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Wisconsin Development Reserve Fund (WHEDA)

[LFB 2001-03 Budget Summary: Pages 710-711, #1, 2 & 3]

CURRENT LAW

WHEDA administers several loan guarantee programs related to business development. The loan guarantee programs are backed by the Wisconsin Development Reserve Fund (WDRF), which generally must contain at least one dollar in its cash balance for every $4.50 in total outstanding guarantees. The WDRF is used to guarantee loans for various programs, including the credit relief outreach (CROP), farm asset reinvestment (FARM), small business (SBG) and agribusiness programs and a loan to the Taliesin Preservation Commission. Under the CROP program, WHEDA generally guarantees one-year agricultural production loans to Wisconsin farmers for such purchases as seed, fertilizer, fuel, pesticides and feed. The FARM program provides loan guarantees for farmers to finance the acquisition of agricultural assets such as machinery, livestock, facilities and land. The agribusiness program provides loan guarantees for projects that result in the development of new or more viable methods for processing or marketing raw agricultural commodities.

Under the small business loan guarantee program, loan proceeds may be used for direct or related expenses associated with the expansion or acquisition of a business, including the purchase or improvement of land, buildings, machinery, equipment or inventory. Loans can also be used for the start-up of a daycare. Individual loans may be guaranteed for up to 80% of the principal or $200,000, whichever is less, and the total principal amount of guaranteed loans to any one borrower can not exceed $750,000.

The WDRF backs guaranteed loans made by private lenders under these separate programs, reserving funds to repay lenders for any losses from defaulted loans. Each of the individual loan guarantee programs backed by the WDRF has a statutory maximum guarantee authority. WHEDA may request the Joint Committee on Finance to authorize an increase or decrease in the guarantee authority for any of the individual programs. The Authority must then receive Finance Committee approval under s. 13.10 of the statutes before any change in guarantee authority becomes effective.

WHEDA is required to regularly monitor the cash balance in the WDRF to ensure that the cash balance in the fund is sufficient to pay all outstanding claims under WDRF guarantee programs and to fund all WDRF loan guarantees, except for the loan to the Taliesin Preservation Commission, at a ratio of $1 of reserve funding to $4.50 of total outstanding principal and outstanding guaranteed principal that the Authority may guarantee under the programs. In December, 1999, $5,845,215 was transferred to the WDRF and used to pay off the guarantee on a defaulted portion of the Taliesin loan. The interest on the remaining $930,000 in the Taliesin loan has been forgiven and the Commission has been making escalating principal payments that are scheduled to continue through 2016.

GOVERNOR

Reduce the amount required to be maintained in the WDRF by increasing the reserve ratio to require one dollar in the cash balance for every $5.50 in total outstanding guarantees for all guarantee programs backed by the fund, except the remaining loan to the Taliesin Preservation Commission, which would remain at its current $1 to $4 ratio.

Delete the individual maximum guarantee authority for the agribusiness, CROP, FARM, recycling and SBG loan guarantee programs that are backed by the WDRF. Replace the individual guarantee authority with an aggregate maximum guarantee authority of the total principal amount or total outstanding guaranteed principal amount of $62 million, excluding the outstanding amount of a remaining loan to Taliesin. Further, allow WHEDA to request the Joint Committee on Finance to authorize an increase or decrease in the $62 million aggregate guarantee authority. Require Finance Committee approval under s. 13.10 of the statutes before any change in aggregate guarantee authority becomes effective.

Allow WHEDA to guarantee loans under the small business loan guarantee program for direct or related expenses, including the purchase or improvement of land, buildings, machinery, equipment or inventory, associated with the start-up of a small business in a vacant storefront in the downtown area of a "rural community" (a city, town or village with a population of less than 50,000).

Require WHEDA to regularly monitor the WDRF to ensure that the cash balance in the fund is sufficient to fund the remaining guarantee to Taliesin, in addition to other outstanding claims and loan guarantees.

DISCUSSION POINTS

Background

1. The WDRF was created by 1991 Wisconsin Act 39 through the consolidation into a single fund of several existing guarantee funds: the CROP fund, the recycling loan fund and the

drought assistance and development loan fund. Each of these separate funds had been created to back guarantees made under one or more legislatively authorized loan guarantee programs. This consolidated WDRF now backs guaranteed loans made by private lenders under separate programs, reserving funds to repay lenders for any losses from defaulted loans made under any of these guaranteed programs. The WDRF also funds the administrative costs of the loan guarantee programs.

2. The consolidated reserves available in the WDRF totaled $12.6 million on March 1, 2001. The ratio of authorized guarantee amount to reserves amount is referred to as WDRF's leverage factor. The 1997-99 biennial budget act increased the leverage factor from 4:1 to 4.5:1 for all guarantee programs backed by the fund, except a loan to the Taliesin Preservation Commission, which remains at a leverage factor of 4:1. This means the WDRF needs to have at least one dollar in reserve for every $4.50 in available guarantee authority. On March 1, 2001, the leverage factor was 3.7:1 for available guarantee authority. Further, based on actual loan guarantee activity through March, 2001, WHEDA has a 3:1 ratio. That is, for every $3.00 in actual outstanding loan guarantees, the WDRF had one dollar in reserve.

3. While the Legislature from time to time appropriates money to the WDRF, the WDRF itself is a separate fund internal to WHEDA that is not considered a part of the state's budget. However, the statutes pledge the state's moral obligation to appropriate any funds necessary to meet obligations of the WDRF. Further, WHEDA is required to transfer annually (on June 30) to the state's general fund, any balance in the WDRF which remains after deducting amounts sufficient to pay outstanding claims and to fund authorized guarantees under each of the loan guarantee programs backed by the fund. No funding has been transferred to the general fund since this statutory requirement was enacted, because the balance in the WDRF has been less than the amounts needed to meet these objectives.

WDRF Reserve Ratio

4. The balance of the WDRF generally has declined since 1991, as shown in Table 1. The $3.6 million increase in the fund in 1997-98 is primarily due to the deposit of $4 million from the recycling fund for brownfields loan guarantees under 1997 Act 27. The $3.9 million reduction in 1999-00 is primarily related to a transfer of $4 million to the environmental fund reflecting the end of the brownfields loan guarantee program. WHEDA officials anticipate the balance of the WDRF in the coming biennium to further decline due to a projected slowdown of the economy.

TABLE 1

WDRF Year End Balances
(in millions)

Year	Balance
1991-92	$19.0
1992-93	17.4
1993-94	15.5
1994-95	15.2
1995-96	14.2
1996-97	12.9
1997-98	16.5
1998-99	16.2
1999-00	12.1
2000-01*	12.5
2001-02*	11.9
2002-03*	11.2

* Estimated.

5. If the fund balance continues to decline, the statutorily required reserve ratio would cause a progressive lowering of the actual amount of loans that could be guaranteed by the fund. Adjusting the reserve ratio would extend the useful life of the WDRF based on existing revenues. That is, the WDRF balance would allow for a greater amount of outstanding guarantees at a 5.5 to 1 ratio than would be allowed by a 4.5 to 1 ratio.

6. By increasing the reserve ratio to 5.5 to 1, or $5.50 in loan guarantees for every one dollar in the balance of the WDRF, the bill would increase the amount of loans that WHEDA could guarantee. For example, the projected June 30, 2001, balance of $12.5 million could back $56.25 million in loan guarantees at a 4.5 to 1 ratio versus $68.75 million (22% greater) at a 5.5 to 1 ratio. Another alternative would be to increase the reserve ratio to 5 to 1, which would enable the WDRF to back $62.5 million in loan guarantees with a $12.5 million account balance.

7. Conversely, while increasing the reserve ratio would raise the amount of loans WHEDA could guarantee, a smaller amount of funds would be available to the WDRF to cover loan defaults. Consequently, the likelihood that the Legislature would be asked to appropriate additional funds to the WDRF in the event of a major economic downturn or other condition that results in extraordinary default rates would rise as the reserve ratio is increased. WHEDA did not request an increase in the reserve ratio. Further, WHEDA officials indicate the current 4.5 to 1 leverage ratio is prudent. As shown in Table 3, if the reserve ratio remains at 4.5 to 1, it is projected the WDRF balance would be sufficient to back estimated total outstanding guarantees through June 30, 2003.

Loan Guarantee Program Consolidation

8. The total outstanding guaranteed principal amount of loans that WHEDA can guarantee under the FARM program is limited to the lesser of $10 million or the difference between $30 million and the total CROP outstanding principal amount. Thus, under current law, the total outstanding principal amount of loans that may be guaranteed under both the CROP and FARM programs cannot exceed $30 million. The recycling loan fund program (which had a total principal guarantee amount of $10 million) was terminated in 1993, and has no outstanding guarantees. The total principal amount of loans that can be guaranteed by WHEDA under its existing loan guarantee programs is $53.4 million, while the allowable guarantee authority on those loans equals $46.3 million, as shown in Table 2.

TABLE 2

Current Law Guarantee and Loan Authority

	Maximum Guaranteed Amount of Loans	Maximum Principal Amount of Loans
CROP/FARM	$27,000,000	$30,000,000
Small Business	14,270,000	17,837,500
Agribusiness	5,000,000	5,555,556
Total	$46,270,000	$53,393,056

9. Under the Governor's proposal, the aggregate maximum guarantee authority of the total principal amount or total outstanding guaranteed amount, excluding the outstanding amount ($930,000) of a remaining loan to Taliesin would be $62 million. However, the projected 2002-2003 balance of the WDRF ($11.2 million) would support aggregate guarantees of $49.5 million under the current leverage factor of 4.5 to 1 ($200,000 of the $11.2 million balance will be needed to support the remaining loan to the Taliesin Preservation Commission), $55 million under a leverage factor of 5 to 1 and $60.5 million under the bill's leverage factor of 5.5 to 1. If the Committee chooses to maintain a 4.5 to 1 leverage factor, it would be advisable to set the aggregate maximum guarantee authority at $49.5 million rather than $62 million to maintain commitments within amounts that could be supported by the fund.

10. While consolidating individual loan guarantee program caps into an aggregate cap amount allows WHEDA greater flexibility to guarantee additional loans in more popular programs, it also could lower the amount of funding available for other loan guarantee programs. For example, if demand for small business loan guarantees continues to grow as projected, under the Governor's recommendation, it would be possible for the WDRF to eventually have most of its funds committed to guaranteeing small business loans, with little funding available to guarantee loans under CROP or other programs. One option to address this issue would be to require WHEDA, in

its annual WDRF balance transfer report to the Joint Committee on Finance, to recommend under the Finance Committee's 14-day passive review process annual caps for each guarantee program that could not be exceeded unless the Committee approved a modification through a subsequent 14-day passive review process under s. 16.505/515. This option would allow the Legislature to monitor loan guarantee program activity to prevent any single program from using an excessive level of guarantee authority.

Small Business Loan Guarantee Program

11. The statutes provide that WHEDA may request the Joint Committee on Finance to authorize an increase or decrease in the guarantee authority for any of the programs. WHEDA used this provision in June, 2000, to request additional loan guarantee authority of $4,370,000 to increase the total amount that it may guarantee from the WDRF for the small business development loan guarantee program from $9.9 million to $14.27 million. The Joint Committee on Finance approved the request under s. 13.10 of the statutes, allowing the change in total guarantee authority to become effective.

12. As of March 1, 2001, the WDRF is liable for $10.6 million in outstanding SBGs. It is estimated that demand under the SBG program will exceed the current law $14.27 million guarantee maximum by 2002. If the individual loan guarantee program caps were not consolidated into an aggregate maximum cap (thereby allowing SBG to use guaranteed amounts that, though authorized, are not being used by other guarantee programs) the SBG program would be curtailed. The other option to extend the program would be to increase the total outstanding guaranteed principal amount from $14.27 million. However, the WDRF would not have an adequate balance to support such an increase unless the reserve ratio is increased or the maximum guarantee amount of other loan programs is lowered. WHEDA officials believe lenders may not use the SBG program once it reaches a statutory limit, even if funds later became available. Table 3 compares June 30, 2000 outstanding guarantees with projected outstanding guarantee amounts for June 30, 2003 under the Governor's recommendation.

TABLE 3

Outstanding Loan Guarantees

	Actual June 30, 2000			Estimated June 30, 2003		
Program	Leverage Ratio	Statutory Maximum Guarantee	Actual Total Outstanding Guarantees	Leverage Ratio	Statutory Maximum Guarantee	Projected Total Outstanding Guarantees
CROP/FARM	4.5	$27,000,000	$15,389,400	5.5		$20,979,800
Small Business	4.5	14,270,000	8,689,700	5.5		20,646,700
Agribusiness	4.5	5,000,000	1,468,900	5.5		3,327,000
Active Totals		$46,270,000	$25,548,000		$62,000,000	$44,953,500
Repealed Program Totals		0	7,904,800		0	2,800,000
TOTAL		$46,270,000	$33,452,800		$62,000,000	$47,753,500
WDRF Maximum Authority at 4.5:1		$53,230,000		at 4.5:1	$49,500,000	
				at 5:1	$55,000,000	
				at 5.5:1	$60,500,000	

13. As shown in Table 3, WHEDA anticipates that outstanding SBG volume would increase to $20.7 million by June 30, 2003. Table 4 reports quarterly approved and closed small business loan guarantees to date. WHEDA has guaranteed $12.3 million of $18.9 million in loans since the program's inception. Due to payoffs and paydowns by businesses, $10.6 million remains outstanding.

TABLE 4

Small Business Loan Guarantees by Quarter

Year	Quarter	Quarterly Total	Annual Total	Average/ Quarter
1997	Fourth Quarter	$361,300	$361,300	$361,300
1998	First Quarter	960,200		
	Second Quarter	546,500		
	Third Quarter	845,200		
	Fourth Quarter	400,200	2,752,100	688,000
1999	First Quarter	815,200		
	Second Quarter	850,900		
	Third Quarter	216,600		
	Fourth Quarter	1,212,900	3,095,600	773,900
2000	First Quarter	1,488,100		
	Second Quarter	1,960,000		
	Third Quarter	1,301,000		
	Fourth Quarter	811,200	5,560,300	1,390,100
2001	First Quarter	533,000	533,000	533,000
	Total All Quarters		$12,302,300	$878,700

14. Guaranteeing loans for direct or related expenses associated with the start-up of a small business in a vacant storefront is inherently riskier than guaranteeing loans for small business expansion. However, since WHEDA currently guarantees loans for daycare business start-ups, the Authority has experience in guaranteeing start-up loans. Further, while the SBG program is only 3½ years old, no participating business has defaulted on a loan.

15. According to WHEDA, some entrepreneurs have requested loan guarantees for vacant storefront start-ups. However, WHEDA expects demand to be low. Still, because growth in the current SBG program already requires guarantees from a large portion of the WDRF balance, it could be argued that the program should not be further extended. Others see a need for such a program to keep storefronts in downtown areas from remaining vacant. WHEDA plans to focus advertising of the vacant storefront program in designated Main Street Communities.

16. Some would argue that if the intent of the bill is to reduce the number of vacant storefronts in rural communities, the municipal population eligibility limit of 50,000 may be overly broad. To ensure that such loan guarantees go to more rural communities, the Committee could

replace this eligibility criteria with that used for the Department of Commerce Rural Economic Development Program (a city, village or town with a population of 6,000 or less or a municipality located in a county with a population density of less than 150 persons per square mile).

17. On the other hand, municipalities of all sizes prefer to keep storefronts from remaining vacant. Since cities with populations over 50,000 may have vacant storefronts in downtown areas, the Committee could choose to allow the program to be used statewide. However, this option may further increase the demand for small business loan guarantees, which already use a large portion of the available WDRF balance.

Cash Balance Monitoring

18. WHEDA is required to regularly monitor the WDRF to ensure that the cash balance in the fund is sufficient to fund guarantees to all programs except for a loan to the Taliesin Preservation Commission. Prior to the 1997-99 biennial budget act (when the leverage factor for all loan guarantee programs except the loan to the Commission was increased from 4:1 to 4.5:1), WHEDA was required to regularly monitor the cash balance in the WDRF to ensure that the cash balance in the fund was sufficient to fund guarantees for all programs (including Taliesin). This provision was inadvertently left out in the drafting of the 1997-99 biennial budget act.

ALTERNATIVES

A. WDRF Reserve Ratio

1. Approve the Governor's recommendation to increase the reserve ratio to require one dollar in the cash balance for every $5.50 in total outstanding guarantees for all guarantee programs backed by the fund, except the remaining loan to the Taliesin Preservation Commission, which would remain at a $1 to $4 ratio.

2. Modify the Governor's recommendation to increase the reserve ratio to require one dollar in the cash balance for every $5.00 in total outstanding guarantees for all guarantee programs backed by the fund, except the remaining loan to the Taliesin Preservation Commission, which would remain at a $1 to $4 ratio.

3. Maintain current law (a 1 to 4.5 reserve ratio).

B. Loan Guarantee Program Consolidation

1. Approve the Governor's recommendation to delete the individual maximum guarantee authority for loan guarantee programs backed by the WDRF and replace the individual guarantee authority with an aggregate maximum guarantee authority of $62 million, excluding the outstanding amount of a remaining loan to Taliesin. Further, allow WHEDA to request the Joint Committee on Finance to authorize an increase or decrease in the $62 million aggregate guarantee authority.

2. Modify the Governor's recommendation to delete the individual maximum guarantee authority for loan guarantee programs backed by the WDRF and replace the individual guarantee authority with one of the following aggregate maximum guarantee authorities, excluding the outstanding amount of a remaining loan to Taliesin. Further, allow WHEDA to request the Joint Committee on Finance to authorize an increase or decrease in the aggregate guarantee authority.

a. $49.5 million (based on a 1 to 4.5 reserve ratio).
b. $55.0 million (based on a 1 to 5.0 reserve ratio).
c. $60.5 million (based on a 1 to 5.5 reserve ratio).

3. In addition to alternative B1 or B2, require WHEDA, in its annual WDRF balance transfer report to the Joint Committee on Finance, to recommend for approval annual target caps for each guarantee program, and allow WHEDA to modify the target caps, subject to Joint Finance 14-day passive review authority under s. 16.505/515.

4. Maintain current law, but increase the maximum guaranteed amount of the small business loan guarantee program to $21 million (this assumes a reserve ratio of 1:5 or 1:5.5).

5. Maintain current law.

C. Expand Small Business Loan Guarantee Program

1. Approve the Governor's recommendation to allow WHEDA to guarantee loans for the start-up of a small business in a vacant storefront in the downtown area of any city, town or village with a population of less than 50,000.

2. Modify the Governor's recommendation to allow WHEDA to guarantee loans for the start-up of a small business in a vacant storefront in the downtown area of any city, town or village with a population of 6,000 or less or a municipality located in a county with a population density of less than 150 persons per square mile. (Same definition of municipal as in the Commerce rural economic development program.)

3. Modify the Governor's recommendation to allow WHEDA to guarantee loans for the start-up of a small business in a vacant storefront in the downtown area of any city, town or village. (Eliminate the population eligibility criteria.)

4. Maintain current law.

D. Taliesin Balance Monitoring

1. Approve the Governor's recommendation to require WHEDA to regularly monitor the WDRF to ensure that the cash balance in the fund is sufficient to fund the remaining guarantee to Taliesin, in addition to other outstanding claims and loan guarantee programs.

2. Maintain current law.

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