GOVERNOR'S PROGRAM BILL

2006

MEMORANDUM

CONCURRENT RESOLUTION OF THE SENATE AND ASSEMBLY

proposing amendments to article 7 of the constitution, in relation to the prohibition of certain borrowing arrangements, the authorization for the contracting of debt and the manner by which payments are appropriated and paid

Purpose:

This bill amends Article VII of the New York State Constitution to implement significant and sweeping debt reform initiatives to permanently improve the State's debt practices. This will ban "back door borrowing", place limitations on total debt levels and debt service costs, encourage greater voter participation in State debt decisions, restrict the use of debt to financing capital works or purposes, reduce the term of State debt to no more than 30 years, and modernize emergency debt provisions.

Summary of Provisions:

The bill amends Article 7, sections 10, 11, 12 and 16 of the Constitution to:

—Permanently Ban "Back Door Borrowing".

The Amendment prohibits the State from authorizing public authorities or any other issuers to contract for State debt that is not authorized by the Constitution. This prohibits "back-door borrowing", where the State would have a direct or indirect obligation to make debt service payments for debts of State agencies, public authorities, municipalities and other issuers. The prohibition prevents the use of obligations subject to appropriation, such as lease-purchase agreements and certificates of participation (whereby the State makes lease payments and, at the end, obtains ownership of the financed property or equipment), contractual obligations (debt secured by a contract obligating the State to make debt service payments), and contingent obligations (where the State is required to make payments - by statute, contract, so-called "moral obligation", or otherwise - if the actual obligated party fails to perform its obligations). The amendment would also prohibit debt obligations whereby State revenues are diverted to or securitized by a debt issuer for the purpose of receiving upfront payments (tobacco bonds), or whereby the State makes payments to another entity and the payments are the sole support for debt service on said entity's own debt obligations (STARC / NYC MAC refinancing and bonds issued to settle prior year school aid claims).
The Amendment is not intended to restrict the ability of the State to make non-bond financed aid payments or other moneys available to such entities for some non-State purpose where the issuer may incidentally use such moneys for debt service payments. This includes State aid payments which may be paid to or "intercepted" by other entities for non-State debt bondholder security for purposes such as regional mass transportation assistance, building aid to local school districts, State-imposed resources used to aid distressed municipalities, and court facilities assistance.

— **Cap total debt outstanding at 4 percent of State personal income.**

Constitutionally impose a cap on total debt outstanding. This will restrict the amount of State debt according to the most commonly accepted measure of debt affordability – debt outstanding as a percentage of personal income. The cap will gradually reduce total State debt in four equal increments, from current levels of about 6 percent to no more than 4 percent of personal income beginning in fiscal year 2024-25. State debt applicable to this cap is defined as total State-related debt outstanding, as reported by the State Comptroller each year on a cash basis of accounting. This reflects all debt issued for State Governmental Activities and Business-type Activities by the State (including blended component units) as defined in the Comprehensive Annual Financial Report issued by the State Comptroller. This classification is the most comprehensive measure of State debt, as reported on and accepted by the State Comptroller, and the rating agencies and other fiscal watchdog groups.

— **Cap total debt service at 5 percent of total governmental funds receipts.**

Constitutionally impose a cap on total debt service costs to ensure that the cost of repaying debt obligations remains affordable. Again, the restriction is based on a commonly accepted measure of debt affordability – debt service as a percentage of total State governmental funds receipts. This cap applies to total State-related debt service spending, and restricts these costs to no more than 5 percent of total receipts.

To avoid discouraging the State from implementing advantageous debt management transactions – such as defeasing high cost debt early - the Amendment excludes from the debt service cap limitations any payments made to retire debt earlier than mandatory payments would have otherwise required. Similar provisions are contained to ensure that debt refundings, which produce present value savings, are not discouraged by the debt outstanding and debt service caps.

— **Encourages greater voter participation in State debt decisions.**

The Amendment encourages increased voter participation in decisions affecting State debt levels through a number of modernization efforts. First, the bill would authorize multiple general obligation bond act proposals to appear before the voters. This would allow for more than one capital initiative to be placed on the ballot at a single time, and afford the voters a greater say in the amounts and purposes for which State debt would be authorized to be incurred.

The Amendment also authorizes a limited amount of constitutionally-permitted revenue debt, to be secured by a pledge of specific State revenues. The amount of revenue debt would be
capped at no more than one-half of the cap on total debt outstanding, or 2 percent of personal income. This ensures that at least one-half of all debt is ultimately submitted to the voters for their approval. (About 80 percent of total State-related debt outstanding was “back door borrowing” done without voter approval.) Section four of the Amendment also requires the Comptroller to set aside revenues received and pledged to pay debt service on the new revenue bonds, and to pay debt service in the event the Legislature fails to enact an appropriation to do so. This would ensure that both general obligation debt (for which debt service may currently be paid without an appropriation) and the newly-authorized revenue debt are both treated consistently in the event of a failure to appropriate debt service, and that payments can be made to bondholders without an appropriation.

The Amendment would also permit any or all of the cap restriction levels imposed on total debt outstanding, total debt service costs, and revenue debt to be amended by a ballot proposal submitted to the voters for their approval.

— Restrict the issuance of debt to capital works and purposes only.

Amend the Constitution to restrict the use of debt to financing capital works or purposes. i.e., "Bricks and mortar" projects, roads, bridges, buildings, water and sewer facilities, equipment, and the construction and reconstruction of State facilities, including design and engineering work related to capital projects.

— Reduce the maximum term of State debt to 30 years.

Amend the Constitution to limit the term of State debt to no more than 30 years. (The Constitution currently permits debt with a final maturity of up to 40 years.)

— Modernizes emergency debt provisions.

The Constitution currently permits the use of debt in emergency situations, such as repelling invasion, suppressing insurrection, defending the State in the event of war, or to suppress forest fires. The Amendment would modernize this provision to allow the State to respond to any other emergencies resulting from a disaster, such as the terrorist attacks on September 11, 2001. Such emergency debt would not count against the limits established above.

Existing Law:

The Constitution currently authorizes the issuance of general obligation debt, subject to voter approval, and is limited to one bond act proposal per ballot.

Constitutional amendments require the passage of two separately elected Legislatures and approval by the voters. As a result, the Amendment could not take effect until January 1, 2008. However, the Amendment would impose the caps on the most comprehensive of the commonly-accepted measures of State debt levels - total State-related debt and debt service costs, which includes “back door borrowings” issued prior to the Amendment’s adoption and thereafter banned.
Statement in Support:

The sweeping debt reform initiatives implemented by this Constitutional Amendment would:

— Impose strict limitations on both debt levels and debt service costs to ensure that they remain affordable, and that debt continues to be prudently managed;
— Encourage greater voter participation by presenting multiple bond act proposals for their consideration, ensuring that at least one-half of all debt is submitted for voter approval, and allowing the populace to revise the cap percentage limitations on total State debt through ballot proposal initiatives;
— Ensure that critical investments in the State's infrastructure are maintained by restricting the use of the State's limited debt capacity to only capital purposes, and;
— Reduce the maximum term of State debt to 30 years.

The 4 percent cap on debt outstanding represents a significant decline from the current level of about 6 percent. The 5 percent cap on debt service ensures that such costs remain affordable, and do not grow from current levels.

Legislative History:

A 1995 Constitutional Amendment to reform the State's debt practices was rejected by the voters. However, this Constitutional proposal is more restrictive than the 1995 Amendment since it:

— Comprehensively bans “back door borrowing” (the 1995 Amendment contained significant loopholes);
— Imposes strict limitations on total State debt and debt service costs, which includes all State general obligation debt, State revenue debt, and prior State-supported and State-related “back-door” borrowings (the 1995 Amendment did not cap total debt and did not have a debt service cap);
— Requires that a least one-half of total debt be approved by the voters (the 1995 Amendment did not impose any restrictions requiring debt to go to the voters);
— Limits the use of debt to capital works and purposes only, and limits the maximum term of debt to 30 years.

Budget Implications:

The Amendment's provisions would permanently cap the amount of debt the State may incur by capping both total debt outstanding and total debt service costs, and authorizing a limited amount of revenue debt. As a result, the amendment will significantly reduce the State's total debt burden and lower its debt service costs.