

J00A04
Debt Service Requirements
Maryland Department of Transportation

Operating Budget Data

(\$ in Thousands)

	FY 08	FY 09	FY 10	FY 09-10	% Change
	<u>Actual</u>	<u>Working</u>	<u>Allowance</u>	<u>Change</u>	<u>Prior Year</u>
Special Fund	\$118,987	\$141,934	\$159,698	\$17,764	12.5%
Adjusted Special Fund	\$118,987	\$141,934	\$159,698	\$17,764	12.5%
Adjusted Grand Total	\$118,987	\$141,934	\$159,698	\$17,764	12.5%

- The fiscal 2010 allowance for debt service payments totals \$159.7 million – an increase of \$17.8 million, or 12.5%, compared to the fiscal 2009 working appropriation.
- The January 2008 financial forecast assumed \$370 million Consolidated Transportation Bonds (CTBs) would be issued in fiscal 2009; however, the department is currently planning to sell \$415 million in CTBs. The department assumes \$410 million in CTB debt will be issued in fiscal 2010.
- The total amount of CTB debt outstanding at the end of fiscal 2010 is expected to total approximately \$1.9 billion and nontraditional debt will total \$661.8 million.

Note: Numbers may not sum to total due to rounding.

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Analysis in Brief

Major Trends

Large Bond Sales in Fiscal 2009 and 2010 Are Followed by Moderately Sized Sales: To maintain as much of the capital program as possible during the recession, the Maryland Department of Transportation (MDOT) has decided to issue \$415 and \$410 million in debt for fiscal 2009 and 2010, respectively. To achieve these bond sales, MDOT has moved below the 2.5 times administrative level for its coverage ratios, falling to 2.1 times in fiscal 2011. Based on MDOT's forecast, a return to coverage ratios in excess of 2.5 is estimated to occur in fiscal 2014.

Issues

Risks Associated with Forecast Debt Assumptions: The department's revenue and operating budget forecasts may not come in at estimated levels, and as a result, the department may fall below the 2.0 times net income coverage ratio. Based upon the agreement with bondholders, MDOT could not issue any additional debt until it returns above the 2.0 times coverage ratio. Returning to the agreed upon coverage ratio could involve increasing revenue, reducing operating spending, or a combination thereof. **The Department of Legislative Services recommends that the fiscal 2010 bond sale be reduced by \$250 million to afford some level of a hedge against falling below the 2.0 coverage ratio.**

Operating Budget Recommended Actions

1. Add annual language limiting the total amount of Consolidated Transportation Bonds outstanding at the end of fiscal 2010.
2. Add language limiting the total amount of nontraditional debt outstanding at the end of fiscal 2010.
3. Add annual language requiring the submission of information concerning nontraditional debt outstanding.

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Budget Analysis

Program Description

Consolidated Transportation Bonds

The Maryland Department of Transportation (MDOT) issues 15-year Consolidated Transportation Bonds (CTB), which are tax-supported debt. Bond proceeds are dedicated for construction projects. Revenues from taxes and fees and other funding sources are combined in the Transportation Trust Fund (TTF) to pay debt service and operating budget requirements and to support the capital program. Debt service on CTBs is payable solely from the TTF.

Nontraditional Debt

MDOT also uses nontraditional debt, which is any debt instrument that is not a CTB or a Grant Anticipation Revenue Vehicle (GARVEE) bond. This includes, but is not limited to, Certificates of Participation (COP), debt backed by customer facility charges, passenger facility charges, or other revenues, and debt issued by the Maryland Economic Development Corporation (MEDCO), the Maryland Transportation Authority (MDTA), or any other third party on behalf of MDOT.

Proposed Budget

The fiscal 2010 allowance for CTB debt service payments totals \$159.7 million, an increase of \$17.8 million, or 12.5%, compared to the fiscal 2009 working appropriation. The increase is largely due to increased interest payments associated with the fiscal 2009 and 2010 bond sales. There is a \$12.3 million increase in interest payments due to a full year's interest being paid on the fiscal 2009 bond sale. In addition, there is a \$6.9 million increase in interest payments associated with the fiscal 2010 bond sale. The two largest debt service payments for the fiscal 2010 allowance are for the 2003 series which totals \$44.5 million and the 2004 series which totals \$48.3 million.

Department Lowers Coverage Ratio So That More Debt Can Be Issued

State law and agency debt policies limits CTB issuances with three criteria: a debt outstanding limit and two coverage tests. The debt outstanding limit is set in statute and is periodically increased to reflect the revenue growth and potential of the TTF. The debt outstanding limit was increased in Chapter 6 of the 2007 special session from \$2.0 billion to \$2.6 billion as a result of the increase in transportation revenues. CTBs count under State debt affordability limits, and thus are evaluated annually by the Capital Debt Affordability Committee.

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The two coverage tests used by the department are established in the department's bond resolutions and mandate that the department's annual net income and pledged taxes from the prior year must each be at least two times greater than the maximum level of future debt service payments. The department has adopted an administrative policy that requires a minimum coverage of 2.5 times. The income coverage test is the ratio of all the prior year's income (excluding federal capital, bond proceeds, and third-party reimbursements) minus prior-year operating expenses, to maximum annual future debt service and typically is the limiting coverage ratio. The pledged taxes coverage test measures annual net revenues from vehicle excise, motor fuel, sales, and corporate taxes (excluding refunds and all statutory deductions) as a ratio of maximum future annual debt service.

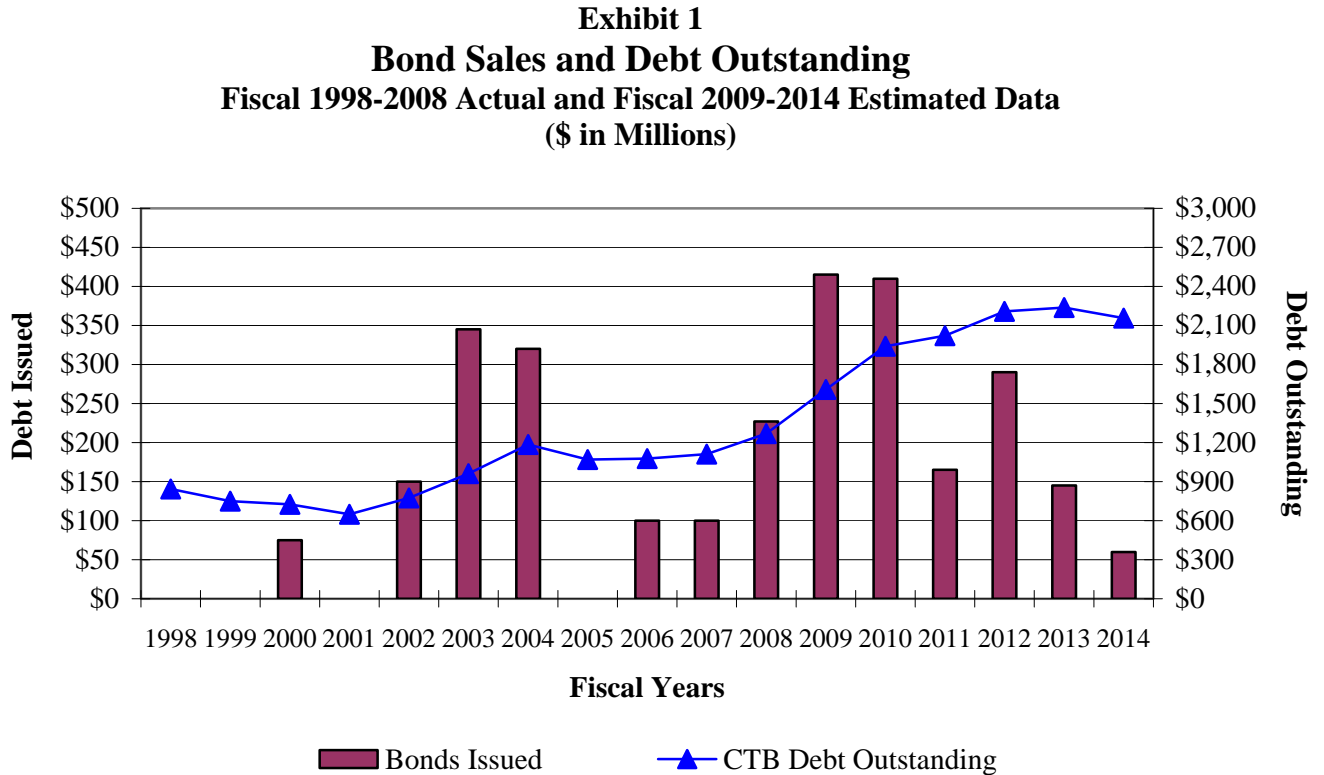
The fiscal 2009 bond sale will raise the total amount of debt outstanding to approximately \$1.6 billion and the bond coverage ratio in fiscal 2009 is estimated to be 5.7 times for pledged taxes and 2.5 times for the net revenues test. In fiscal 2010, the level of debt outstanding is expected to increase to \$1.9 billion with coverage ratios decreasing to 5.3 times for pledged taxes and 2.3 times for the net revenue test. The decline in the coverage ratio for fiscal 2010 is due to revenues declining and the department deciding to increase the issuance of debt to maintain as much of the capital program as possible, which increases debt service payments.

The General Assembly places annual limits on the total debt outstanding at the end of the current and subsequent fiscal years. Statute also limits debt issuance over the six-year forecast period to ensure that transportation debt is managed prudently. Based on current revenue projections, MDOT will be able to manage its CTB debt outstanding within the mandates set by the General Assembly in fiscal 2009 and 2010.

Section 3-202 of the Transportation Article requires the General Assembly to add annual budget bill language limiting the level of maximum CTB debt outstanding. It is recommended that the limit be set at \$1.691 billion in fiscal 2010.

Historical Trend in CTB Debt

Exhibit 1 shows annual new CTB issuances and net debt outstanding from fiscal 1998 through 2014.



CTB: Consolidated Transportation Bonds

Source: Maryland Department of Transportation, January 2009

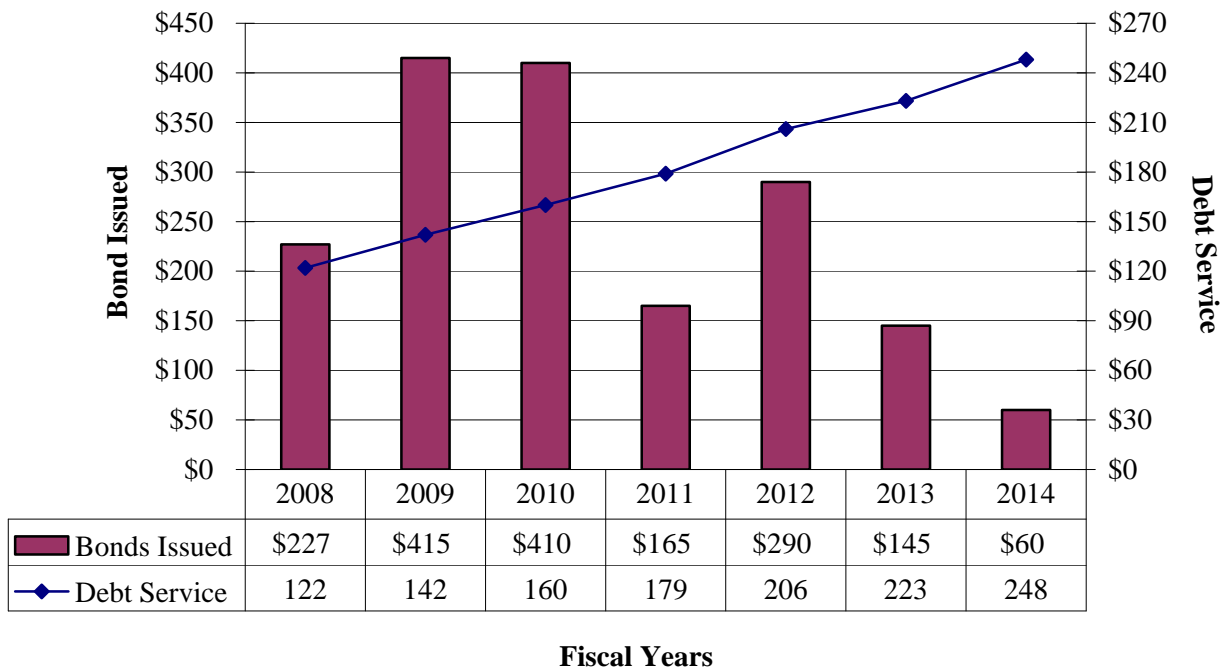
From fiscal 1998 to 2001, bond issuances were limited as revenue growth exceeded estimates thus diminishing the need for debt to support the capital program. The reduced level of debt issuances resulted in debt outstanding decreasing from roughly \$925 million in fiscal 1997 to a low of \$650 million in fiscal 2001. Debt issuances in fiscal 2003 and 2004 increased as revenues were diverted from the TTF to the general fund to help balance the budget. In addition, MDOT was beginning to expand its capital program at this time. As a result of the increased debt issuances, debt outstanding increased to approximately \$1.2 billion in fiscal 2004.

As a result of the registration fee increase passed during the 2004 session and the corresponding phase-in of increased capital spending, debt issuances were limited from fiscal 2005 to 2007. Throughout this time, the department also built up a significant cash balance that could be drawn down instead of issuing debt. In fiscal 2008, \$227 million in debt was issued for the capital program.

CTB Debt Outlook

Due to the downturn in revenues and a desire to maintain as much of the capital program as possible, the department is planning debt issuances of \$415 and \$410 million in fiscal 2009 and 2010, respectively. As indicated earlier, to issue this level of debt, the department has elected to go below the administrative level of 2.5 times for the net income coverage ratios. Future bond issuances continue throughout the six-year capital program; however, they are moderated as the department returns to a coverage ratio of 2.6 times in fiscal 2014. **Exhibit 2** details bond issuances and debt service payments for each fiscal year of the planning period. Debt service will increase throughout the forecast period due to the payments on fiscal 2009 and 2010 debt.

Exhibit 2
Debt Service Payments and Bond Issuances
Fiscal 2008 Actual Data and Fiscal 2009-2014 Estimated Data
(\$ in Millions)



Source: Maryland Department of Transportation

Nontraditional Debt

In addition to CTB, the department uses nontraditional debt. Nontraditional debt is any instrument that is not a CTB or a GARVEE bond. This includes, but is not limited to COPs, debt backed by customer facility charges, passenger facility charges, or other revenues, and debt issued by MEDCO or MDTA on behalf of MDOT.

Exhibit 3 shows that the department currently has nine nontraditional debt issuances outstanding. These issuances are projected to have a combined total of \$661.8 million in unpaid principal outstanding at the end of fiscal 2010.

The General Assembly began placing limits on COP in fiscal 2002 and then all of MDOT’s nontraditional debt in fiscal 2005. The limits placed on nontraditional debt are consistent with the limits placed on CTBs. The General Assembly limited the amount of nontraditional debt outstanding to the amount proposed by the department during the legislative session. If the agency finds that circumstances warrant additional issuances, the department must report to the budget committees on any proposed debt and provide the committees with 45 days to review and comment on the proposal. **It is recommended that the General Assembly continue its policy to limit total nontraditional debt outstanding. It is also recommended that the limit be established at \$661.8 million at the end of fiscal 2010.**

Exhibit 3
Nontraditional Debt Outstanding and Debt Service Payments
(\$ in Thousands)

<u>Year Issued and Maturity</u>	<u>Amount Issued</u>	<u>Principal Outstanding (06/30/10)</u>	<u>FY 2010 Debt Service Payment</u>	<u>Purpose</u>
Certificates of Participation				
1999-2025	\$42,750	\$20,070	\$2,291	Expand Pier B and a de-icing facility at the Baltimore/Washington International Thurgood Marshall (BWI Marshall Airport).
2000-2025	33,000	13,390	1,256	Construction of a parking garage at Maryland Rail Commuter/Amtrak station near BWI Marshall Airport.
2004-2016	15,500	9,000	1,614	Purchase buses for parking garage shuttle operations at BWI Marshall Airport.
2006-2024	26,530	23,830	1,959	Construction of a paper shed at South Locust Point.
Subtotal	\$117,780	\$66,290	\$7,120	

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<u>Year Issued and Maturity</u>	<u>Amount Issued</u>	<u>Principal Outstanding (06/30/10)</u>	<u>FY 2010 Debt Service Payment</u>	<u>Purpose</u>
Maryland Transportation Authority Revenue Bonds				
2002-2027	264,075	220,575	20,746	Construction of Elm Road parking garage near BWI Marshall Airport, roadway improvements, enhanced pedestrian access, and upgrading of utility plants. Bonds backed by parking fees.
2002-2032	117,345	105,855	9,070	Construction of consolidated rental car facility at BWI Marshall Airport. Bonds back by customer facility charge of \$3.25 per vehicle rental per day.
2003-2013	69,700	42,300	11,682	Additional construction at BWI Marshall Airport, including roadway improvements, installation of pedestrian skywalks, and work on taxiway parallel to runway. This issue has a floating interest rate structure. Bonds backed by passenger facilities charges.
Subtotal	\$451,120	\$368,730	\$41,498	
Maryland Economic Development Corporation Debt				
2002-2022	36,000	25,775	2,902	Construction of new Maryland Department of Transportation headquarters building.
2003-2030	223,660	201,015	16,708	Construction of a new 11-gate Concourse A and reconstruction of a portion of Concourse B at BWI Marshall Airport.
Subtotal	\$259,660	\$226,790	\$16,708	
Total	\$834,215	\$661,810	\$68,228	

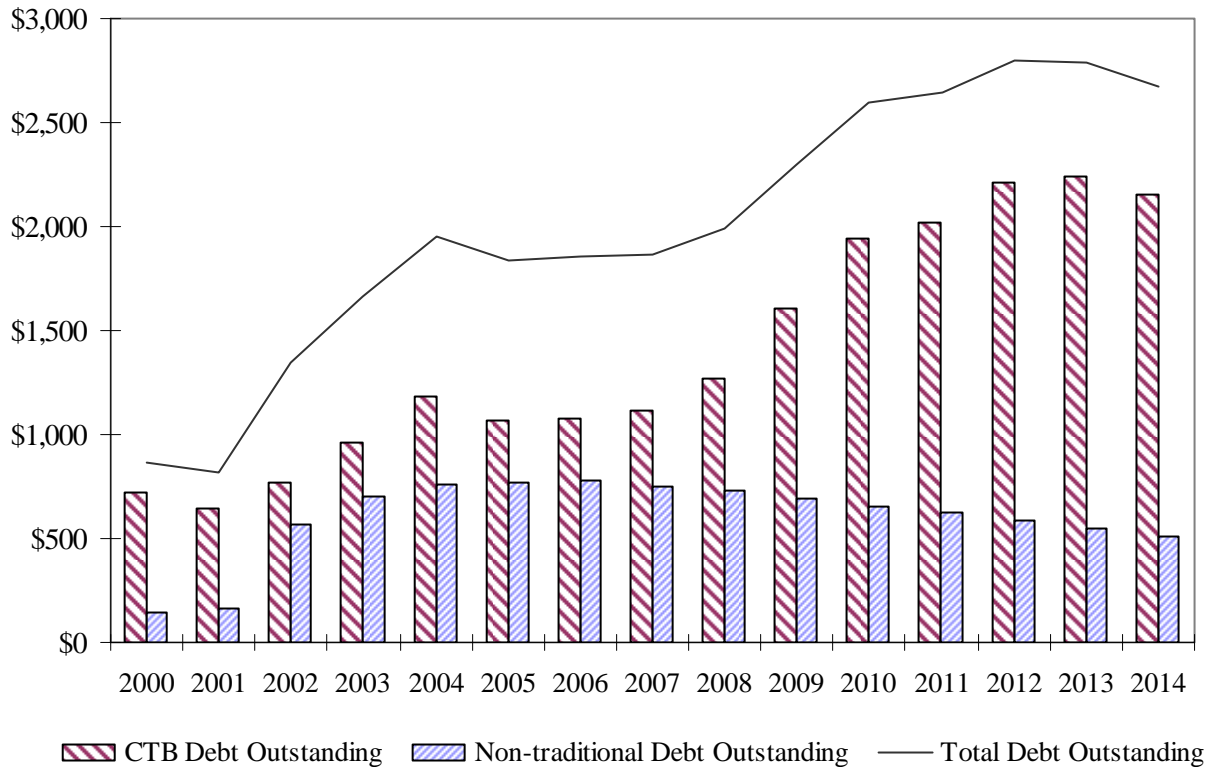
Source: Maryland Department of Transportation, January 2009

The General Assembly annually requires that MDOT report to the budget committees on nontraditional debt when it releases its September and January forecasts. Specifically, the language requires that MDOT report on the outstanding and proposed issuances, debt service costs, and annual debt outstanding. The report should cover the current fiscal year and the following 10 fiscal years. **It is recommended that the General Assembly again require that the department report on the costs of nontraditional debt when it releases its September and January forecasts.**

Total Debt Outstanding

Exhibit 4 shows that MDOT’s total debt outstanding from all sources is expected to increase 207% from \$868 million in fiscal 2000 to \$2.7 billion in fiscal 2014. The percent of total debt outstanding that comes from nontraditional debt is expected to total 25.2% in fiscal 2010. While this is higher than the 17.2% in fiscal 1999, the level of nontraditional debt peaked in fiscal 2006 and has slowly decreased since – as there has been only one nontraditional debt issuance since 2003. In fiscal 2014, CTB and nontraditional debt outstanding is estimated to total \$2.7 billion, with CTB debt outstanding totaling approximately \$2.2 billion.

Exhibit 4
Growth in Maryland Department of Transportation’s Total Debt
Fiscal 2000-2008 Actual Data and Fiscal 2009-2014 Estimated Data
(\$ in Millions)



CTB: Consolidated Transportation Bonds

Source: Maryland Department of Transportation, January 2009

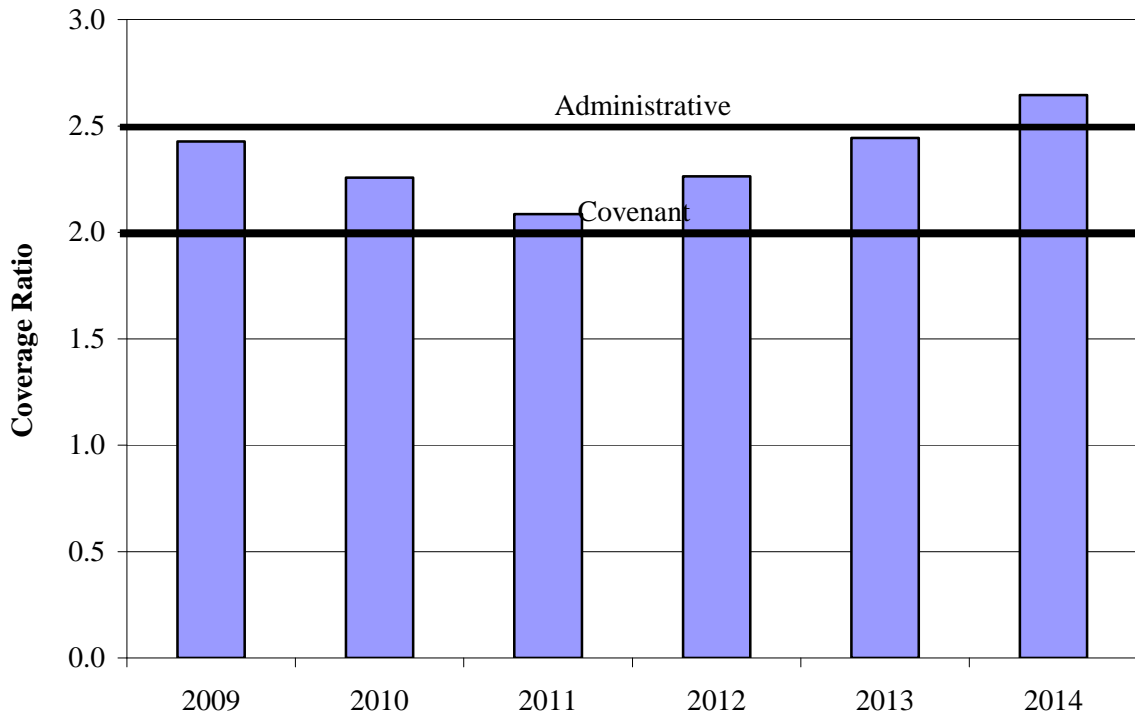
Issues

1. Risks Associated with Forecast Debt Assumptions

Due to the downturn in the economy, the department’s ability to issue debt to support the capital program has been reduced. Historically, the department had maintained a 2.5 times threshold as a prudent measure against a revenue downturn and falling below the 2.0 times level. However, the department elected to go below the administrative level of 2.5 times for the net income test to preserve as much of the capital program as possible and to keep projects moving during the recession.

Exhibit 5 highlights what the department forecasts the net income test will be over the six-year forecast period.

Exhibit 5
Net Income Coverage Ratio
Fiscal 2009-2014



Source: Department of Legislative Services

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The administrative level is in place to provide a hedge against unexpected revenue losses. However, there are risks associated with going below the administrative level and moving so close to the 2.0 ratio in fiscal 2011. Specific issues include:

Revenues May Be Less Than Estimated: To the extent fiscal 2010 revenues are revised downward, this will impact the level of net income used in the fiscal 2011 calculation, and the department could go below the 2.0 times coverage ratio. To offset reduced revenues, the department may need to reduce bond sales and the capital program, reduce operating budget spending, or raise revenues. The department has employed a revenue hedge in fiscal 2010 that can be used to offset a potential decline in revenues; however, if the decline is steep enough, the hedge may be insufficient.

Operating Budget Expenditures May Be More Than Estimated: Similar to revenues, if the operating budget is higher than expected then the amount of net income is reduced. As a result, MDOT may go below the 2.0 times coverage ratio. The department also has an operating budget hedge that can be used to offset unexpected expenditures and can reduce overall operating budget spending. The Department of Legislative Services (DLS) is concerned that the operating budget may not sufficiently fund the ongoing operations of the department. For example, the Maryland Transit Administration (MTA) is presenting a revised spending plan, that when reflected in MDOT's financial forecast, drops the coverage ratio to 2.019 in fiscal 2011.

Implications of Dipping Below 2.0 Times Coverage Ratio

There is the risk that MDOT may drop below the 2.0 times net income coverage test in the short-term. Based upon the agreement with the bondholders, MDOT would not be able to issue any additional bonds if it cannot maintain the 2.0 times coverage for each of the two tests. This means that the department would need to make additional reductions to the capital program. In addition, the department may need to raise revenue or reduce its operating budget or a combination thereof to move above the 2.0 times coverage ratio.

Bondholders may go to the courts to seek a remedy; however, MDOT advises they would not have a cause of action against MDOT unless the debt service payments could not be made. MDOT is not in danger of not making the debt service payment in a given fiscal year; the issue is that if MDOT goes below 2.0 times it can not issue more debt.

Another potential outcome of MDOT going below the 2.0 times coverage ratio is that the rating agencies could downgrade the rating on MDOT's debt issuances. A downgrade in MDOT's rating would increase the interest rate and the amount of interest MDOT must pay on the debt issued once MDOT could issue debt again. This in turn would reduce the level of cash available for the capital program. MDOT indicates, however, that the rating agencies may not downgrade MDOT's debt since the financial plan shows MDOT returning to the administrative coverage ratio level of 2.5 times. DLS notes that MDOT's out-year forecast is based on a combination of strong revenue growth and low operating spending growth relative to actual spending trends. If actual future performance does not mirror the agency's forecast, it is unlikely that the debt coverage ratios will reach 2.5.

Conclusion and Recommendations

The purpose of the 2.5 times administrative level for the net revenues coverage ratio was to provide a hedge against dramatic downturns in revenue or upswings in spending. By going below the administrative level, the hedge no longer exists, and there are concerns regarding MDOT's estimates of revenue and expenditures. This is reflected in a fiscal 2011 coverage ratio of 2.019 when accounting for MTA's adjusted spending. The decisions on spending and debt made in fiscal 2010, coupled with revenues, will determine whether MDOT drops below the 2.0 times coverage ratio and as a result will not be able to issue more debt in fiscal 2011. The budget committees can control debt issuances and operating budget spending and may want to consider reducing the bond sale in fiscal 2010 to provide a hedge against revenue and expenditure uncertainty. For example, based upon the current estimates of revenue and expenditures in the financial forecast, if MDOT eliminated the fiscal 2010 bond sale entirely, it would fall just short of the 2.5 times coverage ratio in fiscal 2011. Reducing the bond sale by \$250 million in fiscal 2010 would result in a coverage ratio of 2.3 times in fiscal 2011 and provide a hedge against further downward revenue revisions downs or unexpected spending.

DLS recommends that the fiscal 2010 bond sale be reduced by \$250 million to afford some level of hedge against dropping below the 2.0 coverage ratio. The reduction in bond sales would result in a reduction to the fiscal 2010 capital budget of \$250 million while increasing the net income coverage test to 2.5 times in fiscal 2010 and 2.3 times in fiscal 2011.

Operating Budget Recommended Actions

1. Add the following language:

Consolidated Transportation Bonds may be issued in any amount provided that the aggregate outstanding and unpaid balance of these bonds and bonds of prior issues shall not exceed \$1,691,000,000 as of June 30, 2010. Provided, however, that the debt service will be reduced by any proceeds generated from net bond sale premiums. To achieve this reduction, the Maryland Department of Transportation may either use projected proceeds from bond sale premiums to reduce the size of the bond issuance or apply the proceeds from the premium to debt service for that bond issuance provided that those revenues are recognized by the department and reflected in the Transportation Trust Fund forecast.

Explanation: Section 3-202 of the Transportation Article requires the General Assembly to establish the maximum debt outstanding each year in the budget bill. The level will be based on outstanding debt as of June 30, 2009, plus projected debt issued during fiscal 2010 in support of the transportation capital program. Although the committees recognize the importance of stimulating the economy and addressing infrastructure needs, the consequence of falling the 2.0 times coverage ratio could have greater impacts on the capital program, the ability to issue future debt, and the cost of any future debt. This reduction in the debt outstanding would result in a reduction to the capital budget of \$250 million while increasing the net income test to 2.5 times in fiscal 2010 and 2.3 times in fiscal 2011.

2. Add the following language:

The total aggregate outstanding and unpaid principal balance of nontraditional debt, defined as any debt instrument that is not a Consolidated Transportation Bond or a Grant Anticipation Revenue Vehicle bond issued by the Maryland Department of Transportation (MDOT), may not exceed \$661,810,000 as of June 30, 2010. Provided, however, that in addition to the limit established under this provision, MDOT may increase the aggregate outstanding unpaid and principal balance of nontraditional debt so long as:

- (1) MDOT provides notice to the Senate Budget and Taxation Committee and the House Committee on Appropriations stating the specific reason for the additional issuance and providing specific information regarding the proposed issuance, including information specifying the total amount of nontraditional debt that would be outstanding on June 30, 2010, and the total amount by which the fiscal 2010 debt service payment for all nontraditional debt would increase following the additional issuance; and
- (2) the Senate Budget and Taxation Committee and the House Committee on Appropriations have 45 days to review and comment on the proposed additional issuance before the publication of a preliminary official statement. The Senate Budget and Taxation Committee and the House Committee on Appropriations may hold a public hearing to discuss the proposed increase and must signal their intent to hold a hearing within 45 days of receiving notice from MDOT.

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Explanation: This language limits the amount of nontraditional debt outstanding at the end of fiscal 2010 to the total amount that is projected to be outstanding from all previous nontraditional debt issuances as of June 30, 2009, and all anticipated sales in fiscal 2010. The language allows MDOT to increase the amount of nontraditional debt outstanding in fiscal 2010 by providing notification to the budget committees regarding the reason that the additional issuances are required.

Information Request	Author	Due Date
Justification for increasing nontraditional debt outstanding	MDOT	45 days prior to the publication of a preliminary official statement

3. Add the following language:

The Maryland Department of Transportation (MDOT) shall submit with its annual September and January financial forecasts information on (1) anticipated and actual nontraditional debt outstanding as of June 30 of each year; and (2) anticipated and actual debt service payments for each outstanding nontraditional debt issuance from fiscal 2009 through 2020. Nontraditional debt is defined as any debt instrument that is not a Consolidated Transportation Bond or a Grant Anticipation Revenue Vehicle bond; such debt includes, but is not limited to, Certificates of Participation, debt backed by customer facility charges, passenger facility charges, or other revenues, and debt issued by the Maryland Economic Development Corporation or any other third party on behalf of MDOT.

Explanation: The budget committees are interested in monitoring the use of nontraditional debt by MDOT. The information requested provides the budget committees with additional information on the usage and annual costs of nontraditional debt.

Information Request	Author	Due Date
Nontraditional debt outstanding and anticipated debt service payments	MDOT	With September forecast With January forecast

Current and Prior Year Budgets

**Current and Prior Year Budgets
Debt Service Requirements
(\$ in Thousands)**

	<u>General Fund</u>	<u>Special Fund</u>	<u>Federal Fund</u>	<u>Reimb. Fund</u>	<u>Total</u>
Fiscal 2008					
Legislative Appropriation	\$0	\$128,319	\$0	\$0	\$128,319
Deficiency Appropriation	0	0	0	0	0
Budget Amendments	0	0	0	0	0
Reversions and Cancellations	0	-9,332	0	0	-9,332
Actual Expenditures	\$0	\$118,987	\$0	\$0	\$118,987
Fiscal 2009					
Legislative Appropriation	\$0	\$141,934	\$0	\$0	\$141,934
Cost Containment	0	0	0	0	0
Budget Amendments	0	0	0	0	0
Working Appropriation	\$0	\$141,934	\$0	\$0	\$141,934

Note: Numbers may not sum to total due to rounding.

Fiscal 2008

Actual expenditures for debt service payments were \$9.3 million less than the appropriation due to the amount of fiscal 2008 bond sales being less than originally projected.