

# **Frequently Asked Questions About PA's Debt**

Pennsylvania recently borrowed more than \$811 million from the bond market. In light of this borrowing, and given the attention focused during the summer on the national debt ceiling, we hope that the information in this document will enhance your understanding of Pennsylvania's debt and borrowing.

Pennsylvania has solid bond ratings and its debt burden is considered low based on the standard metrics used by national bond rating agencies.

## Q: Does Pennsylvania borrow or issue bonds to pay for its budget, like the U.S. government?

**A:** Pennsylvania does not borrow for its operating budget. The state constitution does allow for temporary borrowing within a fiscal year to deal with cash flow issues, since much of the tax revenues are paid later in the fiscal year. These loans, known as tax anticipation notes, must be repaid by the end of the fiscal year, and can only be paid from current year revenues.

## Q: What does Pennsylvania do with the money it borrows?

**A:** The state constitution lays out several purposes for which the commonwealth can incur direct debt, as follows:

- 1. To suppress insurrection or for disaster relief.
- 2. To manage cash flow with tax anticipation notes.
- 3. To refund existing debt.
- 4. For purposes approved by the voters in referenda.
- 5. For the approved capital budget.

The majority of the commonwealth's outstanding direct debt is for the capital budget, which is the portion of the state budget that provides for the construction, rehabilitation, renovation and improvement of state-owned facilities, including the acquisition of land and structures. Because these facilities are used over many years, bond financing is used to spread the costs over the life of the asset.

### Q: Does Pennsylvania have a debt limit?

A: Yes, for certain kinds of debt. The state constitution limits the amount of capital budget debt that can be incurred to 1.75 times the average annual tax revenues for all funds over the previous five fiscal years. The Auditor General certifies the capital debt limit twice a year, so the current debt ceiling is just over \$58 billion. Pennsylvania is nowhere close to itc constitutional capital debt limit and could not support the debt service requirements of a debt load near this limit.

The constitution does not place any limits on debt issued for insurrection suppression, disaster relief, or voter-approved purposes. Debt was incurred for disaster relief such as flooding in the 1996 flood, and for voter-approved investments such as Growing Greener and Pennworks for water and sewer projects.

Aside from the constitutional limit on total capital budget debt, the capital budget act for each fiscal year specifies how much new principal can be incurred in that fiscal year for capital projects. The constitutionally required capital budget has not yet been passed by the Republican-controlled House of Representatives for the current 2011/12 fiscal year. Last year's capital budget, Act 47 of 2010, remains in effect until the new bill is passed, and limits the maximum principal amount of additional capital budget debt to just over \$1.58 billion.

### Q: What is Pennsylvania's bond rating?

**A:** Pennsylvania has a AA bond rating, **the second highest rating available.** Approximately 14 other states have a higher rating than Pennsylvania, and the commonwealth has received five rating increases since 1995.

Opinions from the three major rating agencies from the October 2011 bond sale are as follows:

Moody's Investors Service	Aa1	
Standard and Poor's Rating Service	AA	
Fitch Investors	AA+	

# Q: The recession has caused serious strain on Pennsylvania's budget. Could we default on our bonds?

**A:** Pennsylvania actually *did* default on its bonds in 1841. The commonwealth undertook a large canal construction effort. The profits from which were intended to pay the debt service through canal revenues. The scheme collapsed when canal revenues only brought in 12 percent of the projected income, and because of insufficient tax revenues at the time, the commonwealth defaulted.

The ramifications of this event continue to be felt, as they prompted increased safeguards to be placed in the state constitution. In the event that the General Assembly does not appropriate enough money for debt service, the Treasurer is directed to set aside any and all revenues collected to pay bondholders. Combined with Pennsylvania's low debt levels and long-standing conservative debt policy, it is extremely unlikely that the commonwealth could default on its debt. Pennsylvania's solid bond ratings reinforce the market's confidence in our ability to pay its debts.

## Q: How much debt does Pennsylvania have outstanding?

**A:** Net outstanding General Obligation debt as of June 30, 2011 was approximately \$9.87 billion. In addition, the commonwealth has approximately \$2.1 billion in long-term lease obligations. As these agreements require the commonwealth to pay a determined amount over a long period of time, they are somewhat similar to bonds and are sometimes included in the total amount of commonwealth debt outstanding.

### Q: How much do we spend on debt service?

**A:** Annual debt service for General Obligation debt and lease appropriation debt is approximately \$1.3 billion. Excluding the \$46 million in highway bond debt service attributable to the Motor License Fund, the remaining \$1.25 billion represents 4.6 percent of General Fund revenues.

## Q: For how long do we borrow? Do we borrow over 10 years, 20 years, or 30 years?

**A:** Generally speaking, the commonwealth issues 20-year bonds. For capital projects, the state constitution requires the debt to be paid back within the useful life of the asset and the debt must also begin to be paid off within one-tenth of the term of the debt. The enabling statues also allow borrowing up to 30 years. Since 1980, the policy is to issue debt over a 20-year period.

## Q: How does Pennsylvania's debt level compare with other states?

A: There are several standard metrics to compare debt loads among states. **Pennsylvania's debt per capita is \$950.** According to a 2010 Moody's report, the median debt per capita among the states is \$936, putting Pennsylvania right in the middle of the other states.

Additionally, **Pennsylvania's debt as a percent of personal income is 2.3 percent.** Standard and Poor's rating service guidelines state that debt lower than 3 percent of personal income is considered a low debt burden.

Finally, Standard and Poor's considers debt as a percent of revenues lower than 5 percent to be a low debt burden. Pennsylvania again achieves low debt status by this metric.

