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

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Veterans Mortgage Loan Repayment Fund Transfer to the General Fund (Veterans Affairs -- General Agency Provisions)

[LFB 2003-05 Budget Summary: Page 457, #4]

CURRENT LAW

The veterans mortgage loan repayment fund consists of direct bond proceeds, repayments on loans financed by both tax-exempt and taxable mortgage bonds, amounts attributable to administrative costs included in the repayments, surplus amounts due to arbitrage and other actions, and investment earnings. The projected 2002-03 yearend closing balance in the fund is estimated at $115,569,600 SEG.

GOVERNOR

Transfer $900,300 SEG annually from the available balances in the veterans mortgage loan repayment fund to the general fund.

DISCUSSION POINTS

1. Provisions of 2001 Wisconsin Act 16 directed the Secretary of DOA to transfer $18.8 million annually from executive branch agencies' state operations appropriations funded from program revenues or segregated funds. Among other requirements, the Secretary of DOA was directed to exclude transfers from appropriations that might be subject to limitations as to expenditure or use as a result of federal law or the state constitution that would prohibit a lapse or transfer to the general fund. The Secretary of DOA was also required to submit the proposed transfers in each year to Joint Finance under a 14-day passive review process.

2. Subsequently, the Secretary of DOA identified for transfer to the general fund,

$223,800 SEG in both 2001-02 and 2002-03 from DVA's foreclosure loss payments appropriation. The appropriation is funded from the veterans mortgage loan repayment fund. The appropriation is used to buy houses subject to foreclosure due to deficient payments on housing loans previously approved by DVA. The properties are then resold and the proceeds are credited to the appropriation. Both of these annual transfers to the general fund were subsequently approved by Joint Finance and were implemented.

3. Provisions of January 2002 Special Session Assembly Bill 1 (the 2001-03 budget adjustment bill), as introduced by the Governor, would have transferred an additional $156,700 SEG in 2001-02 and $223,800 SEG in 2002-03 from the same mortgage loan foreclosure appropriation to the general fund. The Legislature deleted this transfer, and no diversion from the mortgage loan repayment fund was included in 2001 Wisconsin Act 109, as enacted.

4. Provisions of January 2003 Special Session Senate Bill 1 (the 2002-03 budget adjustment bill), as introduced by the Governor, would have transferred to the general fund an additional $223,800 SEG in 2002-03 from operational funds appropriated from the mortgage loan repayment fund. The Legislature deleted this transfer, and no diversion from the mortgage loan repayment fund was included in 2003 Wisconsin Act 1, as enacted.

5. The Governor's rationale in all of these actual or proposed transfers was to utilize available, unobligated balances in the mortgage loan repayment fund to help ease pressures on the state's general fund.

6. When the transfers were initially proposed under both January 2002 Special Session Assembly Bill 1 and under January 2003 Special Session Senate Bill 1, the Department raised a number of concerns, since it appeared that what had been considered as a one-time occurrence with the transfers from the mortgage loan repayment fund authorized under 2001 Act 16 might instead become a more regular occurrence.

7. The Department also raised these concerns in light of the language governing the transfers that appeared in both bills. That language prohibited the Secretary of DOA from undertaking any transfer that might violate a condition imposed by the federal government on the expenditure of the funds being transferred.

8. As identified by the Department, the great majority of the funding in the mortgage loan repayment fund has been derived from the issuance (prior to enactment of the federal Tax Reform Act of 1986) of tax-exempt veterans mortgage bonds. Under federal tax regulations governing tax-exempt issues, the proceeds (that is, direct bond proceeds, repayments and investment earnings) from any bond sale must be used solely for making loans to qualified veterans and for other narrowly defined, related purposes.

9. Applicable federal law governing such bonds allows a maximum allowable "spread" between the interest rate on the underlying bond proceeds and the interest rate charged to the veteran of 1.125%. Monies generated by the spread are used to cover insurance fees, servicing fees

and administrative costs. It has been the Department's policy to charge the maximum allowable spread.

10. Federal law would appear to bar the diversion of proceeds from tax-exempt bonds, the related charges and fees funded by the spread, and the associated direct investment earnings. However, the Department advises that its administrative, insurance and related servicing costs applied against the spread have generally been less than the maximum 1.125% permitted under the federal tax code. This net difference is credited to the available balances in the mortgage loan repayment fund and builds surpluses in the fund.

11. The Department also has the ability to refinance higher cost bonds with lower cost ones when interest rates and market conditions are favorable. This practice permits the Department to continue to receive loan repayments at the higher interest on the older bonds that have been refinanced at lower rates (unless the borrower also refinances, in which case the amount of the difference is reduced). The difference between the interest rates on the old bond issue and the new bond issue constitute a profit to the program.

12. Federal tax code treatment relating to any tax-exempt bonds issued in 1985 and later specify that any such profits in excess of the allowable 1.125% spread must be: (a) rebated to the federal government; (b) placed in a subsidy pool to blend down future mortgage loan interest rates; or (c) rebated to veterans in the form of a payment holiday. The Department has traditionally used these surplus amounts to blend down new mortgage loan rates.

13. Once the loans in the pool have been re-lent and subsequently paid back, there are no further limitations as to their future use or disposition under the federal tax code. Further, any taxable bond issue is not subject to strict limitations with respect to how "surpluses" from those issues may be used.

14. Finally, the Department advises that amounts in the mortgage loan repayment fund that are free and clear of any federal limitations and that have been determined by the state's bond counsel as no longer being required for transfer to the bond security and redemption fund for the repayment of bondholders can be authorized by law for transfer to the veterans trust fund to support activities funded from that source.

15. Thus, it would appear that the operation of federal tax regulations would place limits on significant portions of the mortgage loan repayment fund. However, there would still be sufficient residual amounts in the overall fund that either are free of any federal limitations or are not subject to them because of the taxable nature of the original bond issue. These latter funds would be available for transfer to the general fund, and the Committee could act to approve the Governor's recommendation.

16. Alternatively, it could be argued that since the fund's repayment monies are derived solely from veterans, that any excess amounts in the fund should be reserved exclusively for veterans programs. In fact, residual funds in the mortgage loan repayment fund have been an

important source of additional revenues to the veterans trust fund. In 1993, $20.0 million SEG was authorized for transfer from the mortgage loan fund, and in 1997, an additional $5.6 million SEG was authorized for transfer from this source to support veterans programs. If the Committee believes that these uses of such residual amounts in the mortgage loan repayment fund are a priority, it could delete the Governor's recommendation to transfer $900,300 SEG annually from the available balances in the mortgage loan repayment fund to the general fund.

ALTERNATIVES

1. Approve the Governor's recommendation to transfer $900,300 SEG annually from the available balances in the mortgage loan repayment fund to the general fund.

2. Delete the provision.

Alternative 2	GPR
2003-05 REVENUE (Change to Bill)	**-** $1,800,600

Prepared by: Darin Renner