AGENDA

DIVISION OF BOND FINANCE OF THE STATE BOARD OF ADMINISTRATION

To view Agenda Items click on the following link:
DBF Agenda Materials

(Contact person: J. Ben Watkins III - 488-4782)
The Capitol, Florida
December 6, 2016

This meeting is open to the public.

1. Approval of minutes of the meeting of October 25, 2016.

   Attachment #1

2. 2016 Debt Affordability Report.

   The Division of Bond Finance is required to prepare and deliver to the Governing Board and legislative leadership a debt affordability report containing the information required by section 215.98, Florida Statutes. The 2016 Debt Affordability Report satisfies the requirements of section 215.98, Florida Statutes.

STATE OF FLORIDA

IN RE: MEETING OF THE GOVERNOR AND CABINET
_______________________________________/

CABINET MEMBERS: GOVERNOR RICK SCOTT
ATTORNEY GENERAL PAM BONDI
CHIEF FINANCIAL OFFICER JEFF ATWATER
COMMISSIONER OF AGRICULTURE ADAM PUTNAM

DATE: TUESDAY, OCTOBER 25, 2016

LOCATION: CABINET MEETING ROOM
LOWER LEVEL, THE CAPITOL
TALLAHASSEE, FLORIDA

REPORTED BY: NANCY S. METZKE, RPR, FPR
COURT REPORTER

C & N REPORTERS
POST OFFICE BOX 3093
TALLAHASSEE, FLORIDA 32315-3093
(850) 697-8314 / FAX (850) 697-8715
nancy@metzke.com
candnreporters.com

INDEX

* * * *

DIVISION OF BOND FINANCE

GOVERNOR SCOTT: Next I'd like to recognize Ben Watkins with Division of Bond Finance.

DIRECTOR WATKINS: Good morning, Governor.

ATTORNEY GENERAL BONDI: Good morning.

DIRECTOR WATKINS: Cabinet members.

Item Number 1 is approval of the minutes of the September 20th meeting.

GOVERNOR SCOTT: I -- we need a motion.

COMMISSIONER PUTNAM: So moved.

GOVERNOR SCOTT: Is there a second?

CFO ATWATER: Second.

GOVERNOR SCOTT: Comments or objections?

(NO RESPONSE).

GOVERNOR SCOTT: Hearing none, the motion carries.

DIRECTOR WATKINS: Item Number 2 is a resolution authorizing the issuance and competitive sale of $8.2 million of parking revenue refunding bonds for Florida State University for debt service savings.

GOVERNOR SCOTT: Do you guys want to vote on a Florida State project?

DIRECTOR WATKINS: It's to save money,

Governor.

GOVERNOR SCOTT: These are all Gators.

DIRECTOR WATKINS: Got it.

GOVERNOR SCOTT: All right. Is there a motion?

COMMISSIONER PUTNAM: So move.

GOVERNOR SCOTT: Is there a second?

ATTORNEY GENERAL BONDI: Second by the Gators.

GOVERNOR SCOTT: Comments or objections?

(NO RESPONSE).

GOVERNOR SCOTT: Hearing none, the motion carries.

DIRECTOR WATKINS: And Item 3 is a follow-up of the -- it is a report on university debt, and it's a follow-up to a prior meeting where you asked me the question: How is -- about university debt and how it's authorized. So this report is designed to address that issue.

The first part of the presentation is an overview and an outline of the approval process. And secondly, we'll cover the key elements of both the statutory and requirements, as well as debt policies around the issuance of university and DSO debt so that we have a common and clear understanding of the process and the requirements of debt issuance.

I'm also going to talk a little bit about what the Board of Governors has done to improve their oversight function of university and DSO debt.

The second part of the presentation really deals with quantitative data. So we've scrubbed the university and DSO financial statements to try to address the question -- or provide information regarding how much debt there is outstanding and what kind of facilities have been financed using university debt.

And then lastly is our conclusions and recommendations.

So this is a high level overview of the history and evolution of university debt. And so understand, Direct Support Organizations, referred to as DSOs, they're created for a multitude of different purposes. Think of them as a wholly owned subsidiary of the university whose sole mission is to -- whose sole function is to support the university.

So historically, debt had been issued the normal way, through the Board of Regents through the Division of Bond Finance. And then in 1994, the Legislature gave Direct Support Organizations the authority to issue debt, so -- and the important point around that is in terms of the evolution of -- the authority and policies to issue debt is ten years ago we did the -- we, we as in the Board of Governors, as well as legislative staff, engaged in a comprehensive review of policies and statutes around university debt and the process for approving university debt. And the culmination of that process was the enactment of Florida Statutes 1010.62 by the Legislature and the adoption of companion policies by the Board of Governors.

So the essential elements of 1010.62, it clarified the framework or the process by which university and DSO debt is issued. And there's two key elements: One is it defines what revenues can be used to secure debt, and those that cannot. And then secondly, it established a clear and definitive process by which all university and DSO debt is authorized to be issued.

And as you would expect, it's shared responsibility. So what we were doing was balancing the -- or through that exercise we were able to balance different stakeholders' interest in the process.

So what does that mean? So the Legislature still retains authority over what kind of revenues can be pledged and what are not, so they have a role. The university boards of trustees decides what kind of projects to finance and what the dedicated revenues they're going to use to finance those projects.

The Board of Governors reserves in their function of overseeing the State University System by reviewing and approving all university debt and DSO debt, as well as P3s; and the Division of Bond Finance engages with the Board of Governors' staff in reviewing and performing an analysis of every deal that's brought forward by the universities.

So the essential elements of that is the Board of Governors are required -- their review and approval is required of all transactions, all financing transactions; but then debt can be either issued through the Division of Bond Finance or by the university DSO. So that's where the difference emerges.

For transactions that we manage and execute, it comes to you; for transactions the DSO manages and execute, it goes back to the university. And so there's no review by this Board, but there has been a prior review by the Board of Governors.

So policies and principles regarding state debt. So we -- at your direction, we had amended state debt policies to require a more rigorous review whenever debt is being used to finance projects. And so companion policies were also adopted by the Board of Governors back in 2013.

And what is that? It basically requires a justification any time you want to finance a project. And the rubric that we use is, return on investment. But what that really means is bring forth a justification for why we have a critical need and why we need to use debt to finance it.

And so that's what's now required pursuant to the Board of Governors' policy, too, as well as an assessment of the cost and the cost of the students, which is another wrinkle in all of this; and accountability in terms of measuring projected performance versus actual performance, which we are -- will be working to implement.

So the whole reason for the change in policy and the justification of debt is to enhance accountability and transparency whenever debt is being used, and to provide a justification for the use of debt. And so that analysis is done when we, as in Division of Bond Finance staff, together with Board of Governors' staff, is provided information from the universities requesting approval of the project. When it's going to the Board of Governors is when that analysis is done and when that information is provided.

This is an outline of the actions that the Board of Governors has taken to enhance oversight and to implement policies through guidelines that embed these principles. So you can see going back for three years, and actually even before that, the letter from the Governor to the universities explaining what expectations are, there has been ongoing work by the Board of Governors to implement these policies.

So just reviewing these quickly, in September 2015 was adoption of public/private partnership guidelines. That was a year and a half collaborative process with the universities and Board of Governors' staff to come together and develop a comprehensive set of guidelines to govern P3s because in many cases they're simply used as a financing vehicle, and so the policies ought to apply uniformly to that, as well as the issuance of debt.

And then in April of 2016, we had a chancellor memo which has subsequently been formalized in amendments to the Board of Governors' guidelines which requires notification of the Board of Governors, as well as us, any time there is a rating review; and any time there are conversations with the rating agencies, we're to be notified and have an opportunity to be engaged in that dialogue.

And then the Governor's Degrees to Job Summit in 2016, which was a presentation on the P3 guidelines to familiarize the university boards of trustees' members who were there, as well as the Board of Governors' members who were there, about the new guidelines dealing with public/private partnerships.

And then July of 2016 a workshop with VPs finance and administration with the universities to work with them on collaboratively -- how we were going to go forward in implementing the rating agency reviews; and then Board of Governors' amendments -- further amendments of their debt guidelines to clarify whenever a prior deal is modified and when it needs to come back to the Board of Governors for review.

And then lastly, it's my understanding that the Board of Governors is going to be moving forward with an initiative to evaluate the university boards of trustees and what their role and responsibility is with respect to approving debt. So bottom line, a lot has been done to enhance oversight regarding any debt proposals, and the Board of Governors has actively engaged in that exercise.

So now we get to sort of the quantitative information that I wanted to share with you so you can have an idea of how the -- the amount of debt that's outstanding and what the complexion of that debt is and what that debt has been used to finance.

And so this is simply a pie chart. The blue is the DSO debt that's currently outstanding at the end of 2015, and the red component is the university debt that's been issued through the Board of Governors and the Division of Bond Finance.

So $3.8 billion in total debt outstanding, and then I give you a pie chart to stratify it by purpose to show you what kinds of facilities have been financed with the debt that's currently outstanding. And you can see the largest proportion of debt that's been issued is for university housing, followed by healthcare debt; and then you can see the other areas: Athletic facilities and student life facilities also.

This is a comparison of state debt outstanding, a progression -- debt outstanding over the last five years -- over the last six years actually for both the state in green and universities in blue. And you all are very familiar with the liability profile of the state and the reduction in state debt that we've been able to achieve, and contrasted with total university debt, and this includes both university debt as well as DSO debt.

So when I say "university debt," I'm including both because they are, in effect -- the economic substance of the transaction is it's rolled up on the university's balance sheet, whether it's DSO debt or university debt that's been approved by this Board, so we treat them together.

And what you can see is that while state debt has been decreasing, except last year for the I-4 Ultimate Project, and I expect the downward trend in debt outstanding for the state to continue in 2016, and we'll bring that information to you in

December when we do our annual debt report, in contrast to the university that's been going up. It's increased 1.1 billion or 41% over the last five years, with the largest increases being in student housing and healthcare, as you would expect.

But the good news is the rate of debt -- the growth has slowed in the last five years, so you can imagine what it was like the previous ten years, if the rate of growth has slowed to 41% in the last five years.

Then we simply stratify the debt to show you the red is debt that's issued through the Board of Governors and the Division of Bond Finance, and the blue is the DSO debt. And what this reveals is that 90% of the increase in university debt is attributable to DSO debt issuance, and that's simply a function of the universities using the DSO structure more frequently and is more prevalent than historically had been the case.

The BOG -- the DBF debt is typically for housing and parking, and the DSO debt is more healthcare and athletic facility centric. Then I take the same information and stratify it to show what is healthcare debt and what is non-healthcare debt. So this is just simply the DSO debt, with the purple being healthcare related and the blue being all other facilities.

And you can see that the increase in debt has been primarily as a result of increases in healthcare debt, and the total healthcare debt outstanding is $1.2 billion at the end '15; and it's doubled over the last five years and represents 44% of the total DSO debt.

Then we show debt by university, just to show you the complexion of the debt profile of each of the universities in the system with the same color scheme, which is: Purple is healthcare debt; blue is DSO debt, non-healthcare DSO debt; and then the red is debt that's been issued through the Division of Bond Finance. And that's pretty self-explanatory in that the healthcare debt is largely centered at the University of Florida and Shands University Teaching Hospital.

So in conclusion, debt-free universities -- facilities has grown with the growth of the university system. University debt issued through DSOs represents approximately 75% of all university debt. DSOs have been used increasingly to incur debt on behalf of universities and is responsible for 90% of the growth in university debt over the last five years.

On the positive side, clearly the Board of Governors has taken steps to improve oversight of university and DSO debt, with an increased focus on justifying the need for the facilities being financed.

The existing Board of Governors' process -- in my judgment, the existing process that's currently in place provides the framework for adequate oversight of university debt except for Shands University Hospital. And so there's no state-level oversight either through the Board of Governors or any state-level oversight by anybody for Shands University Hospital debt.

So my -- so recommendations are that, from a debt management perspective, that's a bit of a blind spot because there's no review process in place. So either the Board of Governors or the Governor and Cabinet should be responsible for evaluating Shands healthcare debt and applying the policies that are applicable to all state agencies, including universities.

And secondly, and this is going a bit beyond the charge of this report, but just a personal observation having been involved in reviewing all university and P3 debt issuance over the last decade or so, is that the university boards of trustees need to be more actively engaged and should perform a critical evaluation of the university projects being financed with debt or P3s consistent with the Board of Governors' policies so that at each university board of trustees' level, there is the application of the same policies and principles that are going to get applied and asked at the state level through the Board of Governors or this board through its debt management policies so that, in effect, the deal has been scrubbed down and the hard questions have been asked early on in the process rather than waiting until it floats up to the Board of Governors for purposes of review.

So that concludes my presentation of this information, and I'm happy to answer any questions you have.

GOVERNOR SCOTT: So are either of these going to happen?

DIRECTOR WATKINS: Yes, sir, I believe so. I hope so. It doesn't require a statutory change, and so it really is within the prerogative, I think, of the Board of Governors to engage in that and -- engage in that oversight function or for this Board to specifically take it up.

GOVERNOR SCOTT: All right.

ATTORNEY GENERAL BONDI: I think the Chancellor wants to say something.

GOVERNOR SCOTT: Okay. Good morning, Marshall.

CHANCELLOR CRISER: Good morning, Governor, Cabinet.

One, to answer your question with regard to the second bullet point, actually the Board of Governors did amend its debt management guidelines last month. What we are doing now is essentially taking -- what I would describe as the same standard of review that would be presented to this Cabinet for looking at debt issues will now reside, not only at the Board of Governors where it has resided, but now at the local Board of Trustees as well as the local or DSO-type board so that the decisionmaking process from its beginning to its end is subject to the same standard of review and will have the same due diligence and fiduciary responsibility embedded in it so that we understand this conversation from beginning to end.

GOVERNOR SCOTT: Marshall, what about Shands, what's going to happen on that?

CHANCELLOR CRISER: Shands is for -- if you'll pardon the Central Florida vernacular, sort of what I would describe as a mule, which is, it's a hospital and it's a teaching center, which makes it essentially a teaching hospital.

I think in the past Shands has been regarded more in the category of hospitals rather than teaching facilities. But in conversations that we've had with the leadership of the University of Florida, as well as with my Board leadership, I believe that the Board of Governors is fully prepared, capable of taking responsibility and basically instilling this same kind of a review process so that we understand exactly how these decisions should be made, how they should be evaluated; and we have a record for that so that it can be communicated and my Board can continue to be responsible for looking at that.

GOVERNOR SCOTT: Do you think -- at this point nothing has happened, but do you think it will happen?

CHANCELLOR CRISER: Oh, I think it will, yes, sir. I think we have been -- I think, in part, I would say we were -- I won't say we were waiting for this conversation, but we wanted to understand exactly the full context of this conversation. We've already begun having the conversation of how we do that going forward. I believe we'll be able to implement that quickly.

GOVERNOR SCOTT: Marshall, what happened at the University of North Florida where they got downgraded, well, if you -- with the process that the Board of Governors is doing, is that going to stop that from happening again do you believe?

CHANCELLOR CRISER: I think that -- we've worked closely with Bond Finance, and Ben has been our partner in this. What we have done today is started conversations. I think the notion here is, don't have the conversation at the end, have the conversation at the beginning, make sure all the parties are aware of whatever the transaction or what the evaluation is.

By having everyone involved from the very beginning of the process, we're going to be in a position where there's layers now of making sure that everybody is on board and we don't have surprises.

GOVERNOR SCOTT: Does anybody have any questions? CFO.

CFO ATWATER: Yeah, thanks, Governor.

Chancellor, I think these are two good recommendations. I appreciate how you've come up so quickly to say that -- your willingness to address them. I do think we should then formally put it to rest.

So do you sense that within the next 90 days, you all will have voted to say, we own Shands and this is the standard the Trustees will now have to provide to us before we'll take it up and consider it? Is that enough time to say, we can put all that together.

CHANCELLOR CRISER: I think we can get something together in 90 days that would formalize this beyond my representation today.

I'll make the side note that we go through our own process of noticing and when we amend our guidelines or our regulations, so I want to put -- but I think we can take Board action that would be subject to a final -- at a minimum, at a final decision that would only have to recognize whatever the noticing requirements would be.

CFO ATWATER: Thank you.

I wonder if I -- may I ask a question of Ben, or I can wait until after the Commissioner is done.

GOVERNOR SCOTT: So why don't we do this then, let's just put this back on the agenda, and what --

Marshall, what time do you think we should review it?

CHANCELLOR CRISER: I think we would have this in front of our Board by January, and so if there is a Cabinet meeting following -- whatever that Cabinet meeting would be that would follow our January Board meeting would be an opportunity to get this --

GOVERNOR SCOTT: Let's just do February. We'll just put it on the February agenda to review it.

COMMISSIONER PUTNAM: To review what, Governor?

GOVERNOR SCOTT: To see what the Board of Governors has done.

COMMISSIONER PUTNAM: In a couple of your slides, Ben, Shands was included, UCF (sic) medical facilities were included, Moffitt was specifically excluded. So is Moffitt a mule?

DIRECTOR WATKINS: Moffitt -- so we did the deep dive into each of the credits in order to evaluate and make a judgment about how to properly treat it. Moffitt is not a teaching hospital, and it's more of a state-created center for cancer research.

And while the state has downstreamed money to Moffitt that can be leveraged, and they do run, obviously, research and a healthcare facility, a cancer treatment facility, it's not an integral part of University of South Florida and its governance structure doesn't reflect that. Sir?

GOVERNOR SCOTT: USF is not responsible for their debt, and neither is state?

DIRECTOR WATKINS: That's correct.

GOVERNOR SCOTT: No one is responsible for their debt, just the entity, Moffitt?

DIRECTOR WATKINS: Correct, except for one flavor of debt which is well secured, Governor. It's cigarette taxes that's downstreamed to Moffitt that they've leveraged, but there's no problem with that, it's not going anywhere; but, operationally, you're absolutely right.

COMMISSIONER PUTNAM: So Shands predates the DSO law, correct?

DIRECTOR WATKINS: Correct.

COMMISSIONER PUTNAM: So they weren't operating outside of normal procedures because they were not -- they are not a DSO, correct?

DIRECTOR WATKINS: Right.

COMMISSIONER PUTNAM: And the spike that's reflected in the graph, is that a reflection of a number of bond issuances or a single or small number of issuances that were a big number, as anything with the hospital is?

DIRECTOR WATKINS: So more of the latter, a couple of big projects. One would be expanding the footprint to Jacksonville to indigent healthcare, and the other is a particular facility that was built on Shands' campus.

COMMISSIONER PUTNAM: Okay. So if the -- so walk me through -- Shands has a board, right?

DIRECTOR WATKINS: Right.

COMMISSIONER PUTNAM: And who appoints that board?

DIRECTOR WATKINS: The President of the University of Florida.

COMMISSIONER PUTNAM: Okay. And then that board is -- has a -- how is Shands incorporated? Is it an entity of the state, or is it a C-4, or what is it?

DIRECTOR WATKINS: There are a number of different affiliation arrangements. I would characterize it as a spider web because there are a number of different entities that are created. But in effect, Shands proper is a part of the University of Florida; it's Shands Teaching Hospital. And then there are a lot of spinoffs off of that based on various practice groups and financings that had been done and doctors groups.

And so it's a labyrinth underneath that, but if you look at the top in the governance framework, it is, in effect, Shands is -- Shands and Shands Teaching Hospital are a part of the University of Florida. And University of Florida is a part of the state, and all of their debt is rolled up into the State of Florida by virtue of their connection with the University of Florida.

And when you look at credit reports, the Moody's report or the S & P report and you read through it, it talks about the connectedness of the teaching hospital with Shands Hospital -- with Shands and the mutual dependency, and -- but so -- but there's never -- there's not -- to your point, it's technically not a DSO because it was created in statute prior to the DSO statute, but it functions the same as.

So from a -- if you ignore the technical legal requirement, there's no distinguishing that from --

from a credit perspective, distinguishing Shands from any other DSO.

COMMISSIONER PUTNAM: So one of the things that characterizes some of our largest public research universities in the country is the presence of a major health science center. How do similar health science centers operate in other states?

DIRECTOR WATKINS: There are varying models for that. In many cases, it's part of the university, but let me use a notable example: Vanderbilt just spun off their healthcare. They did a junk bond issue to finance the healthcare so that Vanderbilt could cut the connection from a credit standpoint with what is a more challenging operating environment and economically is an overhang on the university.

So they made a strategic decision to walk away from it and to sever the nexus. Other institutions, it's very similar to what you see here in Florida, where the teaching hospital is part of -- an integral part of the university and treated as such. So the answer is: It depends.

COMMISSIONER PUTNAM: Well, I -- I think we need to get this right. It's a big deal for us to have the type of world-class health science centers that are reflected by what USF has, what UF has, the aspirations of other universities to build health science centers and -- you know, I'm interested in what the Board of Governors discusses.

But, you know, I think before this Cabinet makes a decision, I'd like to hear from Shands, I'd like to hear from President Fuchs. I mean I -- this is a big decision to make in a vacuum, and we don't want to jeopardize our ability to continue to provide cutting-edge healthcare and teaching medical student opportunities in a premiere way.

And we certainly need to have protections in place to make sure that the full faith and credit of the university system or the state is not put in jeopardy. But, you know, this is a big conversation about how we do this, and I think it's important to get input from the others.

All the other work that you and Chancellor Criser have done I think is outstanding in terms of avoiding the problem that brought all of this to light to begin with, which was the rating agency review and making sure that DSOs are undergoing appropriate due diligence. But, you know, we do have this interesting piece remaining that I think we need to continue to gather information on.

DIRECTOR WATKINS: I appreciate the comments, and at least from my own individual perspective, but I'll let the Chancellor -- because he's quite capable of speaking for himself.

I don't view the Board of Governors' review and oversight of Shands is creating any impediment whatsoever to them achieving their mission and all of the attributes that you rightfully point out are to be proud of; but that's my personal point of view.

COMMISSIONER PUTNAM: I don't have an opinion either way. I just want to hear both sides before we just toss the hot potato into the BOG's lap.

CHANCELLOR CRISER: A couple of things -- I'm sorry, if I may.

GOVERNOR SCOTT: Go ahead.

CHANCELLOR CRISER: A couple of things I would add to make sure that y'all don't -- I was sitting there thinking: You're going to start getting letters clarifying different things.

Shands is actually a private not-for-profit entity, but it is a component of UF Health Science

Center. And so that would be the context that this is viewed in.

I think where the nexus is is that part of the abilities of Shands are derived through the Board of Trustees at the University of Florida and, therefore, this is the -- I think the opportunity and the area where the conversation between the Board of Governors and the Board of Trustees at UF is the bridge or is the way to connect the dots as we discuss the level of debt and how debt is processed going forward.

I don't want to -- I don't know that I can speak for President Fuchs. I would share with you that he is aware of the conversation, and I believe he would be comfortable with the proposal that I have indicated our comfort level with and more than happy to work with the University of Florida.

I would also share as we look at this, while the example presented to you today was of Shands, I think the important approach for the Board of Governors is actually to contemplate all similarly-situated entities existing now or existing in the future. We have another proposal for a teaching hospital kind of starting up from one of the universities right now.

This is not necessarily a Shands discussion but a university and university system discussion. And as we approach this, our goal would be to have a process in place that we don't have to come back with individual examples over time but generally understand, again, this notion that there is a standard of review that you all expect, my Board expects it, and I believe it can be instilled not only at the Board of Trustees' level but at what I would call the local board or the directly responsible board, DSO, or other entity. And in this case, that would be the Shands board.

GOVERNOR SCOTT: Thank you, Marshall.

CFO, did you have a question?

CFO ATWATER: Well, just that I think the point made, why don't -- at that time that you're back with the specifics of how we would carry out these two recommendations, maybe that would be a nice time for the University of Florida to be present and say, this is -- if we're going to be finding a home, this is the home we would prefer, or we find this home to be -- not to be anything that would be encumbering our path forward so that they could visit with us and communicate that.

CHANCELLOR CRISER: And if I may, and by its nature, our regulation development process is an inclusive process where the universities participate in that dialogue as well.

GOVERNOR SCOTT: All right.

CFO ATWATER: Governor, just one --

GOVERNOR SCOTT: In February, we're going to -- we'll put this back on the agenda.

Go ahead, CFO.

CFO ATWATER: Ben, just the terminology that -- on how you've made this presentation on the changes that have been made over time and your comfort level. You use a term that the processes in place should be adequate to do the job. Is there anything else you want to say? Is there any concern that --

DIRECTOR WATKINS: No, I think that we're -- the Board has been very responsive, and I think if you look at that list in terms of dates and actions, it is happening with -- four things happened in 2016, and so I'll have to say, they get it and understand what the expectations are relative to the university system; and so they've been a good partner in helping move things forward.

And so I hope we can continue to make progress on that front because I do think there is --

remains area for improvement, and that is pushing the review down, a critical review, not a rubber stamp, not a consent agenda, but a critical review to the appropriate level so the Board can exercise their responsibility and their fiduciary obligation in evaluating what the university management is proposing.

GOVERNOR SCOTT: Okay. All right. Thank you, Ben.

DIRECTOR WATKINS: Thank you.

* * * *

State of Florida

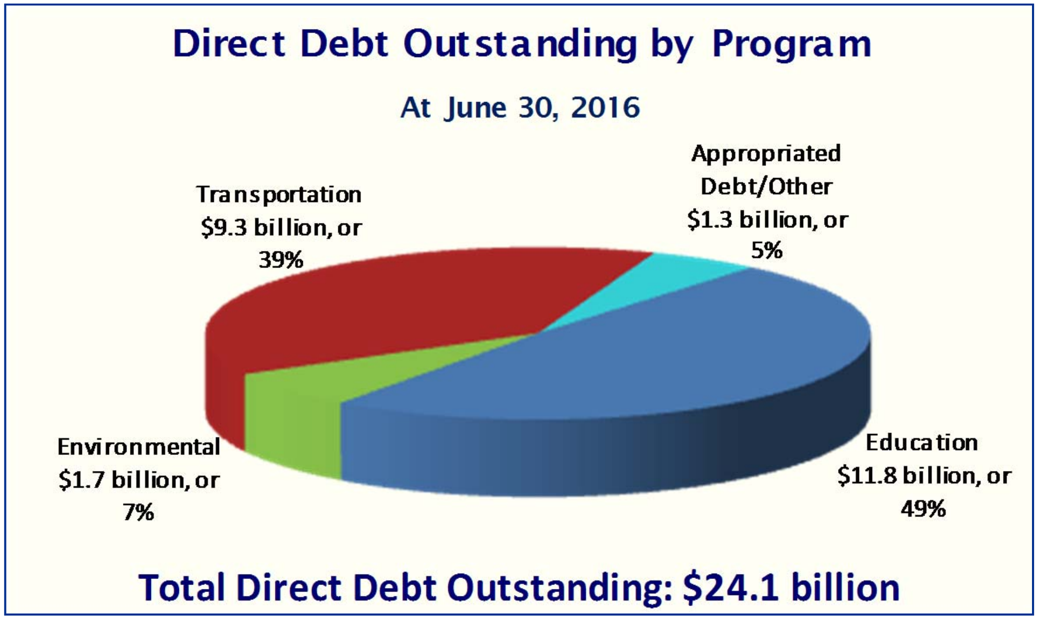
2016 Debt Report

December 2016

Debt Affordability Analysis

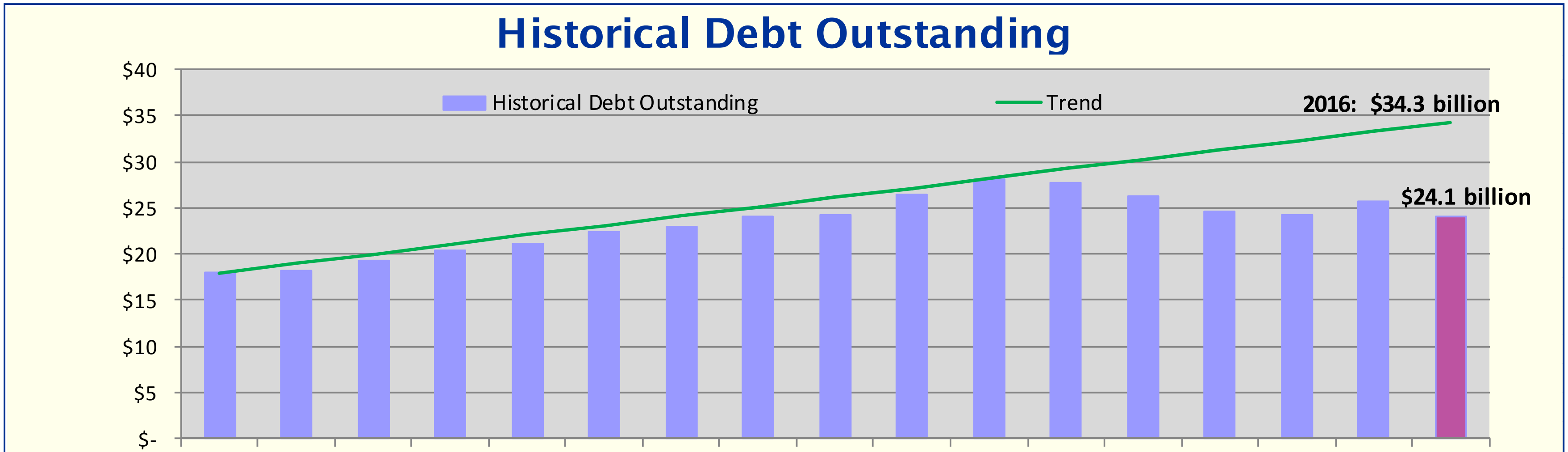
- Purpose of debt affordability analysis is to provide a framework for measuring, monitoring and managing the State's debt
- Provides information to assist Legislature in formulating capital spending plans
- Analytical approach to evaluating the State's debt position
- Financial model used to evaluate debt burden – the "benchmark debt ratio" – based on two variables:
  1) Annual debt service requirements
  2) State revenues available to pay debt service
- Designated benchmark debt ratio – 6% target, 7% cap
- Model provides framework for evaluating long-term impact of bonding
- Requirements for Report:
  - Calculate total State direct and indirect debt outstanding
  - Evaluate changes in debt and annual debt service requirements over last 10 years
  - Update projections for future debt issuance compared to revised revenue estimates
  - Calculate benchmark debt ratio based on projected future debt issuance and projected revenue collections
  - Evaluate level of reserves
  - Review credit ratings

Direct Debt Outstanding



- ***Total outstanding direct debt at June 30, 2016 was $24.1 billion*** (net tax-supported debt was $20.1 billion and self-supporting debt was $4.0 billion)
- Largest infrastructure investment for school construction of $11.8 billion (49%)
- Second largest for transportation projects (primarily long term Public-Private Partnership obligations and toll facilities) of $9.3 billion (39%)
- Third largest for acquiring land for conservation of $1.7 billion (7%)

Decrease In Debt Relative to Historical Trend



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Debt Outstanding	$18.0	$18.3	$19.2	$20.4	$21.2	$22.5	$23.0	$24.1	$24.3	$26.4	$28.2	$27.7	$26.2	$24.6	$24.2	$25.7	$24.1

- State debt outstanding increased annually and more than tripled from 1992 through 2010 before decreasing for four consecutive years (2010-2014)
- ***Total direct debt outstanding has decreased by approximately $4.1 billion over the last six fiscal years***
- Increase in Fiscal Year 2015 due to adding Public-Private Partnership obligations of $2.7 billion for I-4 Ultimate
- ***Decrease in debt resumed in Fiscal Year 2016 ($1.6 billion decrease) continuing reversal of long-term trend of increasing State debt***
- If trend of increasing debt had continued, outstanding debt would be $34.3 billion or 42% ($10.2 billion) more than it was at end of Fiscal Year 2016

University DSO Debt Study

- ***University Debt totals $3.8 billion with $2.8* billion for DSOs and PPPs being categorized as indirect debt in the Debt Report***
- University debt issued through DSOs represents nearly 75% of all university debt
- ***DSOs have been increasingly used to incur debt for university facilities and are responsible for over 90% of growth in university debt over last 5 years***
- Board of Governors has taken steps to improve oversight of University/DSO debt and increase focus on justifying the need for the facilities being financed
- Existing Board of Governors process and policies for approving University/ DSO debt and PPPs provides framework for adequate oversight, except for Shands healthcare debt
- ***Chancellor and Board of Governors committed to having University Board of Trustees perform critical evaluation of university projects being financed with debt or PPPs*** consistent with Board of Governors Policies

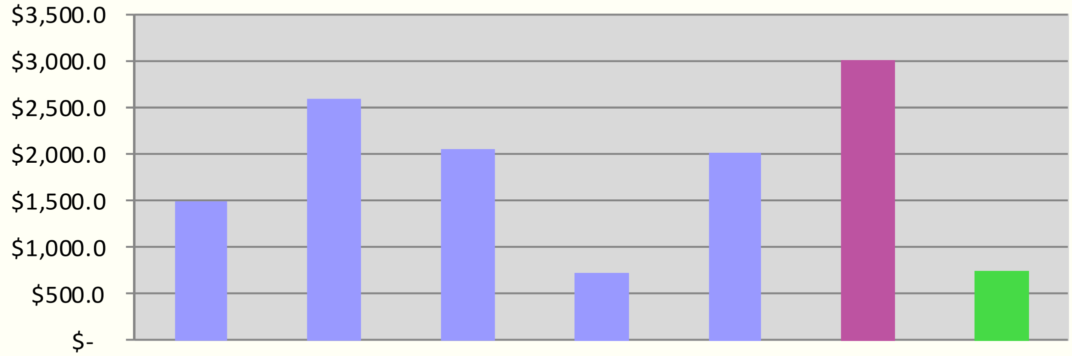
* DSO Debt outstanding as of 6/30/2015

Refinancing Activity

Historical Refinancing Activity

Fiscal Years 2011 through 2016: 2017 Y-T-D

(In Millions of Dollars)



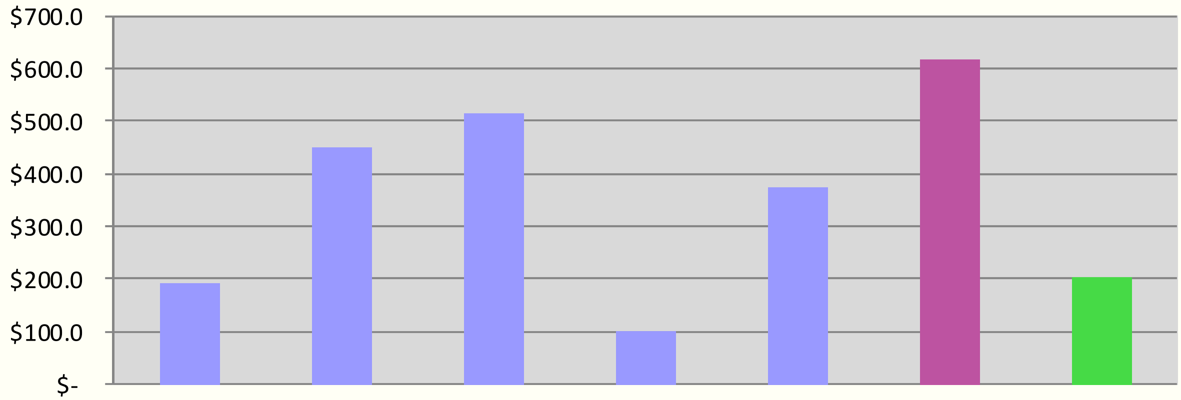
	2011	2012	2013	2014	2015	2016	2017	Total
Number of Transactions	12	20	10	9	14	13	4	82
Refunding Par	$ 1,491.1	$ 2,595.0	$ 2,049.4	$ 713.9	$ 2,004.2	**$ 3,003.6**	$ 749.4	**$ 12,606.6**
Refunding Savings:								
Gross Savings	$ 193.3	$ 450.9	$ 515.6	$ 99.1	$ 375.9	**$ 618.8**	$ 205.1	**$ 2,458.7**
Present Value Savings	$ 162.4	$ 366.2	$ 406.1	$ 87.0	$ 311.1	$ 380.5	$ 171.4	$ 1,884.7

- ***DBF executed 13 refunding transactions in Fiscal Year 2016 totaling $3 billion and generating gross debt service savings of $619 million*** or $381 million on a present value basis
- DBF executed 82 refunding transactions over the last six and a half fiscal years totaling $12.6 billion
- ***Refinancing activity over last 6.5 years has generated gross debt service savings of nearly $2.5 billion*** or $1.9 billion on a present value basis
- 50% - half of all state debt has been refinanced at lower interest rates over the last six and a half years

Savings/Return on Investment

Real Return on Investment Performance Metric

(In Millions of Dollars)



	2011	2012	2013	2014	2015	2016	2017*	Total
Gross Refunding Savings	$ 193.3	$ 450.9	$ 515.6	$ 99.1	$ 375.9	**$ 618.8**	$ 205.1	**$ 2,458.7**
DBF Expenses	$ 3.0	$ 3.3	$ 2.8	$ 2.8	$ 3.0	$ 2.8	$ 2.7	$ 20.5
ROI	64x	135x	181x	36x	125x	**223x**	76x	**120x**

* Year-to-date gross refunding savings and prorated budget July though December

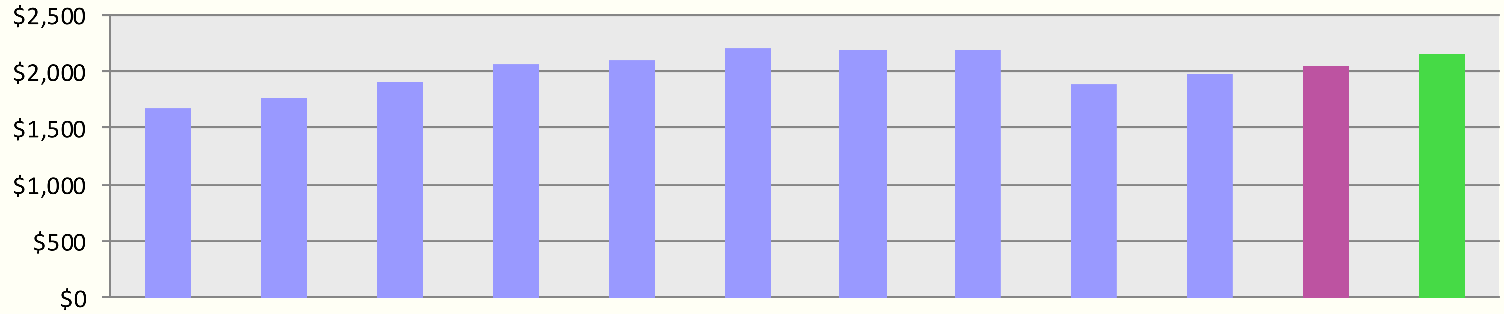
- ***The return on investment based on debt service savings from refinancings in Fiscal Year 2016 was approximately 223x DBF Expenses***
- ***Return on investment on refinancings has averaged 120x the past 6.5 years based on total savings divided by total DBF Expenses***
- The return on investment has varied from a high of 223x in 2016 to a low of approximately 36x in 2014

Changes in Annual Debt Service

Historical Net Tax-Supported Debt Service

Fiscal Years 2006 through 2016 and Projected Fiscal Year 2017

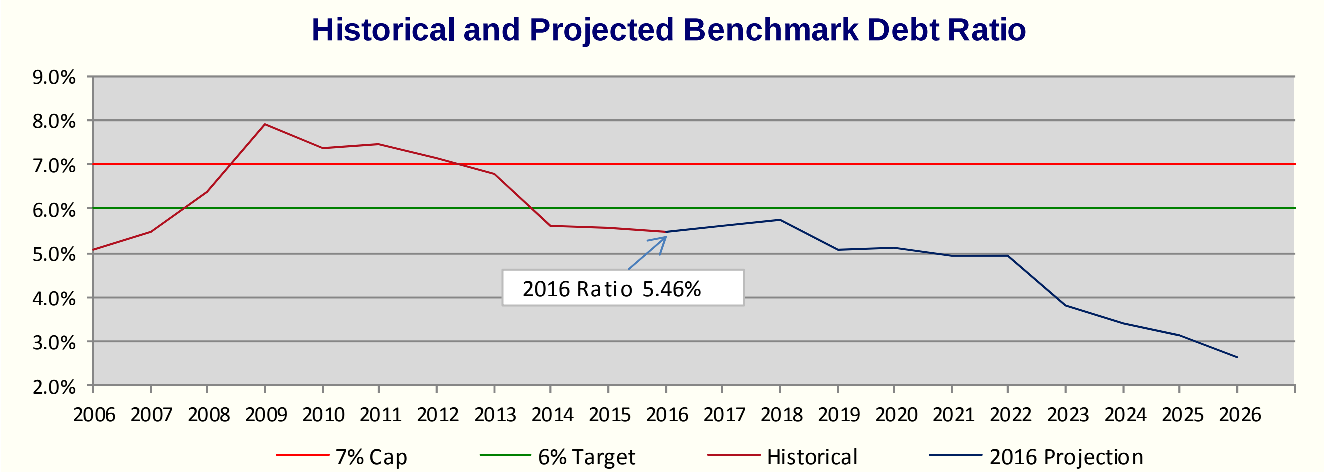
(In Millions of Dollars)



	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Debt Service	$1,681	$1,768	$1,898	$2,058	$2,095	$2,204	$2,191	$2,196	$1,887	$1,971	**$2,053**	**$2,159**

- Annual debt service payments for net tax-supported debt increased nearly 30% over eight years from $1.6 billion in 2006 to $2.2 billion in 2013
- Fiscal Year 2014 debt service decreased approximately $300 million to $1.9 billion due to final retirement of Preservation 2000 bonds in Fiscal Year 2013
- ***Fiscal Year 2016 debt service increased to about $2.1 billion due to refinement of how Public-Private Partnership obligations are reflected in outstanding debt***
- ***Fiscal Year 2017 debt service is expected to be to about $2.2 billion*** before increasing to approximately $2.3 billion in 2018 due to payments required on the I-4 Ultimate Project

Benchmark Debt Ratio



Benchmark Debt Ratio Projection

	Actual 2015	Actual 2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
2016 Projection	5.58%	**5.46%**	5.63%	5.75%	5.08%	5.10%	4.95%	4.93%	3.79%	3.40%	3.11%	2.65%

- Benchmark debt ratio is debt service as percentage of revenues available to pay debt service
- Significant increase in benchmark debt ratio from 2006 – 2009 due to significant revenue declines
- ***Benchmark debt ratio improved for Fiscal Year 2016 at 5.46% and remains under the 6% target***
- Benchmark debt ratio is projected to remain under the 6% target throughout the 10-year projection period but is dependent upon continued revenue growth and restrained issuance of new money debt

Florida's Relative Ranking Among Peer Group

2015 Debt Ratios Comparison of Eleven Most Populous States

	Rank	Net Tax-Supported Debt Service as a % of Revenues	Rank	Net Tax-Supported Debt Per Capita	Rank	Net Tax-Supported Debt as a % of Personal Income	Rank	Net Tax-Supported Debt as a % of State GDP	General Obligation Ratings Fitch/Moody's/S&P
Illinois	1	9.20%	3	$2,522	3	5.20%	2	4.41%	BBB+/Baa2/BBB
New Jersey	2	8.50%	1	$4,141	1	7.30%	1	6.72%	A/A2/A
New York	3	7.60%	2	$3,021	2	5.40%	3	4.29%	AA+/Aa1/AA+
Georgia	4	6.60%	8	$1,029	5	2.70%	7	2.21%	AAA/Aaa/AAA
Florida	**5**	**5.58%**	**7**	**$1,085**	**8**	**2.46%**	**5**	**2.51%**	**AAA/Aa1/AAA**
California	6	5.30%	4	$2,323	4	4.70%	4	3.94%	AA-/Aa3/AA-
Ohio	7	5.20%	6	$1,091	6	2.60%	8	2.20%	AA+/Aa1/AA+
Pennsylvania	8	3.80%	5	$1,172	7	2.50%	6	2.28%	AA-/Aa3/AA-
North Carolina	9	3.50%	9	$721	10	1.80%	10	1.50%	AAA/Aaa/AAA
Michigan	10	2.50%	10	$719	10	1.80%	9	1.59%	AA/Aa1/AA-
Texas	11	2.40%	11	$298	11	0.90%	11	0.64%	AAA/Aaa/AAA
Median		**5.30%**		**$1,091**		**2.60%**		**2.28%**	
Mean		**5.47%**		**$1,647**		**3.40%**		**2.94%**	
National Median		**5.30%**		**$1,012**		**2.60%**		**2.21%**	

- ***Florida's debt burden is lower than the peer group average for all metrics except for debt service as a percentage revenues***
- Florida's benchmark debt ratio is 5th highest
- Florida's debt per capita is 7th highest
- Florida's benchmark debt ratio and debt as a percentage of personal income is 8th highest
- Florida's debt as a percentage of State's GDP is 5th highest

Peer Comparison of Pension Liabilities

2015 Pension Metrics Comparison of Eleven Most Populous States

Adjusted Net Pension Liabilities ("ANPL") and Medians

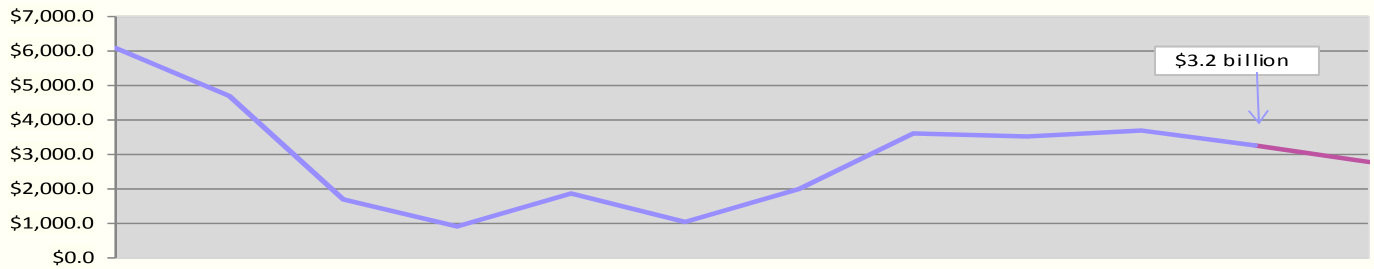
State	Rank	ANPL *(in Millions)*	Rank	ANPL as a % of Revenues	Rank	ANPL Per Capita	Rank	ANPL as a % of Personal Income	Rank	ANPL as a % of State GDP
California	1	186,923	5	74.0%	4	$ 4,775	5	9.1%	5	7.6%
Illinois	2	192,852	1	280.0%	1	14,996	1	30.3%	1	24.9%
Texas	3	123,859	3	109.0%	5	4,509	4	9.6%	4	7.8%
New Jersey	4	90,207	2	157.0%	2	10,070	2	16.8%	2	15.9%
Pennsylvania	5	65,295	4	108.0%	3	5,100	3	10.4%	3	9.5%
Michigan	6	33,311	6	51.0%	6	3,357	6	7.9%	6	7.1%
New York	7	27,760	11	22.0%	8	1,402	9	2.4%	9	1.9%
Georgia	8	19,196	7	50.0%	7	1,879	7	4.6%	7	3.9%
Florida	**9**	**15,223**	**10**	**23.0%**	**10**	**751**	**10**	**1.7%**	**10**	**1.7%**
Ohio	10	13,624	8	27.0%	9	1,173	8	2.7%	8	2.2%
North Carolina	11	5,916	9	23.0%	11	589	11	1.4%	11	1.2%
Median		**$ 33,311**		**51.0%**		**$ 3,357**		**7.9%**		**7.1%**
Mean		**$ 70,379**		**84.0%**		**$ 4,418**		**8.8%**		**7.6%**
National Median		**$ 9,180**		**60.3%**		**$ 3,010**		**5.8%**		**5.0%**

Source: *Moody's Fiscal 2015 Pension Medians - Low Returns, Weak Contributions Drive Growth of State Pension Liabilities*

- Moody's and Fitch each employ "adjustments" to reported pension liabilities for greater comparison of State defined benefit systems
- ***Florida's adjusted net pension liability ("ANPL") metrics are significantly stronger than national averages***
- Florida has the third lowest ANPL in the peer group
- Florida has the second lowest ANPL metric in the peer group for each of the other metrics; per capita, ANPL as a percent of personal income, ANPL as a percent of revenue, and ANPL as a percent of GDP
- ***Pension system management and funding is an important part of credit analysis***

General Fund Reserves

General Fund Reserves
Historical Fiscal Years 2006 through 2016 and Projected 2017
(In Millions of Dollars)



	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
General Fund Reserves	$ 6,081.2	$ 4,682.1	$ 1,674.6	$ 912.7	$ 1,854.5	$ 1,027.7	$ 2,005.1	$ 3,600.6	$ 3,506.0	$ 3,679.0	**$ 3,245.5**	**$ 2,763.2**
Reserves as % of Revenues	22.47%	17.73%	6.95%	4.34%	8.62%	4.55%	8.49%	14.21%	13.37%	13.29%	**11.46%**	**9.42%**

Source: Office of Economic and Demographic Research. Reserve amounts shown include the Budget Stablization Fund.

- General Fund reserves include unspent General Revenue and funds held in the Budget Stabilization Fund
- General Fund reserves accumulated through Fiscal Year 2006 to an unprecedented high of $6.1 billion or 22.5% of general revenues
- In 2007, 2008, and 2009, reserves were used to help balance the budget but were rebuilt in 2012-2013 and have been maintained since then
- ***Fiscal Year 2016 ended with General Fund reserves of $3.2 billion or 11.5% of general revenues***
- ***General Fund reserves are projected to decrease to $2.8 billion or 9.42% of projected general revenues at the end of Fiscal Year 2017*** including $400 million BP payment received July 2016 but not appropriated
- ***Long-Range Financial Outlook assumes spending $375 million of reserves in Fiscal Year 2018***
- ***Adequate reserves are critical to maintaining the State's credit rating and providing financial flexibility to respond to financial contingencies***
- Fitch and S&P evaluating adequacy of reserves using revenue volatility from recession scenarios

Florida's Credit Ratings

State of Florida
General Obligation Credit Ratings

	Ratings	Outlook
Standard & Poor's	AAA	Stable
Fitch Ratings	AAA	Stable
Moody's Investors Service	Aa1	Stable

- Credit ratings are integral in the municipal bond market and are one factor that affects the interest rate on State debt offerings
- Factors analyzed in assigning State's credit ratings:
  - Governance Framework
  - Financial Management
  - Budgetary Performance
  - Debt/Liability Profile
  - Economy
- ***Florida's credit ratings were affirmed during Fiscal Year 2016 and have not changed***

Florida’s Credit Ratings

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

Strengths:

- ***Strong financial and debt management practices***
- ***Structurally balanced budget***
- ***Broad economic recovery and employment growth that currently outpaces the U.S.***
- Moderate and decreasing debt burden with clear guidelines
- Well-funded pension system and full funding for pension contribution every fiscal year since 2014
- Large, service based economy that benefits from a low cost of living and favorable climate

Challenges:

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

- ***Management of the pension system and associated liabilities remain increasingly important to the rating agencies credit analytics***
- Rating agencies will continue to evaluate the State’s ability to meet revenue projections, maintain reserves and structural budget balance
- State ratings are vulnerable to deterioration in economic conditions or developments negatively affecting financial resources or reserves

Conclusions

- ***State debt has been reduced by $4.1 billion over the last six years*** (not including federal loan repayment to unemployment trust fund)
- At June 30, 2016 ***State direct debt totaled $24.1 billion***, ***$1.6 billion less than the prior fiscal year***
- ***Refinancings*** over last 6.5 fiscal years ***have saved the State $2.5 billion***
- Recurring annual debt service payments were $2.1 billion in Fiscal Year 2016, slightly higher than Fiscal Year 2015
- ***Benchmark debt ratio of 5.46% remained below the 6% target for a third consecutive year***
- ***General Fund reserves at June 30, 2016 were approximately $3.2 billion, or 11.5% of General Revenues and are projected to decrease to $2.8 billion during Fiscal Year 2017***
- ***State credit ratings are very strong (AAA, AAA, Aa1)*** but vulnerable to a deterioration in economic conditions negatively affecting financial performance, structural budget balance or reserves
- ***Management and funding of the pension system have become an important part of evaluating the State's credit rating*** and fully funding the ARC is an important credit consideration