Frequently Asked Questions About Pennsylvania’s Debt

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

Article VIII of the state constitution lays out several purposes for which the commonwealth can directly incur debt, such as:

- To suppress insurrection,
- For disaster relief,
- To manage cash flow during the fiscal year with tax anticipation notes,
- To refund and refinance existing debt,
- For purposes approved by the voters in referenda, and
- For the approved capital budget.

The large majority of the commonwealth’s outstanding direct debt is for the capital budget, which provides for the construction, rehabilitation, renovation and improvement of buildings and facilities. Because these assets are used over many years, the commonwealth usually issues bonds to spread the costs over their useful lives.

Under the other categories of general obligation debt, the commonwealth borrowed money to help recover from the 1972 and 1996 floods and voters have authorized several programs to support priorities like water and sewer infrastructure, environmental protection and farmland preservation, and veterans’ benefits.

Over the years, policymakers have addressed important state priorities by creating separate authorities or agencies, some of which have the ability to issue debt. These entities, on occasion, have issued debt on behalf of the commonwealth. While this debt does not have the same full general obligation pledge used for direct debt, the debt service is often paid through specific revenues dedicated by law or through appropriations made each year by the General Assembly. Due to its intrinsic link, the burden of authority debt issued on behalf of and paid for by the commonwealth is also important to consider when thinking about the scope of Pennsylvania’s debt use.

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

Generally, no, but with caveats. The Pennsylvania Constitution requires a balanced operating budget and limits the things for which the commonwealth can issue direct debt. Combined, these provisions do not allow the commonwealth to balance its budget by borrowing using its general obligation pledge and credit. However, the constitutional rules for general obligation debt do not constrain authorities and other instrumentalities created by the General Assembly in the same way, which leads to an exception to the general rule.

Because authorities are not subject to the same restrictions, the General Assembly periodically has used some authorities’ borrowing capacity to solve varying types of budgetary challenges. Some examples include requiring the Pennsylvania Turnpike Commission to contribute resources to fund transportation needs (which led to increased borrowing by the commission), repaying and refinancing a federal unemployment compensation loan incurred over the
Great Recession through the Pennsylvania Economic Development Financing Authority, or switching from annual appropriations to borrowing via the Commonwealth Financing Authority for a number of years to reimburse school districts for construction costs.

In the most direct example from the 2017/18 fiscal year, the General Assembly enacted legislation to direct the Commonwealth Financing Authority to borrow $1.5 billion, backed by the tobacco settlement payments and the sales and use tax. The bond proceeds were deposited in the General Fund to help resolve a single year’s budgetary shortfall.

While legal distinctions exist between a debt of the commonwealth and a debt of an authority, the practical reality is that the General Assembly has engaged in borrowing to balance the budget, in increasingly direct ways. Though authority debt was used for many years to shift costs or support specific activities with an alternative funding plan, the 2017/18 borrowing provided revenue directly into the General Fund to pay for expenses – a significant departure from past practices.

Aside from these recent activities, the Pennsylvania constitution allows for temporary borrowing within a fiscal year to manage cash flow. Much of the commonwealth’s tax revenues are paid in March and April, but expenses are incurred throughout the fiscal year. If necessary, the commonwealth can borrow to ensure enough cash is on-hand to pay the bills earlier in the year until the major revenue months arrive. This kind of debt, known as tax anticipation notes, must be repaid by the end of the fiscal year and can only be paid from current year revenues.

Q: Does Pennsylvania have a debt limit?

Yes, Pennsylvania has a debt limit, but only for certain kinds of debt. Other restrictions come into play on related issues.

The state constitution limits the amount of capital budget debt that can be incurred to 1.75 times the average annual tax revenues for all funds over the previous five fiscal years as certified by the auditor general during the year. As of the latest certification, the debt limit is around $68.8 billion. Pennsylvania’s outstanding capital budget debt is nowhere close to the constitutional limit; however, it could not support the debt service requirements of a debt load near that limit.

Along with the constitutional limit on total capital budget debt, the annual capital budget act specifies how much new principal can be incurred in that fiscal year for capital projects. For 2017/18, the maximum amount of new principal debt that could have been issued for the capital budget was $1.225 billion. At present, the General Assembly has not passed a capital budget for the 2018/19 fiscal year, though the Pennsylvania Constitution requires the General Assembly to adopt a capital budget for the ensuing fiscal year. The commonwealth pays for capital projects on a cash flow basis, so continued delay in passing a capital budget that authorizes debt to be issued could eventually impact the commonwealth’s ability to pay these bills.

The Redevelopment Assistance Capital Program (RACP) portion of the capital budget is subject to a separate statutory limit, set by Act 45 of 2017. The RACP debt limit constrains the maximum amount of debt that can be outstanding at any time. The limit for 2017/18 was $3.35 billion, and the limit will decline by $50 million per year until the sum of outstanding RACP debt reaches $3.15 billion.

The constitution does not place any overall limit on long-term debt for the non-capital purposes - insurrection suppression, disaster relief or voter-approved programs. In these cases, the enabling legislation passed by the General Assembly and the referenda approved by voters sets the maximum amount that can be borrowed.

Q: What is Pennsylvania’s bond rating?

The commonwealth received the following ratings for a general obligation bond issuance in the spring of 2018:

<table>
<thead>
<tr>
<th>Rating Agency</th>
<th>Rating</th>
</tr>
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<tbody>
<tr>
<td>Fitch</td>
<td>AA-</td>
</tr>
<tr>
<td>Moody’s</td>
<td>Aa3</td>
</tr>
<tr>
<td>S&amp;P</td>
<td>A+</td>
</tr>
</tbody>
</table>
Each of the ratings agencies downgraded the commonwealth’s debt over a number of years following the Great Recession. In their opinion, Pennsylvania's finances will continue to be strained because of slow revenue growth and increasing mandated costs. These pressures limit the ability of the commonwealth to deal with unexpected fiscal issues, especially when reserves like the Rainy Day Fund are minimal.

Credit downgrades matter to the extent that it leads investors to require a higher interest rate when the commonwealth issues debt, which would increase the debt service paid each year. Other market factors can have a greater impact in determining the interest rates besides the bond rating, but it’s important to note that both short- and long-term budgetary decisions affect our borrowing activities.

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

Net outstanding general obligation debt as of June 30, 2017, was approximately $12.0 billion. In addition, the commonwealth has approximately $3 billion in lease payment obligations, a large part of which includes authority debt secured by commonwealth payments.

**Q: How much does Pennsylvania spend on debt service?**

For 2016/17, debt service for general obligation debt totaled $1.258 billion. Lease payments, including debt service for authority debt, were $149 million.

The General Fund pays for the large majority of debt service costs for general obligation debt through an annual appropriation to the Treasury Department. The Motor License Fund supports debt service for highway and bridge debt and a handful of special funds also help pay for debt costs associated with specific items. For authority debt issued on behalf of the commonwealth, sales and use tax revenues have become a primary source of revenue for debt service payments, with the required amounts being regularly transferred to a restricted account.

**Q: For how long does Pennsylvania typically borrow?**

Generally speaking, the commonwealth issues 20-year bonds. For capital projects, the state constitution requires the debt to be paid back within the useful life of the asset and the debt must also begin to be paid off within one-tenth of the term of the debt. This means that some projects with a shorter lifespan will be amortized within a shorter time frame.

**Q: How does Pennsylvania’s debt level compare with other states?**

A meaningful comparison of relative debt loads requires adjustment for the different wealth and population levels across the country. The annual “Moody’s State Debt Medians” report makes these adjustments to provide apples-to-apples comparisons amongst states.

The following table summarizes Pennsylvania’s position relative to other states, according to the 2018 Moody’s report, which analyzed 2017 data.

<table>
<thead>
<tr>
<th>Metric</th>
<th>Pennsylvania</th>
<th>National Median</th>
<th>National Average</th>
<th>Pennsylvania Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net tax-supported debt per capita</td>
<td>$1,311</td>
<td>$1,477</td>
<td>$987</td>
<td>21st</td>
</tr>
<tr>
<td>Net tax supported debt as a % of 2016 personal income</td>
<td>2.6%</td>
<td>2.9%</td>
<td>2.3%</td>
<td>23rd</td>
</tr>
<tr>
<td>Net tax supported debt as a % of 2016 state GDP</td>
<td>2.33%</td>
<td>2.05%</td>
<td>2.57%</td>
<td>22nd</td>
</tr>
</tbody>
</table>

Because the interstate comparisons made by Moody’s rely on audited sources, there’s a lag in reporting. The Moody’s calculations do not include recent large tax-supported issuances for authority debt in the 2017/18 fiscal year, which will likely impact these rankings.