Legislative Fiscal Bureau

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GPR Debt Restructuring (Building Commission)

[LFB 2011-13 Budget Summary: Page 80, #1]

CURRENT LAW

The state issues general obligation debt for various infrastructure and program purposes. Principal and interest payments on general obligation debt are paid from general purpose revenue (GPR), program revenue, and segregated revenue sources. The state of Wisconsin has issued approximately $19 billion in general obligation debt through December, 2010, of which approximately $14.3 billion has been repaid and $6.8 billion remains outstanding. Of this $6.8 billion in outstanding debt, approximately $6.2 billion is in the form of bonds and $600 million in variable rate obligations such as commercial paper. The debt service on approximately $4.7 billion of the $6.8 billion in outstanding general obligation debt is GPR-supported. In 2011-12, the state owes principal and interest of an estimated $646,396,300 GPR, $139,952,300 PR, and $137,308,500 SEG on its outstanding general bonds.

The state is authorized $474,000,000 in refunding bonding authority that can be issued to restructure portions of its outstanding debt. Any bonds issued under this authority must be issued by July 1, 2011. This bonding authorization was increased by $165,000,000 in 2011 Act 12.

GOVERNOR

Provide $364,300,000 of general obligation refunding bonding for the purpose of restructuring outstanding principal on GPR-supported, general obligation bonds. Under the proposed restructuring, the proceeds from the authorized refunding bonds would be used pay $332,637,600 in principal due in 2011-12 on state GPR-supported public debt that would otherwise be retired in that year. Although this bonding could be used to restructure both tax-supported and self-amortizing bonds, the administration indicates that only GPR-supported bonds would be restructured. These bonds could not be issued after June 30, 2013. In addition, GPR debt service amounts under the bill also reflect the administration's plans to restructure

$104,810,800 in GPR commercial paper principal that is otherwise scheduled to be retired in 2011-12.

DISCUSSION POINTS

Background

1. Generally, debt is refinanced through 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. The debt refinancing transaction proposed under the bill is not an economic refunding, but rather would be a structural refunding.

2. Under 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 compared to the existing repayment schedule. A structural refunding extends the average life of previously issued debt. Principal on the bonds is outstanding longer and therefore, the interest costs to the issuer are greater. The proposed restructuring under the bill would involve delaying a principal payment that is currently due. No remaining repayment schedule would exist for that principal amount until it is restructured.

3. Over the past ten years, the state has repeatedly delayed paying portions of its current principal amounts due. These restructuring transactions have involved either the issuance of refunding bonds or the rolling over of outstanding principal on state's variable rate commercial paper borrowings. The following table lists the amount of debt principal that has been restructured to delay paying off the debt since 2001-02.

TABLE 1

Past GPR-Debt Restructurings
(in Millions)

Year	Amount
2001-02	$102.0
2002-03	25.0
2003-04	175.0
2007-08	63.6
2009-10	366.0
2010-11	215.0
2011-12*	437.4

* Proposed

Proposed Transaction

4. Under the bill, the proposed debt restructuring actions would reduce individual agency, GPR debt service appropriations by $437,448,400 in 2011-12. As a result of the proposed debt restructuring transaction, GPR debt service appropriations would be reduced from $646,396,300 to $208,947,900 in 2011-12 and then would increase to $682,769,700 in 2012-13. The reductions to the 2011-12 debt service appropriations would occur because the refunding bond proceeds would be used to make the $332,637,000 in GPR principal payments due in 2011-12 and the Department of Administration would use its administrative authority to defer payment on $104,810,800 in outstanding GPR commercial paper principal in 2011-12. Therefore, if the Committee decided to reduce the amount of GPR principal to be restructured in 2011-12 or delete the proposed restructuring altogether, GPR debt service costs in 2011-12 would increase. However, such actions would also reduce or eliminate the estimated initial interest payments due on the restructured debt ($1 million in 2011-12 and $19.7 million in 2012-13).

5. The proceeds from general obligation bonds or short-term commercial paper issued by the state are used to construct or improve long-term assets such as roads, harbors, railways, or state buildings, to purchase land or other assets under programs like the state's stewardship program, or to protect the state's water or other natural resources under program like the nonpoint source pollution abatement program. Conversely, under a debt restructuring the state would incur an additional long-term debt obligation but would not acquire an offsetting asset associated with that debt. Rather, the state would be issuing additional long-term debt only to make a principal payment on its existing debt.

6. While the final repayment schedule for the restructured principal has not been decided, the administration has indicated that the schedule would likely involve the repayment of the principal over a 5- to 20-year period depending on the bond issue being refinanced. Under the proposed transaction, the state would borrow an additional $437,448,400 in GPR-supported debt to make a GPR principal amount that is due in 2011-12 and repay that amount in installments over the next 20 years. The following table shows a potential principal and interest repayment schedule of

the debt restructuring bonds identified by the administration.

TABLE 2

Potential Repayment Schedule Under Proposed Debt Restructuring

Fiscal Year	Principal	Interest	Total
2011-12	$0	$1,005,770	$1,005,770
2012-13	0	19,666,333	19,666,333
2013-14	57,756,716	17,619,648	75,376,363
2014-15	60,061,225	15,315,138	75,376,363
2015-16	62,461,268	12,915,095	75,376,363
2016-17	64,960,943	10,415,420	75,376,363
2017-18	67,564,529	7,811,834	75,376,363
2018-19	27,758,279	5,099,869	32,858,148
2019-20	17,451,859	3,978,664	21,430,524
2020-21	16,279,646	3,269,173	19,548,819
2021-22	15,178,877	2,605,999	17,784,876
2022-23	10,812,467	1,986,257	12,798,724
2023-24	9,664,591	1,540,541	11,205,133
2024-25	6,171,042	1,140,080	7,311,122
2025-26	4,368,394	893,239	5,261,633
2026-27	4,543,130	718,503	5,261,633
2027-28	4,495,786	536,778	5,032,563
2028-29	3,848,084	356,946	4,205,030
2029-30	1,415,234	203,023	1,618,257
2030-31	1,252,042	146,413	1,398,455
2031-32	771,494	96,332	867,826
2032-33	802,353	65,472	867,826
2033-34	834,448	33,378	867,826
Total	$438,452,409*	$107,419,906	$545,872,315

* Principal repayment amount is higher than the restructured principal amount ($437,448,400) due to one-half year of capitalized interest on a bond issue series with annual principal due in November rather than May, as is typically required.

7. As indicated in Table 2, under the proposed debt restructuring, portions of the principal that would have otherwise been repaid in 2011-12 would remain outstanding until 2033-34. Because portions of the 2011-12 GPR principal due would remain outstanding beyond 2012 (for up to 20 years), the state would incur $107.4 million in additional interest on that principal under the proposed restructuring transaction. If the average repayment period on the restructured bonds is shortened, the interest costs to the state would be reduced. Conversely, if the average repayment period is lengthened, the interest costs to the state would increase.

8. Restructuring $437.4 million of principal currently due on the state's debt would add the annual principal and interest costs shown in Table 2 to the principal and interest costs the state is also scheduled to repay in those years on its over $4.0 billion in remaining outstanding GPR debt and on any new debt that will be issued during the 20-year repayment period of the restructured debt. For example, under the proposed debt restructuring, future GPR principal and interest costs would increase by $75.4 million from 2013-14 through 2017-18. This large annual increase in GPR debt service along with debt service increases associated with the state's previous debt restructuring actions, would place demands on future GPR budgets. Therefore, having to continually repay principal that would have otherwise been retired could begin to reduce the state's ability to fund the issuance of new GPR-supported bonds in the future. As a result, the additional GPR debt service costs associated with restructuring large amounts of GPR principal could begin to "crowd out" the state's ability to issue GPR-supported debt necessary to meet its building and infrastructure needs in the future.

9. Debt restructuring also adds to future budgetary concerns in that it commits the state to higher debt service costs in the future, which adds to the state's structural deficit. As shown in Table 2, the proposed restructuring will add $75.4 million to the state's required GPR debt service payments in 2013-14. However, because the proposed restructuring would be carried out in the first year of the 2011-13 biennium, the impact on the 2011-13 biennium is more limited. In contrast, any restructuring that occurs in the second year of a biennium would not only increase out-year costs, but it would lead to a one-time reduction in debt service appropriations in the base year for the next biennium. As a result, a larger increase over base level debt service funding levels would be required in the first year of the subsequent biennium in order to reestablish the actual debt service base, as well as repay portions of the principal that was restructured in the prior year.

10. Restructuring debt is a common financial tool used by institutions when their budgets are stressed due to stagnating or declining revenues or increasing costs. Private sector corporations and households often use debt restructuring as a means to reduce current costs when facing financial stress. For example, a household with eight years remaining on an existing 15-year home mortgage, that is facing a financial hardship due to a reduction in income or an increase in personal costs, may choose to restructure the remaining seven years on its existing mortgage debt. In restructuring its mortgage debt, the household could refinance the remaining eight years of principal associated with its current mortgage by replacing it with another 15-year mortgage. In doing so, the household would spread out its remaining principal over 15 years, which would lower the household's monthly mortgage payment and allow it to more easily make current ends meet. However, similar to the proposed debt restructuring by the state, this action would also extend the household's final maturity date on its mortgage by seven years and increase the overall interest costs paid in financing the home.

11. Governments can experience budget stress when the growth in existing revenues declines due an economic downturn or as a result of legislation that reduces the amount of annual revenue generated from its revenue sources. Also, the over-commitment of existing revenues for spending programs can lead to budget stress. Given the current difficulties facing the state's general fund budget, the Governor recommends restructuring a significant amount of GPR principal in 2011-12 in order to alleviate a portion of the budget shortfall. The Governor's budget also proposes significant reductions in general fund support to local governments and school districts in order to

reduce demands on the state's general fund budget. Absent legislative action that would increase state general fund revenues or further reduce general fund expenditures, any reduction in the amount of debt restructuring recommended by the Governor would require further reductions in state aid to local governments and school districts or other state programs.

12. Local governments and school districts are also experiencing budget problems related to the recent downturn in the state's economy, and in particular the state's housing market, from which local property tax revenues are generated. The proposed reductions in state general fund support to local governments would likely add stress to already tight local budgets. Also, under the bill, local governments would have limited ability to levy additional property taxes to make up for any budget shortfalls. Given the difficult budget at both the state and local levels, some may consider more debt restructuring warranted. The Committee could reduce GPR debt service expenditures by restructuring additional GPR-supported principal that is due in 2012-13, which could make up to $423,500,000 in GPR available for expenditure for local aid programs or to fund other priorities. Although restructuring has occurred over the past decade, capital finance staff indicate that additional restructuring could be a negative factor for bond rating agencies. In addition, if one-time savings from debt restructuring are used to increase ongoing expenditures, the state's out-year commitments will increase.

13. While debt restructuring is often used as a means to ease budget stress, it is generally considered a less desirable approach to debt management that should only be used to get through a specific difficult time. However, due both to revenue reductions enacted in the past and increased, ongoing, expenditure commitments, the state has experienced repeated general fund budget problems over the past decade. Instead of being used sparingly as a financial tool needed to alleviate one-time budget issues, if the proposed debt service restructuring is carried out, the state will have used debt restructuring seven times since 2001-02 to alleviate annual budget concerns.

Restructuring Commercial Paper versus General Obligation Bonding

14. The state incurs a general debt obligation by two means: through the issuance of general obligation bonds and through commercial paper programs. The Building Commission has authorized the Department of Administration (DOA) to use commercial paper and extendible commercial paper financing programs in lieu of issuing long-term bonds. The program involves the state issuing short-term commercial paper notes with maturities of 270 days or less in order to delay the issuance of long-term bonds for a period of time. The program tries to take advantage of short-term borrowing rates, when those rates are substantially lower than long-term rates. Commercial paper can be continually rolled over, to avoid making principal payments. In this case, the state would pay only interest on that constant outstanding principal amount. However, DOA Capital finance establishes a "notional" principal repayment schedule for the commercial paper as if the state had issued long-term bonds for those amounts and informs the holder of the paper each year that the state is choosing to retire a certain amount of principal in that year.

15. The commercial paper obligations issued by the state are counted toward the individual bonding authorizations established for each purpose for which the state issues bonds. For example, if the state issues $50 million in GPR supported commercial paper for a Department of Corrections facility, that amount of that obligation is subtracted from the remaining available bonding authority the Department would have under its correctional facilities bonding authorization.

Unlike general obligation bonds, the Building Commission does not need the Legislature to approve statutory refunding authority to refinance the state's outstanding commercial paper. Rather, the Commission can choose to refinance the principal due on the state's commercial paper by issuing long-term bonds to replace that principal amount. However, under the proposed restructuring, in lieu of issuing long-term bonds to replace the commercial paper, DOA would simply rollover $104,810,800 in GPR commercial paper principal that is scheduled to be paid off in 2011-12 under the "notional" repayment schedule established when the commercial paper obligation was originated. Again, no refunding authority would be needed.

16. When the state carries out a debt restructuring that involves issuing general obligation refunding bonds, the state typically incurs transaction costs associated with carrying out that bond issue. These costs are generally less than 1% of a total bond issue and could equal $2.0 to $2.5 million under the proposed restructuring bond issue. However, when the state restructures its commercial paper payments, DOA simply chooses not to retire the commercial paper principal amount included in its "notional" principal repayment schedule for that year. While the state incurs additional interest costs on the deferred commercial paper principal, no transaction costs are incurred by this decision. Further, because the commercial paper principal is borrowed at a short-term rate, the interest costs to the state associated with deferring this principal would be less.

17. If the Committee makes a reduction to the amount of debt restructuring included in the bill, reducing the amount of bond principal to be restructured would be better financially for the state compared to a similar reduction in the amount of commercial paper principal to be rolled over. For example, the Committee could delete the proposed restructuring of outstanding GPR-supported bond principal and defer just the $104,810,800 in GPR commercial paper principal that is due in 2011-12, which carries a lower interest rate and would also save the state on transaction costs. However, this action would increase GPR debt service costs in 2011-12 by $332,637,600 compared to the bill, and the Committee would have to reduce other GPR spending or increase GPR revenues to offset this cost.

18. Another approach to reducing the amount of debt restructuring and the associated transaction and interest costs would be to limit the GPR debt restructuring to just the commercial paper principal owed in the biennium ($104,810,800 in 2011-12 and $105,500,000 in 2012-13). This would increase GPR debt service costs by in 2011-12 by $332,637,600 GPR compared to the bill, but would reduce GPR debt service appropriations by $105,500,000 in commercial paper principal that is otherwise scheduled to be retired in 2012-13. As a result, the net increase in GPR funding for debt service would be $227,137,600 compared to the bill. Again, the Committee would have to reduce GPR spending or increase GPR revenues elsewhere in the state budget by a similar amount. Or, if additional restructuring is proposed, the Committee could delay paying off the $105,500,000 of commercial paper principal in 2012-13, which would reduce GPR debt service by a corresponding amount.

19. As mentioned earlier, debt restructuring is a financial tool that is used during times of financial stress. However, unlike general obligation bonds, under the state's commercial program, the Governor can restructure any amount of state's commercial paper principal that is due in a year without legislative approval. This flexibility can be useful by allowing a Governor to meet fiscal emergencies that arise during the course of a biennium. However, an administration could

use this authority regardless of whether a fiscal emergency arises. If additional oversight is sought, the Committee could place statutory limitations on DOA and the Building Commission's ability to restructure commercial paper debt obligations.

ALTERNATIVES

1. Approve the Governor's recommendation to provide $364,300,000 of general obligation refunding bonding for the purpose of restructuring $332,637,600 in outstanding principal due in 2011-12 on state GPR-supported public debt and to restructure $104,810,800 in GPR commercial paper principal that is otherwise scheduled to be retired in 2011-12.

2. Modify the Governor's recommendation, by doing one or more of the following:

a. Provide an additional $348,300,000 in general fund supported borrowing to restructure an additional $318,000,000 in outstanding GPR principal in 2012-13. Reduce GPR debt service appropriations by $318,000,000 GPR in 2012-13.

ALT 2a	**Change to Bill** Funding
GPR	- $318,000,000
BR	$348,300,000

b. Direct the administration to roll over $105,500,000 in commercial paper principal that otherwise would be paid off in 2012-13. Provide an additional $348,300,000 in general fund supported borrowing to restructure an additional $318,000,000 in outstanding GPR principal in 2012-13. Reduce GPR debt service appropriations by $423,500,000 GPR in 2012-13.

ALT 2b	**Change to Bill** Funding
GPR	- $423,500,000
BR	$348,300,000

c. Direct the administration to roll over $105,500,000 in commercial paper principal that otherwise would be paid off in 2012-13. Reduce debt service appropriations by $105,500,000 GPR in 2012-13.

ALT 2c	**Change to Bill** Funding
GPR	- $105,500,000

d. Delete the $364,300,000 in refunding bonding authorized under the bill and specify that the Building Commission would only restructure the GPR principal due on its commercial paper programs in 2011-12. Increase GPR debt service costs in 2011-12 by $332,637,600 GPR.

ALT 2d	**Change to Bill** Funding
GPR	$332,637,600
BR	- $364,300,000

e. Delete $364,300,000 in refunding bonding authorized under the bill and specify that the Building Commission restructure $104,810,800 in 2011-12 and $105,500,000 in 2012-13 in GPR principal due under the state's commercial paper programs in the biennium. Increase GPR debt service appropriations by $332,637,600 in 2011-12 and decrease debt service appropriations by $105,500,000 in 2012-13 associated with the restructuring of commercial paper principal that is otherwise scheduled to be retired each year. The net increase in GPR debt service appropriations compared to the bill would be $227,137,600.

ALT 2e	**Change to Bill** Funding
GPR	$227,137,600
BR	-$364,300,000

3. Specify that the Building Commission would be required to establish an amortization schedule associated with the short term commercial paper borrowing program and report that schedule to the Joint Committee on Finance. In addition, specify that the Commission not defer any scheduled repayment of principal on state commercial paper obligations unless authorized by the Legislature. These changes would first apply to the fiscal year following whatever commercial paper restructuring is included in the bill.

4. Delete the Governor's recommendation. Increase GPR debt service appropriations by $437,448,400 in 2011-12 to reflect the payment of GPR principal in that year.

ALT 4	**Change to Bill** Funding
GPR	$437,448,400
BR	- $364,300,000

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