AGENCY: DPI

Paper #: 1224

ISSUE: High School Graduation Test

ALTERNATIVE:

2: Approve Gov's rec. to delay HS Grad test by 2 years, but also take the $3,275,000 GPR related to the Grad. Test. (DPI is OK with this because they don't think they can use the $ anyway w/ the delay.)

SUMMARY: Gov. wants to delay the HS Grad. Test by 2 years.

BY: Tanya

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

March 4, 2002 Joint Committee on Finance Paper #1224

High School Graduation Test (DPI)

[LFB Summary of the Governor's Budget Reform Bill: Page 73, #5]

CURRENT LAW

Under current law, by September 1, 2002, school boards operating high schools must adopt a written policy for granting a high school diploma. The criteria must include: (a) the pupil's score on a high school graduation test (HSGT) adopted by the board; (b) the pupil's academic performance; and (c) the recommendations of teachers. These criteria are in addition to credit requirements.

A school board must adopt a high school graduation exam that measures whether pupils meet pupil academic standards adopted by the board. If the board adopts the statewide standards in mathematics, science, social studies and English language arts as issued and adopted under Executive Order 326, the board could adopt the HSGT developed by DPI. If a school board develops and adopts its own high school graduation exam, it is required to notify DPI.

Beginning in 2003-04, a high school diploma cannot be granted to any pupil unless the pupil has satisfied the school board's written criteria. The test may be administered only in grades 11 and 12, and must be offered twice each year. In addition, a board must excuse a pupil from the exam upon the request or a parent or guardian.

These provisions apply to charter schools operating high schools as well.

Under the provisions of 1999 Act 9 (the 1999-01 budget act), 2.0 permanent positions beginning in 1999-00 and 4.0 two-year project positions beginning January 1, 2000, were provided specifically for DPI's development and administration of the HSGT. The project positions were scheduled to expire at the end of December 2001.

Under 2001 Act 16, base funding of $2.5 million annually was provided to DPI to finish development and to implement the exam beginning in school year 2002-03, including funding for the 4.0 project positions for two more years.

GOVERNOR

Delay by two years, until 2004-05, the current law requirement that beginning in 2002-03, a school board or charter school operating high school grades must administer a high school graduation test. Also delay by two years, until September 1, 2004, the current law requirement that by September 1, 2002, a school board or charter school that operates a high school must adopt a written policy specifying criteria for granting a high school diploma, which must include a pupil's score on a graduation test. Delay by two years, until September 1, 2005, the current law requirement that beginning September 1, 2003, a high school diploma cannot be granted to any pupil unless the pupil has satisfied the school board's or charter school's criteria.

DISCUSSION POINTS

1. Under 1997 Act 27, DPI was required to design a state high school graduation test that local school districts could use if they adopted the model academic standards of Executive Order 326. Act 27 provided that, starting September 1, 2002, a pupil would be required to pass either the state HSGT or an alternative test adopted by the school board to be granted a high school diploma. Act 9 changed the HSGT law to make a passing score on the test one criterion for graduation, rather than a requirement. Act 9 also specified that the test could be administered only in grades 11 and 12, and must be offered at least twice each year. Further, Act 9 provided that, starting September 1, 2003, a pupil would be required to satisfy a school board's or charter school's criteria for graduation in order to receive a diploma. Finally, Act 9 applied the requirements to charter schools.

2. As part of its 2001-03 agency budget request, the Department requested $4,623,800 GPR in 2001-02 and $4,651,800 GPR in 2002-03 above the base level of $2,500,000 GPR, as well as the extension of the 4.0 project positions for another two years. The Governor's 2001-03 budget recommendation provided $4,599,800 GPR in 2001-02 and $4,651,700 GPR in 2002-03, including funding for the 4.0 project positions. DPI requested $24,000 GPR in each year for the estimated cost of administering the HSGT to MPCP pupils. The Governor included this funding only in 2002-03.

3. During its 2001-03 budget deliberations, the Committee deleted the Governor's increase in funding for the HSGT, but retained base funding for the exam and left the statutory requirements related to the HSGT unchanged. Subsequently, the Legislature delayed the requirements by two years, but the Governor vetoed the two-year delays and restored the current law requirements. In his veto message, the Governor stated that it was not possible to restore the funding originally included in his budget request through veto, but indicated that federal funding could become available for pupil assessment costs, allowing DPI to reallocate existing state support for testing in the elementary grades to the HSGT. The Governor also stated that if federal funding

were not forthcoming, then he would propose separate legislation to address implementation of the HSGT.

4. Proponents of the HSGT have contended that in order for Wisconsin to remain competitive in the 21st century, Wisconsin high school graduates must be able to demonstrate their knowledge and skills based on high standards across core academic subjects. A high school graduation test would establish that a Wisconsin high school diploma would ensure a high quality graduate that is prepared for higher education, a competitive job market or community service. The Wisconsin HSGT has been designed to be a reliable, valid assessment, aligned with state academic standards and meeting other legal criteria for "high stakes" exams.

5. In addition, accountability measures in the form of pupil assessments aligned with academic standards continue to gain popularity as educational reforms in response to reports in recent years that the academic performance of U.S. pupils has fallen behind that of other countries, as well as evidence of gaps in performance between whites and minorities and economically advantaged and disadvantaged pupils. Under the reauthorization of the Elementary and Secondary Education Act (ESEA), signed into law by President Bush on January 8, 2002, beginning in 2005-06 states must implement state standards-based annual reading and mathematics tests in grades three through eight. According to *Education Week*, the number of states that administer student assessments that are explicitly aligned with state standards in at least one subject climbed from 35 in 1997-98 to 41 in 2000. According to the National Conference of State Legislatures, twenty-eight states have in place or are considering high school exit exams.

6. Opponents of a high stakes high school examination requirement argue that such an exam would provide little specific information about the skills or knowledge of a high school graduate in Wisconsin. Further, they contend that a high stakes examination may encourage marginal pupils to drop out of high school, rather than fail an examination and be denied a high school diploma. Partly in response to such concerns, Act 9 changed the high stakes nature of the HSGT, so that the exam is now only one criterion for graduation and parents may choose to opt out their children. Based on these provisions, one could call into question the exam's value as an accurate indicator of aggregate student performance or for any individual pupil.

7. Development of the HSGT was completed this winter; therefore, no savings for development costs can be realized at this time. DPI is currently finalizing the copyright process with CTB/McGraw-Hill, the testing vendor, so that the state will retain exclusive rights to the test. A standards-setting administration of the HSGT was scheduled for April 8-11, 2002, to be given to this year's sophomore class, the first cohort of students to be affected by the test under current law. However, DPI cancelled that administration upon the public release of the details of the Governor's budget reform bill that would delay the requirements by two years. By canceling this preliminary administration and delaying the exam for two years, substantial cost savings can be realized in this biennium in areas such as printing, distributing and scoring the exams.

8. Because the state will own the copyright for the HSGT, it would be possible to set aside the instrument that has been developed and implement the test in two years, when full funding

might be more feasible. DOA budget staff indicate that base funding and 6.0 positions were not removed so that work could continue on preparation for administration of the exam in two years. DOA staff remain hopeful that federal assessment funds could be used to fund current state assessments under the new ESEA, and that GPR within the pupil assessment appropriation could then be redirected to partially offset the cost of implementing the HSGT. It is not clear at this time whether it will be possible to use federal assessment funds in this manner.

9. To date, DPI has expended $1.12 million for HSGT development costs from the pupil assessment appropriation for 2001-02. It is possible that additional billing statements from CTB/McGraw-Hill will be forthcoming, and there may be costs associated with currently required changes to the 10th grade test. If the Committee would approve the Governor's recommendation to delay the HSGT for two years, then the Committee could remove the remainder of the HSGT base funding. After consideration of the above factors and the $87,500 in 2001-02 and $125,000 in 2002-03 already deleted in the bill from this $2.5 million of base level funding, an estimated $0.9 million in 2001-02 and $2.375 million in 2002-03 would be available to be removed. Since test development is complete at this point, DPI will not incur additional costs related to the HSGT until test administration. Under the proposed law change, test administration would be delayed until 2004-05, with a standard-setting administration likely given in 2003-04. In that case, funding for the HSGT could be addressed as part of the 2003-05 state budget process. The Committee could leave in place position authorization under the pupil assessment appropriation so that if funding for the positions can be identified, then these positions would remain available to work on the HSGT or on the new federal assessments.

10. On the other hand, the Committee could consider retaining current law, providing additional GPR and requiring DPI to move forward with implementation of the HSGT as scheduled. Some argue that the expenditure to date of over $6.7 million GPR by the state to complete the development of the test, in addition to the significant investments for curricular overhauls made by school districts statewide in anticipation of the test, warrants implementation of the HSGT as planned. It is estimated that an additional $7.1 million GPR in 2002-03 would be necessary to fully fund the HSGT. No additional funding would be necessary in 2001-02, because, due to the relatively short timeframe, it would not be possible to reinstate the April standard-setting administration as originally scheduled.

11. Finally, the Committee could consider eliminating the HSGT entirely. Given the state's limited resources, some argue that implementation of the exam would not be a prudent investment of state funds. Additionally, given the impending federal requirement of annual elementary and middle school assessments, an additional exam so late in the educational process, which is also significantly more expensive to administer than the current 10th grade exam, could be viewed as superfluous. Delaying the HSGT would require school districts to continue to invest in preparation for the exam. As a result, it may be desirable to eliminate the HSGT. Under this alternative, the Committee could eliminate the HSGT requirements and remove base level funding for the HSGT, but allow the position authorization to remain in place so that if funding for the positions can be identified, then work on the new federal assessments can begin.

ALTERNATIVES TO BILL

1. Approve the Governor's recommendation to delay by two years the statutory requirements related to the high school graduation test and retain base level funding.

2. Approve the Governor's recommendation to delay by two years the statutory requirements related to the high school graduation test. Delete $900,000 GPR in 2001-02 and $2,375,000 GPR in 2002-03 from the assessments appropriation.

Alternative 2	GPR
2001-03 FUNDING	- $3,275,000

3. Maintain current law. Provide $7,100,000 GPR in 2002-03 in the assessments appropriation to fully fund implementation of the high school graduation test.

Alternative 3	GPR
2001-03 FUNDING	$7,100,000

4. Eliminate the high school graduation test. Delete $900,000 GPR in 2001-02 and $2,375,000 GPR in 2002-03 from the assessments appropriation.

Alternative 4	GPR
2001-03 FUNDING	- $3,275,000

MO# 2

1	BURKE	Y	N	A
	DECKER	Y	N	A
	MOORE	Y	N	A
	SHIBILSKI	Y	N	A
	PLACHE	Y	N	A
	WIRCH	Y	N	A
	DARLING	Y	N	A
	ROSENZWEIG	Y	N	A
2	GARD	Y	N	A
	KAUFERT	Y	N	A
	ALBERS	Y	N	A
	DUFF	Y	N	A
	WARD	Y	N	A
	HUEBSCH	Y	N	A
	HUBER	Y	N	A
	COGGS	Y	N	A

AYE 16 NO 0 ABS ____

Prepared by: Layla Merrifield

AGENCY: DPI

Paper #: 1225

ISSUE: State support of K-12

ALTERNATIVE: MAINTAIN CURRENT LAW

SUMMARY:

BY: Tanya

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

March 4, 2002 | Joint Committee on Finance | Paper #1225

State Support of K-12 Public Education (DPI)

CURRENT LAW

The state has a goal of funding two-thirds of K-12 partial school revenues. For the purposes of the two-thirds funding goal, state funding is defined as the sum of state general and categorical school aids, the school levy tax credit and the general program operations appropriation for the Wisconsin School for the Deaf and the Wisconsin Center for the Blind and Visually Impaired. With certain exceptions, partial school revenues is defined as the sum of state school aids and property taxes levied for school districts. The two-thirds funding commitment is calculated on a statewide basis; the level of state aid received by an individual district may be higher or lower than two-thirds depending on the district's per member shared cost and equalized value, as well as the amount of funding the district receives through categorical aids and the levy credit.

Under revenue limits, the annual increase in a school district's per pupil revenue derived from general school aids, computer aid and property taxes is restricted. Actual general aids, computer aid and property tax revenues received in the prior school year are used to establish the base year amount in order to compute the allowable revenue increase for the current school year. A per pupil revenue limit increase, which is adjusted annually for inflation, is added to the base revenue per pupil for the current school year. In 2001-02, this per pupil increase is $226.68. There are several adjustments that are made to the standard revenue limit calculation, such as the declining enrollment adjustment, carryover of unused revenue authority and the transfer of service adjustment. These adjustments generally increase a district's limit, providing the district with more revenue authority within the calculated limit. A school district can also exceed its revenue limit by receiving voter approval at a referendum.

GOVERNOR

A summary of state support of K-12 education under the Governor's proposal in 2002-03 is shown in Table 1.

TABLE 1

State Support for K-12 Education -- Governor's Proposal
($ in Millions)

	2002-03
State Funding:	
General School Aids	$4,200.9
Categorical Aids	575.4
School Levy Credit	469.3
State Residential Schools	10.4
Total	$5,256.0
Partial School Revenues	$7,884.1
State Share	66.67%

DISCUSSION POINTS

1. State aid to K-12 public schools is estimated to be approximately 40 percent of general fund expenditures in 2002-03. Given the magnitude of state school aid expenditures, the Committee could choose to make additional reductions in this area to address the projected general fund deficit. Alternatives to reduced state funding for K-12 education, however, could impact the statewide school property tax levy or total school district resources.

2. One alternative for reducing state general fund expenditures for K-12 would be to reduce the percent of partial school revenues that the state supports. Based on current estimates, each percentage point reduction in the state funding goal under the bill would reduce general school aids expenditures by $78.9 million in 2002-03. To address the projected deficit and maintain the required statutory balance solely by reducing the state share of partial school revenues, the percentage of state support would have to be reduced to 52 percent, which would reduce general fund expenditures by $1.156 billion compared to the bill. Table 2 outlines the reduction in general school aids associated with various percentages of state support.

TABLE 2

Reduction to General School Aids under Various Levels of State Support
($ in Millions)

Percent State Support	Reduction in General School Aids
66%	$52.5
65	131.3
64	210.1
63	288.9
62	367.7
61	446.5
60	525.3

3. School district revenue limits restrict the amount of revenue obtained through the combination of general school aids, the property tax levy and computer aid. Under revenue limits, any decrease in the amount of general school aids could be offset by an increase in the school property tax levy. Thus, under this option, school districts would have the ability to offset any state aid loss through the property tax levy. This would maintain their resource base under revenue limits, but the result would be a higher property tax levy than anticipated under current law.

4. Rather than change the percentage of state support, the Committee could also set the general school aids appropriation for 2002-03 equal to the amount appropriated for 2001-02, which is $4.052 billion. This would reduce general school aids funding by $149,376,300 compared to the bill, and result in state support of approximately 64.5% of partial school revenues. Under current law revenue limits, school districts would have the ability under this alternative as well to offset any state aid loss through the property tax levy.

5. If the Committee wishes to reduce general fund expenditures for state support for K-12 education while mitigating any increase in the levy, the per pupil adjustment to revenue limits could be reduced. An option relating to setting the per pupil adjustment equal to $210 in 2002-03 is discussed in the issue paper dealing with the Governor's recommendation on the per pupil adjustment. The Committee could choose to set the adjustment lower. Table 3 shows the reduction in partial school revenues and the corresponding reduction in state two-thirds funding that would result from setting the adjustment at different levels in 2002-03. The table also shows the per pupil percent increase for the highest and lowest-revenue districts as well as statewide under each adjustment.

TABLE 3

Reductions to Partial School Revenues under Various Per Pupil Adjustments
($ in Millions)

			Per Pupil Percent Increase		
Per Pupil Adjustment	Reduction in Partial School Revenues	Reduction in General School Aids	Highest Revenue District	Statewide	Lowest Revenue District
$200	$26.5	$17.7	1.5%	2.6%	3.0%
150	69.7	46.5	1.2	2.0	2.2
100	112.2	74.8	0.8	1.3	1.5
50	153.4	102.3	0.4	0.7	0.8

6. While reducing the per pupil adjustment would have the effect of decreasing state school aids expenditures as well as the school property tax levy, it would have the effect of reducing the overall resource base of school districts statewide. The reductions to school district resources are shown in the Table 3 as the reductions to partial school revenues.

7. Another option for reducing state support of K-12 education is to reduce categorical funding. Categorical aids are provided to reimburse costs for a specific program or specific purpose. In 2002-03, $530.0 million GPR is currently appropriated for various categorical aid programs. Nearly 90 percent of GPR categorical aid funding, or $468.5 million, is provided in the five largest GPR categorical appropriations: special education, SAGE, TEACH educational technology block grants, pupil transportation and tuition payments. If the Committee would reduce those five programs by 10% each, for example, categorical expenditures would be reduced by $46.8 million. Under the two-thirds funding calculation, if categorical aids are decreased, there is an increase in general school aids equal to one-third of the decrease in categorical aid in order to maintain two-thirds funding of partial school revenues. Thus, the $46.8 categorical reduction would be offset by a $15.6 million increase in general school aids, for a net GPR reduction of $31.2 million. Under revenue limits, the increase in general school aids would reduce school property taxes; however, school district resources would be reduced by the full amount of any categorical aid reduction. Table 4 shows the base funding for the five largest GPR categorical aid appropriations and the effect of a 10% reduction on available funding.

TABLE 4

Effect of a 10% Reduction in the Largest GPR Categorical Aid Appropriations

	2002-03 Base Funding	10% Reduction	Base Less Reduction
Special Education	$315,681,400	$31,568,100	$284,113,300
SAGE	90,290,600	9,029,100	81,261,500
TEACH Block Grants	35,000,000	3,500,000	31,500,000
Pupil Transportation	17,742,500	1,774,300	15,968,200
Tuition Payments	9,741,000	974,100	8,766,900
TOTAL	$468,455,500	$46,845,600	$421,609,900

8. Several factors should be considered in reducing categorical aid funding. Special education and pupil transportation funding are prorated, given that eligible costs for school districts statewide already exceeds available funding. Reducing these appropriations would further increase the proration. Programs that are estimated to be fully funded, such as SAGE and tuition payments, may be prorated if funding is reduced. Federal law contains provisions for state maintenance of special education support, under which federal special education funding could be reduced if the state does not maintain special education funding at prior year levels. Also, in the most recent state Supreme Court decision on the constitutionality of the school finance system (Vincent v. Voight), the Court held that the right to an equal opportunity for a sound basic education must take into account districts with disproportionate numbers of special education students, economically-disadvantaged students and students with limited-English proficiency. Reducing funding for special education and SAGE could be considered inconsistent with that goal.

ALTERNATIVES TO BILL

While there are various options for reducing state support of K-12 public education, the following alternatives illustrate some of the possibilities discussed in this paper.

1. Set the level of state support of K-12 education at one of the following percentages, and delete the corresponding amount of general school aids funding to adjust to the percentage:

a.	66%	-$52.5 million GPR
b.	65%	-131.3 million GPR
c.	64%	-210.1 million GPR
d.	63%	-288.9 million GPR
e.	62%	-367.7 million GPR
f.	61%	-446.5 million GPR
g.	60%	-525.3 million GPR

2. Set the general school aids appropriation for 2002-03 at $4,051,569,600, the same level of funding appropriated in 2001-02.

Alternative 2	GPR
2001-03 FUNDING	- $149,376,600

3. Set the per pupil adjustment under revenue limits equal to one of the following amounts in 2002-03 and delete the corresponding amount of general school aids funding to adjust state two-thirds funding:

a.	$200	-$17.7 million GPR
b.	150	-46.5 million GPR
c.	100	-74.8 million GPR
d.	50	-102.3 million GPR

4. Reducing funding for the following categorical aid appropriations by one of the following percentages in 2002-03, and provide the corresponding amount of general school aids to maintain state two-thirds funding.

		a.	b.	c.	d.
	2002-03			Reduction	
	Funding	5%	10%	15%	20%
Special Education	$315,681,400	-$15,784,100	-$31,568,100	-$47,352,200	-$63,136,300
SAGE	90,290,600	-4,514,500	-9,029,100	-13,543,600	-18,058,100
TEACH Block Grants	35,000,000	-1,750,000	-3,500,000	-5,250,000	-7,000,000
Pupil Transportation	17,742,500	-887,100	-1,774,300	-2,661,400	-3,548,500
Tuition Payments	9,741,000	-487,100	-974,100	-1,461,200	-1,948,200
TOTAL	$468,455,500	-$23,422,800	-$46,845,600	-$70,268,400	-$93,691,100
General School Aids Offset		$7,807,600	$15,615,200	$23,422,800	$31,230,400
Net GPR Reduction		-$15,615,200	-$31,230,400	-$46,845,600	-$62,460,700

Prepared by: Russ Kava

gov

PUBLIC INSTRUCTION

Milwaukee Parental Choice Program Funding

Motion:

Move to make the following modifications to the Milwaukee parental choice program: (a) specify that the per pupil payment amount under the program in the 2002-03 school year be set at $2,000 for a student in grades K-8 student and at $3,000 for a student in grades 9-12; (b) specify that the per pupil payment amount under the program in the 2003-04 school year and in subsequent school years be set at $1,000 for a student in grades K-8 student and at $1,500 for a student in grades 9-12; (c) change the appropriation for the program from a sum sufficient appropriation to a sum certain appropriation; (d) specify that if the funding in the appropriation is insufficient to fund program payments, the payments be prorated.

Note:

Under current law, the state will expend an estimated $68,250,000 in 2002-03 from the choice program appropriation. This amount represents the cost of providing payments under the program of an estimated $5,784 per pupil to 11,800 pupils in 2002-03. Expenditures under the program will be partially offset by a reduction from the general school aids for which MPS is eligible equal to 45% of the estimated choice program appropriation, or $30,712,500. The remaining 55% of the cost, or $37,537,500, would be funded from the general fund.

As a result of reducing the per pupil payment under this motion, choice program payment funding would be reduced by $42.9 million in 2002-03. The GPR lapse attributable to the choice program from MPS general school aids would be reduced by $19.3 million in 2002-03. In total, the motion would reduce general fund expenditures by $23.6 million in 2002-03.

To the extent that the reduced payment amount would reduce participation in the choice program, it is possible that some pupils that would otherwise have participated in choice program would enroll in Milwaukee Public Schools. Under revenue limits, one-third of the number of pupils that otherwise would have participated in the choice program that instead enroll in MPS would count immediately under the three-year rolling average of enrollment. Revenue limits for MPS would fully reflect the addition of the number of choice pupils only in the third year.

An increase to revenue limits would increase partial school revenues and therefore increase the cost of maintaining the state's two-thirds funding goal. MPS' membership count for revenue limit purposes declined from 1998 to 1999 to 2000, and increased slightly in 2001. Given that revenue limits are calculated using a three-year rolling average, assuming MPS membership would otherwise hold steady in 2002, up to 2,450 pupils in 2002-03 could potentially move from a choice school to an MPS school and offset declining enrollment.

Under current law, if a school district's three-year rolling average pupil enrollment was less than the prior year three-year rolling average, the district receives a positive, nonrecurring adjustment to its revenue limit in a dollar amount equal to 75% of what the decline in the three-year rolling average memberships would have generated. Thus, the first 2,450 pupils would generate additional partial school revenues equal to the remaining 25% of the dollar amount not provided under the declining enrollment adjustment. For every 1,000 pupils added below the declining enrollment threshold, revenue limits would increase by approximately $0.6 million in 2002-03, with $0.4 million in 2002-03 in general school aids needed to maintain two-thirds funding. For every 1,000 pupils added above the declining enrollment threshold, revenue limits would increase by approximately $2.6 million in 2002-03, with $1.7 million in 2002-03 in general school aids needed to maintain two-thirds funding.

Under this motion, no funding would be provided for general school aids to maintain two-thirds funding of partial school revenues that would result from any increase to the MPS revenue limit as a result of higher membership. Because the number of students by which MPS membership would increase is unknown, the estimated fiscal effect of maintaining two-thirds funding of partial school revenues as a result of any increase in MPS membership is indeterminate. Because shared costs are aided on a prior year basis under the equalization formula, any additional costs incurred by MPS in 2002-03 under this motion would be aided in 2003-04. Further, to the extent that MPS' membership and shared costs increase, this could result in a shift in equalization aid to MPS from other districts in the year after the members and costs are added.

[Change to Bill: -$42,880,000 GPR; -$19,296,000 GPR-Lapse; Net Change to Spending: -$23,584,000 GPR]

MO# 263

1 BURKE	Y	N	A
DECKER	Y	N	A
MOORE	Y	N	A
2 SHIBILSKI	Y	N	A
PLACHE	Y	N	A
WIRCH	Y	N	A
DARLING	Y	N	A
ROSENZWEIG	Y	N	A
GARD	Y	N	A
KAUFERT	Y	N	A
ALBERS	Y	N	A
DUFF	Y	N	A
WARD	Y	N	A
HUEBSCH	Y	N	A
HUBER	Y	N	A
COGGS	Y	N	A

AYE 4 NO 12 ABS ___

Senator Decker

PUBLIC INSTRUCTION

Eliminate September 1 School Start Date Requirement

Motion:

Move to delete the provisions of current law that generally establish a September 1 school start date.

Note:

Under current law, no school board may commence the school term before September 1, unless the school board requests DPI to allow it to commence the school term before September 1 and the school board includes reasons with its request. DPI may grant a request only if it determines that there are extraordinary reasons for granting it and DPI must promulgate rules to implement and administer this provision of current law.

This motion would delete all of these provisions of current law.

MO# 248

2	BURKE	Y	N	A
1	DECKER	Y	N	A
	MOORE	Y	N	A
	SHIBILSKI	Y	N	A
	PLACHE	Y	N	A
	WIRCH	Y	N	A
	DARLING	Y	N	A
	ROSENZWEIG	Y	N	A
	GARD	Y	N	A
	KAUFERT	Y	N	A
	ALBERS	Y	N	A
	DUFF	Y	N	A
	WARD	Y	N	A
	HUEBSCH	Y	N	A
	HUBER	Y	N	A
	COGGS	Y	N	A

AYE 6 NO 10 ABS ____

Senator Shibilski
Senator Moore
Representative Kaufert
Representative Huebsch

PUBLIC INSTRUCTION

Increase Funding for Minority Precollege Scholarships

Motion:

Move to provide $500,000 GPR in 2002-03 for minority precollege scholarships.

Note:

The minority precollege scholarship program provides funds for minority students in grades 6 through 12 to attend precollege courses at campuses throughout the state. The scholarship pays for the cost of the course, books, supplies, room, and board. In the 2001-03 biennium, $1,525,000 GPR in 2001-02 and $1,677,500 GPR in 2002-03 is appropriated for the program.

[Change to Bill: $500,000 GPR]

MO# 331

BURKE	Y	N	A
DECKER	Y	N	A
2 MOORE	Y	N	A
1 SHIBILSKI	Y	N	A
PLACHE	Y	N	A
WIRCH	Y	N	A
DARLING	Y	N	A
ROSENZWEIG	Y	N	A
GARD	Y	N	A
KAUFERT	Y	N	A
ALBERS	Y	N	A
DUFF	Y	N	A
WARD	Y	N	A
HUEBSCH	Y	N	A
HUBER	Y	N	A
COGGS	Y	N	A

AYE 12 NO 4 ABS ____

12 4

Motion #331

Senator Plache

PUBLIC INSTRUCTION

Restore 5% Reduction for the Wisconsin Regional Library
for the Blind and Physically Handicapped

Motion:

Move to provide $36,800 GPR in 2002-03 to restore the 5% reduction to the library service contracts appropriation attributable to the Wisconsin Regional Library for the Blind and Physically Handicapped (WRLBPH), leaving a total remaining reduction for library service contracts of $15,600. Direct DPI to maintain the contract with WRLBPH at its current level.

Note:

DPI is statutorily required to maintain contracts with four service providers to supplement the specialized library services provided statewide by the Division for Libraries, Technology and Community Learning within the Department. DPI maintains contracts with Milwaukee Public Library, Wisconsin Library Services, the Cooperative Children's Book Center, and the WRLBPH. All four contracts are funded from a single appropriation under DPI, totaling $1,047,300 GPR in 2002-03. The bill would make a 5% reduction in this appropriation in 2002-03. The contract maintained with WRLBPH is for $736,400, so the portion of the 5% reduction attributable to the WRLBPH would equal $36,800.

[Change to Bill: $36,800 GPR]

MO#________

2 BURKE	Y	N	A
DECKER	Y	N	A
MOORE	Y	N	A
SHIBILSKI	Y	N	A
1 PLACHE	Y	N	A
WIRCH	Y	N	A
DARLING	Y	N	A
ROSENZWEIG	Y	N	A
GARD	Y	N	A
KAUFERT	Y	N	A
ALBERS	Y	N	A
DUFF	Y	N	A
WARD	Y	N	A
HUEBSCH	Y	N	A
HUBER	Y	N	A
COGGS	Y	N	A

AYE 16 NO 0 ABS ___

Motion #243

Senator Rosenzweig
Senator Shibilski

PUBLIC INSTRUCTION

Home Instruction Program for Preschool Youngsters

Motion:

Move to require DPI to give priority to funding the home instruction program for preschool youngsters, to the extent permitted under federal law, when the Department next awards subgrants of federal funding under the William F. Goodling Even Start Family Literacy program, in order to allocate at least $250,000 to the home instruction program.

Note:

The home instruction program for preschool youngsters is a research-based program to promote parental involvement, family literacy and to prepare children to enter school. The William F. Goodling Even Start Family Literacy program is reauthorized under the No Child Left Behind Act of 2001, the reauthorization of the Elementary and Secondary Education Act of 1965 (Title I, Part B, Subpart 3, sections 1231 thru 1242). Even Start awards competitive grants for integrated programs providing adult literacy, early childhood education and parenting education services to low-income families with children ages birth to seven. DPI must form a consortium of a number of literacy partners in the state, including school districts, public and private nonprofit organizations and institutions of higher education, and provide a matching grant in order to receive funding. The home instruction program for preschool youngsters is specifically listed under the federal law as a nonprofit organization eligible to receive funding under Even Start.

MO#

BURKE	Y	N	A
DECKER	Y	N	A
MOORE	Y	N	A
2 SHIBILSKI	Y	N	A
PLACHE	Y	N	A
WIRCH	Y	N	A
DARLING	Y	N	A
1 ROSENZWEIG	Y	N	A
GARD	Y	N	A
KAUFERT	Y	N	A
ALBERS	Y	N	A
DUFF	Y	N	A
WARD	Y	N	A
HUEBSCH	Y	N	A
HUBER	Y	N	A
COGGS	Y	N	A

AYE 10 NO 6 ABS

Motion #127

Tobacco Control Board

(LFB Summary of the Governor's Budget Reform Bill: Page 84)

LFB Summary Item for Which No Issue Paper Has Been Prepared

Item #	Title
1	Tobacco Control Fund Transfer

Tobacco Securitization

(LFB Summary of the Governor's Budget Reform Bill: Page 85)

LFB Summary Items for Which an Issue Paper Has Been Prepared

Item #	Title
1-3	Tobacco Securitization Bond Transaction (Paper #1250)

LFB Summary Item for Which No Issue Paper Has Been Prepared

Item #	Title
4	Correct Cross Reference to JFC for Future Endowment Fund Transfers

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

March 4, 2002 | Joint Committee on Finance | Paper #1250

Tobacco Securitization Bond Transaction (Tobacco Securitization)

[LFB Summary of the Governor's Budget Reform Bill: Page 85 and 86, #1 thru #3]

CURRENT LAW

Under 2001 Act 16 (the 2001-03 biennial budget), the Department of Administration (DOA) Secretary is authorized to securitize the state's rights to its tobacco settlement payments. The Secretary can sell, transfer or assign the rights to the Wisconsin Health and Educational Facilities Authority (WHEFA) or to a nonstock, nonprofit corporation formed by WHEFA or the state. After receiving the rights to the state's tobacco settlement payments, the corporation would use the newly-acquired revenue stream to back the issuance of revenue bonds. In return for the tobacco settlement payments, the corporation would provide the state with the proceeds from those bonds. In 2001-02, $450 million of the revenue bond proceeds are to be deposited to the general fund. In addition, an estimated $470 million in proceeds from the bonds are to be deposited to a permanent endowment fund created under Act 16.

Under Act 16, beginning on June 15, 2004, the Joint Finance Committee is required to annually transfer from the permanent endowment fund to the tobacco control fund the lesser of $25 million or 8.5% of the market value of the investments in the permanent endowment fund on June 1 in that year. If 8.5% of the market value of investments in the fund is greater than $25 million the difference between the 8.5% calculation amount and $25 million is to be transferred to the general fund. Therefore, net of these transfers, the growth in the balance of the endowment fund is estimated to be approximately 2.0% per year, under DOA's assumption of a 10.5% annual return on the endowment fund for most years of the transaction.

GOVERNOR

Create a sum sufficient segregated appropriation from the permanent endowment fund to make state shared revenue distributions to towns, villages, cities and counties. DOA estimates that the $380,000,000 SEG in 2001-02 and $214,000,000 SEG in 2002-03 would be appropriated from the permanent endowment fund to make 2002 and 2003 shared revenue payments. Specify that these shared revenue payments would be an allowable use of the funds deposited to the permanent endowment fund.

Require the Department of Administration to annually determine the amount to be paid from the permanent endowment fund into one or more sinking funds of the bond security redemption fund and any escrow accounts established under escrow agreements authorized by the Secretary of Administration that relate to contracting public debt. Create a sum sufficient SEG appropriation equal to the amount determined by the Secretary of Administration. Specify that these debt payments are an allowable use the funds deposited to the permanent endowment fund. Require DOA, when preparing the appropriation schedule that will be included in the final printed version of the 2001 statutes, to insert the amount of $200,000,000 as the estimated expenditure amount in 2001-02 from this newly created appropriation. This payment from the permanent endowment fund would offset $200,000,000 GPR of debt service that would otherwise be paid from agency, sum sufficient, GPR debt service appropriations.

DISCUSSION POINTS

1. On February 22, 2002, this office issued a memorandum (copy attached) that analyzed the Governor's proposed tobacco securitization transaction. The memorandum outlined the tobacco securitization transaction that makes up the basis for the Governor's budget reform proposal. It also analyzed the financial implications of the proposal when compared to the tobacco securitization transaction that was considered at the time of legislative deliberations on the 2001-03 biennial budget.

2. Table 1 indicates the estimated bond proceeds under the current law transaction and proposed budget reform bill tobacco securitization transaction. The securitization transaction under the Governor's budget reform bill helps balance state general fund revenues and expenditures in the 2001-03 biennium. Specifically, the $470 million in permanent endowment fund assets as well as an estimated $324 million in additional tobacco securitization bond proceeds generated under the proposed securitization transaction would be used to assist in making payments for shared revenue and debt service on state general obligation bonds, which otherwise would have been paid from the general fund.

TABLE 1

Projected Uses of Tobacco Securitization Bond Proceeds
($ in Millions)

Purpose	Current Law	Budget Reform Bill
Deposit to General Fund	$450	$450
Deposit to Endowment Fund	$560	$794
Less Payments of GPR Debt Service	0	-200
Less Payments of Shared Revenue	0	-594
Net Endowment Fund	$560	$0
Debt Service and Other Reserves	146	159
Capitalized Interest	171	179
Costs of Issuance	12	15
Total	$1,339	$1,597

3. The Governor's budget message indicated that using the bond proceeds to pay debt service would allow for a more efficient use of the tobacco securitization proceeds under federal tax law. The Governor also indicated that in order to incorporate the financial impact of the $200 million reduction in GPR expenditures in 2001-02, the budget reform bill would have to have been passed and effective before February 15, 2002. According to DOA officials, the required passage date was primarily due to the timing of the state's required semi-annual debt service payments. In May and November of each year the state makes debt service payments on its general obligation bonds. Because the state has outstanding operating notes, the state is required to assess each agency for the debt service amounts that result from undertaking agency projects or programs for which bonds have been issued 45 days in advance of the debt service payments being due. Therefore, on March 15, 2002, state agencies will deposit the required amounts to the bond security redemption fund, from which the debt service payments will be made.

4. DOA capital finance officials indicate that the use of tobacco bond proceeds for state debt payment would likely be treated the same as other state capital expenditures under federal tax law. However, if the debt service amounts owed by each agency have been deposited to the bond security redemption fund, federal tax law may no longer allow the state to make the May, 2002, payment using $200 million in tax exempt tobacco securitization bond proceeds. This is believed to be the case because if the March debt service assessment has already been made, the state will have shown that it has operating funds to make the required debt payments and the bond proceeds would not be needed to make these payments. DOA capital finance officials also indicate that a February 15 deadline for passage of the budget reform bill would have been required in order to provide DOA with sufficient direction and time necessary to complete the tobacco securitization transaction prior to the March 15, agency debt service assessment date.

5. Because the March 15 deadline for the securitization transaction is not likely to be met, the $200 million in tobacco bond proceeds could be deposited to the general fund for GPR expenditures other than debt service in 2001-02. However, in order to get the most advantageous federal tax treatment associated with these $200 million in bond proceeds, the proceeds could be used to make the November, 2002, GPR debt payment. However, this alternative would result in the 2001-02 general fund balance being reduced by $200 million from the amount projected under the Governor's budget reform bill.

6. If the Governor's tobacco securitization transaction is not approved and Committee chooses to maintain a $470 million balance in the permanent endowment fund, it is likely that the state would issue a greater percentage of tax exempt bonds than under the current law transaction and use only these tax exempt bond proceeds for immediate expenditure in the biennium. Such a transaction would involve approximately 40% in taxable bonds, with $470 million in proceeds from these bonds being deposited to the permanent endowment fund. Because the endowment would be funded with taxable bond proceeds it would not be restricted by federal tax law on the investment return that could be received on the bond proceeds.

7. By issuing a larger percentage of tax exempt bonds under this alternative transaction, the state would receive an estimated $1.404 billion in bond proceeds, which would result in a total of $596.4 million in bond proceeds being available to the state for expenditure in the 2001-03 biennium. This would be $146.4 million more than the $450 million that is available to the general fund under the current law transaction while the $470 million endowment fund balance that was anticipated under 2001 Act 16 would be maintained.

8. The primary advantages of this securitization alternative are that a permanent endowment fund that is funded with taxable bond proceeds whose earnings are not restricted by federal tax law would be maintained and the state would continue to receive cash flows from the permanent endowment fund over the 30-year transaction period. The total cash flows under this alternative over the 30 year period would be of somewhat lesser value to the state than the value of the current law transaction. However, this alternative transaction would be of greater value to the state than if the state did not securitize its tobacco settlement payments and would be of significantly greater value to the state than the Governor's budget reform proposal.

9. The primary disadvantage of this alternative is that $647.6 million less in bond proceeds would be available for immediate expenditure in the 2001-03 biennium, when compared to the Governor's budget reform proposal. Of this amount $470 million would be associated with maintaining an permanent endowment fund balance at the current law level, with the remaining $177.6 million being associated with issuing partly taxable bonds versus the Governor's proposed 100% tax exempt bond securitization transaction.

10. Alternatively, the Committee could choose to create a smaller endowment fund balance under the tobacco securitization transaction than the $470 balance that was envisioned under Act 16. For example, the Committee could direct DOA to maintain an endowment fund balance of $200 million under the tobacco securitization transaction.

11. The primary advantage of maintaining even a lesser amount in an endowment fund would be that the state would continue to have some funds associated with securitizing its tobacco settlement payments that would be an ongoing asset for the state and would provide revenues to the state in the future. The disadvantage would be that the state would have significantly less in funds available for expenditure in the 2001-03 biennium. The exact amount of taxable bond proceeds, which would primarily make up the endowment fund, and tax exempt bond proceeds, which would make up the funds available for expenditure in the biennium, would depend on the size of the endowment fund to be maintained.

Repayment Schedule for Permanent Endowment Fund

12. As Table 1 indicates, the Governor's proposal would expend all of the bond proceeds generated from tobacco securitization and the permanent endowment fund created under Act 16 would have a zero balance. The Governor, in his budget reform bill message, indicated a commitment to restoring the permanent endowment fund. However, the bill does not specify any schedule or funds for the repayment of the endowment fund.

13. The Legislature could establish a schedule in statute for the repayment of $470 million in bond proceeds to the permanent endowment fund. Beginning in 2003-04, an annual repayment amount of $25 million per year would result in full repayment of the $470 million by 2021-22. An annual repayment of $50 million per year would result in full repayment by 2012-13.

14. While the exact federal tax law treatment is not certain, federal tax law could affect state repayments to the permanent endowment fund. Federal tax law may require that as long as principal on the tobacco securitization bonds remains outstanding, funds deposited to the permanent endowment fund could be treated as if they are derived from tax exempt proceeds and be subject to yield restrictions. However, if these restrictions would result in significant foregone earnings, the Legislature could modify the repayment schedule of future general fund monies to instead deposit the monies in the state's budget stabilization fund until total payments of $470 million have been made. This could provide for a fund balance outside the state's general fund, similar to the permanent endowment fund envisioned under Act 16, while avoiding the more stringent federal tax law restrictions that may be associated with deposits to that endowment fund.

ALTERNATIVES TO BILL

A. Governor's Securitization Transaction

1. Approve the Governor's recommendation to sell only tax exempt bonds related to securitization and deposit the funds in the permanent endowment fund.

2. Modify the Governor's recommendations relating to the state's tobacco securitization by specifying that $200,000,000 in bond proceeds in the permanent endowment fund would be expended for debt service in 2002-03 rather than in 2001-02 to reflect that the funds would be used to assist with the state's November, 2002, GPR debt payments rather than the May, 2002, GPR debt

payments.

3. Delete the Governor's recommendation and direct the Department of Administration to carry out a tobacco securitization that involves a mixture of taxable and tax exempt bonds that would provide for a deposit of $470 million to the permanent endowment fund. In addition to the $450 million in tobacco securitization bond proceeds to be deposited to the state's general fund in 2001-02 under current law, deposit an additional $146.4 million in bond proceeds to the state's general fund in 2001-02 to be available for expenditure in the biennium.

Alternative A3	GPR
2001-03 REVENUE	- $433,600,000

B. Future Payments to Permanent Endowment Fund

1. Specify that beginning in 2003-04, in June of that fiscal year, the state would make an annual transfer of $25 million from the general fund to the permanent endowment fund, until total payments of $470 million have been made.

2. Specify that beginning in 2003-04, in June of that fiscal year, the state would make an annual transfer of $50 million from the general fund to the permanent endowment fund, until total payments of $470 million have been made.

Prepared by: Al Runde
Attachment

Legislative Fiscal Bureau

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

February 22, 2002

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Discussion of Governor's Tobacco Securitization Proposal

This memorandum provides a comparison of the projected use of proceeds from tobacco securitization under current law and the proposed transaction included in the Governor's budget reform bill recommendations.

Current Law

Under 2001 Act 16 (the 2001-03 biennial budget), the Secretary of the Department of Administration (DOA) is authorized to securitize the state's rights to its tobacco settlement payments. The Secretary can sell, transfer or assign the rights to the Wisconsin Health and Educational Facilities Authority (WHEFA) or to a nonstock, nonprofit corporation formed by WHEFA or the state. After receiving the rights to the state's tobacco settlement payments, the corporation would use the newly-acquired revenue stream to back the issuance of revenue bonds. In return for the tobacco settlement payment revenue, the corporation would provide the state with the proceeds from those bonds.

At the time of legislative deliberations on the 2001-03 biennial budget, it was estimated that the state would receive $1.257 billion in bond proceeds under the tobacco securitization transaction, which would have involved the issuance of tax exempt and taxable bonds. The taxable bond proceeds, which can be invested at a higher rate of return compared to tax exempt bond proceeds, would have made up most of the monies deposited to the permanent endowment fund. Due primarily to lower market interest rates, the same transaction would generate estimated bond proceeds of $1.339 billion, because with lower debt service costs, the same revenue stream (the state's tobacco settlement payments) could support a larger bond issue. Net bond proceeds available to the state would total an estimated $1.01 billion ($450 million to the general fund and $560 million to the endowment fund) compared to the $920 million that was estimated during the 2001-03 biennial budget deliberations ($450 million to the general fund and $470 million to the endowment fund). While the final transaction has always been subject to change, for the purposes of discussion, the securitization transaction that was envisioned at the time of legislative deliberations on Act 16 is referred to as the current law transaction.

Under Act 16, beginning on June 15, 2004, the Joint Finance Committee is required to annually transfer from the permanent endowment fund to the tobacco control fund the lesser of $25 million or 8.5% of the market value of the investments in the permanent endowment fund on June 1 in that year. If 8.5% of the market value of investments in the fund is greater than $25 million the difference between the 8.5% calculation amount and $25 million is to be transferred to the general fund. Therefore, net of these transfers, the growth in the balance of the endowment fund is estimated to be approximately 2.0% per year, under DOA's assumption of a 10.5% annual return on the endowment fund for most years of the transaction.

Governor's Budget Reform Bill Securitization Transaction

Under the transaction that is proposed as part of the budget reform bill, the state would issue only tax exempt bonds. Tax exempt bonds tend to have lower debt service costs and allow a larger total bond issue compared to taxable bonds, but have the disadvantage that federal tax law limits the investment return that could be received on the bond proceeds. By issuing solely tax exempt bonds, the state would receive an estimated $1.597 billion in bond proceeds, which would result in net proceeds to the state of $1.244 billion ($450 million to the general fund, $200 million for debt service and $594 million for shared revenue). All of the bond proceeds would be expended during the 2001-03 biennium and the permanent endowment fund would end the biennium with a zero balance. While the Governor has indicated a commitment to repaying the endowment fund the $470 million in bond proceeds, the budget reform bill would not specify a repayment schedule.

Under both the current law and budget reform bill securitization proposals the state would be assigning the next 30 years of its rights to its tobacco settlement payments. While 30 years of tobacco settlement payments will be pledged to support the bonds issued, it is likely that fewer years of payments will actually be needed. It is estimated that the bonds would be repaid by 2017 under the current law transaction and by 2020 under the Governor's budget reform bill securitization proposal.

The following table indicates the estimated bond proceeds under the projected current law transaction and proposed budget reform bill. The transaction under the Governor's budget reform bill would provide additional monies to balance state revenues and expenditures in the 2001-03 biennium. Specifically, the $470 million in permanent endowment fund assets as well as an estimated $324 million in additional tobacco securitization bond proceeds generated under the proposed securitization transaction would be used to assist in making general fund payments for shared revenue and GPR debt service on state general obligation bonds.

TABLE 1

Projected Uses of Tobacco Securitization Bond Proceeds
($ in Millions)

Purpose	Current Law	Budget Reform Bill
Deposit to General Fund	$450	$450
Deposit to Endowment Fund	$560	$794
Less Payments of GPR Debt Service	0	-200
Less Payments of Shared Revenue	0	-594
Net Endowment Fund	$560	$0
Debt Service and Other Reserves	146	159
Capitalized Interest	171	179
Costs of Issuance	12	15
Total	$1,339	$1,597

It should be noted that the DOA Secretary has the authority to structure a tobacco securitization transaction that could involve both tax exempt and taxable bonds being issued, similar to the transaction outlined during the 2001-03 biennial budget deliberations, or to issue only tax exempt bonds, as is currently being proposed under the Governor's budget reform bill. Therefore, prior to any legislative action on the current tobacco securitization proposal, DOA has the authority to move ahead with a transaction that would result in a 100% tax exempt bond funded transaction. At that point, due to the federal tax law constraints on the investment of tax exempt bond proceeds in an endowment fund, retaining an endowment fund with such proceeds would result in cash flows to the state would be of lesser value than if taxable bonds had been issued.

The amounts shown in Table 1 are only an estimate of the amount tobacco bond proceeds the state's settlement payments may support. Any changes in the conditions surrounding the master settlement agreement with tobacco manufacturers or changes in market conditions at the actual time of the bond sale could affect the amount of bond proceeds generated. If conditions surrounding the market for tobacco bonds are better than anticipated, additional bond proceeds could be available for deposit in the permanent endowment fund or for expenditure in the 2001-03 biennium. If conditions are less favorable, less than $1.244 billion in net bond proceeds may be available in the biennium for expenditure or a smaller endowment fund may result.

Impact of Budget Reform Securitization Proposal on the General Fund

In securitizing its tobacco settlement payments, the state is reducing revenues to the general fund by the projected tobacco settlement payment amounts. Over the next 30 years, portions of these revenues would however be replaced under both the current law securitization transaction and the transaction included in the Governor's budget reform proposal.

During legislative deliberations on tobacco securitization during the 2001-03 biennium, DOA initially assumed the state's general would receive annual "residual" amounts of tobacco settlement payments that would not be needed to meet annual debt service on outstanding tobacco revenue bonds. However, due to market conditions surrounding tobacco revenue bonds, it is now assumed that regardless of the type of securitization transaction carried out by the state, every dollar of the annual tobacco settlement payments will be required to prepay principal on outstanding bonds. As a result, the state will again receive tobacco settlement revenues only after the all the bonds are repaid and the state regains the rights to its annual tobacco settlement revenues.

In addition to the $450 million in bond proceeds that are to be deposited to the general fund in 2001-02 under the current law securitization transaction, the state is expected to receive the following amounts: (a) beginning in 2003-04, an annual transfers from the permanent endowment fund equal to 8.5% of the balance in the fund are to be made with the first $25.0 million being deposited to the segregated tobacco control fund and the remainder being deposited to the general fund; and (b) the annual amounts of tobacco settlement payment revenues that will again flow to the state's general fund when the bonds are repaid, which is estimated to occur in 2017, under the current law proposal.

Under the Governor's budget reform bill, all $1.244 billion in estimated tobacco securitization bond proceeds available to the state would be expended in the 2001-03 biennium. Therefore, while the authority to make annual transfers from the permanent endowment fund to the tobacco control fund and the general fund would continue to exist under the Governor's proposal, no bond proceeds would remain available for deposit to the permanent endowment fund and therefore no funds would be available for transfer in future years. However, similar to the current law transaction, the state would also receive the annual tobacco settlement payment revenues that would again flow to the state's general fund when the bonds are repaid. However, it is estimated that the state would not regain the rights to its tobacco settlement payments until 2020 under the Governor's proposal compared to 2017 under the current law transaction.

As indicated earlier, under Act 16, beginning in 2003-04, the first $25.0 million in earnings on the permanent endowment fund are deposited to the tobacco control fund to fund tobacco control activities. Conversely, because no funds would be available from the endowment fund in the future, the Governor's budget reform proposal would annually transfer $25.0 million from the general fund to fund tobacco control activities beginning in 2003-04. The following table provides estimates of the biennial impact on the general fund that would result if the securitization transaction and annual tobacco control fund transfer included in the Governor's budget reform bill were undertaken.

TABLE 2

Impact of Proposal on the State General Fund

Biennium	Governor's Proposal	Current Law Transaction	Difference	Cumulative Difference
2001-03	$1,244.0	$450.0	$794.0	$794.0
2003-05	-50.0	69.4	-119.4	674.6
2005-07	-50.0	71.5	-121.5	553.2
2007-09	-50.0	73.6	-123.6	429.6
2009-11	-50.0	75.8	-125.8	303.8
2011-13	-50.0	78.1	-128.1	175.7
2013-15	-50.0	81.0	-131.0	44.7
2015-17	-50.0	385.5	-435.5	-390.7
2017-19	-50.0	452.6	-502.6	-893.3
2019-21	406.3	465.3	-59.0	-952.3
2021-23	335.7	478.7	-143.0	-1,095.4
2023-25	346.6	492.8	-146.2	-1,241.6
2025-27	358.3	507.8	-149.5	-1,391.1
2027-29	370.5	523.3	-152.8	-1,543.9
2029-31	383.2	539.4	-156.2	-1,700.1

As the table indicates, aside from the 2001-03 biennium, revenues to the general fund would be reduced each biennium when the Governor's proposal is compared to the current law transaction, with the general fund being a cumulative total of $1.7 billion worse off through the 2029-31 biennium. However, due to the greater use of bond proceeds in the 2001-03 biennium to assist with the state's general fund deficit, the general fund would receive more cumulative revenues from securitization through the 2013-15 biennium under the Governor's proposal.

Analysis of Proposed and Current Law Securitization Transaction Cash Flows

Under an all tax exempt securitization transaction, which is the basis for the Governor's budget reform bill, the cost of financing is expected to be 7.2% on the $1.597 billion in revenue bonds issued. This compares to an overall blended rate of financing of 8.7% on the $1.339 billion taxable and tax exempt bonds to be issued under the current law transaction.

In analyzing the proposed securitization transaction and the transaction outlined by DOA during the biennial budget deliberations, a comparison of the total cash flows available to the state under each transaction is useful. In addition, a comparison of the present value of cash flow streams under each transaction is also relevant. Present value is the value in today's dollars assigned to an amount of money or stream of payments to be received in the future at a specified discount rate. Table 3 compares the total cash flows at a 10.5% endowment fund investment rate where relevant, and the present value of those cash flows if no securitization transaction were undertaken by the state, if the transaction proposal under current law went forward and if the Governor's proposed for an all tax exempt securitization transaction were undertaken. For the purposes of calculating the present value of the cash flow streams under each scenario, an annual discount rate of 7.5% is applied.

TABLE 3

Comparison of Cash Flows and Present Value At 10.5% Annual Investment Rate

	Total Cash Flow	Present Value
No Securitization		
Tobacco Payments	$5,281.6	$1,763.5
Current Law Transaction		
Proceeds Expended in Biennium	$450.0	$450.0
Annual Transfer to General Fund	1,987.1	684.0
Annual Residuals	3,308.4	656.6
Endowment Fund Balance	854.8	92.0
Total	$6,600.3	$1,882.6
Governor's Proposal		
Proceeds Expended in Biennium	$1,244.0	$1,244.0
Annual Transfers to General Fund	0.0	0.0
Annual Residuals	2,722.0	473.4
Endowment Fund Balance	0.0	0.0
Total	$3,966.0	$1,717.4
Impact of the Proposal		
Governor's Proposal	$3,966.0	$1,717.4
Less No Securitization	- 5,281.6	- 1,763.5
Difference in Value	-$1,315.6	-$46.1
Governor's Proposal	$3,966.0	$1,717.4
Less Current Law Transaction	- 6,600.3	- 1,882.6
Difference in Value	-$2,634.3	-$165.2

As indicated in Table 3, under the Governor's proposed tobacco securitization, total cash flows to the state would be reduced by $1.3 billion compared to just receiving its tobacco settlement revenues through 2032 and by $2.6 billion compared to the current law securitization transaction. On a present value basis, which compares the discounted value to the state of the cash flows under each transaction, the Governor's securitization proposal would cost the state $46.1 million in value compared to not securitizing its tobacco settlement payments and $165.2 million in value compared to the current law transaction.

It should be noted that the above present value analysis uses a 10.5% annual investment rate on the permanent endowment fund in evaluating the current law transaction. This was the assumed rate of investment identified by DOA at the time of legislative deliberations on the tobacco securitization proposal outlined for the 2001-03 biennial budget. If an 8.5% annual investment rate is assumed for the permanent endowment fund under that transaction, the cash flows under the Governor's proposal would have approximately the same present value as the transaction outlined during the biennial budget deliberations and would result in no loss in value to the state. The following table provides the cash flows and present values of the same three scenarios under an 8.5% investment rate on the endowment fund.

TABLE 4

Comparison of Cash Flows and Present Value At an 8.5% Annual Investment Rate

	Total Cash Flow	Present Value
No Securitization		
Tobacco Payments	$5,281.6	$1,763.5
Current Law Transaction		
Proceeds Expended in Biennium	$450.0	$450.0
Annual Transfer to General Fund	1,478.8	556.8
Annual Residuals	3,308.4	656.6
Endowment Fund Balance	490.6	52.8
Total	$5,727.8	$1,716.2
Governor's Proposal		
Proceeds Expended in Biennium	$1,244.0	$1,244.0
Annual Transfers to General Fund	0.0	0.0
Annual Residuals	2,722.0	473.4
Endowment Fund Balance	0.0	0.0
Total	$3,966.0	$1,717.4
Impact of the Proposal		
Governor's Proposal	$3,966.0	$1,717.4
Less No Securitization	- 5,281.6	- 1,763.5
Difference in Value	-$1,315.6	-$46.1
Governor's Proposal	$3,966.0	$1,717.4
Less Current Law Transaction	- 5,727.8	- 1,716.2
Difference in Value	-$1,761.8	$1.2

As indicated in the Table 4, under the Governor's proposed tobacco securitization, total cash flows to the state would be reduced by $1.76 billion compared to revenues under the current law securitization transaction through 2032, if an 8.5% investment rate assumption is used. On a present value basis, which compares the discounted value to the state of the cash flows under each transaction, the Governor's securitization proposal would cost the state $46.1 million in value compared to not securitizing its tobacco settlement payments, but would have a slightly higher present value ($1.2 million) compared to the current law transaction.

However, if the assumed annual investment rate for the permanent endowment fund would have been 8.5% when the Legislature deliberated tobacco securitization during the 2001-03 biennial budget, the cash flows in the securitization transaction outlined at that time would have cost the state approximately $47.3 million in value on a present value basis when compared with the state's expected tobacco settlement payments.

Potential Impact of Governor's Securitization Proposal on State Bond Ratings

Under the budget reform bill, the Governor would use all the anticipated proceeds from tobacco securitization. On its own, it is likely the rating agencies would not look favorably on the immediate expenditure of all of the bond proceeds from tobacco securitization. However, the proposed eventual elimination of approximately $1.0 billion in on-going expenditures for shared revenue would bring on-going general fund revenues and expenditures more in line, which would be a favorable change for the long term fiscal condition of the general fund and could offset the detrimental effects of expending the endowment fund. As a result, it is unclear how the three major rating agencies would reconcile these two aspects of the Governor's budget reform bill if it were enacted.

Prepared by: Al Runde

Shared Revenue and Tax Relief

(LFB Summary of the Governor's Budget Reform Bill: Page 77)

LFB Summary Items for Which Issue Papers Have Been Prepared

Burke smart growth notion

Item #	Title
1	Shared Revenue Modifications -- Distribution of 2002 Payments (Paper #1235)
1	Shared Revenue Modifications -- Shared Revenue Payments for 2003 and Thereafter (Paper #1236)
1	Shared Revenue Modifications -- Utility Aid Distribution for 2003 and Thereafter (Paper #1237)
1	Shared Revenue Modifications -- Payments for 2003 and Thereafter Under Programs Related to Shared Revenue (Paper #1238)
2	County and Municipal Operating Levy Limit (Paper #1239)
3	Waiver from State-Imposed Mandates on Local Governments (Paper #1240)

Even communities which have received planning grants will be reluctant to follow through with the other half of the costs. ***Our position: Retain the current budget funding for shared revenues.***

1

Smart Growth Dividend. One of the most nationally innovative parts of Wisconsin's Smart Growth law, the Smart Growth Dividend would reward communities for compact, mixed use development. The idea – *your idea* – was that when communities grow more efficiently service delivery of all kinds (sewer lines, street construction and maintenance, school bus routes, snow plowing, garbage pickup, etc.) is less expensive for taxpayers. Consequently, pressure for state shared revenues would also decrease. The dividend would reward communities for growing smart. In the long run encouraging efficient local development means savings both for the state and for local property taxpayers. ***Our position: While we should retain shared revenues, it is also time to reform the program. The Smart Growth Dividend should become part of the shared revenue formula.***

3

School Siting. The governor would cap the state's commitment to school capital projects. As you know, from reading the recent study from the National Trust for Historic Preservation, school siting decisions play a major role in influencing development. Far too often, schools are placed on greenfields and in locations that make them accessible only by car or bus. Recent studies have also suggested that one reason for the high rate of obesity among American children is development patterns that discourage walking and biking. State government should not be supporting local school siting decisions that consume too much land, spur sprawl and contribute to unhealthy conditions for our children. ***Our position: Create a higher level of state support for school building projects that support walkable schools.***

Dane County Regional Planning Commission. Under current law, the DCRPC will terminate in October. The Dane County RPC is perhaps the most effective regional planning commission in the state. Moreover, if the commission is eliminated, it is possible that existing urban service areas will be frozen, as no statutorily authorized entity will exist to amend them. A committee appointed by Governor Thompson to work towards a new multi-county plan commission has stalled. While a multi-county RPC would be ideal, it may not be possible under current political conditions. ***Our position: Move back the termination date for the Dane County RPC by two years to October, 2004 and change the mandate of the committee studying its replacement agency so that it can consider both a multi-county RPC and a Dane County only commission.***

You have been the Legislature's most effective and innovative leader on growth management issues. We hope that you can take the lead on these important smart growth initiatives in the current budget. Thanks for your consideration of our positions.

Sincerely,

David Cieslewicz
Director

cc: Sen. Chuck Chvala
Rep. Spencer Black