**Legislative Fiscal Bureau**
One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873
Email: fiscal.bureau@legis.wisconsin.gov • Website: http://legis.wisconsin.gov/lfb

---

April 30, 2013 | Joint Committee on Finance | Paper #720

# Wisconsin Development Reserve Fund
# (Wisconsin Housing and Economic Development Authority)

[LFB 2013-15 Budget Summary: Page 503, #1]

---

## CURRENT LAW

The Wisconsin Housing and Economic Development Authority (WHEDA) administers the Wisconsin Development Reserve Fund (WDRF) to provide loan guarantees to farmers, other agribusinesses and small businesses. Currently, the WDRF supports the following programs: (a) the agricultural production loan guarantee, or Credit Relief Outreach Program (CROP), including an agricultural production drought assistance program the Authority is offering through December 31, 2013; (b) the Farm Assets Reinvestment Management (FARM) loan guarantee program; (c) the small business development loan guarantee program, including a contractors loan guarantee; and (d) the agricultural development (agribusiness) loan guarantee program. For loans guaranteed under these programs, and upon which a borrower defaults, payments are made from the WDRF on the basis of the agreed-upon guarantee percentage after the lender has disposed of collateral offered with the loan. The fund is intended to provide participating lending institutions certainty that they will be compensated for losses if defaults occur in eligible loans. This certainty is intended to increase credit access for borrowers targeted by each loan guarantee program.

Since the creation of the first loan guarantee program in the 1980s, approximately $18.4 million in net state funding has been provided to the WDRF and several predecessor loan guarantee funds. Currently, the fund receives income from various application, closing, and servicing fees charged to borrowers or participating lenders, as well as interest on fund balances and recoveries of previously paid guarantees. Annual fund expenses, in addition to any guarantee claims, include WHEDA's administrative costs in operating the loan guarantee programs. The statutes limit total guarantee authority among all loan guarantee programs to $49.5 million. Further, the WDRF must hold at least $1 in reserve for every $4.50 in outstanding guarantees. This means that for the maximum of $49.5 million in outstanding guarantees, the WDRF balance must be at least $11 million. As of June 30, 2012, the WDRF had a balance of $6.2 million and outstanding guarantees of $23.5 million.

Should the WDRF ever realize a fund deficiency, the statutes contain a moral obligation clause, under which the Legislature has expressed its expectation that it would appropriate sufficient funds to meet any guarantee demands made on the WDRF. However, WHEDA reports it also has set aside $3 million from its general reserves for future guarantee claims that may not be supported by remaining WDRF balances.

Also, WHEDA is currently administering an initiative, known as Transform Milwaukee, that is targeting resources of several housing and economic development programs administered by WHEDA to certain parts of the metropolitan Milwaukee area. The initiative proposes to deploy $100 million in WHEDA-administered financing, which would include WHEDA assets, tax-exempt bonds, federal funds, and federal affordable housing and economic development tax credits, by approximately May, 2014. The WHEDA-administered financing would be expected to generate an additional $100 million or more in mostly private financing for construction or rehabilitation of housing, as well as demolition of certain blighted properties, and activities promoting economic development in the area. The WDRF small business development loan guarantee is expected to account for part of total Transform Milwaukee funding.

## GOVERNOR

Provide $2.5 million GPR in 2013-14 to the WDRF to be used for small business loan guarantees. WHEDA and the administration have agreed the funding would be used for small business development loan guarantees under the Transform Milwaukee initiative.

## DISCUSSION POINTS

1. WHEDA annually reports to the Joint Committee on Finance and the Legislature on the condition of the WDRF and the outstanding guarantees attributable to WDRF programs. Table 1 shows WHEDA estimates as of March 1, 2013, for the condition of the WDRF through 2014-15 under current law. WHEDA reports as of March, 2013, the WDRF balance was $5.7 million, with outstanding guarantees totaling $18.1 million. Under current conditions, remaining guarantee authority would be approximately $7.6 million, but WHEDA estimates additional guarantee and administrative costs before the close of the fiscal year may be perhaps $490,000, which would reduce available guarantee authority to approximately $5.5 million on June 30, 2013, assuming no change in outstanding guarantees. Under the bill, the balance as of June 30, 2015, would be an estimated $5.1 million, as opposed to $2.6 million under current law. While Table 1 shows WHEDA administrative costs at $1 million in each year of the 2013-15 biennium, actual costs may vary depending on the available guarantee authority and associated loan guarantee activity that may occur.

**TABLE 1**

**Wisconsin Development Reserve Fund Condition (Current Law)**

| | 2011-12 | 2012-13 (Est.) | 2013-14 (Est.) | 2014-15 (Est.) |
|---|---|---|---|---|
| Opening Balance | $7,883,500 | $6,241,000 | $5,243,200 | $3,945,200 |
| Revenues | 316,900 | 234,100 | 352,000 | 330,000 |
| Guarantee Claims/Subsidies | -787,200 | -453,900 | -650,000 | -650,000 |
| WHEDA Admin. | -1,172,200 | -778,000 | -1,000,000 | -1,000,000 |
| Closing Balance | $6,241,000 | $5,243,200 | $3,945,200 | $2,625,200 |
| Outstanding Guarantees (End of Fiscal Year) | $23,463,700 | $18,100,000 | $17,753,000* | $11,813,000* |
| Reserve Ratio | 3.76 | 3.45 | 4.5 | 4.5 |

*Maximum supportable guarantees based on year-end balance.

2. Table 2 shows the year-end balances (June 30) of the WDRF, with outstanding guarantees, since 2006. Under normal circumstances, fee revenues and interest earnings have covered substantial portions, and occasionally all, of the WDRF's annual expenses for administrative costs and guarantee claims. However, historically high guarantee claims, administrative reimbursements to WHEDA that exceed fund income, and declining revenues from investment income each have contributed to recent declines in the fund balance.

**TABLE 2**

**WDRF Balances and Outstanding Guarantees, 2006-2015**
**(in Millions)**

| Year Ending June 30 | Balance | Outstanding Guarantees |
|---|---|---|
| 2006 | $11.0 | $31.3 |
| 2007 | 10.7 | 35.4 |
| 2008 | 10.3 | 34.1 |
| 2009 | 10.1 | 43.6 |
| 2010 | 9.3 | 29.1 |
| 2011 | 7.9 | 25.4 |
| 2012 | 6.2 | 23.5 |
| 2013 (Est.) | 5.2 | 18.1 |
| 2014 (Est.) | 3.7 | 16.9 |
| 2015 (Est.) | 2.2 | 10.0 |

3. 2011 Acts 79 and 80 amended the statutory authorizations of CROP and the small business development loan guarantee to allow for larger guarantee amounts. Act 79 increased the

maximum small business development loan guarantee from $200,000 to $750,000. The maximum guarantee percentages, as specified by statute, were not affected and remain at 80%. Act 80 increased the maximum principal of CROP loans from $100,000 to $150,000, which are also eligible for up to an 80% guarantee ($120,000 of a maximum loan). At the time this legislation was being debated in the fall of 2011, WHEDA did not identify the declining balance of the WDRF as a concern in its fiscal note, or in its testimony relating to the bills. Between Act 79's effective date of December 5, 2011, and June 30, 2012, WHEDA had guaranteed 10 small business development loans. One loan in that period, guaranteed in December, 2011, received a $750,000 maximum guarantee (80%) on a loan of $937,500. Two other loans, one each in March and April of 2012, were guaranteed for amounts greater than the previous maximum of $200,000. However, as of April, 2013, WHEDA reports it has made two small business development guarantees to date in 2012-13 for total guarantees of $140,000. (This reduction is discussed further in a following point.) Of the 68 CROP loans WHEDA had guaranteed in the 2012 calendar year through June 30, 13 loans were for $150,000. An additional four were higher than the previous maximum of $100,000 but less than $150,000, and 11 were at the previous maximum of $100,000. All were guaranteed at 80%. Of 59 CROP loans guaranteed in 2012-13 through April 15, 12 guarantees were for more than $80,000, including nine made at the maximum guarantee of $120,000.

4. Beginning in 2012, WHEDA has undertaken several measures to help stabilize the WDRF. Effective May 1, 2012, WHEDA's governing board approved several changes to loan guarantee programs, including: (a) increases to certain fees, which are anticipated to increase WDRF revenues by perhaps $100,000 annually beginning in 2012-13; (b) capping new guarantees at a maximum term of five years in the small business development and agribusiness programs, which is expected to turnover guarantee authority more quickly, while still providing credit enhancement in the most critical period following a business startup or expansion when default risk also is highest; (c) reducing the maximum guarantee percentage on small business development and agribusiness loan guarantees to 50%, which is expected to increase the number of loans that could receive guarantees; and (d) prioritizing small business development and agribusiness guarantees based on potential economic or community impacts, such as the availability of other financing, projected increases in employment for low-income communities, or providing critical services such as grocery stores or pharmacies where no such service currently is provided. WHEDA reports these changes have contributed to reduced demand for small-business and agribusiness guarantees in 2012-13, and potentially into the future. Instead, WHEDA has continued using WDRF funds available under current law for agricultural loans such as those under CROP. The Authority reports CROP loan guarantees have few analogs in the marketplace, and CROP is the most desirable program to operate as close to typical funding levels as possible with currently available resources.

5. Although WDRF-backed small business guarantees have declined, WHEDA expects some guarantees for small businesses would continue under federal funding through the State Small Business Credit Initiative (SSBCI), which was enacted in 2010 with the intention of increasing credit access to small businesses. WHEDA is administering $22.4 million FED awarded to Wisconsin, and WHEDA has allocated $1,363,600 for future small business loan guarantees. WHEDA expects SSBCI funds to begin supporting a portion of new small-business guarantees that otherwise would be WDRF-supported. WHEDA intends for this change in fund sources to allow current commitments of the WDRF to expire, while limiting further commitments on small-

business loans and preserving available guarantee authority for agricultural guarantees such as CROP. However, to date no SSBCI funds have been used for loan guarantees.

6. Also, it should be noted WHEDA expects to allocate $750,000 for small-business loan guarantees, as part of Transform Milwaukee, using a portion of $2 million transferred to the Authority by the Department of Justice from the state's portion of the National Mortgage Settlement. As of April 1, 2013, this funding had not been received by the Authority, however, and no loans have been guaranteed. WHEDA expects this funding would likely use a leverage factor of $1 in reserve for every $4.50 in guarantees, as with WDRF programs, and make guarantees in the Transform Milwaukee area at 80%. This would be expected to guarantee perhaps $3,375,000 on total original loans of approximately $4.2 million.

7. Although administered by WHEDA, the WDRF has primarily been state-funded. To allow WHEDA to carry out these activities, the state has appropriated $26.7 million since 1984-85, when the first loan guarantee fund was created for CROP. Most of the funding ($20.7 million) has been GPR, with the remaining amounts SEG from the agrichemical management fund ($162,500), the petroleum inspection fund ($375,000) and the former recycling fund ($5.5 million). The WDRF also has transferred approximately $3.5 million back to the general fund and $4.8 million back to the recycling and environmental funds since 1986-87, for net transfers to the WDRF of $18.4 million.

8. The WDRF is intended to provide credit enhancement for farmers and small businesses with reasonable borrower profiles, but for whom traditional private financing for business expansions or working capital may otherwise be unaffordable. Therefore, WHEDA and others argue providing credit enhancement to support these entities is a suitable use of state funds for economic development purposes. Further, because the benefits may be widespread, GPR is the most appropriate source. The Committee could consider retaining the Governor's recommendation [Alternative 1].

9. If the Committee wished to change the amount of GPR appropriated under the bill, the Committee could consider deleting the provision [Alternative 2a] or lowering the appropriation. If the Committee wished to reduce the recommended appropriation, one of the following amounts could be considered: (a) $500,000 [Alternative 2b]; (b) $1,000,000 [Alternative 2c]; (c) $1,500,000 [Alternative 2d]; or (d) $2,000,000 [Alternative 2e]. Table 3 shows the additional total lending one of the above amounts could support assuming: (a) $4.50 in additional guarantees for each additional $1 in reserve; (b) a 50% guarantee under the small business development loan guarantee program; and (c) none of the funding provided would be diverted for administrative costs. However, WHEDA indicates guarantee percentages may be increased, up to the statutory maximum, if such an action would increase the rate at which funding available would encourage new lending.

**TABLE 3**

**WDRF Funding Alternatives**

| Amount | Maximum Guarantees | Total Loans |
|---|---|---|
| $500,000 | $2,250,000 | $4,500,000 |
| 1,000,000 | 4,500,000 | 9,000,000 |
| 1,500,000 | 6,750,000 | 13,500,000 |
| 2,000,000 | 9,000,000 | 18,000,000 |
| 2,500,000 | 11,250,000 | 22,500,000 |

10. In addition, fund sources other than GPR could be considered. One alternative source may be WHEDA's unencumbered reserves, or surplus. WHEDA is required by statute to create a plan, known as Dividends for Wisconsin, for expending its annual surplus. Amounts typically are allocated among programs for single-family housing, multifamily housing, economic development and other initiatives, such as grants to organizations providing temporary housing and shelter for persons in crisis. (The plan is presented to housing-related standing committees of the Legislature under a passive review process, and it is referred to the Joint Committee on Finance if a standing committee objects to the plan.) However, budget acts for several biennia have required transfers to the state general fund from WHEDA's surplus. Amounts transferred have been both for replacing GPR reallocated to housing-related programs and for directly helping balance the state general fund, similar to lapses required of state agencies. Table 4 lists these transfers since 2003-04. As of February 28, 2013, WHEDA's regular financial reports to its governing board show approximately $4.3 million in unencumbered general reserves that would be available for the Dividends plan to be created beginning in August, 2013. The bill does not contain any requirement for WHEDA to transfer a portion of its surplus to the state in 2013-15.

**TABLE 4**

**Transfers from WHEDA Unencumbered Reserves**

| Year | Recipient Department/Fund | Amount | Dividends Available | Transfer Percentage |
|---|---|---|---|---|
| 2003-04 | General Fund | $2,375,000 | $10,055,500 | 23.6% |
| 2004-05 | General Fund | 2,125,000 | 8,150,500 | 26.1 |
| 2005-06 | Commerce | 3,000,000 | 8,066,300 | 37.2 |
| 2006-07 | Commerce | 2,000,000 | 7,757,300 | 25.8 |
| 2007-08 | Commerce | 3,025,000 | 5,627,600 | 53.8 |
| 2008-09 | Commerce | 3,000,000 | 8,000,400 | 37.5 |
| 2009-10 | General Fund | 225,000 | 3,453,000 | 6.5 |
| 2010-11 | General Fund | 225,000 | 4,405,500 | 5.1 |
| 2011-12 | General Fund | 900,000 | 14,316,100 | 6.3 |
| 2012-13 | General Fund | 900,000 | 8,887,000 | 10.1 |
| Total | | $17,775,000 | $78,719,200 | 22.6% |

11. The statutes establish in WHEDA a housing rehabilitation loan program, currently known as the Home Improvement Advantage program, which is to be supported by a program administration fund, also administered by WHEDA. WHEDA reports as of June 30, 2012, the housing rehabilitation loan program administration fund had total assets of $12.1 million and a net balance of $11.3 million, of which $7.5 million consisted of cash and cash equivalents. WHEDA reported total encumbrances and commitments of $12.2 million, however, including $6.5 million for second-mortgage programs the Authority plans to pursue beginning in 2013, as well as other amounts for operating Home Improvement Advantage. The fund was begun with $600,000 GPR as seed funding, and the statutes contain a requirement that WHEDA transfer annually to the state general fund any amounts no longer required for housing rehabilitation loan programs. In 2000, the first year of the requirement, WHEDA transferred $1,500,000, but has not made any transfers since. As of June 30, 2012, WHEDA considers approximately $788,700 of the fund balance as being held on behalf of the state. Additionally, the fund has been used for transfers in the past. A 1993, WDRF-guaranteed WHEDA loan to Taliesin, the home of Frank Lloyd Wright in Spring Green, defaulted in 1999, and 1999 Act 9 transferred $5,845,200 from the housing rehabilitation loan fund to make the WDRF whole for guarantee payments made on the debt instruments.

12. The Committee could consider specifying the transfer in 2013-14 with one of the amounts shown in Table 3, and specifying that the transfer take place from GPR [Alternative 2], the housing rehabilitation loan program fund [Alternative 3], from WHEDA's unencumbered reserves [Alternative 4], or from a combination of the funds. For example, if the Committee wished to match the Governor's recommended transfer to the WDRF but replace the GPR expenditure, an amount of $1,000,000 from WHEDA's unencumbered general reserves, which is approximately consistent with $900,000 in annual transfers to the state general fund required by Act 32, could be combined with a transfer of $1,500,000 from the housing rehabilitation loan program administration fund. It could be argued such a transfer from WHEDA or WHEDA-administered funds would be consistent with either past budgeting practices, in the case of WHEDA's surplus, or statutory requirements, in the case of the housing rehabilitation loan program fund. On the other hand, it could be argued that such transfers would divert funding that would otherwise be available for WHEDA's housing and economic development programs.

13. Without additional future transfers the WDRF balance is expected to continue to decline. In addition to any transfers, the Committee also could consider specifying an ongoing transfer from the housing rehabilitation loan program administration fund to the WDRF instead of the state general fund [Alternative 5]. One could argue this would provide another potential funding source for the WDRF, and perhaps limit any need for future state appropriations. However, it could also be argued this could reduce funding for housing rehabilitation programs, which allow for improvements or repairs that preserve housing values to the benefit of homeowners and lenders.

**ALTERNATIVES**

1. Adopt the Governor's recommendation to transfer $2,500,000 GPR to the Wisconsin Development Reserve Fund in 2013-14.

2. Delete the transfer of $2.5 million GPR in 2013-14 to the WDRF. Instead, substitute

one of the following GPR amounts:

a. $0 (delete the Governor's recommendation);

| ALT 2a | Change to Bill Funding |
|---|---|
| GPR | - $2,500,000 |

b. $500,000;

| ALT 2b | Change to Bill Funding |
|---|---|
| GPR | - $2,000,000 |

c. $1,000,000;

| ALT 2c | Change to Bill Funding |
|---|---|
| GPR | - $1,500,000 |

d. $1,500,000; or

| ALT 2d | Change to Bill Funding |
|---|---|
| GPR | - $1,000,000 |

e. $2,000,000.

| ALT 2e | Change to Bill Funding |
|---|---|
| GPR | - $500,000 |

3. Specify one of the following transfers to the WDRF from the housing rehabilitation loan program fund (any option, by itself, would have no effect on the state budget):

a. $500,000;
b. $1,000,000;
c. $1,500,000;
d. $2,000,000; or
e. $2,500,000.

4. Specify one of the following transfers to the WDRF from WHEDA's unencumbered general reserves (any option, by itself, would have no effect on the state budget):

a. $500,000;
b. $1,000,000;
c. $1,500,000;
d. $2,000,000; or
e. $2,500,000.

5. In addition to Alternatives 1, 2, 3 or 4, amend statutory requirements that amounts in the housing rehabilitation loan program administration fund not required for the housing rehabilitation loan program are to be transferred to the WDRF. (Current law specifies transfers from the housing rehabilitation loan program administration fund are to the general fund.)

Prepared by: Paul Ferguson