



Legislative Fiscal Bureau

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May 27, 2015

Joint Committee on Finance

Paper #684

Investment of Certain PR Balances (UW System)

CURRENT LAW

With the exception of the UW's trust funds, all of the UW System's cash is held in the state investment fund (SIF) which is invested by the State of Wisconsin Investment Board (SWIB). Under 2011 Act 32, the UW System retains the interest earned related to its program revenue balances.

GOVERNOR

No provision.

DISCUSSION POINTS

1. Under the Governor's proposal to convert the UW System to a public authority, the UW System Authority would have been required to deposit all of its revenues in the local government pooled-investment fund except for auxiliary enterprises revenues, segregated fees accumulated for building projects, and gifts, grants, and donations. This exception would have permitted the Board of Regents to invest those funds. As of June 30, 2014, the auxiliary operations, gifts, and grants and contracts account balances held by UW institutions totaled of \$429.6 million.

2. Based on recent earnings reports, the SIF generates an annualized rate of return of 0.13%. One reason why the SIF has such a low rate of return on its investments is that SWIB needs to maintain a high level of liquidity to meet the state's and other depositors' cash flow needs and therefore is unable to make longer-term investments. By contrast, the UW System accumulates auxiliary enterprises balances and gifts over time to support its capital projects and other activities. This may allow the UW System to invest a certain portion of its auxiliary enterprises, segregated fees accumulated for building projects, and gifts, grants, and donations balances in longer-term

investments than those in which the SIF is currently invested.

3. To estimate the potential increase in revenue under this provision of the Governor's budget, the UW System did an analysis of its auxiliary operations, gifts, grants and contracts, and federal indirect cost reimbursement balances over the most recent 15 years and determined that the average balance for those accounts has been \$258 million. (It should be noted that the UW System assumed that the Board would have the ability to invest federal indirect cost reimbursement balances although the Governor's budget would not have specifically excluded these funds from deposit in the local government pooled-investment fund.) The UW System estimated that it could invest 45% of this amount in an intermediate fund and 30% in a long-term fund with the remaining 25% being held as cash or in cash equivalents. Using this data, the UW System estimated that it could increase its PR revenues by \$6.3 million annually if the Board of Regents were granted the authority to invest its auxiliary operations, gifts, grants and contracts, and federal indirect cost reimbursement balances. This estimate assumes that the UW System would be able to earn 3.25% annually on the 75% of its auxiliary operations, gifts, grants and contracts, and federal indirect cost reimbursement balances that would be invested in intermediate and long term funds. A portion of this increase in revenue would be offset by an increase in staff costs and one-time costs related to adding additional capabilities to the UW System's financial management system.

4. Under current practice, investment income accrues to the account that generated it. The UW System's current appropriation for general fund interest specifies that interest earned should be used for the purpose to which it is attributable. This means that, for example, investment income generated by the balance held in an institution's housing account should only be used to support housing activities at that institution. As a result, those earnings could not be used to offset the proposed \$150 million reduction in the UW System's GPR base budget. As an alternative, the Committee could direct the UW System to use the additional income generated if it is permitted to invest its auxiliary operations, gifts, grants and contracts, and federal indirect cost reimbursement balances to support its missions of instruction, research, and public service to the extent possible. Even with this direction, the UW System may not be able to use the additional income generated by certain gifts and grants if those gifts and grants have been restricted either by the donor or a grant agreement. Based on PR balance data from June 30, 2014, gifts and grants and contracts balances were 47% of total auxiliary operations, gifts, and grants and contracts balances and 34% of total auxiliary operations, gifts, grants and contracts, and federal indirect cost reimbursement balances.

5. It could be argued that granting the UW System the authority to invest balances held in its auxiliary enterprises accounts, segregated fees accumulated for building programs, and gifts, grants, and donations may create an incentive for the UW institutions to accumulate those funds instead of spending them. The level of the UW System's program revenues balances has been a cause of concern for legislators since it was shown that these balances had increased to \$1,045.2 million as of June 30, 2012. In addition, because these funds would no longer be held in the SIF, the state would not be able to temporarily borrow from these accounts to meet its cash flow needs. However, as the UW System's tuition revenues would continue to be held in the SIF and the state would continue to be able to borrow those funds, permitting the Board of Regents to invest balances held in its auxiliary enterprises accounts, segregated fees accumulated for building programs, and gifts, grants, and donations should not create cash flow issues for the state.

ALTERNATIVES

1. Modify current law to permit the Board of Regents to invest the balances held in its auxiliary enterprises accounts, segregated fees accumulated for building programs, and gifts, grants, and donations instead of depositing those funds in the state investment fund. (This language would be consistent with the Governor's bill provision.) Specify that the Board would use the income generated under this provision to fund its mission of instruction, research, and public service, subject to any legal restrictions governing gifts, grants, and contracts.

2. Modify current law to permit the Board of Regents to invest the balances held in its auxiliary operations, gifts, grants and contracts, and federal indirect cost reimbursement balances instead of depositing those funds in the state investment fund. (This language would be consistent with the analysis performed by the UW System.) Specify that the Board would use the income generated under this provision to fund its mission of instruction, research, and public service, subject to any legal restrictions governing gift, grants, and contracts.

3. Take no action.

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