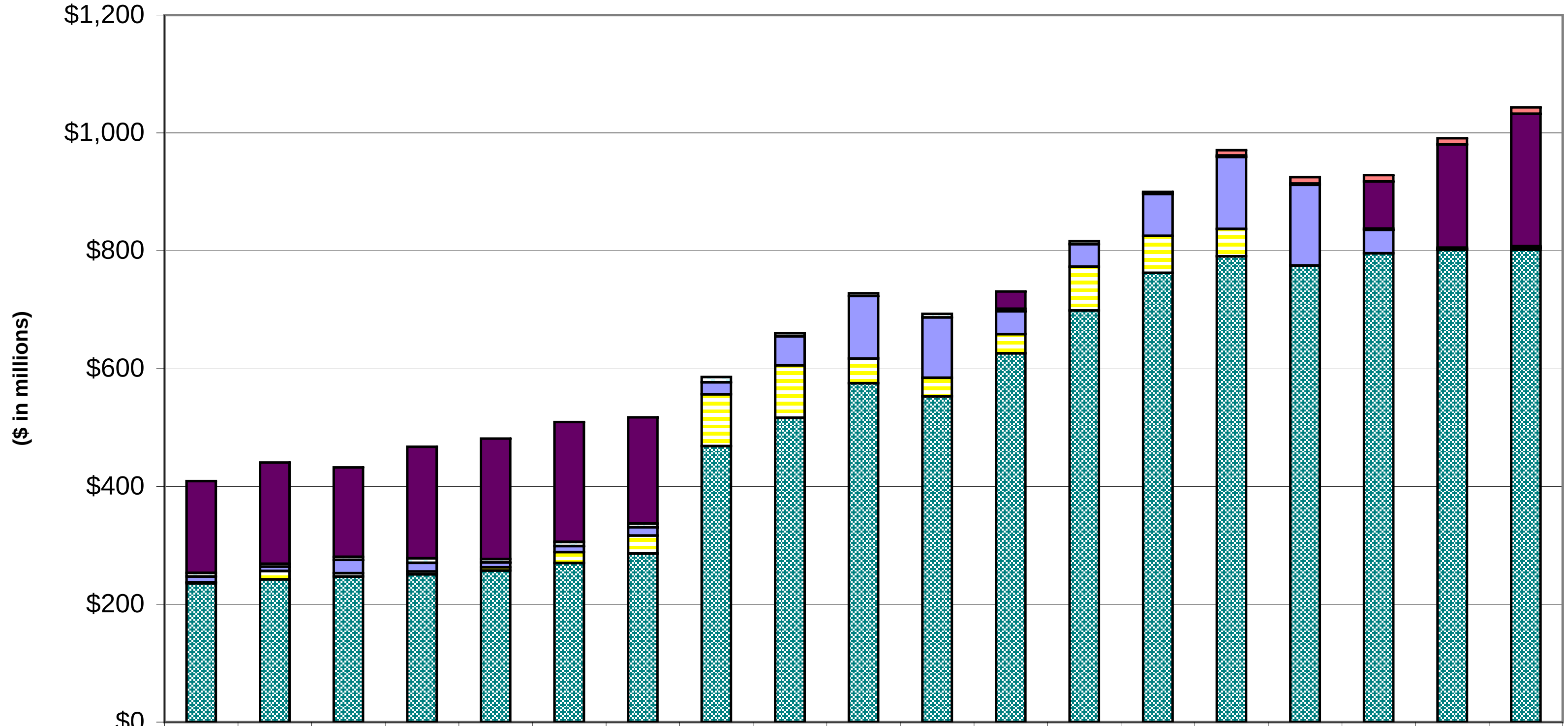
Garvee Bond Revenues:
- 2008-2020: Federal highway capital revenues; source MdTA, September 2010

Stadium Revenues:
- represents lottery revenues transferred to the Stadium Authority net of debt service on the 2010 Sports Facilities Revenue Bonds, updated September 2010

Bay Restoration Fund Revenues:
- 2008-2020 total program revenues; source MDE, MWQFA, updated September 2010

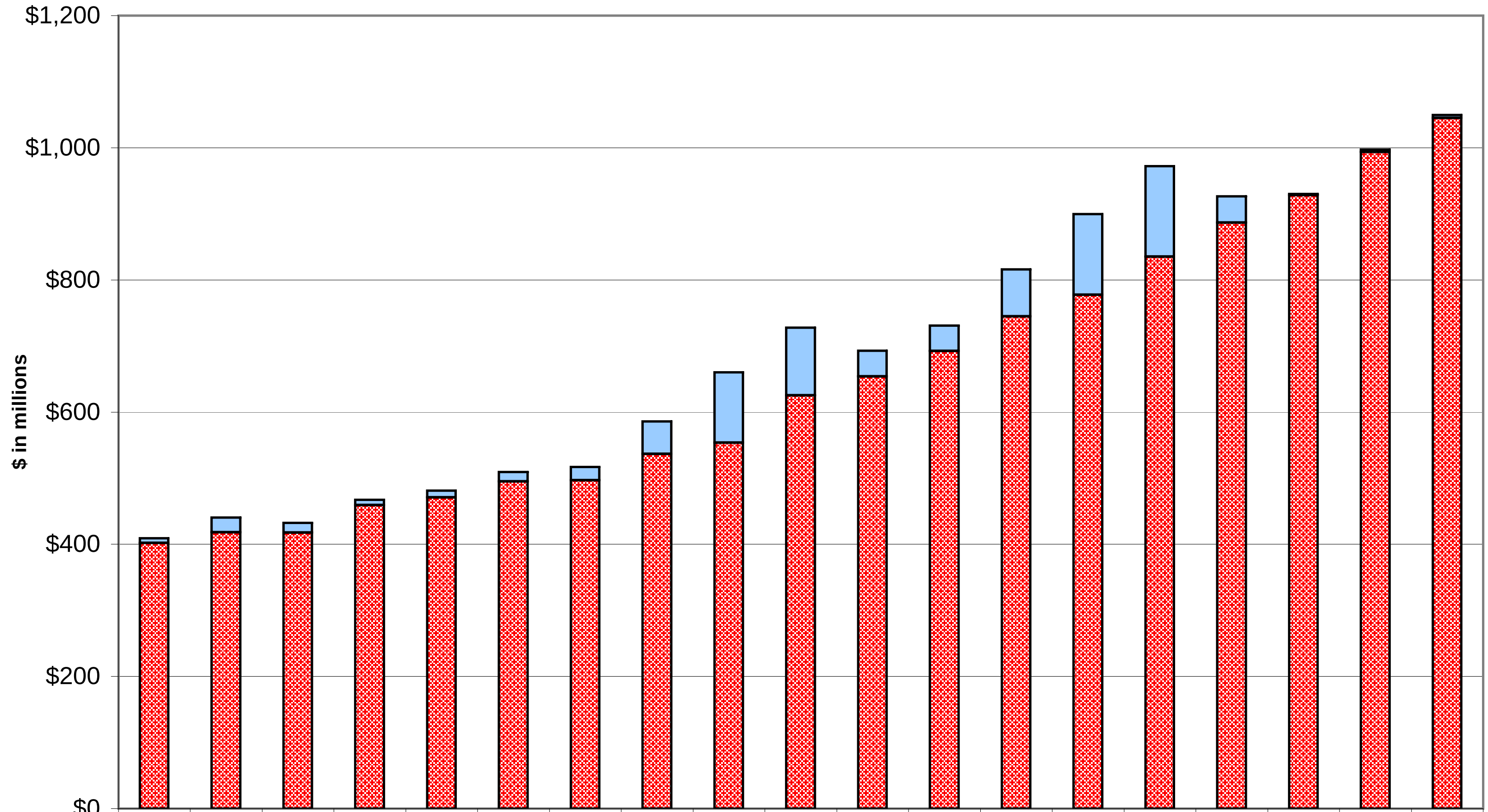
Projected Status of the Annuity Bond Fund

Graph 2.1
Annuity Bond Fund Sources
1997-2009 Actual, 2010-2015 Projections
as of September 2010



	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Federal Funds														0.9	9.1	10.8	10.8	10.8	10.8
General Fund	155.9	172.0	151.8	189.3	204.3	203.6	180.4	-	-	-	-	29.4	-	-	-	-	80.0	175.0	225.0
Miscellaneous Receipts	6.1	4.8	5.2	7.9	6.0	7.2	6.2	9.2	5.5	4.6	5.9	4.4	5.0	2.4	2.4	2.2	2.2	2.2	2.2
Transfer from prior year	9.7	7.3	22.6	14.7	8.2	10.2	14.1	20.3	49.0	106.3	102.6	38.7	38.3	71.3	122.2	136.9	39.8	1.6	3.5
Bond Premium-net of disc.	1.7	14.2	5.8	4.7	5.4	18.4	30.5	88.0	89.0	41.8	31.6	32.7	74.1	62.7	46.7	-	-	-	-
Property Tax Receipts	235.6	242.2	246.9	250.8	257.1	270.0	286.0	468.4	516.5	575.1	552.7	625.7	698.6	762.4	790.4	774.9	795.5	801.4	801.8

Graph 2.2
Annuity Bond Fund Uses
1997-2009 Actual, 2010-2015 Projections
as of September 2010



	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Transfer to next year	7.3	22.6	14.7	8.2	10.2	14.1	20.3	49.0	106.3	102.6	38.7	38.3	71.3	122.2	136.9	39.8	1.6	3.5	4.6
Debt Service	401.8	417.9	417.6	459.2	470.9	495.2	496.9	536.8	553.8	625.2	654.1	692.5	744.8	777.5	835.1	886.6	928.4	993.6	1,045.

Discussion of Recommendations

September 22, 2010

The Honorable Martin J. O'Malley
Governor of Maryland
State House
Annapolis, Maryland 21401

The Honorable Thomas V. M. Miller, Jr.
President of the Senate
Maryland General Assembly
State House
Annapolis, Maryland 21401

The Honorable Michael E. Busch
Speaker of the House
Maryland General Assembly
State House
Annapolis, Maryland 21401

Gentlemen:

The Capital Debt Affordability Committee, created pursuant to Section 8-104, *et seq*., of the State Finance and Procurement Article, is required to submit to the Governor and the General Assembly each year an estimate of the maximum amount of new general obligation debt that prudently may be authorized for the next fiscal year. The Committee is also required to submit an estimate of the amount of new academic facilities bonds that prudently may be authorized.

At this time, the Committee recommends a $925 million limit for new general obligation authorizations by the 2011 General Assembly to support the 2012 capital program. The Committee's projections for future authorizations assume level authorizations through 2016 of between $925 million and $955 million. In 2017 the projected authorization is $1,200 million and it increases by approximately 3% through 2020. With these authorization levels, the debt affordability ratios remain within the CDAC benchmarks of 4% debt outstanding to personal income and 8% debt service to revenues.

The motion to adopt this level specifically recognized that authorization levels proposed in the Governor's 2012 capital budget could be adjusted to reflect up-to-date economic and fiscal information and the Board of Revenue Estimate's December revenue estimates. Accordingly, the Capital Debt Affordability Committee will review its authorization in December 2010 and make any necessary modifications to its recommendation.

Based on its review of the condition of State debt in light of the debt affordability guidelines, the Committee recommends a limit of $27 million for new academic facilities bonds for the University System of Maryland for fiscal year 2012.

We are pleased to present to you the Committee's Annual Report, with the recommendations relating to the fiscal 2012 capital program.

Nancy K. Kopp
State Treasurer
Chair

Peter Franchot
State Comptroller

T. Eloise Foster, Secretary
Budget and Management

Beverley Swaim-Staley, Secretary
Department of Transportation

Paul B. Meritt
Public Member

Follow-up – Public Private Partnerships and the University System

UNIVERSITY SYSTEM OF MARYLAND

OFFICE OF ADMINISTRATION AND FINANCE

September 15, 2010

Ms. Patricia Konrad
Director
Maryland State Treasurer's Office
Division of Debt Management
Goldstein Treasury Building, Room 108
80 Calvert Street
Annapolis, Maryland 21401

Re: Public Private Partnerships for Student Housing

Dear Ms. Konrad:

At the August 11, 2010 meeting of the Capital Debt Affordability Committee, I mentioned that the USM was not currently pursuing public private partnerships for student housing because the high interest rates and additional financing costs make the projects unaffordable. The Committee asked that the USM consider a System-wide approach to lower the costs.

Another limiting factor, that I did not mention at the meeting, is the rating agencies' changing perspective on how these projects would impact a university's debt capacity. The USM has been concerned that the ratings agencies were beginning to see PPPs as "direct debt" of the USM.

I am attaching a March 2010 document from Moody's titled "Privatized Student Housing and Debt Capacity of US Universities". This document:

- Eliminates the category of "indirect debt"
- States that any PPP student housing project on university or foundation land will have some impact on USM credit
- Provides criteria (page 4) when a project would have a "strong impact" on our credit.

The USM's concern is that it appears our need for on-campus undergraduate housing would be viewed by Moody's as having a "strong impact" on our credit. This, of course, defeats the purpose of working with the private sector for housing.

We are taking the time to better assess our housing needs and better understand the changing views of the rating agencies. We will develop a plan to meet our housing needs in the most efficient way possible. During this process, we will consider a System-wide or multi-campus approach and keep you informed.

Sincerely,

James E. Sansbury
Associate Vice Chancellor for
Financial Affairs

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MOODY'S
INVESTORS SERVICE

SPECIAL COMMENT

Privatized Student Housing and Debt Capacity of US Universities

All Affiliated Projects Affect University Credit—Indirect Debt Classification Discontinued

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Summary Opinion

This special comment updates Moody's treatment of privatized student housing projects as contingent liabilities of affiliated U.S. universities. These types of projects[1] always affect an affiliated university's credit position because student housing is a strategic core business of most U.S. universities—an integral part of a university's student market position, financial management, and capital strategy. The ultimate credit impact of a privatized financing on a university will vary depending on the project specifics, including the project's strategic importance and the university's involvement with the project. It is important to note that the credit impact on a university may not be static, but could vary over the life of the project. Our rating approach applies to all university affiliated privatized projects, including newer structures being used to finance these projects, such as equity-based models, subordinate debt, and pooled trust structures.

Moody's will discontinue the use of the "indirect debt" category for privatized student housing projects due to the lack of transparency implied by this term and the complexity of the contingent aspects of these projects. Projects currently treated as "direct debt" will remain classified as such due to the more explicit strategic and contractual ties of the projects to affiliated universities. The direct debt category includes all direct borrowings by the university and component units of the university, capital leases, and a small number of privatized borrowings that effectively have similar characteristics to other direct obligations (i.e. separately secured debt of a subsidiary of an affiliated fundraising foundation). The discontinuation of the "indirect debt" category for privatized housing projects, affects only our ratio calculations, it does not change our analytical approach. We will continue to assess these projects for their impact on credit quality of the university.

[1] Excludes off-campus, non-affiliated student housing projects which are 100% developer financed, constructed, managed, and owned by a private developer. These projects are not located on land owned by the university or an affiliated foundation and then ground leased to a private developer.

Overview of the Privatized Student Housing Market

Many U.S. public universities, and even some private colleges, continue to expand student housing to meet growing demand despite a weak economy by utilizing privatized student housing transactions with third-party developers. In some cases, universities are motivated to keep financing for student housing "off-credit" in hopes of preserving the institution's core debt capacity. As Moody's has noted in the past, we view all privatized student housing transactions as affecting an affiliated university's credit position, although the impact can vary based on the project's specific characteristics.

Moody's currently maintains 38 public underlying ratings for 31 privatized student housing transactions based on their own credit, which represents $1.57 billion of debt outstanding. The median rating for these transactions is Baa3, with more than half of the underlying ratings in the Baa category. The ratings reflect the typical attributes of these projects: 100% debt financed, single asset collateral, debt service coverage in the 1.20 times range, construction risk at initial issuance, annual lease up risk, targeted tenant base, and affiliation with the university. For more information on Moody's ratings on privatized student housing transactions, please see our special comment from September 2009, "Privatized Student Housing Review: Strong Student Demand Underlies Solid Performance Despite Challenges in the Real Estate and Higher Education Sectors."

The structure of privatized student housing transactions varies, but in nearly all cases the affiliated university has no direct legal obligation to make debt service payments on the bonds issued to finance the project. Moody's does not opine on the efficacy of a particular model or structure, but instead evaluates the credit impact that a project will have on the affiliated rated university. In order to determine the impact, Moody's assesses the same risks that it would for a direct university-financed student housing project, including the university's involvement and strategic interests in the project (please see *Figure 1* below).

Most often, privatized projects are located on land owned by a university or its affiliated foundation and ground leased to a third-party (typically a separate not-for-profit, single purpose limited liability company). Until recently, most projects were 100% debt financed and construction risk was often partially mitigated with capitalized interest and a debt service reserve fund. Bondholders are expected to be repaid from net revenues of the project and, in most cases, excess revenues after payment of operating expenses and debt service flow to the affiliated university. Generally, the affiliated university receives title to the project at the end of the financing term.

More recently, Moody's has seen universities consider privatized student housing transactions that are structured differently from the traditional model. These transactions may be financed by the third-party developer's own equity, corporate level debt, or a combination of the two.

Categorization of Debt Liabilities

Moody's has historically utilized three categories to label the relative credit impact of a student housing financing on a college or university's credit position. In a few cases, we believe there is a very high likelihood the university will treat the project as its own facility and obligation, leading us to include the debt of the project as a "direct debt" similar to other debt obligations issued by the university. However, we have treated the vast majority of privatized housing financings as "indirect debt". This treatment reflected our conclusion that, despite the lack of legal obligation of the university to make debt service payments, these projects remained highly strategic to the university. Therefore, there remained a meaningful probability that the university would support the project in times of financial stress.

Credit rating reports on affiliated universities have discussed in some detail why these projects would be treated as indirect debt and how the relative importance in an institution's credit profile shifted based on project specific characteristics. For some projects that were either significantly less important to the university (i.e. a commercial development off-campus) or for some projects funded out of a third-party equity structure, we treated the debt as neither direct nor indirect debt, but continued to review the terms of agreements as well as the benefits and risks of the projects to the university as they evolved over time.

The credit impact of these projects varies according to the complex legal arrangements and strategic motivations of the affiliated university. For example, there are cases where a project treated as indirect debt has had little impact on our opinion of debt capacity or credit quality, while others had more significant impact. Because these analytical conclusions rarely lead to a rating change on the university and are not expressed in a quantitative measure, the use of the indirect categorization has not added to transparency around our credit opinions.

The use of these categorizations has encouraged over-simplification by external users of our ratios, leading many to artificially draw distinct conclusions about the relative credit effects of a project that is classified as "direct debt" compared to one that is "indirect debt"; or, the differences in credit impact between "indirect debt" and no-debt treatment. For example, market participants might conclude that projects that are not classified as direct or indirect debt "have no impact" on the university credit position, debt capacity or rating. Or, market participants might conclude that two projects treated as "indirect debt" have exactly the same impact on debt capacity and credit quality. These incorrect conclusions might be reached despite our long standing view that all material projects and financial transactions are included in our rating analysis and affect a university's credit position to varying degrees depending on the project's specific characteristics.

Discontinuation of Indirect Debt Category for Privatized Student Housing

In order to avoid the potential for reduced rating transparency and incorrect conclusions of our analysis of these projects, the use of the "indirect debt" category for privatized housing projects will no longer be used by Moody's. Projects currently treated as "direct debt" will remain classified as such due to the more explicit strategic and contractual ties of the projects to affiliated universities. This change is an adjustment to our ratio calculations and labeling, but not a methodology change.

We will continue to view privatized student housing projects as part of the financial and market position of affiliated universities. We will also continue to monitor the effects of the projects on university behavior—specifically assessing ways in which universities might support them including direct financial support as well as other means of support, such as marketing, shuttle service to campus, etc. As more fully discussed below, the relative credit impacts of these projects will continue to vary based on the details of each organization, project economic, financing terms, and management team capabilities.[2]

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2 We will continue to utilize the indirect debt concept to capture the use of operating leases and unfunded defined benefit pension obligations (see Moody's Views on "Not-For-Profit Healthcare: Capital Access: Moody's View on Operating Leases: Off Balance Sheet But On Credit", August 2004).

FIGURE: 1

Impact on Credit Quality/Analysis

PROJECT CHARACTERISTIC	LIMITED IMPACT	MODERATE IMPACT	STRONG IMPACT
Location	Project located off-campus and not adjacent to campus	Project located on campus or adjacent to campus	Project located in central on-campus location amid university-owned student housing
Ground Lease	Housing not constructed on university or foundation owned land	University or foundation owns underlying land which is ground leased to a third-party	University or foundation owns underlying land which is ground leased to a third-party
Share of Student Residences	Project is minimal amount of student housing (less than 10%)	Project is meaningful amount of student housing (10-30%)	Project is strategic component of student housing (over 30%)
Student Market Segment	Project is not limited to university use	Project is intended to house upperclassmen, graduate, or professional students	Project is intended to house undergraduate students, especially freshmen
Student Services	No university services available at project	Some minor university services available such as shuttle bus	Similar services available as at other university housing
Rental Rates	No university involvement in setting rental rates	University involvement in setting rental rates along with third-party	University substantially controls rental rates
Marketing and Management	No university involvement in management, marketing, or directing students	University involved in management, marketing, or directing students	University markets project as on-campus housing and manages housing
Project Assistance	No direct/indirect assistance	University assists the project to obtain tax-exempt status	University assists the project in obtaining access to same utility rates and other public services as university-owned student housing
Cash Flow	University does not receive residual cash flow or project at end of financing term	University receives residual cash flow or project at end of financing term	University receives previously established cash flow (not dependent on project performance) and/or is required to purchase project at end of financing term
Construction Risk	No interim or other type of financing extended from university or foundation to developer	Implicit university oversight of the project is an important aspect of mitigation of construction risk	Interim loan to construct the facility eliminating construction and lease up risk
Non-Compete Clause	University does not enter into non-compete clause	University agrees to limited lease up or occupancy tests in privatized housing before building additional housing	University agrees to stringent lease up or occupancy tests in privatized housing before building additional housing
Guarantees and Support Agreements	No university guarantee regarding minimum beds or rent levels; no first fill policy or support agreement; if the university markets the privatized student housing project, it is distinguished from other university housing options	Privatized housing is marketed along with university housing with minimal differentiation in the status of the housing; university agrees to recommend housing to students who are on waiting list.	University enters into minimum bed or rent guarantee, first fill policy, or support agreement
Other	No action taken to enforce payment of rental fees on privatized student housing	University offers option to have financial aid applied directly to rental housing payments, but does not take other action if payment is not made	University requires that financial aid be applied to rental payments and withholds transcripts if rental payments are not made on a timely basis

University Credit Impact Varies Based on Specific Project Characteristics

Moody's believes that affiliated privatized student housing projects always impact the credit profile of an affiliated university to some degree. This conclusion holds for the more traditional as well as newer models of privatization that use equity or corporate level debt of a third party to finance the transaction. In Moody's view, the absence of project-level debt alone does not imply that there is no credit impact, particularly if the project can be leveraged in the future.

In assessing the credit impact of a privatized student housing project, Moody's takes into account the project's structure, strategic ties of the affiliated university, the university's role in the project (i.e. setting rent, marketing the project to students, managing the facility), and certain legal considerations. In the table above, Moody's has outlined the most important factors it considers when assessing the credit impact of a privatized student housing project on an affiliated university. The presence of one or more factors that fall into the "strong" category creates greater credit impact on the university.

It is important to note that the credit impact on a university may not be static, but could vary over the life of the project. When a privatized student housing project is meeting its occupancy and performance targets, the credit impact on the affiliated institution is modest and can even be neutral depending on the consistency of operations. However, many privatized projects are vulnerable to volatile performance. When a project is not performing as planned, it will often force the university to consider taking various actions to stabilize what is usually considered a strategic asset with an impact on student market position. These decisions could well result in the university choosing to commit financial, management, or operational resources that would have otherwise been allocated to other programs, even in the absence of any legal requirement to do so.

Conclusion

We will continue to evaluate privatized student housing projects on a case-by-case basis to determine the credit impact on the affiliated university. The depth of our analysis will depend on the size of the project and the importance relative to the university's overall housing stock and strategic plans, consistent with our existing approach outlined in our special comment from October 2006, "Privatized Student Housing & Debt Capacity: Direct & Indirect Impacts on Affiliated University." We will discontinue use of the "indirect debt" category for privatized housing projects that are not so closely aligned as to warrant treatment equivalent with directly issued debt of the university. As we have in the past, in all cases we will continue to pay particular attention to the specific terms of the agreements between universities and third-party managers, developers, or owners of privatized student housing to evaluate the credit implications.

Key Questions that Form Moody's Approach to Analyzing Credit Risks of These Transactions

When analyzing the credit impact of privatized student housing projects, Moody's applies a standard set of questions to guide our review.

1. Is this a financial transaction entered into purely for potential revenues or is it for the development of a facility that is part of the strategic needs of the organization?

   If the project is entered into with an investment mindset, the university may be more likely to cut losses and allow the project to fail. If it is a necessary part of long-term plans, the university may choose to become more involved, rather than less.

2. How "core" is the project to the mission, market position, and operation of the university?

   If the project is seen as a core part of the development and growth of the organization, it is unlikely that the university would not support a struggling project.

3. What direct benefits does the university gain from the proposed structure of the financing?

   Moody's evaluates the likely benefits from the endeavor, including potential revenue streams, indirect market enhancements, and potential for long-term growth in value of facility.

4. What is the likelihood that the project will run into challenges or not meet expectations?

   The more aggressive the assumptions built into the financing plans, the more likely the university may need to support the project.

5. What would the university likely do if the project were to struggle/fail?

   Often, despite no legal requirement to support a project, universities decide early in the process that they would be willing to take steps to support a project. In these cases, debt capacity impact is likely to be larger.

6. What direct covenants and obligations has the university taken on within the various legal agreements between the university and other parties?

   Often, the university may insert some direct control of aspects of projects, including a role in influencing pricing of rental rates.

   Conversely, has the university agreed to any covenants that are limiting, such as non-compete or first-fill provisions.

Related Research:

- » Public-Private Partnerships in U.S. Higher Education, June 2008 (109385)
- » Privatized Student Housing and University Support, January 2007 (101436)
- » Privatized Student Housing & Debt Capacity, October 2006 (100310)
- » Privatized Student Housing Review: Strong Student Demand Underlies Solid Performance Despite Challenges in the Real Estate and Higher Education Sectors, September 2009 (119733)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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