Legislative Fiscal Bureau

One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

May 16, 2003 Joint Committee on Finance Paper #194

Refunding General Obligation Debt Payments (Building Commission)

[LFB 2003-05 Budget Summary: Page 76, #2]

CURRENT LAW

Under 2001 Act 16 (the biennial budget), the Building Commission was authorized to issue up to $75 million of general obligation bonding to refund tax-supported and self-amortizing general obligation debt that would otherwise have been paid off in the 2003-05 biennium. No debt may be incurred under this refunding authorization after June 30, 2003.

GOVERNOR

Increase the amount of general obligation refunding bonds authorized under current law by $350 million, from $75 million to $425 million. Specify that these general obligation refunding bonds may not be issued unless requested by the Secretary of the Department of Administration (DOA), as described below, and that this additional bonding could not be issued after June 30, 2005.

Annually, on or before September 1, but not after 2005, require DOA to prepare an estimate of the net balances of the general fund for that fiscal year. Require that copies of the estimates be provided to the Co-chairpersons of the Joint Committee on Finance and to the Legislative Fiscal Bureau. Provide that if the estimated net general fund balance for the fiscal year, as certified by DOA, is less than the estimated net general fund balance for that fiscal year, as shown in the most recent fund condition schedule, the DOA Secretary could request that the Building Commission refund the whole or any part of any unpaid indebtedness used to finance tax-supported or self-amortizing facilities from this additional bonding.

DISCUSSION POINTS

1. The Building Commission is authorized to issue state debt, including the refunding of such debt for refinancing purposes. To date, the Commission has been authorized approximately $2.8 billion to refund state general obligation debt, of which $440 million remains available. This bonding authority is intended for use only if the true interest costs to the state can be reduced. In addition, 2001 Act 16 authorized the Building Commission to issue up to $75 million in refunding bonds to refinance the GPR, PR and SEG-funded debt payments in the 2001-03 biennium. This bonding was provided to allow the refunding of bonds that otherwise would have been paid off in the 2001-03 biennium, in order to reduce GPR debt service expenditures.

2. DOA Capital Finance officials indicate that $350 million in authority represents the amount of GPR principal that the state will owe on its outstanding general obligation debt over the two years of the 2003-05 biennium.

3. The refinancing or refunding of debt is a debt management tool that can be used to replace an existing stream of debt service payments with an alternative stream of payments. In refinancing state debt, the state issues new general obligation bonds (the refunding bonds) and uses the proceeds of that bond issue for payments on outstanding debt (the refunded bonds). The general goal of refunding bonds is to reduce interest costs on state debt, which produces savings to the state.

4. Generally, debt is refinanced in either an economic refunding or a structural refunding, or a combination of those methods. In an economic refunding, the new stream of debt service payments is designed to reduce the interest costs on the outstanding debt by taking advantage of lower current interest rates. No increase in debt service payments occurs in any year under an economic refunding and debt service payments are reduced in some or all years during the life of the refunding issue. The transaction can be structured so that the debt service savings are realized equally in each year during the life of the refunding bonds or concentrated in the early or late years of the transaction.

5. In a structural refunding, the new stream of debt service payments on the refunded amounts can have a higher cost in a given year than under the current stream of payments on the original debt amounts. A structural refunding tends to increase the average life of debt. Because the debt associated with the refunded amount is outstanding longer, the total interest costs tend to be greater. For example, a refunding issue could have lower debt service payments in the early years compared to the existing payment structure on that debt and higher debt service costs compared to the existing structure in the later years of the refunded issue. Or, a refunding issue could simply extend the payoff date associated with the original debt further out into the future. As a result, a structural refunding may not always produce savings to the state in terms of gross debt service or in present value terms.

6. The Legislature addressed the matter of structural refunding in its deliberations on 1991 Act 324. As passed by the Legislature, Act 324 increased the state's refunding bonding authorizations, but would have prohibited the Building Commission from using the refunding

authority to restructure the state's general obligation debt. This prohibition provision was vetoed by the Governor, who, in his veto message indicated that the meaning of the words "restructuring public debt" was uncertain and could prevent state bond counsel from giving an approving opinion for a refunding bond issue that produces savings for the state in term of lower debt service and in present value terms. In his veto message the Governor indicated the following:

"A structural refunding component to a refunding bond issue will not be used if that structural refunding component reduces the present value debt service savings for the state. A structural refunding component of a refunding bond issued may be presented to the Building Commission for their consideration if it increased the present value debt service savings for the state."

7. From 1993 through 2001, DOA and the Building Commission used refunding bonds to carry out economic refundings rather than structural refundings. During this period, it was DOA's intention to make principal payments under the replacement stream of debt service payments at the same levels and term as the original debt service payment stream. In doing so, debt service payments for any given year during the repayment period would not be higher than the payments that would have otherwise occurred under the original debt schedule nor would the life of the debt be extended.

8. More recently, 2001 Act 16 provided refunding bonding authority that resulted in the borrowing of $75 million to refund GPR supported bonds that otherwise been paid off in the 2001-03 biennium. These refunding bonds were specifically authorized by the Legislature for this structural refunding, in order to help balance the 2001-03 budget. While this structural refunding did not extend the maturity of the debt of the refunded bond issues beyond the pay off dates of the original bond issues, the refunding did extend the average life of the bond issues refunded. This action will result in higher interest costs to the state associated with those bond issues that were refunded than would have been incurred if the bonds were paid off as originally scheduled.

9. State general obligation debt is issued to fund state capital projects or other activities that have a public purpose and are permitted under the state Constitution. Examples of these other activities include the stewardship program or the Department of Natural Resources and Department of Agriculture, Trade and Consumer Protection program bonding activities that attempt to improve the state's waters and overall environment. Structural refunding bonds, while still tied to the purpose for which the original bonds were issued, are being carried out to reduce the current year debt costs associated with the original bonds issued for that purpose and will result in higher future year debt service costs to the state.

10. The Governor, in his Budget in Brief, indicated that the $350 million in structural refunding bonding would only be used as a last resort in response to unanticipated financial problems for the state. The Governor further indicates that his 2003-05 budget proposal does anticipate the use of these bonds to balance the budget and permits the bonds to be used only in the event that DOA determines revenues are to be significantly less than initially estimated.

11. If refunding bonds are needed to balance fiscal year 2004-05, the revenues in the form of bond proceeds that would be used to make 2004-05 debt payments would be one-time in nature. Relying on such one-time revenues to cover ongoing costs could lead to an imbalance between ongoing costs and revenues, in what will be the base year for the 2005-07 biennium.

12. The Governor's proposal would require that DOA annually, on or before September 1, but not after 2005, prepare an estimate of the net balances of the general fund for that fiscal year. Copies of these estimates would be provided to the Co-chairpersons of the Joint Committee on Finance and to the Legislative Fiscal Bureau. Under the bill, if these estimate show a net general fund balance for the fiscal year that is less than the estimated net general fund balance for that fiscal year, as shown in the most recent fund condition schedule, the DOA Secretary could request that the Building Commission to issue the refunding bonds.

13. If the Committee desires additional oversight related to the DOA Secretary's request for the issuance of the refunding bonds, the Committee could require that DOA submit any request for the issuance of the refunding bonds to the Committee for approval under a 14-day passive review process, prior to being submitted to the Building Commission. This would establish a passive review approval process identical to that used for Committee approval of the issuance of operating notes under current law.

14. In addition, in order to determine the debt service appropriations and program purposes that would be affected by any refunding carried out under this authority, DOA could be required to submit a report to the Committee that indicates which bonds were refunded under this authority and the debt service appropriations that would be affected by such a refunding. Such a report would only be required if the refunding authority provided under the bill is used.

15. If the Committee desires greater oversight by the Legislature at the time a possible future budget shortfall is addressed, it could simply delete this bonding authority. The administration could seek legislative authorization of such refunding bonds in separate legislation, if needed.

ALTERNATIVES

1. Approve the Governor's recommendation to authorize the Building Commission to issue up to $350 million in refunding bonds to refinance state general obligation debt payments in the biennium. Require that DOA annually, on or before September 1, but not after 2005, prepare an estimate of the net balances of the general fund for that fiscal year. Require that copies of the estimates be provided to the Co-chairpersons of the Joint Committee on Finance and to the Legislative Fiscal Bureau. Provide that if the estimated net general fund balance for the fiscal year, as certified by DOA, is less than the estimated net general fund balance for that fiscal year, as shown in the most recent fund condition schedule, the DOA Secretary could request that the Building Commission to issue the refunding bonds.

2. Modify the Governor's recommendation by requiring that any DOA request to the

Building Commission for the issuance of all, or part, of the $350,000,000 in refunding bonds be subject to approval by the Joint Finance Committee under a 14-day passive review process prior to the submission of the request to the Building Commission. In addition, require DOA to report to the Joint Committee on Finance indicating the debt service appropriations and bonding program purposes that would be affected by any refunding carried out under the $350,000,000 authorization provided under the bill, within 30 days after issuance of the bonds.

3. Delete provision.

Alternative 3	BR
2003-05 FUNDING (Change to Bill)	**-** $350,000,000

Prepared by: Al Runde