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Accumulated Sick Leave Conversion Credit Program Liability -- Revenue Obligations and Appropriation Obligations (Building Commission)

CURRENT LAW

Under current law, state employees accumulate unused sick leave that may be converted to credits to pay health insurance premiums on behalf of the employee or the employee's surviving dependents under the state group health insurance plan once the employee either terminates state employment or dies. The employee's accumulated unused sick leave is converted to credits based on his or her basic pay rate immediately prior to termination or death. In order to use accumulated sick leave in this manner, the individual is required to be covered under the state group health insurance plan at the time of termination of employment or death. Where the employee is terminating employment, he or she must immediately qualify for a Wisconsin Retirement System (WRS) annuity benefit. However, certain employees who have 20 years of creditable service under the WRS and defer application for a retirement annuity may subsequently use their credits, provided that during the interim they have been covered by what is deemed to be comparable group health insurance.

The sick leave conversion credit benefit also has an actuarially unfunded liability component attributable to previous funding deficiencies and to benefit improvements that were applied retroactively. Each state agency contributes a percentage of its payroll toward the state's accumulated sick leave conversion credit program liability. The funds necessary to make these payments are appropriated each year as part the employer-required contributions included in the fringe benefit funding provided each state agency.

GOVERNOR

No Provision.

DISCUSSION POINTS

Background

1. In a May 6, 2003, letter to the Co-chairs of the Joint Committee on Finance, the DOA Secretary identified several changes to the Governor's biennial budget proposal. One of the proposed changes identified would be to refinance the state's unfunded accumulated sick leave conversion credit program liability. This proposal would be similar to the Governor's proposal to issue bonds to refinance the state's unfunded prior service pension liability included in SB 44.

2. The state's basic sick leave conversion credit benefit allows a retiring employee to convert unused sick leave to a cash equivalent that pays the retired employee's medical insurance premium each month until that cash balance is exhausted. In addition, a supplemental sick leave conversion credit program exists whereby the state provides additional credits upon retirement to career employees who have not drawn down their sick leave credits below specified threshold levels. Both the basic and supplemental portions of the sick leave conversion benefit have an actuarially unfunded liability component similar to the state's unfunded prior service liability. However, unlike the unfunded prior service liability, the unfunded sick leave conversion liability applies only to state agencies and not to all Wisconsin Retirement System (WRS) employers.

3. The state's accumulated sick leave conversion benefit liability is treated as an employer cost. These liabilities become an obligation spread across all state agencies. The costs are amortized through additional contributions paid by employers over an extended period of time. The current amortization period to pay off the sick leave conversion credit program's liability would extend through 2026. Table 1 shows by calendar year, the unfunded liability starting balance for the state's accumulated sick leave conversion credit program, annual required payments, and annual interest assessments over the remaining term of the payment schedule. The payment schedule is based on the current actuarial assumptions governing the WRS. These assumptions provide for an 8.0% interest rate and a 4.5% annual increase to the state's base payroll.

Sick Leave Conversion Credit Program Liability
Payment Schedule

Year	Beginning Balance	Adjustment	Payments	Ending Interest	Balance
2001					$463,731,863
2002	$463,731,863	$29,589,415	$14,016,039	$35,977,266	515,282,505
2003	515,282,505	30,920,939	14,646,761	40,050,860	571,607,543
2004	571,607,543		34,868,386	42,939,133	579,678,290
2005	579,678,290		36,437,464	43,459,266	586,700,092
2006	586,700,092		38,077,149	43,889,835	592,512,778
2007	592,512,778		39,790,621	44,217,773	596,939,930
2008	596,939,930		41,581,199	44,428,698	599,787,429
2009	599,787,429		43,452,353	44,506,806	600,841,882
2010	600,841,882		45,407,709	44,434,734	599,868,907
2011	599,868,907		47,451,056	44,193,428	596,611,279
2012	596,611,279		49,586,353	43,761,994	590,786,920
2013	590,786,920		51,817,739	43,117,534	582,086,715
2014	582,086,715		54,149,538	42,234,974	570,172,151
2015	570,172,151		56,586,267	41,086,871	554,672,755
2016	554,672,755		59,132,649	39,643,209	535,183,315
2017	535,183,315		61,793,618	37,871,176	511,260,873
2018	511,260,873		64,574,331	35,734,923	482,421,465
2019	482,421,466		67,480,176	33,195,303	448,136,593
2020	448,136,593		70,516,784	30,209,585	407,829,394
2021	407,829,395		73,690,039	26,731,148	360,870,504
2022	360,870,504		77,006,091	22,709,153	306,573,566
2023	306,573,567		80,471,365	18,088,176	244,190,378
2024	244,190,378		84,092,576	12,807,824	172,905,626
2025	172,905,627		87,876,742	6,802,311	91,831,196
2026	91,831,195		91,831,195	0	0
		$60,510,354	$1,386,334,200	$862,091,980	

4. The payment schedule for liquidating the unfunded liabilities of the accumulated sick leave conversion credit program is based on a level percentage of payroll over an extended period. While this approach results in stable payments as a percentage of payroll, the actual annual payment amounts will significantly increase over time due to underlying assumed annual increases to agencies' base payrolls. Consequently, the schedule is not a flat amortization schedule; rather, the payments are effectively "back-end loaded" with the amounts paid during the early years significantly lower than the later years of the payment schedule. Also, under the repayment schedule, the state's annual payments in the early years will not cover the annual interest amounts

that accrue on the principal. Not until after year 2009, when the liability reaches $600.8 million, will the state's annual payment cover the interest on the outstanding principal, at which time the outstanding principal amount on the liability will begin to decline.

5. The state's contribution rate is comprised of two components. First, there is the contribution amount necessary to fund the obligations of the program that are being incurred in the current year by active state employees. This contribution amount funds what are called the "normal cost" of the program and is 1.9% of payroll for 2003. Second, there is the contribution amount necessary to fund the unfunded liability obligations of the program. There are two types of unfunded liability costs under this program: (a) the costs that are attributable to the obligations that developed before the program was operated on an actuarially sound basis; and (b) the costs that are attributable to the obligations that developed when the supplemental accumulated sick leave conversion credit program was developed to provide additional sick leave credit benefits to long-term state employees and the new benefit was granted retroactively. The contribution amount required for the total unfunded liability costs of the program is 0.9% of payroll for 2003, and for budgeting purposes is 1.0% of payroll for 2004 (and thereafter).

6. The state employee accumulated sick leave conversion credit program is funded by an employer-paid contribution, based on a fixed percentage of salary. This contribution rate is determined annually by the Department of Employee Trust Fund's consulting actuary. For calendar year 2002, the contribution rate was set at 2.7% of payroll. For the 2003 calendar year the contribution rate is set at 2.8% of payroll. For budgeting purposes, state agencies must include a 2.8% of payroll contribution rate for the unfunded sick leave conversion liability as part of the calculations used to determine their fringe benefits funding needs during the 2003-05 biennium. Table 2 indicates, by fund source, the amounts included in the Governor's budget to make each agency's unfunded sick leave conversion liability contribution payments in the biennium.

TABLE 2

Budgeted State Unfunded Accumulated Sick Leave Conversion Liability Contributions by Fund Source

	2003-04	2004-05	2003-05
GPR	$12,378,100	$12,999,200	$25,377,300
PR	10,698,200	11,417,000	22,115,200
SEG	2,069,300	2,131,500	4,200,800
FED	3,732,500	3,912,400	7,644,900
Total	$28,878,100	$30,460,100	$59,388,200

7. The amounts shown in Table 2 differ from the actuarial payment schedule on the state's accumulated sick leave liability presented in Table 1 because the budgeted amounts reflect the reductions made to agencies' base payroll funding under SB 44.

Unfunded Sick Leave Conversion Liability Obligation Proposal

8. Under the current proposal, the state would issue up to $600 million in bonds to pay off its unfunded accumulated sick leave conversion credit program liability. The proposal assumes that the rates on the revenue bonds issued would be lower than the current 8% financing rate on the state's unfunded accumulated sick leave conversion liability and would result in savings associated with the lower interest costs necessary to retire the principal amount of the state's accumulated sick leave conversion credit program liability. DOA Capital Finance officials indicate that while the transaction is very interest rate sensitive, the current record low long-term rates make the proposal possible at this time.

9. In his letter to the Co-Chairs, the DOA Secretary indicated that $23,100,000 in 2003-04 and $31,000,000 associated with the savings generated under this accumulated sick leave pension bond proposal could be deposited to the general fund in the biennium. Under the transaction outlined by DOA, it is assumed the state would issue enough taxable revenue bonds to pay off all of the state's accumulated sick leave conversion credit program liability and establish a 30-year repayment schedule on those bonds. The transaction envisioned assumes that the bonds would be structured so that no debt service payments would be made on the revenue bonds in the 2003-05 biennium. Debt service payments on the revenue bonds could continue to be less than the state's current annual unfunded accumulated sick leave conversion credit program liability contributions through 2009. After 2009, the state would make annual debt service payments that would equal the payments that would have been made under the current repayment schedule on the state's unfunded liability. Such a debt service schedule would allow the state to maximize the amount of savings in the 2003-05 biennium related to the transaction and take all of the savings associated with the transaction in the earlier years of the transaction.

10. As indicated earlier, SB 44 includes $28,878,100 in 2003-04 and $30,460,100 in 2004-05 to make state agency's unfunded accumulated sick leave conversion credit program liability contributions in the 2003-05 biennium. Under the proposed transaction to pay off the liability with bond proceeds, the state would not have to pay these monies to fund either the accumulated sick leave conversion credit program liability or debt service on bonds issued to retire that liability. Rather DOA would have the authority to lapse these amounts to the general fund.

11. Similar to the unfunded pension liability proposal under SB 44, DOA Capital Finance officials indicate that it is uncertain whether the state would have the authority to lapse the federal contribution amounts to the general fund in the biennium. These funds may revert back to the federal government or be used for other federal program purposes. However, DOA would continue to have the authority to lapse federal funds that may result from a bond transaction to pay off the state's unfunded accumulated sick leave conversion liability, if doing so becomes a possibility, but the state would not be budgeting for these savings at this time.

12. Excluding the $3,732,500 in 2003-04 and the $3,912,400 in 2004-05 in federal funds from the amount of accumulated sick leave liability contributions that may be lapsed to the general fund in the 2003-05 biennium, the estimated GPR lapse associated with transaction would total $51.7 million in the 2003-05 biennium. This amount would be $2.4 million less than the $54,100,000 ($23,100,000 in 2003-04 and $31,000,000 in 2004-05) that the DOA Secretary indicated could be lapsed to the general fund in the biennium. The difference exists because DOA's estimates of the savings from the proposal were based on the actuarial contribution amounts identified by the ETF rather than the actual amounts budgeted under SB 44 for the accumulated sick leave conversion credit program liability to be paid through agency fringe benefit budgets in the 2003-05 biennium. The reductions in payroll costs associated with the position reductions contained in SB 44 reduced the amount that is budgeted in the 2003-05 biennium for fringe benefits, including the unfunded accumulated sick leave conversion credit program liability contributions.

Authorization of Both Revenue Obligation and Appropriation Obligation Bonds

13. Under the proposal, DOA or the Building Commission would be provided the authority to issue up to $600 million of either revenue obligation bonds or appropriation obligation bonds to pay of the state's accumulated sick leave conversion credit program liability. The revenue obligation bond program would involve the issuance of bonds backed by the state's excise taxes on alcoholic beverages, cigarette and tobacco products. Debt service on these bonds would be a first draw on the revenues associated with these excise taxes. The bonds would also be backed by the state's moral obligation pledge to appropriate any funds that may be necessary to repay the obligations and maintain the required reserves on the bonds. If appropriation obligation bonds would be used, the bonds would be payable from a GPR appropriation in the amounts appropriated by Legislature each year. Both types of bonds could be used to pay off the state's unfunded accumulated sick leave conversion credit program liability and the bonds would not be considered public debt of the state. The revenue obligation bonds would be issued by the Building Commission, while the DOA Secretary would have the authority to issue appropriation obligation bonds.

14. DOA Capital Finance officials indicate that both types of bonds are needed because it is not known which type of bonds would be issued at this time. While it is not certain, issuing appropriation bonds could be more favorable in allowing the state to capture the federal contributions toward the accumulated sick leave liability. It is believed that because the amounts necessary to retire the appropriation bonds would have to be appropriated each year, the federal government could view this annual expense as being similar to its current annual unfunded accumulated sick leave conversion credit program liability commitment with the state. In addition, unlike revenue obligations that are backed by certain revenues, appropriation obligations involve the appropriation of general purpose revenues and could be viewed by some bond-buyers as similar in nature to general obligation debt, which could lower the reserve requirements needed for the bonds, and have a positive impact on the interest rate paid on the bonds. Providing both types of bond authorizations would allow DOA the flexibility to construct a transaction that could allow for the capture of the federal funds at a lower interest cost.

15. By allowing $600 million of either type of bonds to be issued, DOA or the Building Commission would be provided $1.2 billion in bonding authority. DOA Capital Finance officials indicated that only $600 million in total bonding authority would be used to carry out the transaction. Because only $600 million in bonds would be needed to liquidate the state's unfunded accumulated sick leave conversion credit program obligation, the Committee could specify that any amount of bonds issued under excise tax revenue bond obligation authority would reduce the amount of authority for the appropriation obligation bonds, and vice versa. This would limit the overall amount of bonds authorized for issuance to $600 million.

16. Under either type of bonds, the state would be setting a precedent by using a portion of the state's general fund revenues to back bonds that would not be considered general obligation debt of the state. That is, while debt service on state general obligation bonds is funded as a first draw on state's general fund revenues each year, state revenue obligation bonds are funded by revenues from a specific, non-GPR funding source. Two examples of state revenue obligation bonds include the clean water fund revenue bonds, which are backed by clean water fund loan repayments and transportation revenue bonds, which are backed by motor vehicle registration fees. This would be the first time the state would carve out revenues from existing general fund taxes or appropriate general purpose revenue to support bonds other than general obligation bonds. However, the state does use a master lease program to obtain shorter-term financing for equipment purchases, which involves the use of GPR funding drawn from agency operating appropriations.

17. The Wisconsin Constitution enables the state to issue public debt to "acquire, construct, develop, extend, enlarge or improve land, waters, property, highways, buildings, equipment or facilities for public purposes." The language was deliberately broad, requiring only that bonding be intended to affect physical property directly and be undertaken for public purposes. However, the provision has been interpreted to clearly exclude public debt being issued to fund the annual operation and administration of state government.

18. Due to these constitutional constraints on public debt, the state could not issue general obligation bonds to pay off the state's unfunded sick leave conversion credit program

liability. However, these constitutional requirements do not apply to revenue obligations, which are not considered public debt under the Constitution, because the bonds are not backed by the full faith and credit of the state. For appropriation obligations, the debt service would be funded from an annual sum certain GPR, subject to appropriation by the Legislature and the bill states that such bonds would not be considered public debt.

19. Using general fund revenues to pay off revenue obligation bonds or GPR funding to pay the appropriation obligation bonds authorized under the bill could establish another precedent for the state's debt programs. Such borrowing programs that use state general fund revenues to support debt that is not constitutionally limited in its use or amount, could be statutorily expanded to support bonds that could be issued for any state government operating function or expense.

20. Both the revenue obligations or appropriation obligations would be backed by the state's moral obligation pledge to appropriate any funds that may be necessary to repay the obligations and maintain the required reserves. Providing the state's moral obligation would likely enhance the marketability of any bonds issued, which would improve the financing costs of the bonds. Therefore, providing the state's moral obligation on the bonds may be necessary to achieve the spread between the current 8% rate paid on the state's accumulated sick leave conversion credit program liability and the rates on the bonds, so as to generate savings to the state associated with the transaction.

21. Providing the state's moral obligation on the bonds could require the state to make payments associated with the debt service on the bonds in the future. However, placing a moral obligation on these sick leave conversion liability bonds would be unlike other moral obligations the state has placed on revenue bond issues in the past. For example, the state has applied its moral obligation on Wisconsin Center District bonds, and if that obligation is exercised, the state could be required to make payments on a facility that would have not otherwise required any state funds. Under the current proposal, the state would be bonding to pay off an existing long-term obligation. Therefore, any state payments resulting from the state's moral obligation on the bonds could be seen as simply replacing funds the state is currently paying on that liability.

22. Currently, the state's unfunded accumulated sick leave conversion credit program liability is considered a "soft" liability, because it does not show up on the state's annual financial reports. However, if the state would issue bonds to pay off that liability, the outstanding principal associated with those bonds would show up as "hard" liability on the state balance sheet and other financial reports. While it is unknown whether such a liability would have material effect on any financial analysis of the state, bond rating agencies do conduct such an analysis in completing their ratings on state bond issues.

Impact of Transaction on Future Biennia

23. Under the proposal, the bonds would be repaid with general fund dollars; general fund excise tax revenues would support the excise tax revenue obligations and a GPR sum certain appropriation would support the appropriation obligations. Conversely, the bond proceeds would be

used to pay off the state's unfunded accumulated sick leave conversion credit program liability, which is currently being funded from GPR, PR, SEG, and FED funding sources. Therefore, beginning in 2005-07, a liability that was funded from all funding sources would be funded 100% from general fund revenues.

24. An alternative would be to charge each PR and SEG account, and FED account, if federal funds are involved in the transaction, for the percentage of debt service costs that are associated with the share of the liability that would have otherwise been paid by those funding sources. DOA could be required to include in their biennial fringe benefit calculations the percentage each fund source's contribution to debt service on the unfunded accumulated sick leave conversion credit program bonds in that biennium, based on each fund source's percentage of the state's liability at the time the liability is liquidated. In order to capture these monies for the general fund in the future, the authority provided under the bill that would allow the DOA Secretary to lapse or transfer each agency's unfunded accumulated sick leave conversion credit program liability payments in the 2003-05 to the general fund could be extended until the bonds issued to pay off than liability are retired.

ALTERNATIVES

1. Authorize the Building Commission or the DOA Secretary to issue up to $600 million in either revenue obligation bonds or appropriation obligation bonds. Estimate the GPR-Lapse amounts from agency appropriations to be $51,693,300 ($25,145,600 in 2003-04 and $26,547,700 in 2004-05).

Alternative 1	GPR-Lapse	BR
2003-05 FUNDING (Change to Bill)	$51,693,300	$600,000,000

2. In addition to Alternative 1, do one or more of the following;

a. Require that the any amount excise tax revenue bond obligation issued would reduce the bonding authority for appropriation obligation bonds, and vice versa. This would statutorily limit the overall amount of bonds authorized to $600 million.

b. Direct the DOA Secretary to assess each PR and SEG account, and FED account, if federal funds are involved in the transaction, for the percentage of debt service costs that are associated with each fund's share of the unfunded accumulated sick leave conversion credit program liability that would have otherwise been paid by those funding sources. In making this determination, require the DOA Secretary to include in their biennial budget fringe benefit calculations the percentage each fund source's contribution to debt service on bonds issued to pay of the state's accumulated sick leave conversion credit program liability in that biennium. Specify that the calculation be based on the percentage that each fund source makes up of the state's unfunded accumulated sick leave conversion credit program liability at the time the liability is liquidated.

Authorize, until the bonds are retired, the DOA Secretary to lapse or transfer each agency's unfunded accumulated sick leave conversion credit program liability payments to the general fund.

3. Maintain current law.

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