# Debt Report

## State of Florida

## 2020

Prepared by:
The Division of Bond Finance
December 2020

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# Executive Summary

The State of Florida Debt Report (the “Report”) is prepared annually by the Division of Bond Finance in accordance with Section 215.98, Florida Statutes. The Report reviews the State’s debt position how future debt service payments, debt issuance, and revenue projections will affect the State’s benchmark debt ratio. The Report also provides information on matters important to the State’s credit ratings such as pension liabilities and reserves, as well as developments in alternative financing techniques.

The debt affordability analysis contained in the Report is based on the ratio of debt service to revenues available to pay debt service. Policy guidelines established by the Legislature include a 6% target and a 7% limit for the State’s benchmark debt ratio.

**Debt and Debt Service Payments**

Total State direct debt outstanding as of June 30, 2020, was $19.2 billion - a $1.4 billion decrease from the prior fiscal year and continuing a downward trend which began in 2011 totaling $9.0 billion or 32%. Net tax-supported debt for programs supported by State tax revenues or tax-like revenues totaled $15.6 billion while self-supporting debt, representing debt secured by revenues generated from operating bond-financed facilities, totaled $3.6 billion. Indirect State debt, debt secured by revenues not appropriated by the State or debt obligations issued by a separate legal entity, was approximately $7.0 billion.

Annual debt service payments increased by $274 million in Fiscal Year (“FY”) 2020 to $2.3 billion. The increase in FY 2020 reflects the variability in annual payments under Public Private Partnerships (“PPP”) financing transportation projects and specifically the additional payments negotiated by the Department of Transportation (DOT) for the I-4 Project. Projected debt service is expected to decrease by approximately $126 million in FY 2021 but increase again in FY 2022 by $100 million.

Approximately $2.7 billion of debt is projected to be issued over the next ten years, primarily for financing transportation projects. Projections exclude any additional borrowing for Public Education Capital Outlay (“PECO”), Everglades Restoration, PPP projects not yet entered into by DOT, or proposed borrowing contained in agencies’ Legislative Budget Requests. Projected debt issuance over the next ten years has decreased by approximately $1.3 billion relative to the $4.0 billion projected issuance in the 2019 Debt Report.

Revenues available to pay debt service in FY 2020 totaled $41.2 billion, approximately $1.7 billion, or 3.9% less than FY 2019. Revenues were down because of the economic impact caused by the COVID-19 pandemic. The August 2020 the Revenue Estimating Conference (“REC”) revised prior estimates to incorporate the realized impacts of COVID-19 and the REC’s outlook for future revenue collections. FY 2021 revenues are projected to be $3.4 billion lower than the revenue forecasts used to formulate the FY 2021 budgeted spending plan. Revenues have recovered in the first quarter of FY 2021 from the steep declines in the last quarter of FY 2020. Revenues have continued to improve in FY 2021, coming in above

the August estimates through October 2020. Changes in revenue estimates have a significant impact on the calculation of available debt capacity.

**CARES Act**

The State received an allocation of Coronavirus Relief Funds ("CRF") totaling $5.9 billion under the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") (State allocation of $4.6 billion plus an additional $1.3 billion for local governments not qualified to receive direct federal support). The CRF funds have been used to pay for eligible expenses related to the State's response to COVID-19. The Governor's Office of Policy and Budget designated a team to manage the expense tracking and reporting to the U.S. Treasury. Utilization of CRF funds has helped offset the fiscal impact of additional expenses related to the State's response to the COVID-19 pandemic. As of October 22, 2020, the State had reported a total of $3.8 billion in eligible CRF expenditures to the U.S. Treasury. CRF funds are not included as a revenue available for debt service since they are non-recurring revenues.

**Benchmark Debt Ratio and Debt Capacity**

The benchmark debt ratio is sensitive to declines in state revenues caused by economic downturns. As such, the State's benchmark debt ratio - debt service to revenues available to pay debt service - increased in FY 2020 to 5.49% from 4.64% in FY 2019. The benchmark ratio increased due to the combined effect from lower revenue, due to the economic impact of COVID-19 and increasing debt service payments, due to the variability in PPP payments. The benchmark debt ratio remained below the 6% policy target for a seventh consecutive year and is forecasted to continue below the policy target due to the projected growth in revenues and restrained debt issuance. Projections for the benchmark debt ratio remain consistently below 6% through 2030 but are dependent on the projected economic recovery and continued restrained borrowing.

The total debt capacity available over the next ten years within the 6% policy target is nearly $34.1 billion. However, debt capacity available in FY 2022 is generated primarily through increases in projected revenue growth rather than decreases in debt service. Assuming the revenue growth currently projected by the REC, there is approximately $6.6 billion of net debt capacity available within the policy target in FY 2022. There is significant uncertainty regarding projected revenues. If projected revenue growth is not realized, debt capacity will be negatively impacted and could be constrained within the target in FY 2022. Assuming no revenue growth, there is approximately $3.5 billion of net debt capacity available within the policy target in FY 2022. Debt capacity generated by both revenue growth and decreasing debt service returns in FY 2023 and FY 2024. Debt capacity should be considered a scarce resource and, once used, it is not available again for twenty to thirty years, i.e. after the debt is repaid.

## Important Credit Factors

Credit ratings play an integral role in the municipal bond market and are one factor that affects the State's borrowing cost. Standard and Poor's ("S&P") and Moody's Investor Service (Moody's) revised their sector outlooks for U.S. States to negative on April 1, 2020 and May 1, 2020, respectively. Both rating agencies have stressed the importance of Florida

maintaining structural budget balance and the likelihood that sales tax may be slow to recover from the impacts of COVID-19.

In late September, the State's bond ratings were all affirmed which was significant in light of the economic, fiscal and budgetary consequences precipitated by COVID-19. In their reports, the rating agencies recognize the State will likely see lingering revenue impacts related to the pandemic but expect the state to maintain healthy reserves and continue the history of making timely budget adjustments and returning to structural budget balance to continue to support the triple-A ratings.

*Reserves*

General Fund Reserves declined by more than $2.1 billion from $4.0 billion in FY 2019 to $1.9 billion at the end of FY 2020. Reserves were used to support budgeted spending in FY 2020 and offset revenue declines. The discipline of setting aside sufficient funds during times of economic prosperity helped ensure that the State had adequate reserves to mitigate revenue declines caused by COVID-19. General Fund Reserves are projected to be approximately $3.0 billion at the end of FY 2021. This balance reflects full utilization of the CRF funds available from the CARES Act. However, projected reserves are subject to continued uncertainty due to better than projected revenue collections, additional distribution of CRF funds to local governments, and further budgetary spending that may be required to combat COVID-19. Trust fund balances also serve as an additional source of reserves, augmenting the State's financial flexibility. Reserve balance projections rely on assumptions and are subject to the uncertainty of the economic recovery and budgetary restraint.

*Pension Funding*

The rating agencies have increasingly focused on the financial challenges presented by defined benefit retirement systems. In recent years, there have been downgrades of state credit ratings due to outsized pension liabilities. Outsized pension liabilities have been caused by inadequate pension contributions. In addition to pension funded status, there is an increasing focus on the reasonableness of assumptions in calculating pension liabilities and how those assumptions affect required contributions and liabilities over the long-term.

This year, Florida continued to make important progress in lowering its investment return assumption and made incremental improvement by reducing the amortization policy to 25 years from 30 years. The investment return assumption, which had been lowered from 7.75% to 7.2% over the previous six years, was reduced to 7.0%. However, the Florida Retirement System's ("FRS") investment consultants and the State's actuary believe that 6.5% to 6.6% is more realistic. S&P has published guidance, which indicated 6.5% as a sustainable return assumption. Inadequate contributions may lead to a weaker financial position for the FRS and challenges to maintaining the State's triple-A credit ratings.

## Conclusion

The debt ratio remains below the 6% target due to limited debt issuance and projected revenue growth. The State is well positioned with significant debt capacity available to fund

critical infrastructure needs. However, available debt capacity and the ratio are sensitive to revenue declines from economic weaknesses such as those precipitated by the COVID-19 pandemic.

The State faces an ongoing vulnerability to maintaining Florida's triple-A credit ratings as a result of the fiscal and economic impacts of COVID-19. Revenue declines, coupled with sizeable additional borrowing, may put downward pressure on the State's credit ratings. Rating agencies have indicated that credit direction will depend largely on a state's willingness to make fiscal and budget adjustments and maintain structural budget balance. The State should not rely too heavily on non-recurring, one-time solutions such as federal government stimulus or borrowing; instead, the State should focus on restrained and prudent spending in order to mitigate the uncertain depth and duration of the impacts of COVID-19.

# Introduction

The annual Debt Report is required by Section 215.98, Florida Statutes and is presented to the President of the Senate, Speaker of the House, and the chair of each appropriation committee. The analysis included in the Debt Report is a tool to guide policymakers when assessing the impact of borrowing on the State's fiscal position, helping to inform prudent decision making regarding financing proposals and capital spending priorities.

To encourage fiscal responsibility on matters pertaining to state debt, Section 215.98, Florida Statutes, establishes a 6% target and 7% limit as policy guidelines for the benchmark debt ratio. The ratio is determined using a financial model that measures the impact of changes in two variables: (1) the State's annual debt service payments; and (2) the amount of revenues available for debt service payments. The analysis compares the State's current debt position to relevant industry and peer metrics and evaluates the impact of issuing additional debt given current economic conditions reflected in revenue forecasts.

Additional debt causing the benchmark debt ratio to exceed the 6% target may be issued only if the Legislature determines that the additional authorization and issuance are in the best interest of the State. Additional debt causing the benchmark debt ratio to exceed 7% may be issued only if the Legislature determines that such additional debt is necessary to address a critical State emergency.

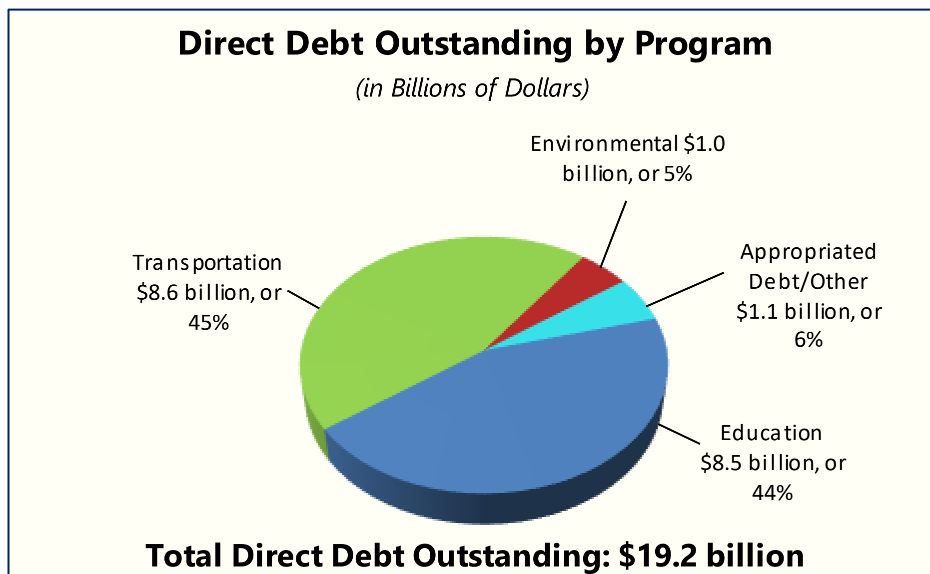
The purpose of the Report is to review the State's debt position and show how future debt issuance and revenue projections will affect the State's benchmark debt ratio. Performing the debt affordability analysis enables the State to monitor changes in its debt position.

The Report provides information as of June 30, 2020, unless otherwise noted. Updates to the analysis occur as REC forecasts are revised in order to ensure the Legislature has the latest information available when making critical future borrowing decisions during the appropriations process.

## Outstanding State Debt

The State had $19.2 billion in total direct debt outstanding. Educational facilities financed with bonds, represent $8.5 billion or 44% of total debt outstanding. The bulk of outstanding debt for educational facilities is comprised of PECO bonds, which accounts for $6.7 billion. The August 2020 PECO estimating conference estimated the current borrowing capacity at approximately $2.9 billion. Despite the estimated capacity, no new bonding for PECO has been included in the 2020 Report. Transportation infrastructure at $8.6 billion or 45% of total debt outstanding. The largest part of transportation debt reflects the State's payment obligations for financing transportation infrastructure through Public Private Partnerships ("PPPs")—$3.4 billion. Contributing to the next largest portion of transportation debt are toll roads primarily financed with bonds for Florida's Turnpike Enterprise—$2.7 billion, and Right-of-Way Acquisition and Bridge Construction bonds—$2.0 billion. Environmental program bonding is the third largest component of State debt, with $1.0 billion of bonds outstanding for the Florida Forever, Everglades Restoration, Florida Water Pollution Control, and Inland Protection programs.

Net tax-supported debt consists of debt secured by state tax revenue or tax-like revenue. Self-supporting debt is secured by revenues generated from operating the facilities financed with bonds. The Turnpike Enterprise is the primary self-supporting program with outstanding debt. The remaining self-supporting debt relates to other toll facilities, university auxiliary enterprises, which primarily finance campus housing and parking facilities, and the water pollution control revolving loan program, which provides low interest rate loans to local governments for wastewater projects.



## Direct Debt Outstanding by Type and Program

**As of June 30, 2020**

*(In Millions Dollars)*

| Debt Type | | Amount |
|---|---|---|
| Net Tax-Supported Debt | | $15,620.6 |
| Self-Supporting Debt | | 3,583.8 |
| **Total State Debt Outstanding** | | **$19,204.4** |

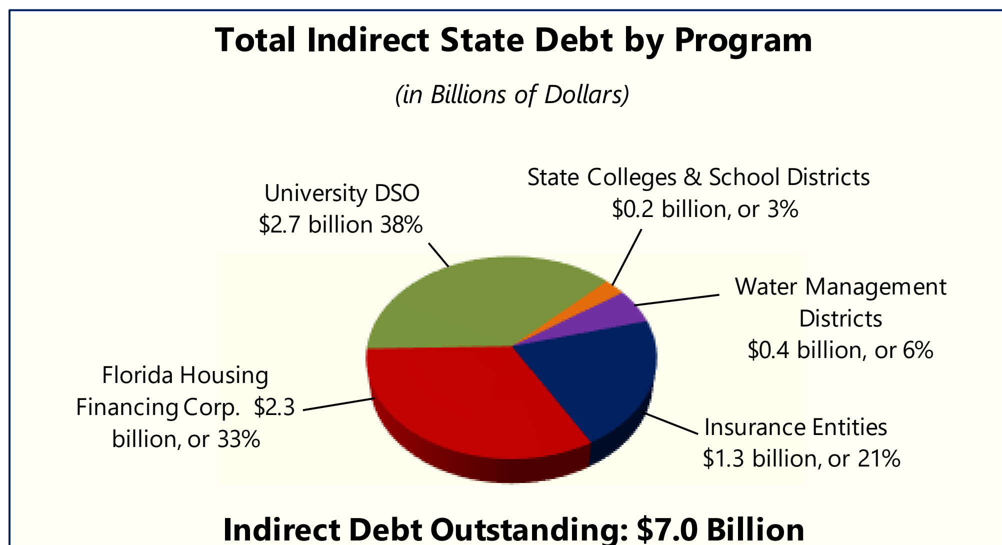
| | | |
|---|---|---|
| **Net Tax-Supported Debt** | | |
| Education | | |
| Public Education Capital Outlay | $6,724.2 | |
| Capital Outlay | 81.9 | |
| Lottery | 801.3 | |
| University System Improvement | 86.6 | |
| University Mandatory Fee | 61.9 | |
| State (Community) Colleges | 59.7 | |
| Total Education | | $7,815.7 |
| Environmental | | |
| Florida Forever Bonds | 567.6 | |
| Everglades Restoration Bonds | 157.4 | |
| Inland Protection | 21.6 | |
| Total Environmental | | $746.5 |
| Transportation | | |
| Right-of-Way Acquisition and Bridge Constructic | 1,994.8 | |
| State Infrastructure Bank | 10.6 | |
| GARVEE | 118.0 | |
| DOT Financing Corporation | 146.9 | |
| PPP Obligations | 3,412.5 | |
| Florida Ports | 276.8 | |
| Total Transportation | | $5,959.6 |
| Appropriated Debt / Other | | |
| Facilities | 161.6 | |
| Prisons | 289.1 | |
| Children & Families | 63.9 | |
| Lee Moffitt Cancer Center | 270.3 | |
| Master Lease | 4.8 | |
| Energy Saving Contracts | 21.7 | |
| Sports Facility Obligations | 287.4 | |
| Total Appropriated Debt / Other | | $1,098.8 |
| **Total Net Tax-Supported Debt Outstanding** | | **$15,620.6** |
| **Self-Supporting Debt** | | |
| Education | | |
| University Auxiliary Facility Revenue Bonds | | $682.7 |
| Environmental | | |
| Florida Water Pollution Control | | 214.2 |
| Transportation | | |
| Toll Facilities | 2,686.9 | |
| Total Transportation | | 2,686.9 |
| **Total Self-Supported Debt Outstanding** | | **$3,583.8** |

# Indirect Debt

In addition to direct debt, the State has indirect debt. Indirect debt represents debt secured by revenues not appropriated by the State or debt obligations of a separate legal entity. In some cases, indirect debt may represent a financial burden on Florida citizens (e.g., assessments that are pledged to the Florida Hurricane Catastrophe Fund ("Cat Fund") and Citizens debt). Indirect debt is not included in the State's debt ratios or the analysis of the State's debt burden.

Indirect debt of the State totaled approximately $7.0 billion, approximately $1.2 billion less than the previous year. Indirect debt decreased primarily due to substantial reductions in debt associated with insurance entities ($1.5 billion), which was partially offset by an increase in debt associated with State housing programs ($332 million). Cat Fund and Citizens represented $1.3 billion or 21% of total indirect debt and consists of pre-event financings to provide cash to pay potential losses incurred following a hurricane. However, the Cat Fund issued $3.5 billion in pre-event bonds in September 2020, which are not reflected within this report. If included, the additional Cat Fund debt would increase indirect debt by 50% and insurance entities relative percentage to 46% from 21%. The proceeds of the Cat Fund pre-event bonds have not been spent but are available if the need arises to pay residential losses covered by the Cat Fund.

Pre-event debt outstanding as of June 30, 2020 was $820 million for Citizens and $650 million for the Cat Fund. Although the State views the insurance entities as independent and responsible for their own obligations, rating agencies consider the amount of debt outstanding by the insurance entities integral to the State's overall credit due to the fiscal impact the insurance entity assessments could have on Floridians. University Direct Support Organizations ("DSOs") comprise nearly $2.7 billion or 38% and Florida Housing Finance Corporation, which administers the State's housing programs, accounts for $2.3 billion or 33% of the total indirect debt outstanding.



## Total Indirect State Debt by Program

*(In Millions of Dollars)*

| | | |
|---|---|---|
| Insurance Entities | | |
| Florida Hurricane Catastrophe Fund Finance Corporation | $ 650.0 * | |
| Citizens Property Insurance Corporation | 820.0 | |
| Total | | $ 1,470.0 |
| Florida Housing Finance Corporation | | |
| Single Family Programs | 1,207.3 | |
| Multi-Family Programs | 1,097.0 | |
| Total | | 2,304.3 |
| University Direct Support Organizations | | |
| Shands Teaching Hospital & Affiliates | 990.6 | |
| University of South Florida | 324.2 | |
| University of Central Florida | 355.6 | |
| Florida Gulf Coast University | 165.0 | |
| Florida Atlantic University | 169.0 | |
| North Florida | 129.3 | |
| University of Florida | 216.3 | |
| Other State Universities | 316.8 | |
| Total | | 2,666.8 |
| Water Management Districts | | 388.5 |
| School Districts | | |
| Bay | 10.4 | |
| Lee | 13.0 | |
| Palm Beach | 22.4 | |
| Other School Districts | 46.5 | |
| Total | | 92.2 |
| State (Community) Colleges and Foundations | | 96.5 |
| **Total State Indirect Debt** | | **$ 7,018.2** |

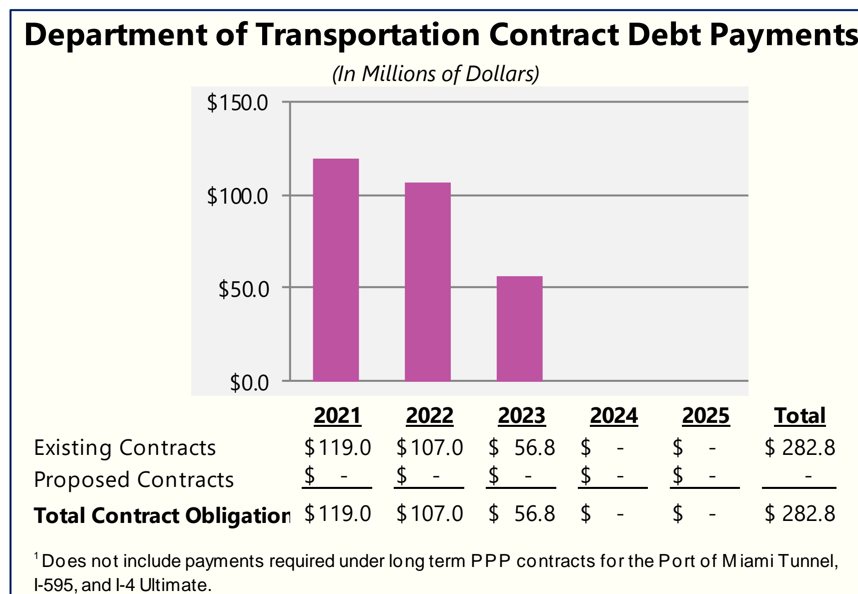
**Does not include $3.5 billion in Pre-Event bonding issued in FY 2021.*

## Alternative Financing Techniques

Alternative financing techniques provide funding for capital projects and utilize State resources for repayment. Four alternative financing techniques are noted in this Report: DOT short-term PPP contracts; DOT long-term PPP projects; debt issued through university DSOs or through PPP contracts; and charter school transactions. Tracking and disclosing alternative financing transactions is important as they frequently commit future state resources but may not be reflected in State debt.

### Short Term Contract Debt

DOT has used build-finance and design-build-finance contracts (collectively referred to as "Contract Debt") to advance construction projects. Contract debt accelerates project construction but obligates DOT to make payments at a later date based on a pre-determined contractual schedule, functionally equivalent to short-term debt. DOT generally begins making the mandatory cash availability payments from State Transportation Trust Fund ("STTF") revenues during construction but payments sometimes continue once construction is complete. DOT Contract Debt totaled approximately $283 million. Although a portion of the payments may be offset with other funding sources (e.g. toll revenues or contributions by local governments), the amounts represent the total payments due under contract debt payable from STTF revenues, as the State is the ultimate obligor.




| | 2021 | 2022 | 2023 | 2024 | 2025 | Total |
|---|---|---|---|---|---|---|
| Existing Contracts | $119.0 | $107.0 | $ 56.8 | $ - | $ - | $ 282.8 |
| Proposed Contracts | $ - | $ - | $ - | $ - | $ - | - |
| **Total Contract Obligation** | $119.0 | $107.0 | $ 56.8 | $ - | $ - | $ 282.8 |

[1] Does not include payments required under long term PPP contracts for the Port of Miami Tunnel, I-595, and I-4 Ultimate.

DOT's required payments under Contract Debt have been included as State debt, but excluded from calculating the benchmark debt ratio because the term of the contract debt is generally no longer than five years and repaid within DOT's five-year Work Program. Including required payments under the contract debt would introduce near-term volatility in the benchmark debt ratio, impairing the usefulness of the analysis as a long-term planning tool.

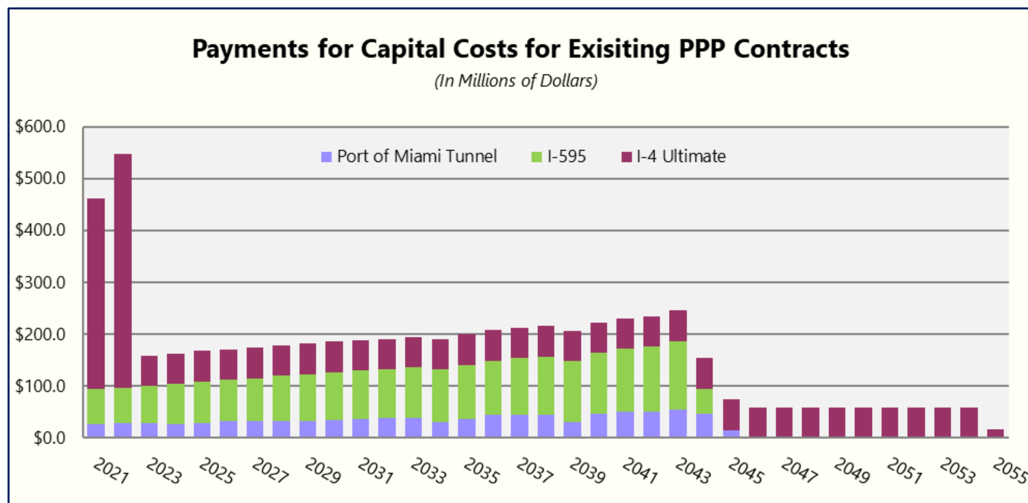
## Long-Term PPP Projects

Pursuant to Section 334.30, Florida Statutes, DOT has executed three agreements with private partners to advance construction of the I-595 Corridor Improvement Project, the Port of Miami Tunnel Project, and the I-4 Project through Orlando. These projects have original combined construction costs of $4.5 billion—$1.3 billion for the I-595, $543 million for the Port of Miami Tunnel, and $2.7 billion for the I-4 Project.

The capital costs and operations/maintenance expenses of these PPP projects are paid through "availability payments" or mandatory, scheduled payments that commence when construction is complete and continue for 30 to 35 years. The capital costs of these PPP projects are included as outstanding debt of the State. The capital portion of the required payments for DOT's PPP projects total $5.9 billion over the next 35 years. The maximum aggregate annual payment of $548 million for the capital costs associated with these projects is due in 2022.

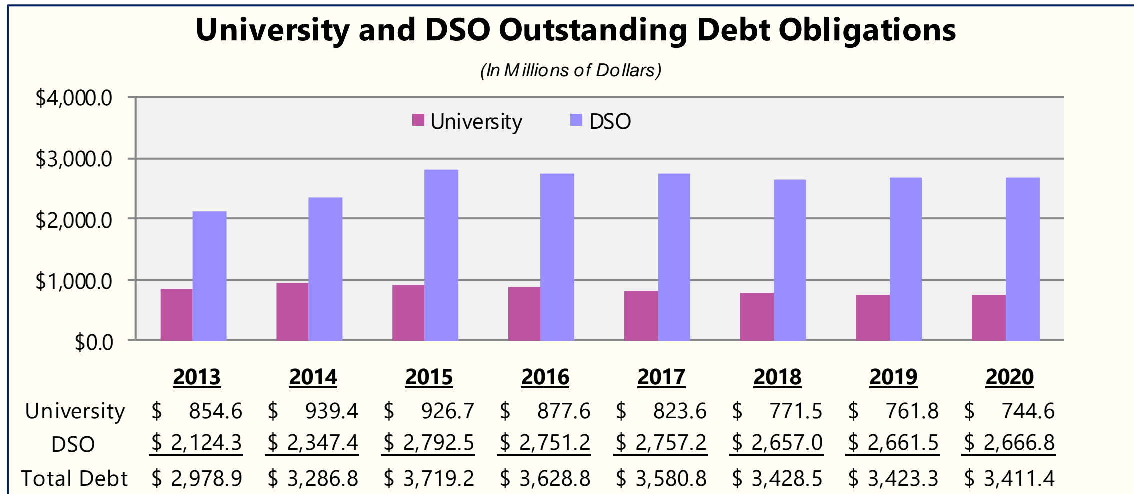
DOT and I-4 Mobility Partners (the "Concessionaire") entered into the I-4 Supplemental Agreement to settle claims and disputes regarding additional project costs and delays in FY 2020. The Supplemental Agreement provided an additional $125 million payment to the Concessionaire to settle outstanding claims, which allegedly arose from unforeseen conditions and issues outside the Concessionaire's control. The Supplemental Agreement also makes revisions to the schedule for Final Acceptance payments and Availability Payments, including a penalty to the Concessionaire for delayed delivery of the project.

Section 334.30, Florida Statutes, requires DOT to ensure that no more than 15% of the total available federal and state funding in the STTF in any given year be obligated to required payments for contract debt and PPP contracts. The amount available under the 15% limit varies annually over the next ten years. The amount available under the statutory limit generates additional debt capacity of $9.5 billion within DOT's 10 year plan. If this amount were added to the State's FY 2020 benchmark debt ratio calculation, the debt ratio would increase by approximately 3.79%, significantly exceeding the benchmark debt ratio target and limit.



## University PPP and DSO Obligations

State universities utilize their DSOs to support various auxiliary functions (e.g. athletics, healthcare, fundraising, research activities, etc.). DSOs can also serve as a conduit issuer or shell corporation for universities to finance capital projects, including campus housing, parking and athletic facilities. DSO transactions are approved by the universities' Boards of Trustees, DSO Boards, and the Board of Governors. Unlike transactions managed by the Division of Bond Finance, DSO transactions do not require approval by the Governor and Cabinet. Universities have increasingly used DSOs to incur debt for infrastructure projects. University PPP obligations and DSO debt are estimated to be approximately $2.7 billion and represented 78% of university debt outstanding. University PPP and DSO debt are excluded from State direct debt in this report; if they were included, State debt would be approximately 14% higher.




| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|
| University | $ 854.6 | $ 939.4 | $ 926.7 | $ 877.6 | $ 823.6 | $ 771.5 | $ 761.8 | $ 744.6 |
| DSO | $ 2,124.3 | $ 2,347.4 | $ 2,792.5 | $ 2,751.2 | $ 2,757.2 | $ 2,657.0 | $ 2,661.5 | $ 2,666.8 |
| Total Debt | $ 2,978.9 | $ 3,286.8 | $ 3,719.2 | $ 3,628.8 | $ 3,580.8 | $ 3,428.5 | $ 3,423.3 | $ 3,411.4 |

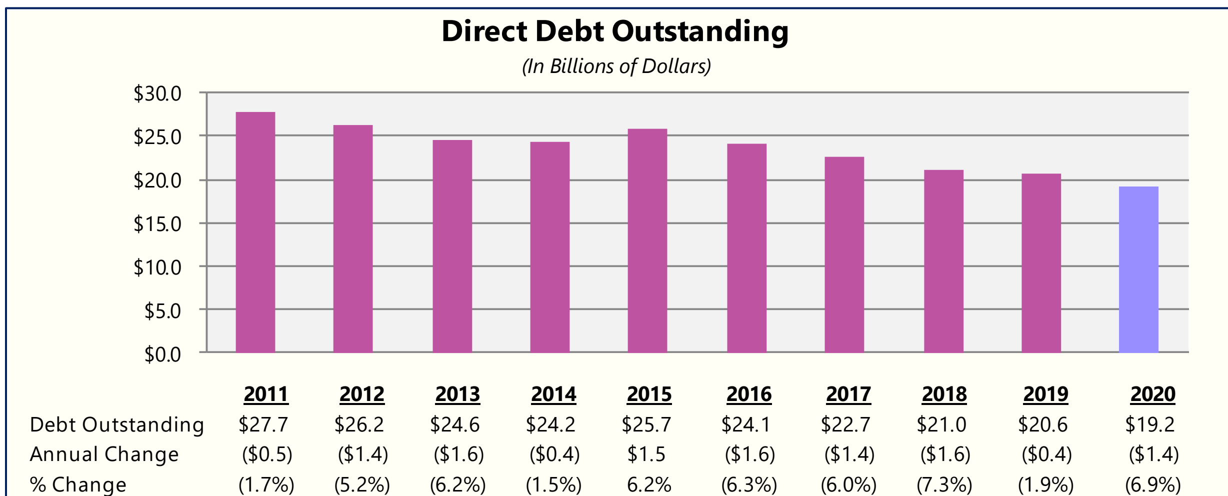
## Charter Schools

According to the Department of Education, there were 673 charter schools educating approximately 329,000 students in Florida in FY 2020, an enrollment increase of 5%. The 329,000 students enrolled in charter schools represents approximately 11.5% of Florida's total PK-12 enrollment of 2.9 million. Like Florida public schools, charter schools receive funding for operations from the State on a per student basis. In addition, charter schools can become eligible for capital outlay funding beginning in the fourth year of operation. Capital outlay disbursements to charter schools totaled more than $158 million, an increase of approximately $13 million from the previous fiscal year. If the $158 million annual appropriation were fully leveraged, charter schools could issue a combined $2.4 to 2.7 billion of debt secured by Charter School Capital Outlay. Enrollment demand has pressured existing charter school facilities and contributed to the proliferation of debt issuance to finance new schools or refinance existing schools. Since charter school debt is not a direct obligation of the State and municipal market participants evaluate obligations based on the operator and success of the school, it is not treated as State direct debt and is excluded when calculating the benchmark debt ratio.

# Debt Outstanding

The trend in the State's outstanding debt is important in evaluating how debt levels have changed over time. Total State direct debt grew to a peak of $28.2 billion in FY 2010. The increases in debt outstanding were primarily due to the issuance of PECO bonds, the State's largest bonding program, Florida Forever bonds, PPP obligations and correctional facility financings.

Over the past 10 years, total direct debt declined by approximately $9.0 billion, or 32%, because very little new money debt was authorized. The decrease was due in part to a change in debt management policy that requires more rigorous scrutiny of debt financed projects with a focus on the return on investment or other appropriate quantitative metrics. In FY 2015, debt increased by approximately $1.5 billion due to substantial investment in transportation infrastructure (I-4 Project) and a refinement in how PPP obligations are recorded. In FY 2020, debt declined $1.4 billion and continued the downward trend that, except for FY 2015, started in FY 2011.



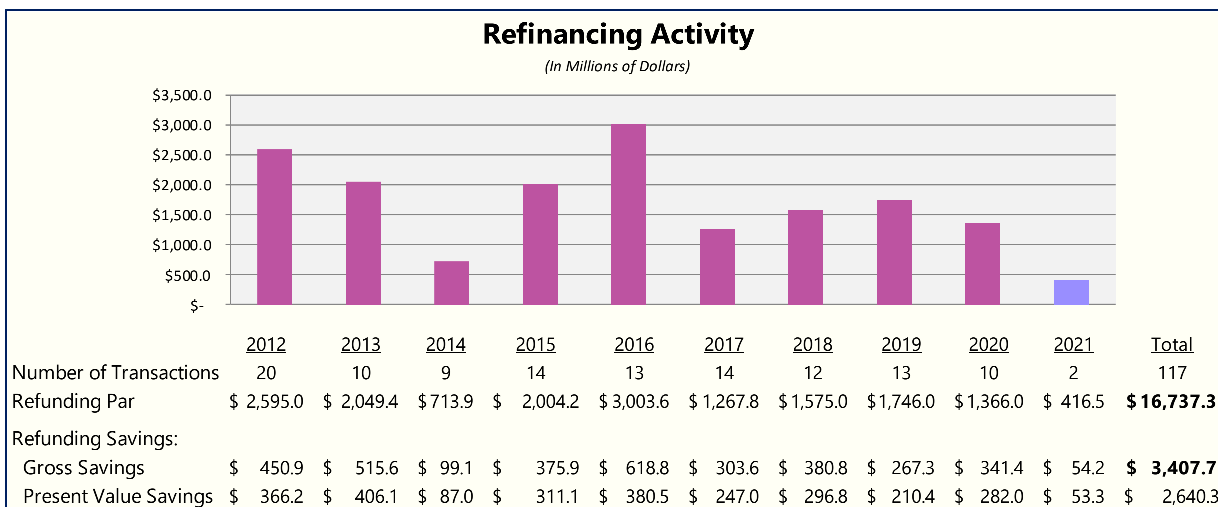

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| Debt Outstanding | $27.7 | $26.2 | $24.6 | $24.2 | $25.7 | $24.1 | $22.7 | $21.0 | $20.6 | $19.2 |
| Annual Change | ($0.5) | ($1.4) | ($1.6) | ($0.4) | $1.5 | ($1.6) | ($1.4) | ($1.6) | ($0.4) | ($1.4) |
| % Change | (1.7%) | (5.2%) | (6.2%) | (1.5%) | 6.2% | (6.3%) | (6.0%) | (7.3%) | (1.9%) | (6.9%) |

## Refinancing Activity

The State executed 10 refinancing transactions in FY 2020 generating gross debt service savings of $341 million or $282 million on a present value basis. The vast majority of debt issuance in the past several years has been to refinance debt at lower interest rates and reduce annual debt service payments. Since FY 2012, the State has executed 117 refinancings totaling $16.7 billion generating gross debt service savings of more than $3.4 billion over the remaining life of the bonds or $2.6 billion on a present value basis. More than 85% of all State debt has been refinanced to lower interest rates.

Prior to January 1, 2018, Florida had been able to take advantage of historically low interest rates through the use of advance refunding bonds or bonds that are issued prior to the call date of the bonds being refunded. The Tax Cuts and Jobs Act of 2018 eliminated states' ability to issue tax-exempt advance refunding bonds. Eliminating advance refundings limits the tools available to the State to refinance its debt at lower interest rates.

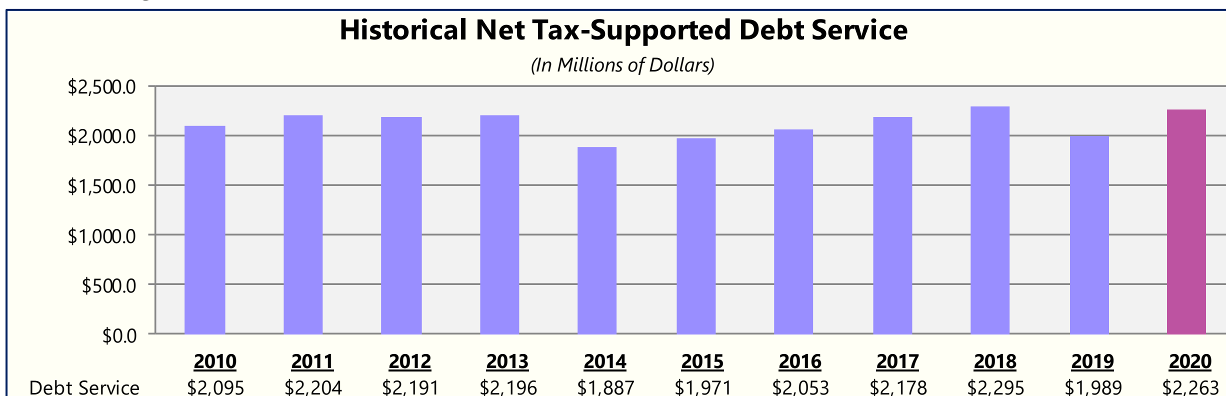
The Division continues to actively manage the State's debt portfolio for refunding opportunities, to take advantage of favorable interest rates and lower the interest cost on the State's borrowings. However, the candidates available for refinancing in the future is diminishing. Over the next five years, there is only $4.4 billion of debt which can be refinanced if market conditions remain favorable and interest rates low enough to generate debt service savings.




| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Number of Transactions | 20 | 10 | 9 | 14 | 13 | 14 | 12 | 13 | 10 | 2 | 117 |
| Refunding Par | $ 2,595.0 | $ 2,049.4 | $ 713.9 | $ 2,004.2 | $ 3,003.6 | $ 1,267.8 | $ 1,575.0 | $ 1,746.0 | $ 1,366.0 | $ 416.5 | **$ 16,737.3** |
| Refunding Savings: | | | | | | | | | | | |
| Gross Savings | $ 450.9 | $ 515.6 | $ 99.1 | $ 375.9 | $ 618.8 | $ 303.6 | $ 380.8 | $ 267.3 | $ 341.4 | $ 54.2 | **$ 3,407.7** |
| Present Value Savings | $ 366.2 | $ 406.1 | $ 87.0 | $ 311.1 | $ 380.5 | $ 247.0 | $ 296.8 | $ 210.4 | $ 282.0 | $ 53.3 | $ 2,640.3 |

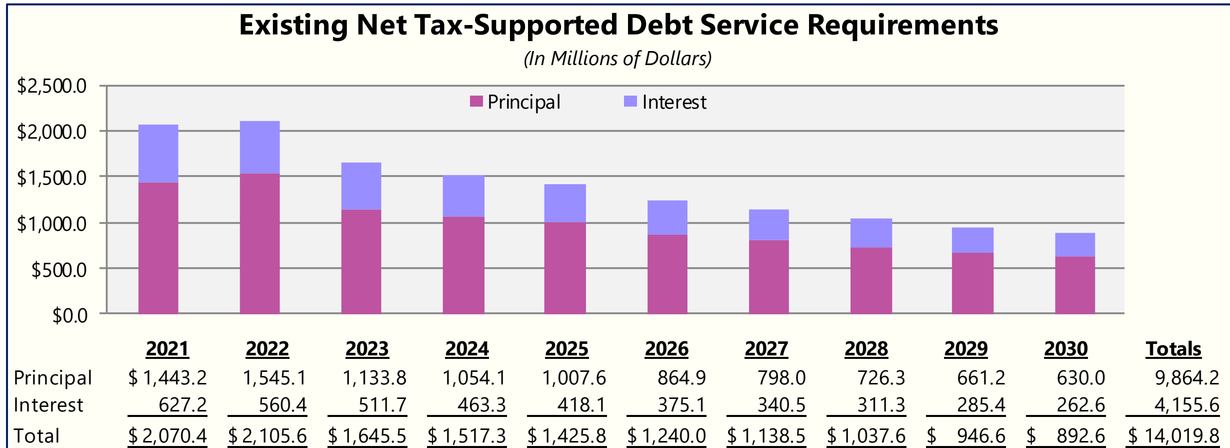
## Annual Debt Service Payments

Annual debt service payments for the State's existing net tax-supported debt in FY 2020 totaled approximately $2.3 billion. Over the past ten years, annual debt service payments increased between FYs 2010 and 2013, peaking at $2.2 billion in FY 2013 before declining 14% to $1.9 billion in FY 2014. The decline in annual debt service in 2014 was due to final payments on Preservation 2000 bonds. The increase in FYs 2015 through 2018, decline in FY 2019, and increase in FY 2020 reflect the variability in PPP availability payments. From a budgetary perspective, measuring the growth in annual debt service indicates how much of the State's resources are obligated for paying debt service before providing for other essential government services.




| | **2010** | **2011** | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** | **2018** | **2019** | **2020** |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Debt Service | $2,095 | $2,204 | $2,191 | $2,196 | $1,887 | $1,971 | $2,053 | $2,178 | $2,295 | $1,989 | $2,263 |

Debt service payments on existing outstanding debt total $14.0 billion over the next ten years, with principal payments of $9.9 billion and interest payments of $4.2 billion. Annual debt service payments decrease next fiscal year to $2.1 billion but increase again in FY 2022 by $100 million before decreasing to approximately $1.6 billion in FY 2023.




| | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | Totals |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Principal | $ 1,443.2 | 1,545.1 | 1,133.8 | 1,054.1 | 1,007.6 | 864.9 | 798.0 | 726.3 | 661.2 | 630.0 | 9,864.2 |
| Interest | 627.2 | 560.4 | 511.7 | 463.3 | 418.1 | 375.1 | 340.5 | 311.3 | 285.4 | 262.6 | 4,155.6 |
| Total | $ 2,070.4 | $ 2,105.6 | $ 1,645.5 | $ 1,517.3 | $ 1,425.8 | $ 1,240.0 | $ 1,138.5 | $ 1,037.6 | $ 946.6 | $ 892.6 | $ 14,019.8 |

## Projected Debt Issuance

Projected debt issuance is provided by State agencies that receive proceeds under authorized bond programs. Projections exclude any additional borrowing for PECO, Florida Forever, or additional PPP projects not yet entered into by DOT as the amounts and timing of debt issuance under these programs are unknown.

Approximately $2.7 billion in debt issuance is projected over the next ten years, primarily for transportation. The projected issuance decreased by approximately $1.3 billion or 32% from $4.0 billion projected in the 2019 Report. The decrease since last year is due to lower anticipated borrowing for transportation; specifically, $273 million for ROW, $898 million for GARVEE, and $100 million for DOT Financing Corporation. The August 2020 PECO estimating conference shows that nearly $2.9 billion in PECO bonding capacity is available for FY 2022. However, no additional PECO issuance is included in the 2020 Report.

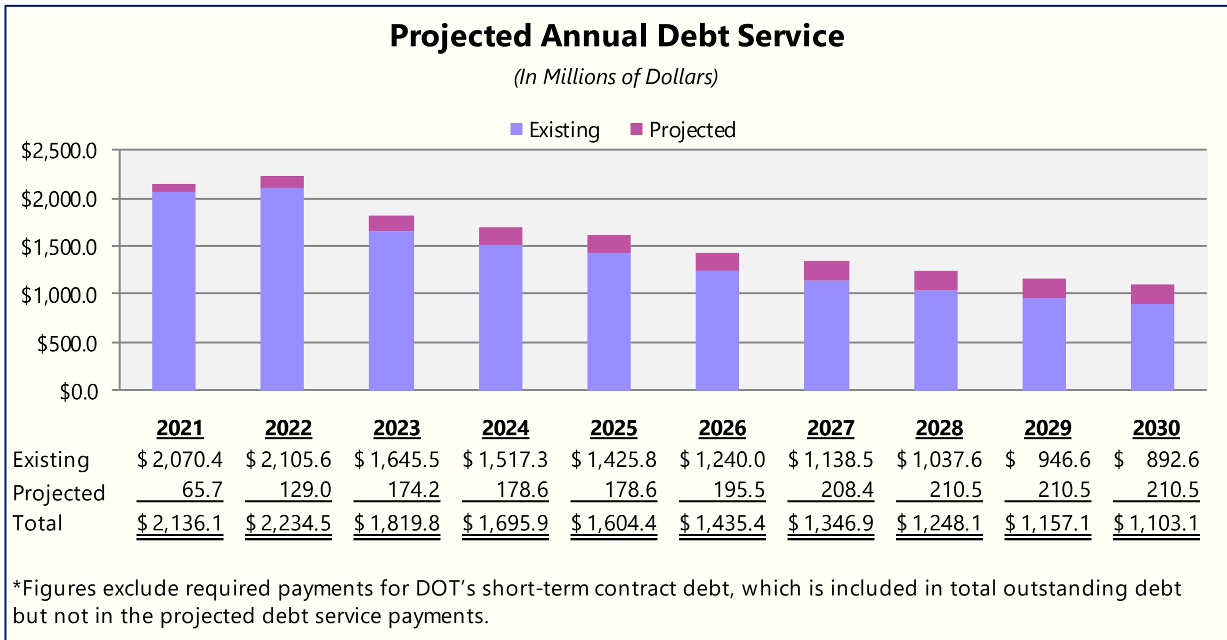
**Projected Debt Issuance By Program**

*(In Millions of Dollars)*

| Fiscal Year | DMS COPs | ROW | GARVEE | DOT Fin. Corp. | Master Lease | Total Issuance |
|---|---|---|---|---|---|---|
| 2021 | $ 134.3 | $ 250.0 | $ 200.0 | $ 188.1 | $ 1.6 | $ 774.0 |
| 2022 | - | 400.0 | 250.0 | 121.3 | - | 771.3 |
| 2023 | - | 300.0 | 245.0 | - | - | 545.0 |
| 2024 | - | 80.0 | - | - | - | 80.0 |
| 2025 | - | - | - | - | - | - |
| 2026 | - | 275.0 | - | - | - | 275.0 |
| 2027 | - | 210.0 | - | - | - | 210.0 |
| 2028 | - | 35.0 | - | - | - | 35.0 |
| 2029 | - | - | - | - | - | - |
| 2030 | - | - | - | - | - | - |
| Total | $ 134.3 | $ 1,550.0 | $ 695.0 | $ 309.4 | $ 1.6 | $ 2,690.3 |

## Projected Debt Service

Based on existing and projected debt service, FY 2021 annual debt service is expected to decrease to $2.1 billion. Subsequently, projected debt service is expected to increase by $100 million from $2.1 billion to $2.2 billion in FY 2022, before declining to approximately $1.8 billion in FY 2023. The decreasing annual debt service reflects the combined effect of bonds that mature being greater than new bond issuance.




| | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 |
|---|---|---|---|---|---|---|---|---|---|---|
| Existing | $ 2,070.4 | $ 2,105.6 | $ 1,645.5 | $ 1,517.3 | $ 1,425.8 | $ 1,240.0 | $ 1,138.5 | $ 1,037.6 | $ 946.6 | $ 892.6 |
| Projected | 65.7 | 129.0 | 174.2 | 178.6 | 178.6 | 195.5 | 208.4 | 210.5 | 210.5 | 210.5 |
| Total | $ 2,136.1 | $ 2,234.5 | $ 1,819.8 | $ 1,695.9 | $ 1,604.4 | $ 1,435.4 | $ 1,346.9 | $ 1,248.1 | $ 1,157.1 | $ 1,103.1 |

*Figures exclude required payments for DOT's short-term contract debt, which is included in total outstanding debt but not in the projected debt service payments.

## Revenue Forecasts

Revenue available to pay debt service is one of the two variables used to calculate the benchmark debt ratio. Actual revenue collections were below FY 2019 collections by $1.7 billion, a 3.9% decrease. The primary decrease in available revenues—$1.5 billion—was the result of decreased General Revenues, primarily sales taxes. The decrease in revenues in FY 2020 was concentrated within the last quarter of the fiscal year because that is when measures were taken to curtail the spread of COVID-19.

In August 2020, the REC revised prior estimates to incorporate the realized impacts of COVID-19 and the REC's outlook for future revenue collections. The REC decreased projected FY 2021 revenues by $3.4 billion, or 9.9%. Additionally, projected General Revenues for FY 2022 through FY 2025 were decreased by an aggregate $7.0 billion.

Revenues recovered in the first quarter of FY 2021 from the steep declines in the last quarter of FY 2020 and continue to improve. General Revenue collections for July 2020 through September 2020 were approximately $400 million higher than the revised August 2020 estimates, demonstrating significant improvement over the last quarter of FY 2020. In

aggregate, FY2021 net general revenue collections through October 2020 are approximately $725 million over the August 2020 estimates.

Changes in revenue estimates have a significant impact on the calculation of available debt capacity and are especially important given the State's economic environment. The August 2020 REC results have been used for purposes of this Report. Revenue forecasts will be reviewed and revised by the REC in December 2020 and this Report will be updated. Forecasted revenue growth could be materially impacted by uncertainties around the duration and depth of the fiscal and economic impacts of COVID-19.

General revenues, as well as specific tax revenues pledged to various bond programs (e.g., gross receipts taxes pledged to the PECO bonds, motor fuel taxes pledged to Right-of-Way bonds, and dedicated percentages of documentary stamp tax collections pledged to the Florida Forever and Everglades Restoration bonds), are available for debt service.

**Projected Revenue Available for State Tax-Supported Debt**

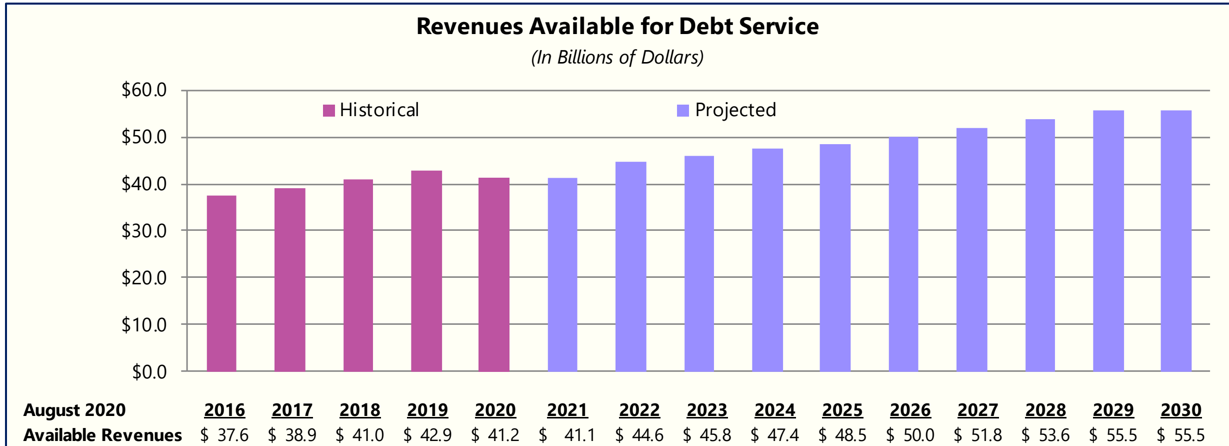
*(In Millions of Dollars)*

| | Actual | | Projection | | |
|---|---|---|---|---|---|
| **Fiscal Year** | **2019** | **2020** | **2021** | **2022** | **2023** |
| **Revenue Available:** | | | | | |
| **General Revenue** | $ 32,870.6 | $ 31,366.2 | $ 30,990.1 | $ 33,691.2 | $ 35,279.3 |
| Less : Documentary Stamp Tax Included Below | (912.1) | (983.1) | (1,003.4) | (1,076.8) | (1,101.8) |
| Net General Revenue | $ 31,958.5 | $ 30,383.1 | $ 29,986.7 | $ 32,614.4 | $ 34,177.5 |
| **Specific Tax Revenue** | | | | | |
| Gross Receipts | 1,148.9 | 1,115.1 | 1,112.9 | 1,135.5 | 1,150.9 |
| Motor Vehicle License | 787.1 | 793.1 | 818.5 | 836.3 | 846.3 |
| Lottery | 1,917.6 | 1,851.5 | 1,875.5 | 1,866.0 | 1,886.1 |
| Documentary Stamp Tax | 2,651.1 | 2,874.9 | 2,936.7 | 3,167.7 | 3,246.6 |
| Motor Fuel Tax | 1,517.9 | 1,449.5 | 1,398.4 | 1,519.8 | 1,587.9 |
| Motor Vehicle License-Surcharge | 26.8 | 26.7 | 19.5 | - | - |
| Tax on Pollutants-IPTF | 235.6 | 214.6 | 201.9 | 216.0 | 221.9 |
| University Net Bldg Fees & Cap. Impr. Fees | 58.5 | 58.8 | 58.8 | 58.8 | 58.8 |
| Community College Cap. Impr.Fees | 39.2 | 38.5 | 38.5 | 38.5 | 38.5 |
| Title Fees | 200.0 | 200.0 | 200.0 | 200.0 | 200.0 |
| Federal Reimbursements for Transportation | 2,330.6 | 2,175.3 | 2,288.4 | 2,857.0 | 2,397.6 |
| **Other Sources** | | | | | |
| Designated for P3 Debt Payments | 2.8 | - | 199.2 | 53.0 | 3.1 |
| **Total State Revenue Available** | **$ 42,874.4** | **$ 41,181.2** | **$ 41,135.0** | **$ 44,563.0** | **$ 45,815.2** |

Consistent improvement in the State's economy positively affected revenues available for debt service prior to the COVID-19 pandemic. FY 2020 revenues were down due to the economic impacts associated with COVID-19. FY 2020 revenues declined $1.7 billion, or 3.9% from FY 2019. The revenue decline was concentrated in the fourth quarter of FY 2020 because of the measures taken to combat the spread of the virus. Revenues are expected to remain relatively flat in FY 2021 as the State recovers from the sharp, concentrated economic impacts experienced in the fourth quarter of FY 2020.

Revenue growth is expected to resume in FY 2022 reflecting the REC's expectations for the State's economic recovery from COVID-19 and positively influences the benchmark debt ratio. The REC's August 2020 adopted projections include an 8.7% increase in general revenue for FY 2022, as the State and nation recover from the impacts of the COVID-19 pandemic. However, there is significant uncertainty regarding the duration and severity of

the fiscal and economic impacts of COVID-19. Near-term revenues will be updated by the REC in December 2020 and the impact on benchmark ratio will be adjusted accordingly.

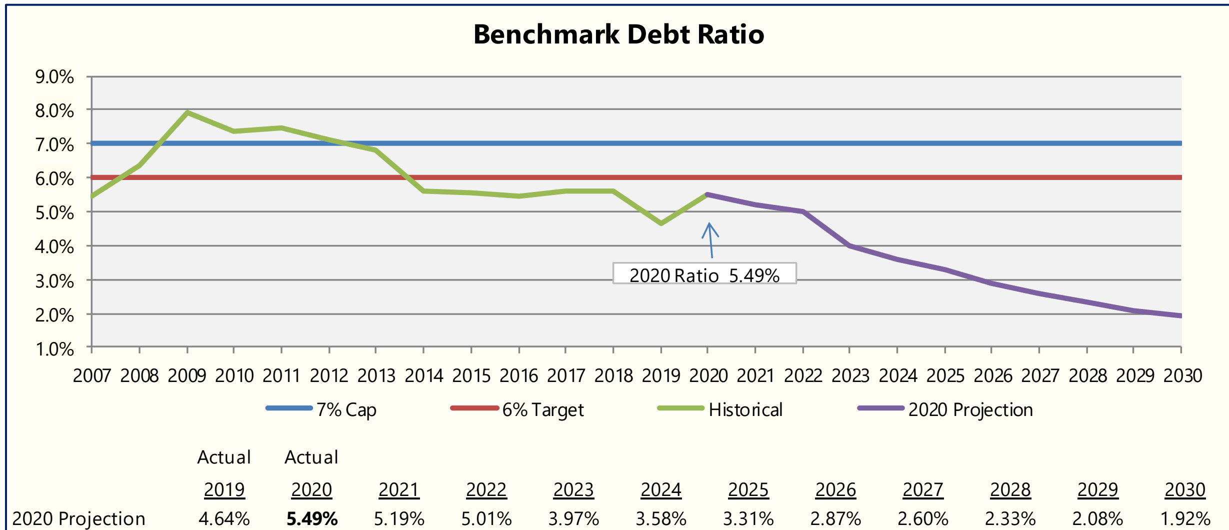



| August 2020 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Available Revenues | $ 37.6 | $ 38.9 | $ 41.0 | $ 42.9 | $ 41.2 | $ 41.1 | $ 44.6 | $ 45.8 | $ 47.4 | $ 48.5 | $ 50.0 | $ 51.8 | $ 53.6 | $ 55.5 | $ 55.5 |

# Benchmark Debt Ratio

The debt affordability analysis is based on the ratio of debt service to revenues available to pay debt service. The policy guidelines established by the Legislature include a 6% target and a 7% limit for the benchmark debt ratio. The benchmark debt ratio increased significantly between FYs 2007 and 2009 as revenues declined during the Great Recession. Following FY 2010, the benchmark debt ratio gradually declined when revenues improved and debt service payments remained flat.

Total debt service payments of approximately $2.3 billion this year were nearly $274 million higher than FY 2019 and include a non-recurring $125 million payment related to the I-4 Supplemental Agreement. The benchmark debt ratio of 5.49% for FY 2020 was significantly and unexpectedly up from 4.64% in FY 2019 because of the combined effect from decreasing revenues, due to COVID-19, and increasing debt service, due to the variability of PPP payments and the $125 million non-recurring supplemental payment for the I-4 project. Revenues for FY 2021 are projected to remain relatively flat in relation to FY 2020 before growth is projected to return in FY 2022.




| | Actual<br>2019 | Actual<br>2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2020 Projection | 4.64% | **5.49%** | 5.19% | 5.01% | 3.97% | 3.58% | 3.31% | 2.87% | 2.60% | 2.33% | 2.08% | 1.92% |

The projected benchmark debt ratio for the next ten years is based on the August 2020 revenue forecasts and projected debt issuance as of the date of this Report. Projections show the benchmark debt ratio remaining below the 6% policy target over the forecast period reflecting lower projected issuance and steady recovery from the economic impacts of the COVID-19 pandemic. The REC scheduled in December 2020 is expected to revise the general revenue forecast, and projections of the benchmark debt ratio will be updated. The projected improvement in the benchmark debt ratio is dependent on realizing the revenue growth projected by the REC and is subject to significant uncertainty because of the unpredictability of COVID-19.

## Debt Capacity

The final step in the debt affordability analysis is estimating future debt capacity. Debt capacity is based on projected issuance over the next ten years and the August 2020 revenue projections. Debt capacity can change significantly with changes in revenue estimates reflecting a changing economic environment. With the benchmark debt ratio below the 6% policy target, a substantial amount of debt capacity is available for future bonding, but is subject to significant uncertainties because it is dependent upon realizing future revenue growth.

Over the next ten years, nearly $34.1 billion in theoretical bonding capacity is available based on the 6% benchmark debt ratio. As shown previously, projected debt issuance under existing bond programs is approximately $2.7 billion for the next ten fiscal years leaving $31.4 billion of net debt capacity available within the 6% target over the next ten years. However, debt capacity available in FY 2022 is generated primarily through increases in projected revenue growth rather than decreases in debt service. Assuming the revenue growth currently projected by the REC, there is approximately $6.6 billion of net debt capacity available within the policy target in FY 2022. There is significant uncertainty regarding projected revenues. If projected revenue growth is not realized, debt capacity will

be negatively impacted and could be constrained within the target in FY 2022. Assuming no revenue growth, there is approximately $3.5 billion of net debt capacity available within the policy target in FY 2022. Debt capacity generated by both revenue growth and decreasing debt service returns in FY 2023 and 2024. Debt capacity should be considered a scarce resource and, once used, it is not available again for twenty to thirty years, i.e. after the debt is repaid.

**Debt Capacity Projection**

**6% Target; 7.0% Cap**

*(In Millions of Dollars)*

| | 6% Target | 7% Cap |
|---|---|---|
| Total Debt Capacity Available | $ 34,050.0 | $ 41,410.5 |
| Estimated Bond Issuance | 2,690.3 | 2,690.3 |
| Net Debt Capacity Available | $ 31,359.7 | $ 38,720.2 |

Projections in this report indicate the benchmark debt ratio will remain consistently below the 6% target through 2030 which provides flexibility for the State to issue additional debt while maintaining compliance with the policy target. Debt capacity between the 6% target and 7% cap is best viewed as a cushion to mitigate the impact of revenue declines. Estimated debt capacity should be considered a scarce resource and used sparingly to provide funding for critical State infrastructure needs. Once used, the capacity is not available until after the debt is repaid, typically 20 to 30 years. Additionally, as noted previously, debt capacity is subject to significant variability because it is dependent on realizing projected revenue growth.

# Florida Compared to Other States

The municipal bond market evaluates governments' debt position with four primary debt ratios: debt service to revenues; debt per capita; debt to personal income; and net tax-supported debt as a percentage of a state's gross domestic product ("GDP"). Florida's debt ratios are compared to national and peer group medians where the State's peer group is comprised of the 11 most populous states. Florida improved from 5$^{th}$ to 6$^{th}$ highest in debt service as a percent of revenues. Florida maintained the 8$^{th}$ spot in debt per capita, debt as a percent of State personal income, and debt as a percent of State GDP.

**Debt Ratios**

**2019 Comparison of Florida to Peer Group and National Medians**

| | Net Tax-Supported Debt Service as a % of Revenues | Net Tax-Supported Debt Per Capita | Net Tax-Supported Debt as a % of Personal Income | Net Tax-Supported Debt as a % of GDP |
|---|---|---|---|---|
| Florida | 4.64% | $803 | 1.57% | 1.53% |
| Peer Group Mean | 5.28% | $1,657 | 2.70% | 2.37% |
| National Median | 3.80% | $1,071 | 2.00% | 1.91% |

| 2019 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 | 9.90% | 3 | $2,635 | 3 | 4.50% | 2 | 3.72% | BBB-/Baa3/BBB- |
| New Jersey | 2 | 9.60% | 1 | $4,125 | 1 | 5.80% | 1 | 5.68% | A-/A3/BBB+ |
| New York | 3 | 7.50% | 2 | $3,314 | 2 | 4.60% | 2 | 3.72% | AA+/Aa2/AA+ |
| Ohio | 4 | 5.50% | 6 | $1,158 | 6 | 2.30% | 6 | 1.94% | AA+/Aa1/AA+ |
| Georgia | 5 | 5.40% | 7 | $971 | 7 | 2.00% | 7 | 1.67% | AAA/Aaa/AAA |
| **Florida** | **6** | **4.64%** | **8** | **$803** | **8** | **1.57%** | **8** | **1.53%** | **AAA/Aaa/AAA** |
| California | 7 | 4.20% | 4 | $2,147 | 4 | 3.20% | 4 | 2.70% | AA/Aa2/AA- |
| Pennsylvania | 8 | 3.50% | 5 | $1,519 | 5 | 2.60% | 5 | 2.39% | AA-/Aa3/A+ |
| North Carolina | 9 | 2.90% | 10 | $586 | 9 | 1.20% | 10 | 1.04% | AAA/Aaa/AAA |
| Texas | 10 | 2.50% | 11 | $379 | 11 | 0.70% | 11 | 0.58% | AAA/Aaa/AAA |
| Michigan | 11 | 2.40% | 9 | $593 | 9 | 1.20% | 9 | 1.09% | AA/Aa1/AA |
| **Median** | | **4.64%** | | **$1,158** | | **2.30%** | | **1.94%** | |
| **Mean** | | **5.28%** | | **$1,657** | | **2.70%** | | **2.37%** | |
| **National Median** | | **3.80%** | | **$1,071** | | **2.00%** | | **1.91%** | |

## Pension Liability and Funding

The pension system is relatively well-funded with a funded ratio of 82.6% as of June 30, 2019. Following a three year period of underfunding for budget relief during the Great Recession, Florida has fully funded its actuarially determined contribution to the pension system since FY 2014. Rating agencies continue to evaluate the credit impact of unfunded pension liabilities and several states have been downgraded due to the magnitude and poor management of the pension obligation. Annual pension contributions are viewed as long-term fixed costs by rating agencies, and like debt service, potentially crowd-out other expenditures and create structural budget imbalance, if not managed properly.

As a result, management and funding of the pension system are important aspects of evaluating Florida's credit rating. Rating agencies have developed quantitative methodologies to evaluate states' pension liabilities and integrate them into their credit analysis. Moody's and Fitch each employ various "adjustments" to reported pension liabilities for greater comparability across the state sector including application of a common investment return assumption.

| 2019 Pension Metrics Comparison<br>Adjusted Net Pension Liabilities ("ANPL") and Medians | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| State | Rank | ANPL *(in Millions)* | Rank | ANPL as a % of Own-Source Revenues | Rank | ANPL Per Capita | Rank | ANPL as a % of Personal Income | Rank | ANPL as a % of State GDP |
| Illinois | 1 | $ 229,887 | 1 | 445% | 1 | $ 18,181 | 1 | 30.8% | 1 | 25.6% |
| California | 2 | 214,492 | 6 | 112% | 4 | 5,450 | 5 | 8.1% | 6 | 6.8% |
| Texas | 3 | 131,402 | 4 | 161% | 5 | 4,550 | 4 | 8.6% | 5 | 7.0% |
| New Jersey | 4 | 112,547 | 2 | 255% | 2 | 12,684 | 2 | 17.9% | 2 | 17.5% |
| Pennsylvania | 5 | 78,996 | 3 | 166% | 3 | 6,174 | 3 | 10.5% | 3 | 9.7% |
| Michigan | 6 | 39,654 | 5 | 120% | 6 | 3,972 | 6 | 7.9% | 4 | 7.3% |
| New York | 7 | 38,812 | 10 | 39% | 8 | 1,998 | 8 | 2.8% | 9 | 2.2% |
| Georgia | 8 | 21,986 | 7 | 80% | 7 | 2,083 | 7 | 4.3% | 7 | 3.6% |
| **Florida** | **9** | **21,973** | **9** | **41%** | **10** | **1,026** | **10** | **2.0%** | **10** | **2.0%** |
| Ohio | 10 | 16,230 | 8 | 47% | 9 | 1,389 | 9 | 2.7% | 8 | 2.3% |
| North Carolina | 11 | 9,146 | 11 | 29% | 11 | 880 | 11 | 1.8% | 11 | 1.6% |
| **Median** | | **$ 39,654** | | **112%** | | **$ 3,972** | | **7.9%** | | **6.8%** |
| **Mean** | | **$ 83,193** | | **136%** | | **$ 5,308** | | **8.9%** | | **7.8%** |
| **National Median** | | **$ 11,258** | | **80%** | | **$ 2,528** | | **5.2%** | | **4.8%** |

Additionally, for multi-employer plans like Florida's, Moody's and Fitch allocate the unfunded liability to all participating governments, attributing only a portion to the State. The pension liabilities are analyzed relative to the economic metrics used to evaluate debt obligations among Florida's peer group. According to Moody's medians, Florida's adjusted pension liability of about $22.0 billion falls significantly below the median of nearly $39.7 billion for the largest states and ranks 3rd lowest in the peer group.

Rating agencies continue to refine their analysis used to evaluate pension liabilities. They now evaluate the reasonableness of assumptions used to calculate the pension liability and required contributions, and whether investment returns are reasonable. S&P has published guidelines which indicated 6.5% is a sustainable investment return assumption. The actuarial methodologies, which vary across plans, are also being assessed. The assumptions used to calculate the required contribution to the FRS are set by the FRS Actuarial Assumption Conference ("Conference"). The actuary uses the assumptions and actuarial methodologies set by the Conference to calculate the pension liability and, more importantly, the required contribution.

This year, Florida continued to make important progress in lowering its investment return assumption and made incremental improvement by reducing the amortization policy to 25 years from 30 years. In 2019, the Conference moved to the best practice of using "individual entry age" which produces a more realistic estimate of the cost and required contributions. The Conference has made significant progress in recent years in lowering the investment return assumption from 7.75% to 7.0%. The conferees acknowledge the need to continue to reduce the investment return assumption and address other actuarial methodologies being used that are not best practice (i.e. amortizing the unfunded liability based on percent of pay vs. level dollar).

Using actuarial assumptions and methodologies that are not best practice causes an understatement of pension liabilities and, more importantly, lead to underfunded pension contributions. Some larger states (e.g. California and New York) have adopted a glide-path to systematically lower the pension return assumption over a number of years. Although the State has lowered the pension return assumption from 7.75% to 7.20% over the past six years and to 7.00% for the upcoming year, more progress to lower the return assumption is needed. The Legislature should consider creating a plan to systematically bring the investment return assumption more in line with expected investment returns and generally accepted accounting principles and adopt methodologies which are best practice for amortizing the unfunded actuarial liability and funding based on a level dollar approach.

If underfunding the pension contribution continues, the financial strength of the FRS could be undermined and the State's credit ratings could be adversely impacted. It is imperative that the annually required contribution be made to adequately fund the FRS.

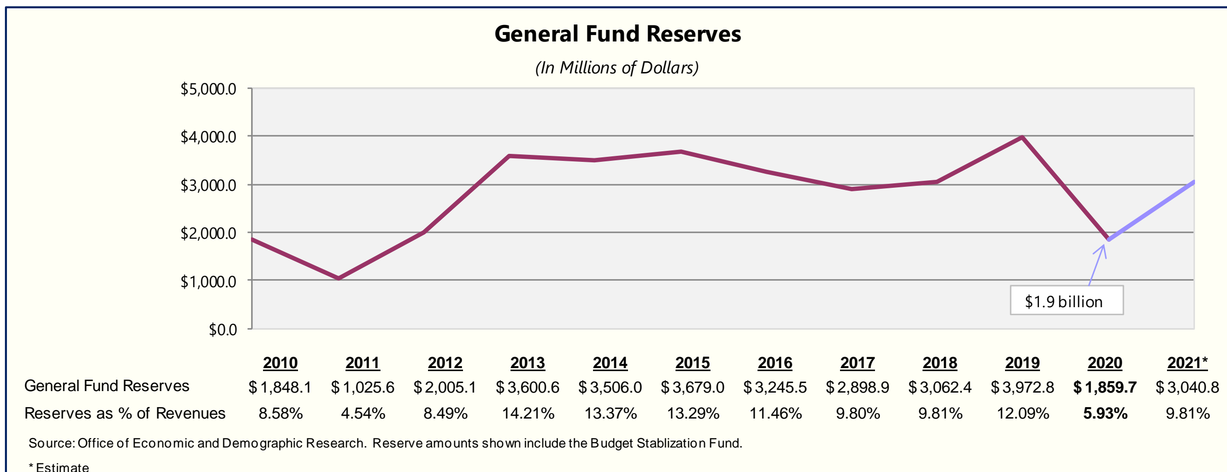
# Reserves

An important measure of financial health and ability to respond to unforeseen financial challenges is the level of the State's general fund reserves. Unspent general revenue combined with the Budget Stabilization Fund ("BSF") are collectively referred to herein as the "General Fund Reserves." Historically, Florida's level of reserves resulted from conservative financial management practices, and rating agencies cite financial flexibility provided by reserves as a key credit strength. Reserve levels were cited as a credit strength when Moody's upgraded Florida to "Aaa" in June, 2018. The discipline of setting aside sufficient funds during times of economic prosperity helped ensure that the State had adequate reserves to mitigate revenue declines caused by COVID-19. The traditional measure used by credit analysts, investors and rating agencies to assess the strength of the State's financial position is the ratio of General Fund Reserves to general revenues, expressed as a percentage.

## General Fund Reserves

The State increased General Fund Reserves from $1.8 billion in FY 2010 to approximately $4.0 billion in FY 2019. The State utilized reserves during FY 2020 in order to effectively respond to and mitigate the fiscal and budgetary impacts of COVID-19. Without the strong reserve balance of approximately $4.0 billion, or 12.1%, at the end of FY 2019, the State may have experienced additional fiscal and budgetary challenges when confronted with the impacts of COVID-19 during FY 2020.

Fiscal Year 2020 General Fund Reserves were $1.9 billion or 5.9% of general revenues. General Fund Reserves declined by more than $2.1 billion as reserves have been used to supplement revenue collections to fund the FY 2020 budget. The BSF has not been used in responding to revenue shortfalls and remains fully funded at the constitutionally required 5% of general revenues.




| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| General Fund Reserves | $ 1,848.1 | $ 1,025.6 | $ 2,005.1 | $ 3,600.6 | $ 3,506.0 | $ 3,679.0 | $ 3,245.5 | $ 2,898.9 | $ 3,062.4 | $ 3,972.8 | **$ 1,859.7** | $ 3,040.8 |
| Reserves as % of Revenues | 8.58% | 4.54% | 8.49% | 14.21% | 13.37% | 13.29% | 11.46% | 9.80% | 9.81% | 12.09% | **5.93%** | 9.81% |

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

* Estimate

General Fund Reserves are projected to be $3.0 billion at the end of FY 2021. This reflects full utilization of the CRF funds available from the CARES Act. However, projected reserves are

subject to continued uncertainty due to better than projected revenue collections, additional distribution of CRF funds to local governments, and additional budgetary spending that may be required to combat COVID-19. Reserves have provided significant financial flexibility in the State's response to the fiscal and economic impacts of COVID-19.

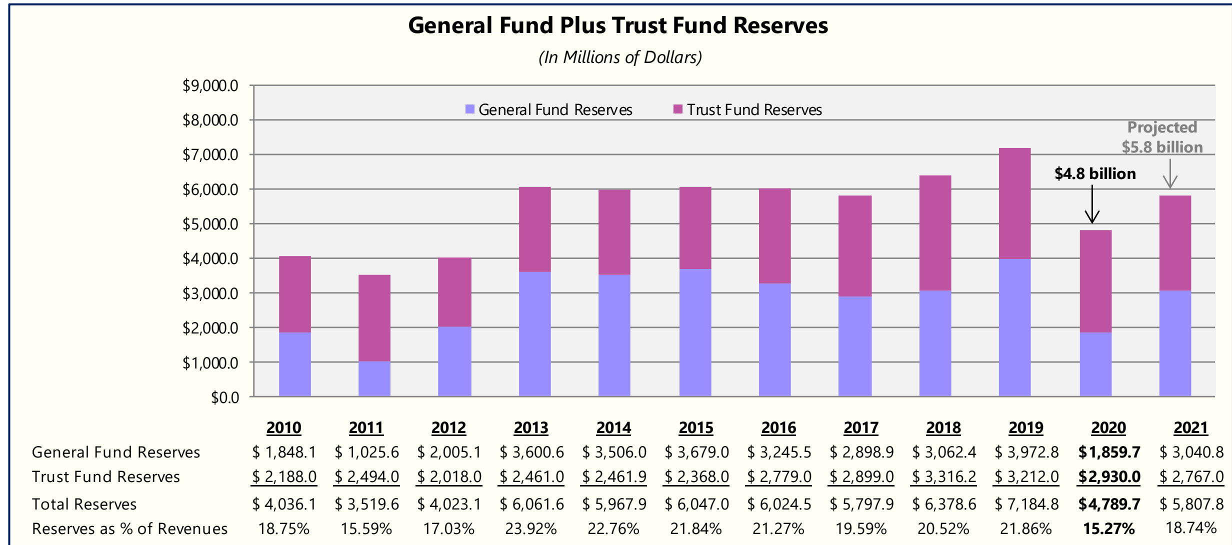
The critical role that reserves played in mitigating the general revenue shortfalls precipitated by COVID-19 demonstrates that the Legislature should consider formalizing targeted General Fund Reserves. Currently the amount of unspent general revenue targeted as reserves is $1 billion and this has been helpful in maintaining prudent reserves and financial flexibility. However, a more dynamic target should be considered (e.g., a percentage of General Fund Revenue rather than a fixed dollar amount) to provide adequate financial flexibility with a growing state budget and inevitable revenue volatility experienced during changing economic climates or to address unexpected financial events like viral pandemics, the Great Recession and hurricanes.

Recently, rating agencies have been updating their rating criteria and methodology to include revenue and reserve sensitivity analysis. Fitch's FAST Model, for example, tests state revenue and reserve sensitivity to a recession on the national level. This dynamic analysis is being used in order to move away from "hard and fast" rating specific reserve requirements and instead, move toward understanding how a state's current level of reserves can serve to offset potential revenue volatility. Florida's reserves should be relatively higher because of the sensitivity of sales taxes to economic cycles.

### Trust Fund Reserves

Prior to 2009, trust fund balances that could be considered a "reserve," were not included in measuring the State's reserves. The State has historically created trust funds and dedicated specified revenues for particular purposes. Well over half of the State's budget is comprised of trust-funded programs and activities. Established budgetary practices identify excess trust fund balances that are available and can be used for other purposes if directed by the Legislature. In fact, the Legislature has routinely swept available trust fund balances to supplement the general fund budget during periods of economic weakness to offset declining revenue collections. Therefore, including trust fund balances in the reserve analysis provides a more holistic picture of the State's financial flexibility.

Total reserves of approximately $4.8 billion or 15.3% of general revenues are considered strong by the rating agencies. Total reserves are projected to improve to $5.8 billion or 18.7% of general revenues at the end of FY 2021, but are subject to substantial uncertainty because of COVID-19 and the potential for additional spending in FY 2021.




| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| General Fund Reserves | $ 1,848.1 | $ 1,025.6 | $ 2,005.1 | $ 3,600.6 | $ 3,506.0 | $ 3,679.0 | $ 3,245.5 | $ 2,898.9 | $ 3,062.4 | $ 3,972.8 | **$1,859.7** | $ 3,040.8 |
| Trust Fund Reserves | $ 2,188.0 | $ 2,494.0 | $ 2,018.0 | $ 2,461.0 | $ 2,461.9 | $ 2,368.0 | $ 2,779.0 | $ 2,899.0 | $ 3,316.2 | $ 3,212.0 | **$2,930.0** | $ 2,767.0 |
| Total Reserves | $ 4,036.1 | $ 3,519.6 | $ 4,023.1 | $ 6,061.6 | $ 5,967.9 | $ 6,047.0 | $ 6,024.5 | $ 5,797.9 | $ 6,378.6 | $ 7,184.8 | **$4,789.7** | $ 5,807.8 |
| Reserves as % of Revenues | 18.75% | 15.59% | 17.03% | 23.92% | 22.76% | 21.84% | 21.27% | 19.59% | 20.52% | 21.86% | **15.27%** | 18.74% |

# Credit Ratings

The State's credit rating is a rating agency's assessment of the willingness and ability to timely repay debt obligations. Credit ratings play an integral role in the municipal bond market and are one factor that affects the State's borrowing cost on debt offerings. Each rating agency considers four primary factors in its analysis: governance, debt and liability profile, budget and financial management, and economic indicators. The four factors are assessed on a quantitative and qualitative basis relative to the state's peers within its rating category. Despite the standardization of credit factors, each are evaluated slightly differently based on the agency's published criteria.

Florida is rated in the highest rating category by each of the three major credit rating agencies. In late September, all three major rating agencies affirmed the State's AAA general obligation ratings and Stable outlooks which was significant in light of the economic, fiscal and budgetary consequences precipitated by COVID-19. The stability in the State's general obligation ratings and credit strengths reflect Florida's historically strong economy and population growth; financial flexibility through expenditure reductions and reserve levels; ample liquidity; and a relatively well-funded pension system. The State has been continually recognized for its conservative financial and debt management practices. In their reports, the rating agencies expect Florida to maintain its history of making timely budget adjustments to continue to support the triple-A ratings.

| Florida General Obligation Credit Ratings | Rating | Outlook |
|---|---|---|
| **Standard and Poor's** | AAA | Stable |
| **Fitch Ratings** | AAA | Stable |
| **Moody's Investor Service** | Aaa | Stable |

However, rating agencies recognize the State will likely see lingering revenue weakness related to the pandemic due to the impact of decreased leisure and business travel on sales tax revenues. The State faces an ongoing credit challenge as a result of the fiscal and economic impacts of the COVID-19 pandemic. The REC reduced projected revenues in their forecast to account for the impact of COVID-19 and the responses thereto reducing projected general revenue by $3.4 billion for FY 2021 and $2.0 billion for FY 2022. Notwithstanding the projected revenue reductions, no budget reductions have been formalized for FY 2021. CRF funds have permitted the State to continue providing essential services and provided financial flexibility. S&P and Moody's revised their sector outlooks for U.S. States to negative on April 1, 2020 and May 1, 2020, respectively. Florida's ratings are consider vulnerable because of the State's reliance on tourism and sales taxes which have been significantly impacted by COVID-19 and are expected to be slow to recover.

The State faces other ongoing credit challenges, which include maintenance of structural budget balance despite absorbing spending pressures; ongoing improvement in reserve balances; and the potential negative fiscal and economic consequences or unmanageable assessments caused by a catastrophic hurricane. In addition, the rating agencies will continue to evaluate how management of long-term liabilities such as PPP contracts and pension funding will affect the State's budget.

Rating agencies have also increased their focus on issuer pension liabilities. Moody's and Fitch make adjustments to issuer reported pension liabilities to reflect their view of reasonable investment return assumptions, amortization periods, and other actuarial methodologies. Late last year, Moody's updated their "US States Rating Methodology" to increase the weighting assigned to the debt and pension factor, further underscoring the importance of prudent financial management and funding of the pension system. The update also combines pension liabilities and debt into one sub-factor, reflecting how credit rating agencies are evolving related to their view of total state long-term liabilities.

# Conclusion

Florida's debt position improved in FY 2020 as a result of a prolonged favorable interest rate environment and a reduction in the amount of debt outstanding due to restrained borrowing. There is debt capacity available within the target benchmark to finance investments in the State's infrastructure. However, debt capacity available in FY 2022 is generated primarily through increases in projected revenue growth rather than decreases in debt service. Debt capacity generated by both revenue growth and decreasing debt service returns in FY 2023 and FY 2024. Debt capacity should be considered a scarce resource and, once used, it is not available again for twenty to thirty years, i.e. after the debt is repaid.

Market demand for municipal bonds along with low interest rates will allow the State to continue to reduce costs through refinancing outstanding debt at lower interest rates and borrowing at historically low interest rates.

The debt ratio remains below the 6% target due to limited debt issuance and projected revenue growth. The State is well positioned with significant debt capacity available to fund critical infrastructure needs. However, available debt capacity and the ratio are sensitive to revenue declines from economic weaknesses such as those precipitated by the COVID-19 pandemic.

The State faces an ongoing vulnerability to maintaining Florida's triple-A credit ratings as a result of the fiscal and economic impacts of COVID-19. Revenue declines, coupled with sizeable additional borrowing, may put downward pressure on the State's credit ratings. Rating agencies have indicated that credit direction will depend largely on a state's willingness to make fiscal and budget adjustments and maintain structural budget balance. The State should not rely too heavily on non-recurring, one-time solutions such as federal government stimulus or borrowing; instead, the State should focus on restrained and prudent spending in order to mitigate the uncertain depth and duration of the impacts of COVID-19. Even in times of fiscal stress, failing to make adequate pension contributions, will put downward pressure on the State's credit ratings. The rating agencies expect the State to continue its practice of making timely budget adjustments to achieve structural balance in the wake of revenue declines should the economic impact of COVID-19 be prolonged.