MEMORANDUM

DATE: April 15, 2020
TO: Assembly Finance Committee
FROM: Jeff Rogers, Finance Director
SUBJECT: Debt Service Overview

Introduction

Typically, the calculation of the debt service mill rate is simple. Annual required debt service payments are simply divided by the borough’s total assessed valuation. So, to pay $6 million of general obligation debt service from $5 billion of property assessed valuation, CBJ would need to assess a 0.12% tax or 1.2 mills on property value. It can be just that easy.

Unfortunately, CBJ’s calculation of the debt service mill rate is made considerably more complex by two factors:
1. Anticipated state reimbursement of school bond debt is highly uncertain
2. In 2013, CBJ voted affirmatively to pre-fund future debt service costs from 1% temporary sales tax

Uncertainty of School Bond Debt Reimbursement

The Proposed FY2021/2022 Budget assumes that the state will honor 50% of its commitment to reimburse school bond debt in both years. That assumption follows the Governor’s FY2020 veto of school bond debt reimbursement down to 50% of the amount committed. For FY2021, the Legislature funded 100% of school bond debt reimbursement in the budget, but the Governor vetoed 100% of that amount—which would result in zero dollars coming to CBJ as state reimbursement. However, the Governor indicated that it is his intention to fund 100% of school bond debt reimbursement via federal funding from the CARES Act.

Observers have speculated that budget items like school bond debt reimbursement may not be eligible for CARES Act funding. The Governor’s Chief of Staff indicated on a call with the Alaska Municipal League that the state would work with the federal government to obtain the flexibility to meet community needs—whatever those needs were. To add to the uncertainty, the Senate President sent a letter to the federal government seeking to understand the Governor’s potential latitude in allocating CARES Act funds. Hence, uncertainty prevails.

Mechanically, debt service payments for all bond issues (including schools) are made from the debt service fund. State reimbursement of school debt is just a funding source to the debt service fund. Hence, the state’s failure to reimburse school bond debt erodes the debt service fund balance and eventually causes it to go negative.

The Assembly Finance Committee took action at its meeting on January 8, 2020 to direct staff to introduce an ordinance to fund unreimbursed school bond debt from the general government fund. That ordinance would have transferred funds from the general government fund to the debt service fund. However, with the dire financial uncertainty that ensued from COVID-19, the Finance Department delayed drafting and introducing that appropriation until the Assembly Finance Committee could consider the issue in the process of reviewing the FY2021 budget proposal. Hence, school bond debt service payments for FY2020 have been made from the debt service fund, but the amount unreimbursed by the state has not been resolved. Effectively, the debt service fund is still holding the tab.

2013 Ballot Measures: Prefunding Future Debt Service Costs with Sales Tax

Juneau voters endorsed two interrelated ballot measures in 2013. The first was a $25 million general obligation
bond package, and the second was a 5-year extension of the temporary 1% sales tax for projects. One of the items funded by the extension of the 1% sales tax for projects was “Bonded Debt Service,” the future cost of the related $25 million bond. In general, this leveraging strategy generated more funding in the near-term while mitigating the medium-term impact on the debt service mill rate. Effectively, sales tax receipts were used to pre-fund future debt repayments, which would have had a mitigating effect on the debt service mill rate.

The description of Bond Debt Prepayment from the voter information pamphlet:

From FY2015 to FY2019, a portion of the 1% sales tax for projects was transferred from sales tax fund to the debt service fund. Over five fiscal years, those transfers totaled $10 million. By the end of FY2019, $4.9 million had effectively “subsidized” the debt service mill rate, and the debt service fund had accumulated a balance of $5.1 million. Projections from Finance indicate that this $5.1 million debt service fund balance would have continued to pay a portion of general obligation debt costs for the next 2 to 3 years, effectively continuing to subsidize the debt service mill rate over that time.

Discussion

This memo is weedy, for sure. Nevertheless, these intricacies of the debt service fund are relevant to any decisions about how to resolve unreimbursed school bond debt. Namely, the amount of school bond debt service that was not reimbursed by the state in FY2020 has been “paid” by the accumulated debt service fund balance—which built up from sales tax receipts deposited there to mitigate the cost of the 2013 general obligation bond debt service. That is allowable and reasonable, but it eliminates a portion of a future debt service subsidy, which will cause the debt service mill rate to be higher than expected in the future. Additionally, any amount of unreimbursed school debt in FY2021 and FY2022 will similarly erode the debt service fund balance or cause it to go negative.

In order to address the shortage in the debt service fund, the Committee must strike the balance between transferring in general funds and adopting a higher debt service mill rate. Generally, the more general funds transferred, the lower the future debt service mill rate. The less general funds transferred, the higher the future debt service mill rate is required to be. But striking this balance is a challenge because the Committee does not know how much school bond debt will be reimbursed in the future. And, in the current environment, any transfer of general funds may require an increase to the areawide mill rate to generate the necessary revenue. A debt service fund model is available to the Committee. That model demonstrates the outcome of these variables.

Recommendation

I recommend that the Committee take no action in FY2020—meaning do not transfer general funds into the debt service fund (which the AFC directed staff to do in its January meeting). In the midst of the COVID-19 crisis, it is sensible to use the prefunding of other general obligation debt that accumulated in the debt service from 1% sales tax receipts. Doing nothing preserves unrestricted general government funds to be used for their highest purpose in the coming year. This will induce slightly higher than expected debt service mill rates in the future, but those rates could be similarly subsidized by future transfers from general funds.

Likewise, I recommend that the Committee authorize the 1.2 debt service mill rate as proposed. If funds for reimbursement of FY2021 school debt remain fully vetoed and unfunded, the Committee will need to appropriate general funds to cover any unreimbursed amount. The same will be true in FY2022 and beyond, though the amount of school debt service, and the expected reimbursement, drops significantly in FY2023.