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The Large and Growing Commonwealth Financing Authority

There is a large component unit of Pennsylvania's government that seekers of public funding know about all too well but which the public and taxpayers know very little about—the Commonwealth Financing Authority (CFA). The CFA came into existence through the Public Authorities and Quasi-Public Organizations Act of 2004, P.L. 163 as amended by the Commonwealth. The Authority was created to provide financial assistance in the form of loans, loan guarantees, grant and private equity participating loans to promote the creation and retention of jobs, to establish economically viable communities, to develop stable tax bases, reuse of abandoned sites, the promotion and commercialization of Pennsylvania products and services, and investment of private capital in Pennsylvania communities.

To carry out this vast assignment the legislation initially required the Authority to support eight specific programs:

a. Business in Our Sites Program—site preparation assistance;
b. First Industries Program—tourism and agricultural;
c. Second Stage Loan Program—loans guarantees to lending institutions to make loans to certain industries;
d. Pennsylvania Venture Guarantee Program—guarantees to venture capital partnerships;
e. Building Pennsylvania Program—loans for investment in real estate;
f. TIF Guarantee Program—guarantees for TIF bonds;
g. New Pennsylvania Venture Capital Investment Program—loans to venture capital partnerships;
h. Penn Works Programs—loans and grants for water supply and wastewater infrastructure.

Since the original list of programs to be supported was enacted, there have been six more added having to do with water and sewer improvements, solar energy, renewable energy, alterative and clean energy, high performance buildings, mitigation of the impact of gaming and related activities, and grants for well plugging, greenways, watershed restoration, etc.

Initially, the CFA's debt limit for all the programs was set by law at $1.135 billion. There were exceptions for borrowing to fund some individual programs and an unintelligible series of requirements for subsequent fiscal years.

Bear in mind that the CFA operates within and under the control of the Department of Community and Economic Development (DCED). And the DCED has other programs with appropriated funds such as the Ben Franklin Partnership. In total the DCED budget for FY2013-14 is $236.38 million of which $78.02 million will be transferred to the CFA to cover debt costs. In fact, total economic development outlays by the Commonwealth totaled $1.033 billion in fiscal 2012-2013. Of that amount, $473.06 million came from the General Fund and the other $555.77 million from non-major funds, primarily grants and transfers such as gaming revenue and gas impact fees. The current economic development spending is down about a half billion dollars as a result of the continued phase out of Federal ARRA (stimulus) dollars.

During its first fiscal year of operation ending in June 2006, the CFA issued bonds totaling $375 million. Operating costs and grants and provision for loan losses exceeded operating income by $5.16 million. Non-operating expenses including $8 million in interest on bonds issued and a transfer of $15 million to the Machinery and Equipment Loan Fund as required by statute were partially offset by a transfer of $5 million from the state. In total, after one year, the CFA had a net loss of $23.13 million, had amassed $369.25 million in long term debt and was obligated to debt service payments of $31 million per year beginning in FY 2006-07 and continuing through 2021, dropping to $28 million from 2022 through 2026.

Meanwhile, the CFA board was busy arranging to disperse the $316 million in cash it had raised from the bond issue (less the dollars already distributed or spent). According to the audit report for the fiscal year ending June 30, 2006, the Authority had approved loans of $245.82 million, grants of $151.3 million, $28.5 million in venture capital and $6.75 million in loan guarantees—for a total of $432 million. Obviously, the CFA would need to issue more bonds to fund those approvals as well as new ones to be made in the next year.

And borrow it certainly has done over the last eight years to raise money to fund the grant and loan requests flowing from all the programs the Authority was created to support. By year end June 30, 2013, the CFA had amassed total liabilities, mostly bond debt, of $1.727 billion. Assets totaled $966 million, $630 million in cash and equivalents, receivables of $31 million and non-current assets of $305.6 million held in loans. Thus, the CFA had a net asset position last June of negative $760 million. And, while the exact amount is not yet published, a large part of the $630 million in cash has been dispersed in grants and loans since last June, further worsening the net negative asset position. More borrowing to replenish the cash will not improve the balance sheet. Only net pay down of debt or receipt of far more non-borrowed funds will improve the net asset position.

Note that the negative net asset situation at the CFA worsened dramatically from June 2010 to June 2013, jumping from a minus $287 million to a negative $760 million. No doubt, this is due in large part to the new programs requiring support that have been added to the CFA's list of beneficiaries by the Commonwealth. The $330 million in bond issuance in FY 2012-13 pushed the total since the inception of the CFA to $1.872 billion of which $1.658 billion is still outstanding. The 2013 bond debt stood $313.5 million above the June 2012 level. Moreover, last year's borrowing boosted the annual debt service payments from $125 million to $147.9 million.

Because net operating expenses always swamp operating revenues at the CFA, a source of funds to make the debt service payments is needed. Where does the money come from? In

FY 2013, the Commonwealth provided $119.5 million while another $27.5 million arrived from gaming funds to be used in a county of the second class and redevelopment authority created in 1945—presumably the URA of Pittsburgh. Beginning with 2013, a portion of the Marcellus Shale gas well impact fee revenue is slated to come to the CFA. Its use is specified but might offer a source for debt service payments as well.

In any event, the $147.9 million payment for year ending June 2014 and every year through 2042 will require a substantial increase from the general fund or other special funds. And, the projected annual debt service payment assumes no further borrowing. The current budgeted transfer from the DCED is about $80 million and that will not be nearly enough to cover the total needed. So where will the other $67 million or so come from? The CFA could reduce the outflow of loans and grants and use some of the interest on its loan portfolio or loan repayments to cover the amount or the Commonwealth will have to meet the short fall. For the CFA to reduce loan and grants would mean lowering its support level to the programs it was created to raise money for.

As is typical in legislation creating authorities, there is a provision in the CFA creating law stating that the debt of the CFA will not constitute any indebtedness, liability or obligation of the Commonwealth nor can it pledge the faith and credit of the Commonwealth or any political subdivision—*64 PA C.S. section 1521, paragraph d*. (See Article VIII, sections 8 and 9 of the Pennsylvania Constitution for legal requirement language regarding obligating the Commonwealth.)

However, according to all the audits since the inception of the CFA, there is a service agreement between the Authority and the Commonwealth wherein the Commonwealth has pledged to seek annual appropriations to pay the debt service of the CFA. After all, if the Authority is borrowing large amounts of money and giving sizable fractions of that money away in grants, it will almost certainly need infusions of money from somewhere to pay back the debt with interest.

So far, the Commonwealth has been able to come up with necessary funds to cover CFA debt service. As mentioned above DCED has been providing about $80 million a year. But that is not going to be enough. Gas impact fees presumably are helping fill the gap. But to meet the $67 million dollar hole this year and perhaps bigger gaps in future years as the borrowing continues to pile up the total indebtedness, the Commonwealth will be constantly looking for ways to meet this obligation.

And therein lies the problem. The bonds being issued by the CFA are very highly rated by the rating agencies because there is a commitment by the Commonwealth to make sure the debt service is paid. As the CFA annual debt service grows, will there come a point when the commitment of the Commonwealth to the CFA cannot be met without a tax increase because of the rising demands of pension funding and other pressing core function funding needs?

It certainly appears that could be the case. The question is: has the Commonwealth entered into an agreement that in fact does pledge the faith and credit of the state to the CFA? That is something the law creating the Authority says cannot and will not happen. It might be a matter of legal semantics but it appears the Commonwealth has gone too far with respect to obligating itself to repay CFA borrowing. One of the primary reasons for creating authorities is to be able to have borrowing for public purposes increased without having the debt show

up as sovereign government debt. But unlike most authorities created in the state, the CFA was not provided any independent revenue source such as the power to levy fees for services provided as at a water authority. The CFA is totally reliant on its limited portfolio to produce revenue and tax and fee revenue collected by the state that must be appropriated or dedicated by the Legislature.

Given the breakneck pace at which the net asset position is sliding toward a billion dollars and the inability of the state's economy to generate faster revenue gains without tax rate hikes—which would themselves be a deterrent to faster job and revenue growth—it is becoming apparent that the rapid debt growth of the CFA (theoretically not a claim on Commonwealth taxpayers' wealth and income) needs to be brought to a halt. It should be stopped at least long enough to see if the Commonwealth can afford to meet the growing debt service of the CFA without dipping into core government spending or forcing tax increases, either of which would be a de facto constitutional violation.

This situation is similar to the legal requirement for the Turnpike to borrow $450 million a year to fund highways and public transportation. The debt is piling up and is being serviced by ever rising tolls on the Turnpike. With CFA, it is borrowing to meet the needs of a dozen or more state programs in order to provide far more money than the state could afford if it funded them through the normal budget process. Indeed, the CFA is simply a way to leverage limited DCED dollars and other funds by using them as debt service payments as opposed to directly spending them on economic development and other DCED programs. This is inherently a limited and possibly imprudent course of action. It depends heavily on the economic returns on the CFA loans and grants and the additional tax revenue they generate. There is no free lunch. Sooner or later if not checked borrowing by the CFA will haunt taxpayers. Just as the borrowing by the Turnpike is already hurting Turnpike users.

Jake Haulk, Ph.D., President

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Allegheny Institute for Public Policy
305 Mt. Lebanon Blvd.* Suite 208* Pittsburgh PA 15234
Phone (412) 440-0079 * Fax (412) 440-0085
E-mail: aipp@alleghenyinstitute.org