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May 25, 2005 Joint Committee on Finance Paper #181

Unlimited Refunding Bonding Authority (Building Commission)

[LFB 2005-07 Budget Summary: Page 88, #2]

CURRENT LAW

The Building Commission is authorized to issue up to $1,000,000,000 in tax supported and self amortizing refunding bonds and up to $840,000,000 in Veterans Affairs refunding bonds from two current bonding authorizations. Bonds can only be issued using this refunding authority if the debt refinancing meets the requirement that the true interest costs to the state must be reduced. The Building Commission has authority to approve the issuance of refunding bonds up to the statutory limit, and the Department of Administration carries out the refunding transaction.

GOVERNOR

Delete the current statutory limit on the amount of tax supported, self amortizing, and Veterans Affairs refunding bonds that can be issued by the Building Commission. Specify that for tax supported and self amortizing refunding bonds, it would be the intent of the Legislature that this unlimited refunding bond authority only be used if the true interest costs of the state can be reduced.

DISCUSSION POINTS

1. Article VIII, Section 7 of the Wisconsin Constitution allows the state to contract public debt for certain public purposes subject to the aggregate amount of debt limit outlined under the section. The state is allowed to contract public debt, without limit, to refund all or part of any public debt contracted by the state. The Constitution also requires the Legislature to prescribe all matters relating to the contracting of public debt including the public purposes for the which the

debt may be contracted, the amount of debt that may be contracted for any class of such purposes, and the public debt which may be funded or refunded.

2. Under current law, the amount of bonding authority available for refunding state general obligation debt is set in statute. Typically, each biennium this refunding authority is increased to cover the amount of outstanding debt that DOA Capital Finance determines could be refinanced in the biennium. Generally, any adjustments to this authority have been included as part of the state's biennial budgets. However, additional authority has also been provided under separate legislation when refinancing opportunities have arisen. Currently, $33.2 million in tax supported and self amortizing refunding bond authority and $118.8 million in Veterans Affairs refunding bond authority remains available.

3. Under the bill, the Building Commission and DOA would have unlimited authority to refund the state's outstanding debt. Recently, state bond counsel has opined that the constitutional requirement that the Legislature prescribe the purpose and amount of public debt for which the state may contract only applies to new money borrowing. Bond counsel indicates that new money borrowing is borrowing that would not be used to replace previous borrowing. Therefore, bond counsel concluded that the Legislature is not required under the Constitution to set a specific amount of general obligation bond refunding authority.

4. Generally, debt is refinanced in either an economic refunding or a structural refunding, or a combination of those methods. In an economic refunding, the new stream of debt service payments is designed to reduce the total cost of the outstanding debt and is typically undertaken to take advantage of reduced interest rates. No increase in debt service payments occurs in any year due to an economic refunding and debt service payments are reduced in some or all years during the life of the refunding issue. The transaction can be structured so that the debt service savings are realized equally in each year during the life of the refunding bonds or concentrated in the early or late years of the transaction. Most of the state's debt refunding issues in the past have been economic refinancings carried out to provide the state interest cost savings on its outstanding debt. Most recently, in January, 2005, the state issued $527.0 million in tax supported and self amortizing refunding bonds, which will generate approximately $23.8 million in interest savings to the state.

5. In a structural refunding, the new stream of debt service payments can be higher or lower in a given year than under the current stream of payments. For example, the debt service payments in the early years of the refunding could be reduced while debt service payments are increased in future years. A structural refunding extends the average life of previously issued debt. Principal on the bonds is outstanding longer and therefore, the interest costs tend to be greater. In recent years, in order to balance the general fund budget and make GPR revenue available by reducing GPR expenditures in a fiscal year, the state has structurally refunded a portion of the principal due on its debt in that year. In 2003-04, as authorized by 2003 Act 129, the state borrowed $175 million to refund GPR supported bonds that otherwise would have been paid off in that year. In the 2001-03 biennium, as authorized by 2001 Act 16, the state borrowed $75 million to refund GPR supported bonds that otherwise would have been paid off during the 2001-03 biennium.

6. One reason for providing unlimited refunding authority is that the state would be

assured of having sufficient refunding authority available to take immediate advantage of an opportunity for the state to refinance a portion of its debt at lower interest rates due to of any changes in the bond markets. On several occasions during the past year, the bond market provided the state with general obligation debt refinancing opportunities. However, the existing amount of refunding authority during those times was not sufficient to take full advantage of those opportunities. Legislation that would have increased the state general obligation refunding authority to the amount necessary to take full advantage of these refunding opportunities was pending as these refinancing opportunities came and went, depending on changes in market conditions. In January, 2005, during a period when a refinancing opportunity was present, the state issued $527.0 million in general obligation refunding bonds that will result in $23.8 million in savings for the state, including $19.3 million in GPR savings. These savings are greater than the savings envisioned during earlier refunding opportunities over the past year. However, had the refinancing opportunity not reemerged, the lack of statutory refunding authority could have cost the state these savings.

7. Under the bill, the unlimited authority to refund debt would only be restricted by the provision under the bill that states it would be the intent of the Legislature that this unlimited refunding bond authority only be used if the true interest costs of the state can be reduced. However, this statement of the Legislature's intent would appear to be a weaker test for determining when the refunding bonds could be issued than the current law requirement, which requires that the refunding authority can only be used if the true interest costs to the state are reduced. A statement of legislative intent is not legally binding. Therefore, a refinancing transaction that would not reduce the true interest costs of the state, which is explicitly prohibited under current law, could go forward if the Building Commission chooses not to conform with the proposed statement of legislative intent relative to the use of the unlimited refunding authorization provided under the bill.

8. Furthermore, even the current law true interest savings requirement would not prevent the Building Commission and DOA from using this unlimited bonding authority to restructure a certain amount of the state's debt. A refunding transaction that reduces or eliminates any current principal due on state debt, while at the same time shortening the term that future principal amounts remain outstanding by doubling up on future years principal payments, could meet the true interest cost savings requirement. This occurs because reducing the term of the bonds as a part of the refinancing saves the interest costs on the debt that would otherwise remained outstanding. Such a transaction would have the effect of reducing current expenditures for debt service while increasing the state's future principal payments due on that debt as well as the overall outstanding indebtedness of the state.

9. The Building Commission is made up of six members from the Legislature which would provide some measure of legislative oversight over the use of the unlimited refunding authority provided under the bill. However, if the Committee would like to maintain full legislative oversight over the amount of refunding authority provided as well as the type of refinancing transaction that may be envisioned for the refunding authority, the Governor's recommendation could be deleted. Instead, the Committee could provide sufficient authority for tax supported, self amortizing, and Veterans Affairs refunding to meet potential refinancing opportunities in the 2005-07 biennium.

10. DOA Capital Finance officials indicate that it would require $872 million in

authority to refund all callable, non-refunded, general obligation bonds, excluding veterans affairs refunding bonds. However, considering that in January the state just refinanced $560 million in outstanding bonds that were the best available candidates for refunding, it is unlikely that any more that half of $872 million in eligible bonds would become candidates for refunding in the 2005-07 biennium. Therefore, if the Committee were to provide $400 million in additional refunding for tax supported and self amortizing general obligation bonds, it would likely be sufficient to take advantage of refinancing opportunities that may arise in the 2005-07 biennium. Along with the $33.2 million in existing refunding authority, this alternative would make a total of $433.2 million in tax supported and self amortizing refunding authority available for the 2005-07 biennium.

11. Similarly, it is unlikely that the entire amount of eligible veterans bonds outstanding would become eligible candidates for refunding in the biennium. Therefore, if the Committee were to provide additional refunding authority equal to the $175 million provided in the 2003-05 biennial budget, it would likely be sufficient to take advantage of refinancing opportunities that may arise in the 2005-07 biennium. Along with the $118.8 million in refunding authority currently available, this alternative would make a total of $293.8 million available in Veterans Affairs refunding authority available in the 2005-07 biennium.

ALTERNATIVES

1. Approve the Governor's recommendation to delete the current statutory limit on the amount of tax supported, self amortizing, and Veterans Affairs refunding bonds that can be issued by the Building Commission. Specify that for tax supported and self amortizing refunding bonds, it would be the intent of the Legislature that this unlimited refunding bond authority only be used if the true interest costs of the state can be reduced.

2. Delete the Governor's recommendation and, instead, authorize $400,000,000 in tax supported and self amortizing refunding bonding and $175,000,000 in Veterans Affairs refunding bonding.

Alternative 2	BR
2005-07 FUNDING (Change to Bill)	$575,000,000 but Deletes Unlimited Issuance

3. Delete the Governor's recommendation.

Alternative 3	BR
2005-07 FUNDING (Change to Bill)	Deletes Unlimited Issuance

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