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State Cashflow Management

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In response to repeated general fund cashflow problems in the early 1980s, the state developed a number of cashflow management procedures. This paper provides an overview of these procedures, including the statutory provisions that govern cashflow management. In addition, information is presented on recent state cashflow experience and cashflow management alternatives.

State Cashflow Management Procedures

Under current law, there are three tools that are available to the Secretary of the Department of Administration (DOA) in managing the state's cashflow. These tools are: (a) borrowing cash from other state funds on a temporary basis; (b) borrowing cash from investors through the issuance of short-term operating notes; and (c) delaying payments from a fund until enough cash is available to meet its obligations.

Temporary Borrowing from Other State Funds

The state uses the state investment fund as an investment pool for portions of retirement trust assets and cash balances of the state's various funds. In addition, local governments can elect to invest their cash balances in the fund. The state investment fund, which is managed by the State of Wisconsin Investment Board, had approximately $7.2 billion in assets during November, 2010.

Under the provisions of 2009 Act 28, during the 2009-11 biennium, the Secretary of DOA is authorized to temporarily reallocate to the general fund an amount equal to 7% of total general purpose revenue (GPR) appropriations in order to support the fund’s cashflow (approximately $987 million in 2010-11). This 7% amount will revert to the prior law amount of 5% on July 1, 2011. The Secretary may permit an additional 3% to be used for temporary reallocations to the general fund for a period not to exceed 30 days (approximately $423 million in 2010-11). Reallocations of the additional 3% may not be made for consecutive periods. In total, 10% of GPR appropriations ($1,410 million in 2010-11) may be allocated to the general fund on a temporary basis. No limit applies to temporary reallocations from the budget stabilization fund to the general fund.

For funds other than the general fund, up to $400 million can be reallocated between the general fund, certain segregated funds, and the local government investment pool.

In order to be eligible for temporary reallocations, a fund must have accounts receivable balances or monies anticipated to be received from lottery proceeds, tax revenues, gifts, grants, fees, sales of service, or interest earnings. The Secretary of Administration determines the allowability of accounts receivable balances and anticipated monies to be received for this purpose.

In no case can borrowing be made from retirement trust assets or from several specific segregated funds. In addition, the fund from which money is borrowed receives interest at the current state investment fund earnings rate. Further, the Secretary cannot temporarily reallocate balances if such borrowing would cause cashflow problems for the fund or account from which it is made. The Department of Administration estimated that the state investment fund had $1.7 billion of monies available for temporary reallocations as of October 31, 2010.

Short-Term Borrowing from Investors--Operating Notes

Operating notes can be issued to fund a cashflow deficit in the general fund. Operating notes were first issued by the state in 1983-84. If a general fund cashflow problem is anticipated, the Secretary of DOA, with the Governor's approval, can request the issuance of operating notes. This request is subject to approval by the Joint Committee on Finance under a 14-day passive review process. If the request is approved, the Building Commission issues the notes.

The amount of operating notes that can be outstanding during a fiscal year is limited to 10% of total GPR and program revenue appropriations for that year. In 2010-11, this 10% limit is approximately $1.8 billion. In addition, operating notes must be repaid before the end of the fiscal year of issuance. Table 1 shows the amount of operating notes that have been issued annually since 1993-94.

In deciding on the amount of operating notes to issue, three factors are considered. First, federal arbitrage regulations require that the actual cash deficit equal at least 90% of the issuance amount, or the state must rebate interest earnings above the rate paid on the note.

Second, the operating notes should provide sufficient cash to largely avoid temporary reallocations of available state investment fund balances during the fiscal year.

The third factor involves a comparison of the interest cost of the notes and the investment earnings the state would accrue on the note proceeds. In the absence of interest rates favoring operating notes over interfund borrowing, the minimum amount needed to ensure that no payment delays will occur should be issued. If interest rates favor operating notes over interfund borrowing, then a larger amount of notes could be issued, to reduce the state's use of interfund borrowing, but still within the limits of the federal arbitrage regulations. In a case where interest rates favored operating notes over interfund borrowing, the state's general fund could achieve interest savings by issuing notes in excess of the minimum amount needed to avoid payment delays, compared to not issuing notes or issuing the minimum needed.

As shown in Table 1, two notes were issued in 1997-98; one dated July 1 for $300 million and a second dated November 12 for $150 million. The second note was issued to offset the cashflow effects of a $215 million payment made to the special investment performance dividend lawsuit settlement. There were no notes issued during 1999-00, 2000-01, or 2002-03 because it was anticipated that there was sufficient cash available in each of those years to avoid a deficit. For the 2003-04 fiscal year, the administration received authority to issue up to $800 million in operating notes. However, following an assessment of interest rates and cash flow projections, only $400 million in operating notes was issued in 2003-04. In 2004-05, the administration was authorized to issue up to $800 million in

Table 1: Operating Notes Issuance Since 1993-94 (In Millions)

Fiscal Year	Amount
1993-94	$350
1994-95	350
1995-96	250
1996-97	150
1997-98*	450
1998-99	350
1999-00	0
2000-01	0
2001-02	800
2002-03	0
2003-04	400
2004-05	0
2005-06	0
2006-07	0
2007-08	600
2008-09	800
2009-10	800
2010-11	800

*Two notes were issued in 1997-98, one for $300 million and a second for $150 million.

operating notes, but decided not to issue notes, based on interest rates and cash flow projections at the time. DOA did not request authority to issue operating notes in 2005-06 or in 2006-07. Notes were issued in 2007-08, 2008-09, 2009-10 and 2010-11.

Payment Delays

The Secretary of DOA can prorate or delay payments from any fund that is having cashflow problems. This authority can only be used after all other possible procedures, including temporary reallocations of available state investment fund balances, have been used and found to be insufficient. In addition, the Secretary has to notify the Joint Committee on Finance and cannot act without a meeting of the Committee if such a meeting is scheduled within two working days after notification by the Secretary.

The statutes establish a priority schedule for payment in case of cashflow problems. The first priority is debt service payments on state general obligation debt and the second priority is debt service payments on state operating notes. Neither of these debt service payments may be prorated or reduced. State employee payrolls have third priority. The Secretary determines the priority of payments for all other items.

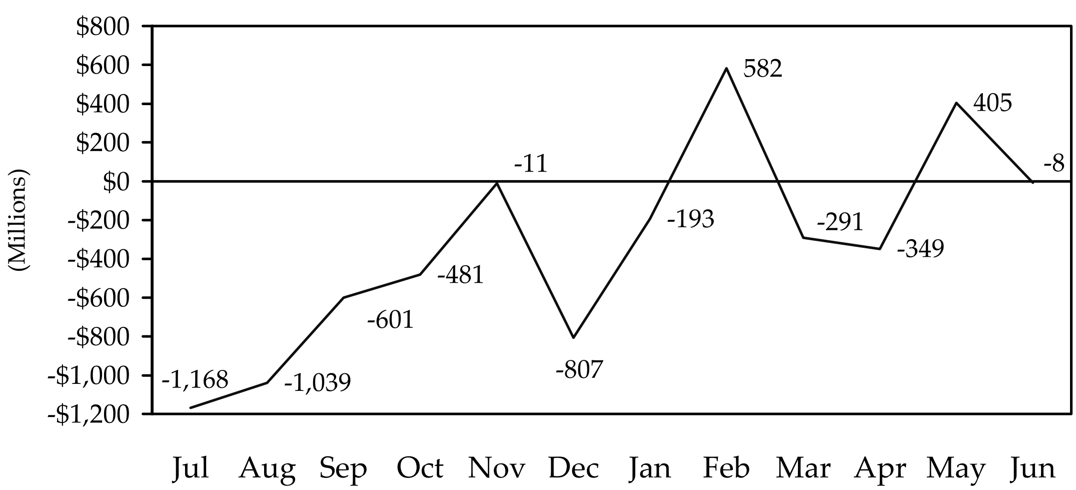
If payments to local units of government are delayed, the Secretary must establish a procedure under which the delay can be appealed for a unit that would be adversely affected. In addition, interest is paid on delayed payments to local units of government at the state investment fund earnings rate for the period of the payment delay.

State Cashflow Experience

The general fund receives revenues and makes expenditures for programs funded with general purpose revenue, federal revenue, and program revenue. Due to the timing of revenue collections and payments of large aid amounts, the state has experienced repeated cashflow problems.

Historically, with some exceptions, the general fund experiences a negative cash balance in December in the absence of operating notes. This

Lowest Cash Balance in 2009-10



trend varied somewhat in 2009-10, after deducting the operating note proceeds, when the general fund's lowest cash balance of the year, -$1,168 million, occurred in July. The fiscal year began with a negative cash balance and even accounting for note proceeds, disbursements were higher than receipts for the month. A number of larger local aid payments occur each July, including shared revenue and the school property tax credit and first dollar credit. During 2009-10, negative cash balances would have occurred in 10 of the 12 months of the fiscal year, if no operating notes had been issued. However, the state was able to cover the negative cash balances in the general fund by the issuance of $800 million in operating notes and temporarily borrowing from other state funds under the authority described above.

Generally, the state's cashflow pattern is attributable to the uneven distribution of both revenues and expenditures. On the revenue side, 52.1% of all general fund revenues were received during the last half of fiscal year 2009-10. The state's individual income tax and federal receipts were revenue sources that contributed to this imbalance, with 54.9% of individual income tax receipts and 52.4% of federal receipts collected in the second half of the fiscal year. It would be difficult for the state to modify the timing of these revenues, because income tax filing deadlines coincide with federal deadlines, and payments under other federal programs are not subject to direct state control.

For expenditures, the current payment schedule for county and municipal aids, and for property tax relief through the school levy and first dollar tax credits, contributes to the general fund cashflow difficulties. Payments under these state aid and credit programs are made in July and November. In 2009-10, these appropriations total approximately $1.6 billion, which are all paid out in the first five months of the fiscal year.

Over the full course of fiscal year 2009-10, general fund receipts of $29.70 billion, including general purpose revenue, program revenue, and federal receipts, including $1.2 billion in federal stimulus funds, were more than disbursements of $29.17 billion by $530 million. The fiscal year, which had started with a -$147 million cash balance, ended with a cash balance of $383 million.

While 2009-10 ended with a cash balance of $383 million, the undesignated balance in the general fund at the year's end was $71 million. The undesignated balance is calculated by comparing general fund assets and liabilities as of June 30, of the fiscal year, and deducting required reserve and designated amounts. Since it is an accounting balance, it differs from the cash balance of the general fund, which varies on a daily basis. The state's cashflow problems have occurred even when the general fund ended with positive undesignated balances.

Cashflow Management Alternatives

Historically, the state has managed its need for additional cash at certain times of the year by issuing operating notes. Under current law, the state is able to borrow money at tax-exempt interest rates to support the general fund's cashflow, rather than at the higher rate paid on the taxable securities held in the state investment fund. Under this authority, the state issued operating notes each fiscal year from 1983-84 to 1998-99. Each of these note issues was repaid by the end of the fiscal year of issue and supplied sufficient cash for the state to make payments in a timely manner, without having to make significant temporary reallocations from available balances of the state investment fund after the note issue. As an example, in fiscal year 1998-99, it was estimated that the state saved approximately $3.8 million through the issuance of operating notes, compared to utilizing temporary reallocations from the state investment fund.

While issuing operating notes is typically less costly than temporary borrowing through the investment fund, this is not always the case. In 2001-02, the interest rate paid to investors for the operating notes exceeded the rate earned in the state investment fund (SIF) for some months. Therefore, the interest paid on the notes was higher than the interest that would have been paid for temporarily using other state funds in those months. However, in the absence of the operating notes, there would have been a greater risk of negative cash balances exceeding the amounts available under the temporary borrowing authority. In 2003-04, the short-term cash needs could have been met through temporary borrowing. But in the early part of the year, it appeared that there was a risk that negative cash balances would exceed the amounts available under the temporary borrowing authority. In 2004-05, 2005-06, and 2006-07, no operating notes were requested as it appeared that the state would be able to cover its cashflow needs through temporary borrowing. Notes were issued in 2007-08 through 2010-11, in order to provide sufficient cash balances for the general fund to make payments in a timely manner through the fiscal year.

One alternative to relying on operating notes would be to increase the statutory balance requirements under current law. Wisconsin statutes provide that no bill may be enacted by the Legislature if it would cause the estimated general fund balance on June 30 of any fiscal year to fall below a specified amount or a specified percentage of budgeted gross general fund appropriations plus GPR compensation reserves for the fiscal year. The most recent reserve requirements, provided under 2009 Act 28, established a $65.0 million reserve for fiscal years 2009-10 through 2012-13, and a reserve of 2.0% of total GPR appropriations plus compensation reserves for 2013-14 and thereafter. The $65.0 million reserve requirement represents approximately 0.46% of total GPR appropriations plus compensation reserves budgeted for 2010-11. Based on 2010-11 budgeted expenditures, a reserve of $284 million would be required to provide a reserve equal to 2.0% of total GPR appropriations plus compensation reserves. Similarly, a reserve of $852 million would represent 6.0% of total GPR appropriations plus compensation reserves budgeted for 2010-11.

A second alternative to issuing operating notes would be to add to the current budget stabilization fund. Under the provisions of 2001 Act 16, the Secretary of DOA is required to transfer into the budget stabilization fund 50% of the amount by which actual tax collections exceed those that had been forecast for the fiscal year (up to a maximum of 5% of estimated GPR expenditures for that fiscal year). In the absence of an excess of actual revenues over those forecast, no amounts are transferred to the budget stabilization fund under this mechanism. Also, under 2003 Act 33, the State Building Commission and DOA are required to deposit certain property sales proceeds to the budget stabilization fund.

In 2006-07, actual general fund tax revenues exceeded the amounts projected for 2006-07 in the 2005-07 budget bill. Under the Act 16 provisions, $55.6 million was transferred from the general fund to the budget stabilization fund in the fall of 2007. Under 2007 Act 226 (the 2007-09 budget adjustment act), $57 million was transferred by law from the budget stabilization fund to the general fund in June, 2008, to help address a budget shortfall of an estimated $652 million in the 2007-09 biennium. This left a balance of $1.3 million in the budget stabilization fund on June 30, 2008. As of June 30, 2010, the balance in the budget stabilization fund was $1.7 million.

In order to guarantee future increases in the budget stabilization fund, the Legislature could require that sums be transferred to the fund whether or not actual revenues exceed tax collections that had been projected for the fiscal year.

An additional alternative to issuing operating notes would be to shift a portion of the shared revenue and school levy credit payments to later in the fiscal year. The lowest cash balance after deducting the operating notes has historically occurred in December, although the lowest cash balance was in July in 2009-10. Under current law, 15% of the county and municipal aid under the various shared revenue appropriations and all of the school levy and first dollar credit are paid in the first month of the fiscal year (approximately $950 mllion in 2009-10). If $300 to $400 million of these payments were shifted to May or June in the state's same fiscal year, the state's cashflow in the fiscal year would be improved.

A major disadvantage of this alternative is the effect this type of shift would have on municipal budgets. Since municipalities budget on a calendar year basis, the shift of $300 to $400 million in shared revenue or school levy credit payments to the following May or June would result in a significant one-time loss of revenues for municipalities. Alternatively, the state could advance $300 to $400 million of payments from July and November to the preceding May or June to establish the proposed payment schedule. However, this approach would represent a one-time cost of the same amount to the state's general fund.

A final alternative would be to channel any future increases in these state aid programs to payment dates in the later part of the state's fiscal year. This would more slowly balance the state's cashflow pattern. This alternative does not relate to the policy decision of which state aid programs should receive additional funding, but rather to the timing of the payment of any increased funding for each of these state aid programs. If additional payment amounts for these programs could be scheduled late in the state's fiscal year, the general fund's cashflow situation would be improved.