Legislative Fiscal Bureau

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Permanent Endowment Fund Transfer to Health Care Quality Fund (Permanent Endowment Fund and Tobacco Financing)

Bill Agency

[LFB 2007-09 Budget Summary: Page 451, #1 and #2]

CURRENT LAW

Under 2001 Act 16 (the 2001-03 budget), the DOA Secretary is authorized to securitize the state's rights to its tobacco settlement payments. Using this authority, the DOA Secretary assigned the rights to the state's tobacco settlements to the Badger Tobacco Asset Corporation (BTASC) on April 18, 2002. BTASC, after receiving the rights to the state's tobacco settlement payments, used the newly-acquired revenue stream to back the issuance of $1.59 billion in revenue bonds. In return for the rights to the state's tobacco settlement payment revenues, BTASC provided the state with the net proceeds from those bonds.

The securitization transaction resulted in $1.275 billion in net bond proceeds being available to the state. Under 2001 Act 109, $681 million in proceeds were deposited directly to the state's general fund in 2001-02. The remaining $594 million in proceeds were deposited to the permanent endowment fund, and later expended in lieu of GPR funding for the shared revenue, county mandate relief, and small municipalities shared revenue programs in 2002-03.

GOVERNOR

Transfer $50,000,000 annually from the permanent endowment fund to the health care quality fund created under the bill. The permanent endowment fund currently has no money in it.

DISCUSSION POINTS

New Securitization Transaction -- $50 Million of Annual Moneys

1. Under the 2002 securitization transaction, the state assigned the rights to the next 30 years of its tobacco settlement payments to BTASC. However, as indicated in the offering circular on the bonds, fewer years of the state's settlement payments are expected to be needed to retire those bonds. The repayment requirements associated with most of the bonds that were issued require that any excess annual tobacco settlement revenues, after all of the scheduled annual debt service payments are made, must be used to prepay the outstanding principal on the BTASC bonds. Therefore, according to the offering circular, using a conservative independent forecast of the annual tobacco settlement revenues to be received by BTASC, it is projected that all of BTASC's outstanding tobacco bonds will be paid off by 2017 or 2018. Therefore, beginning sometime in 2018, tobacco settlement revenues currently assigned to BTASC will again flow to the state.

2. Detailed information on the proposed 2007 securitization transaction is not available. However, any transaction must first pay off the existing bonds, because all of the tobacco settlement revenues are pledged for the repayment of the existing bonds. Once the bonds are paid off, this pledge to current bondholders would no longer apply. As a result, the transaction would first use the proceeds from a new bond issue to pay off the existing bonds. The administration indicates that paying off the old bond issue would save the state interest costs, because the new bond issue would have a lower interest rate in the current market. It is estimated that the savings from a pure refinancing issue could allow the state to pay off the bonds around three months earlier than under the current issue, which would save an estimated $45 million in either 2017 or 2018.

3. Based on a memorandum to the Secretary of Administration dated May 25, 2007, the proposal would also include a second securitization transaction, which would generate the proposed $50 million of annual revenues for the permanent endowment fund. This additional revenue would be generated by taking longer to repay the new bonds compared to the existing bonds. Extending the repayment schedule would lower the required annual debt service amount needed to retire the bonds, which would allow the state to receive $50 million a year from the tobacco settlement moneys. Effectively, under this transaction, the state would receive $50 million annually through 2024 associated with forgoing its tobacco settlement payments from 2018 though 2024, which are otherwise expected to revert back to the state in 2018 under the existing tobacco securitization transaction.

4. As part of this transaction, the state would receive compensation bonds from BTASC with a face value in a range of $500 million to $700 million. These bonds from BTASC would be deposited in the permanent endowment fund. The interest rate on these bonds would be assigned to be consistent with the proposed receipt of $50 million each year by the state. These bonds held by the permanent endowment fund would be paid off by BTASC using tobacco settlement revenues between 2024 and 2032.

5. The administration indicates that this proposed transaction would accomplish two

major policy goals. First, the new bond issue would refinance the existing bonds and would capture the savings attributable to lower interest rates. Second, by forgoing tobacco settlement payments from 2018 through 2024, the state would receive $50 million annually from 2007-08 through 2023-24.

Alternative Transaction--Receive All Moneys in 2007-08

6. As an alternative to the transaction described in the May 25th memorandum, a new bond issue could pay off the existing tobacco bonds and then deposit the excess bond proceeds into the permanent endowment fund. This approach is similar to the transaction envisioned when the Governor introduced the budget. The excess proceeds would be generated as result of having a longer repayment schedule on the new bonds. Extending the repayment schedule would lower the required annual debt service amount needed to retire the bonds, which would allow the state to borrow additional funds. It is estimated that this transaction could provide $650 million for the permanent endowment fund. Based on discussions with staff at DOA, a transaction that would net $650 million for deposit into the permanent endowment fund would involve issuing $2.3 billion in taxable revenue obligations. Approximately $1.5 billion of these bond proceeds would fund an escrow account that would be used to pay off the current tobacco bonds and $150 million would fund a debt service reserve fund.

7. Similar to the proposal presented in the May 25th memorandum, this alternative transaction would result in some savings of interest costs. However, most of the moneys deposited in the permanent endowment fund would involve using tobacco settlement payments from 2019 through 2029, which would otherwise flow to the state under the 2002 securitization transaction.

8. The Department of Administration has identified three concerns with the approach used under this second alternative. First, there would be uncertainties in the investment return of moneys deposited in the permanent endowment fund. It may be difficult to guarantee $50 million of annual earnings. Second, if the intention is to expend the proceeds from this option immediately, such a large one-time use of tobacco securitization proceeds for operating purposes could cause problems with bond rating agencies. Finally, in a memorandum dated May 30th, the Secretary of Administration indicates that as a matter of policy, the Governor would veto any budget proposal that would use these bond proceeds for one-time purposes.

Transfer of Permanent Endowment Revenues

9. Under SB 40, $50 million from a second securitization transaction would be available for transfer to the health care quality fund annually in the 2007-09 biennium. If this transfer would be deleted, it could reduce the impetus for DOA to carry out the transaction at this time.

10. Also, deleting the transfer provision relating to the permanent endowment fund could provide additional oversight on the final transaction and the use of these proceeds. Under this option, the health care quality fund, which has an estimated balance under SB 40 of $97.3 million at

the end of 2007-08, would have sufficient funds to support budgeted expenditures in 2007-08 even without the transfer, but would need an additional $100 million of revenues to fund its budgeted expenditures in 2008-09. Once DOA determines the final transaction, separate legislation could transfer any available revenues from the transaction from the permanent endowment fund to the health care quality fund. Under this approach, the Legislature could review the outcome of the transaction and the proposed use of any moneys in the permanent endowment fund when it considers this separate bill.

ALTERNATIVES TO BILL

1. Approve the Governor's recommendation to transfer $50,000,000 annually from the permanent endowment fund to the health care quality fund.

2. Delete provision. Under this alternative, if the administration proceeds with a new securitization transaction, subsequent legislation would be needed to authorize the transfer of any moneys in the permanent endowment fund to the proposed health care quality fund.

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