Legislative Fiscal Bureau

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

April 19, 2005 Joint Committee on Finance Paper #180

Medical Assistance Revenue Obligation Bonds (Revenue Obligation Bonds)

[LFB 2005-07 Budget Summary: Page 88, #3]

CURRENT LAW

In April, 1969, voters approved an amendment to the Wisconsin Constitution authorizing the state to issue debt directly. This amendment allows the issuance of general obligation bonds by the state.

Chapter 29, Laws of 1977, added a major provision to Chapter 18 of the statutes by specifically authorizing the state to issue revenue bonds through the State Building Commission. Notwithstanding the provisions specifying that state-issued revenue bonds do not constitute debt of the state, the statutes allow the issuance of revenue bonds backed by a state "moral obligation" pledge.

GOVERNOR

Authorize the Building Commission to issue revenue obligation bonds backed by the state's alcoholic beverage, cigarette, and tobacco products excise taxes that could generate up to $130,000,000 in net proceeds to fund costs associated with the state's medical assistance (MA) program. Specify that bond proceeds could be: (a) transferred to the proposed health care quality improvement fund; (b) used to provide for reserves and to make ancillary payments as determined by the Building Commission; and (c) transferred to a proposed excise tax revenue obligation redemption fund. If the bonds would be issued, all revenues from the state's alcoholic beverage, cigarette, and tobacco products excise taxes would be deposited to the segregated excise tax fund. As determined by the Building Commission, any tax revenues not needed to retire the revenue obligation bonds, or to provide required reserves or ancillary payments on such obligations, would be transferred to the general fund. If issued, these bonds would be backed by a moral obligation pledge, under which the Legislature expresses its expectation and aspiration that, if the excise tax fund cannot pay debt service, the Legislature would provide GPR funding to pay the debt service or replenish reserves.

Specify that the Secretary of the Department of Administration would determine the requirements for funds to be obtained from revenue obligation bonds issued to fund medical assistance (MA) costs. Require that the amount of expenditures to be paid from these revenue obligations could not exceed $130,000,000. Specify that the Legislature finds and determines that financing the MA program to fund costs from the net proceeds of these revenue obligation bonds is appropriate and will serve a public purpose by improving the quality of, and access of this state to, health care services.

Provide that the occupational taxes on fermented malt beverages and intoxicating liquor would be converted to excise taxes.

DISCUSSION POINTS

1. Due to the limited availability of general fund revenues in the 2005-07 biennium, the administration proposes to use revenue bond proceeds to fund a portion of MA program expenditures. Under the Governor's recommendation, up to $130,000,000 in revenue bonds backed by state general fund excise taxes could be issued. The bond proceeds would be transferred to the proposed segregated health care quality improvement fund and appropriated as segregated revenues to support the costs to continue the current MA program, adjusted to reflect projected increases in caseload and utilization.

2. If the Committee chooses not authorize the excise tax supported revenue bonds for MA program purposes, as recommended by the Governor, other funding sources would need to be identified for the MA program in 2006-07, if no other changes in program services and eligibility are made to reduce program costs.

3. In using $130,000,000 of revenue bonds to fund the administration's estimated expenditure levels in the biennium for the current MA program, the Governor's proposal would use one-time revenues, in the form of revenue bond proceeds, to fund ongoing MA expenditure levels. As a result, going into the 2007-09 biennium, MA program expenditure levels would exceed ongoing revenues available to fund annual program costs by $130,000,000. This could be addressed by making significant changes to reduce the ongoing costs of the program, providing other state revenues, or authorizing additional revenue bonding in the 2007-09 biennium

4. In recent years, the state has used one-time revenues or transfers to the general fund to support ongoing expenditure levels in one year that could not be sustained by ongoing state revenues in subsequent years. Bond rating agencies have noted this practice in assessing the financial management of the state for bond rating purposes. Between 2002 and 2004, the major rating agencies downgraded Wisconsin's general obligation bond issues. In announcing these rating changes, these agencies cited credit concerns related to the state's finances, including the state's use of one-time revenues to fund ongoing expenditures. They noted that this practice, which reduces the ability of the state to generate general fund surpluses or reserves, has contributed to the state's

ongoing accounting deficit under generally accepted accounting principles (GAAP). The GAAP deficit generally reflects the state's year end general fund balance under its statutory basis of accounting adjusted for revenue and expenditure items attributable to the current fiscal year, and is exacerbated when annual general fund surpluses are low, or do not exist.

5. The 2003-05 biennial budget authorized the issuance of either revenue obligation bonds backed by the state's alcoholic beverage, cigarette, and other tobacco products taxes, or appropriation obligation bonds to finance the state's unfunded pension and sick leave credit conversion program liabilities. In December, 2003, the state issued appropriation obligation bonds to finance the liabilities, but did not issue any revenue obligation bonds. The MA revenue bond program would be created by modifying the unused provisions established for the earlier revenue obligation bond program and the related revenue obligation bond appropriations to refer to the MA program. The bill would also delete any obsolete statutory references under the revenue obligation bond program established to pay off the state's unfunded pension and sick leave credit conversion liabilities.

6. While the bill would authorize up to $130,000,000 in excise tax revenue bonds to be issued to fund MA program costs, administration officials indicate that other provisions in the bill may reduce or eliminate the need to issue the bonds. Provisions in the bill would allow any unanticipated general fund revenues received in the 2005-07 biennium, after any amount used to supplement general equalization aid for school districts, to be transferred to the healthcare quality improvement fund to fund MA program costs. The amount to be transferred would be determined by the DOA Secretary. Administration officials indicate that these provisions provide a "trigger mechanism" as to whether any MA revenue bonds would need to be issued and, if so, the amount to be issued. They indicate that the intent of these provisions would be to reduce the amount of MA bonds to be issued in the biennium by the amount of any unanticipated general fund revenues transferred to the healthcare quality to assist in funding MA program costs in 2006-07.

7. However, the bill would not require DOA to reduce the amount of MA bonds issued by the amount of the unanticipated general fund revenues in the 2005-07 biennium that become available to assist in funding MA program costs. In addition, if 2005-07 general fund revenues would not exceed the amounts estimated under the 2005-07 biennial budget act, the proposed MA revenue bonds would likely be issued. Further, if the unanticipated general fund revenues materialize, and are expended under the bill, this practice would have the effect of reducing future general fund balances that would have otherwise accrued.

8. While debt service on GPR supported general obligation bonds is funded from GPR sum sufficient appropriations each year, current 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. Because the revenue source for repayment of the bonds is more narrow, revenue bonds can carry higher interest rates than general obligation bonds.

9. Under the bill, all annual revenues from the state's alcoholic beverage, cigarette, and

tobacco products excise taxes would initially be deposited to the segregated excise tax fund rather than to the general fund. In 2006-07, the excise taxes would total an estimated $360.4 million. Any remaining revenues in the excise tax fund after annual debt service is paid on any revenue bonds issued for MA program purposes would be transferred to the general fund. It is estimated that revenues from these taxes would be reduced by $3,900,000 in 2006-07, and segregated revenues would increase by the same amount, to reflect the funds needed to meet the first debt service payment on the 20-year revenue obligation bonds to be issued to fund MA program costs. This debt service estimate is consistent with the issuance of the entire $130,000,000 in bonds in 2006-07. It is believed that revenue bonds could be issued on a federal tax exempt basis. However, because the use of the bond proceeds could provide private benefits to those under MA program care, interest on the revenue bonds may be federally taxable, which would result in a higher financing rate on the bonds. Assuming a 20-year, flat repayment schedule, and a 6% rate on the bonds, the following table illustrates the annual debt service on the bonds and outstanding principal amount of the bonds through the last payment in 2026-27.

Estimated Repayment Schedule of
MA Excise Tax Supported Revenue Bonds

Fiscal Year	Principal	Interest	Total Payment	Outstanding Balance
2006-07	$0	$3,900,000	$3,900,000	$130,000,000
2007-08	3,533,992	7,800,000	11,333,992	126,466,008
2008-09	3,746,032	7,587,960	11,333,992	122,719,976
2009-10	3,970,794	7,363,199	11,333,992	118,749,182
2010-11	4,209,042	7,124,951	11,333,992	114,540,140
2011-12	4,461,584	6,872,408	11,333,992	110,078,556
2012-13	4,729,279	6,604,713	11,333,992	105,349,277
2013-14	5,013,036	6,320,957	11,333,992	100,336,241
2014-15	5,313,818	6,020,174	11,333,992	95,022,424
2015-16	5,632,647	5,701,345	11,333,992	89,389,777
2016-17	5,970,606	5,363,387	11,333,992	83,419,171
2017-18	6,328,842	5,005,150	11,333,992	77,090,329
2018-19	6,708,573	4,625,420	11,333,992	70,381,756
2019-20	7,111,087	4,222,905	11,333,992	63,270,669
2020-21	7,537,752	3,796,240	11,333,992	55,732,917
2021-22	7,990,017	3,343,975	11,333,992	47,742,899
2022-23	8,469,418	2,864,574	11,333,992	39,273,481
2023-24	8,977,584	2,356,409	11,333,992	30,295,897
2024-25	9,516,239	1,817,754	11,333,992	20,779,659
2025-26	10,087,213	1,246,780	11,333,992	10,692,446
2026-27	10,692,446	641,547	11,333,992	0
Total	$130,000,000	$100,579,848	$230,579,848	

10. The Wisconsin Constitution enables the state to issue public debt (general obligation bonds) to "acquire, construct, develop, extend, enlarge or improve land, waters, property, highways, railways, buildings, equipment or facilities for public purposes," as well as for veterans' housing

loans. The language is 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.

11. Due to these constitutional constraints, the state could not issue general obligation bonds to fund the types of activities that are funded under the state's MA program. Therefore, the general taxing power of the state could not be pledged to pay debt service on bonds issued for MA program purposes. These constitutional requirements do not apply to revenue obligation bonds, which are not considered public debt under the Wisconsin Constitution and are not backed by the full faith and credit of the state. Therefore, in order to conform with the constitutional requirements relative to the use of public debt, the Governor's proposal would deposit existing general fund excise tax revenues into a special excise tax fund to support the MA revenue bonds. As a result, despite being supported by what are currently considered general tax revenues, the MA bonds would not be considered general obligation debt of the state.

12. The proposal would create a borrowing program that uses state general fund revenues to support debt that is not constitutionally limited in its use or amount. Such a bonding program would establish a precedent that could move the state in the direction of using general fund revenues to support debt financing of the operations of government rather than for financing physical improvements to the state. Once established, the borrowing program could be statutorily expanded to support bonds that could be issued for any state government operating function or expense.

13. By limiting the state's use of general obligation bonding to only fund improvements to the land, waters, property, highways, buildings, equipment, or facilities for public purposes, the Constitution also constrains the state's public debt usage to longer-lived assets. Limiting general obligation borrowing to the acquisition of assets like the lands purchased under the state's stewardship program, or to the construction or rehabilitation of state facilities and highways, results in the state having physical assets that offset the debt used to finance such assets. Also, long-term borrowing for these assets allows the cost of the asset to be spread over the useful life of the asset, with future users of these assets sharing in the costs of financing the assets.

14. Conversely, borrowing to pay for current MA program expenditures would not involve long-term assets. From a financial management basis, the state would not be acquiring or constructing an offsetting asset associated with the debt. Because no asset would exist, future taxpayers would be paying for the debt but receiving no benefit from the initial expenditure of the bond proceeds.

15. The bill would change all references to "occupational" under the beer and liquor tax statutes to "excise". An occupational tax is a tax imposed on the privilege of engaging in an occupation, but the tax base can still be a specified product or products. An excise tax is a tax imposed on a narrow base of products. For example, the current state taxes on cigarettes and tobacco products are excise taxes. The rates of tax and the tax bases would not be modified under the bill. Therefore, it is estimated that these provisions would have no fiscal effect.

16. The purpose for converting the beer and liquor taxes from occupational to excise taxes would be to enable such taxes to support the proposed MA revenue obligation bonds. Current law provides for the use of excise taxes for such a special fund obligation, but makes no reference to occupational taxes being used in this manner.

ALTERNATIVES

1. Approve the Governor's recommendation to authorize the Building Commission to issue revenue obligation bonds backed by the state's alcoholic beverage, cigarette, and tobacco products excise taxes that could generate up to $130,000,000 in net proceeds to fund costs associated with the state's MA program.

2. Delete the provision (an additional $130,000,000 in funding would be needed to fully-fund the costs of the MA program under AB 100 in 2006-07).

Alternative 2	GPR-REV	BR
2005-07 REVENUE (Change to Bill)	$3,900,000	
2005-07 FUNDING (Change to Bill)		- $130,000,000

Prepared by: Al Runde