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Use of One-Time Cash for Building Program or Debt Reduction Purposes (Building Commission/Building Program)

[LFB 2023-25 Budget Summary: Page 88, #2]
[LFB Building Program Summary Memorandum (April 17, 2023): Page 9, #5]

BACKGROUND

The state issues three types of debt obligations: general obligation debt and commercial paper, revenue obligation debt and commercial paper, and appropriation obligation debt. The table below summarized the level of outstanding principal as of December, 2022, for each type of debt issued by the state.

Outstanding Principal on State Bonding Programs

Type of Bonds	Outstanding Debt December, 2022
General Obligation Bonds	
General Purpose Revenue Supported	$3,512,680,364
Program Revenue Supported	1,857,753,186
Segregated Revenue Supported	1,449,682,450
Transportation Revenue Obligations	1,565,305,000
Clean Water Revenue Obligations*	394,970,000
Appropriation Obligations (GPR Supported)	
Pension	1,244,110,000
Tobacco Settlement	1,416,725,000
Total	$11,441,226,000

*Includes Environmental Improvement Fund bonds.

Under 2007 Act 226, DOA was authorized to issue appropriation obligation bonds to refund the outstanding tobacco securitization bonds issued by the Badger Tobacco Asset Securitization

Corporation in 2002, and repurchase the rights to the state's tobacco settlement revenues. Under the corresponding bond issuance, 2009 Series A, $1.53 billion of principal was issued for this purpose, and the debt service on the appropriation obligation bonds would be repaid from a GPR appropriation through 2036-37.

DISCUSSION POINTS

1. After the May revision to revenue estimates, there is an estimated $10.8 billion of general fund moneys available based on Committee actions to date, of which $2.2 billion is ongoing. Although there are many competing uses for GPR funding, there may be sufficient one-time GPR resources available to substitute cash for the GPR-supported borrowing typically used in funding projects included in the state's building program or to use cash to pay off existing debt.

2. This paper discusses three options for one-time uses of cash as it relates to the state's debt and building program. These options include: (a) using cash to fund projects enumerated in the 2023-25 building program; (b) using cash to pay off outstanding general fund supported general obligation debt; and (c) using cash to pay off outstanding tobacco settlement appropriation obligation bonds. Each option discussed below would avoid creating an ongoing expenditure obligation. Further, the Committee could choose any combination of the alternatives and in any amounts.

A. Cash Funding the 2023-25 Building Program

3. Under AB 43/SB 70, $1,955,000,000 would be transferred from the general fund to the state capital improvement fund in the 2023-25 biennium. The moneys transferred would be kept separate from other moneys in the capital improvement fund and would have to be used, in lieu of bonding, to fund building projects authorized in the 2023-25 state building program. All earnings on or income from the investment of the transferred moneys would be deposited in the general fund. Additionally, any excess moneys that are not used to fund building projects would be transferred to the general fund.

4. Similar to the recommendation under AB 43/SB 70, the Committee could choose to transfer moneys from the general fund to the capital improvement fund to fund 2023-25 building program projects [Alternatives A1 through A4]. Funding the 2023-25 building program with one-time cash from the general fund would result in debt service savings compared to funding those projects with general obligation bonds. The table below shows estimated total interest savings that would be realized at various funding levels, if all or a portion of the 2023-25 building program were funded with cash rather than general obligation bonding. The table assumes that bonds would have a 20-year life and would have an interest rate 3.5%. At a 3.5% interest rate, every $100 million of bonds issued would accrue an estimated $40.7 million of interest over their 20-year life. The most recent new money general obligation bond issuance, in January of 2023, had a true interest cost of 3.58%.

Interest Over the Life of the Bonds at Various Bonding Levels
(Millions)

Bonding Amount	Interest Rate 3.5%
$500	$204
1,000	408
1,500	612
2,000	816

5. Utilizing surplus moneys rather than bonding to fund 2023-25 building program projects allows the state to avoid creating ongoing expenditure obligations. The state could free up funds that would otherwise be used to make annual debt service (principal and interest) payments. For example, if the state were to issue $1.0 billion of general fund supported general obligation bonds at a 3.5% interest rate with a level payment structure, it would have to budget $70 million annually for GPR debt service payments (principal and interest) over the 20-year life of the bonds.

6. However, given the timing needed to plan, bid, and construct projects that would be included in the 2023-25 building program, any bonds authorized would likely not be issued until later in the 2023-25 biennium or in the 2025-27 biennium. As such, debt service savings from funding projects with cash would be realized in future biennia.

B. Pay Off Outstanding General Obligation Bonds

7. As of December, 2022, the state had $6.8 billion of outstanding debt on general obligation bond issues. Of the amount outstanding, $3.5 billion is supported by debt service payments from the general fund and $1.4 billion is supported by payments from other tax-supported funds, primarily the transportation fund and the conservation fund. The remaining $1.9 billion of outstanding obligations are self-amortizing, which means that they have revenue streams resulting from the programs for which they were issued and from which debt service payments are made.

8. Capital Finance has indicated that it has two options when it comes to paying off existing debt: defeasing debt and making a debt tender offer. Defeasing debt is a process in which Capital Finance would set aside funds by purchasing a portfolio of securities (held in escrow) that would be sufficient to meet all payments of principal and interest on an outstanding bond as they become due. A debt tender offer is a process used to retire debt, in which the state has the ability to make an offer to its existing bondholders to repurchase a specified number of bonds at a particular price and a specified time.

9. According to Capital Finance, the decision of whether to make a debt tender offer or to defease debt is best made at the time such actions would be taken. If the Committee were to decide to use cash on a one-time basis to retire general fund supported general obligation debt, it could specify the amount of funds to be used for this purpose, which would be transferred to the bond security and redemption fund [Alternatives B1 through B3]. Capital Finance would then assess current market

conditions to determine the most cost-effective approach for using those funds. Capital Finance could target debt in various ways, including based on an issue's coupon rate, or based on timing of debt service payments.

C. Pay Off Outstanding Tobacco Settlement Appropriation Obligation Bonds

10. Alternatively, the Committee could consider using cash to pay off all or a portion of outstanding debt on tobacco settlement appropriation obligation bonds [Alternatives C1 through C3]. As of December, 2022, the state had $1.4 billion of outstanding principal on tobacco settlement appropriation obligation bonds. In the 2023-25 biennium, debt service (principal and interest) is budgeted at $111.2 million GPR in 2023-24 and $119.7 million GPR in 2024-25. After consideration of the principal payments to be made in 2022-23 and in the 2023-25 biennium under debt service payments approved by the Committee ($136.5 million), there would be $1,282.2 million of these bonds still outstanding. The following table shows the current schedule for principal and interest payments on this debt from 2025-26 through final maturity in 2036-37.

Tobacco Settlement Appropriation Bonds Debt Service
from 2025-26 to Final Maturity

	Principal	Interest	Total
2025-26	$58.1	$62.1	$120.2
2026-27	436.3	52.9	489.2
2027-28	70.4	30.9	101.3
2028-29	76.0	28.0	104.0
2029-30	17.4	24.8	42.2
2030-31	18.4	24.1	42.4
2021-32	19.4	23.3	42.7
2032-33	20.4	22.5	43.0
2033-34	132.8	21.7	154.4
2034-35	139.3	16.3	155.7
2035-36	147.2	10.8	158.0
2036-37	146.7	4.8	151.5
Totals	$1,282.2	$322.2	$1,604.4

11. If the Committee wishes to pay off all or a portion of these tobacco settlement bonds, it could increase the current appropriation used to pay debt service on these bonds in 2023-24. Capital Finance could use these moneys to defease or use a tender offer to pay off this debt. If for whatever reason these moneys would remain unused at the end of 2023-24, they would lapse to the general fund.

ALTERNATIVES

A. Cash Finance 2023-25 Building Program

1. Transfer $500,000,000 from the general fund to the capital improvement fund to fund building projects authorized in the 2023-25 state building program. Specify that the moneys transferred would be kept separate from other moneys in the capital improvement fund and that all earnings on or income from the investment of the transferred moneys would be deposited in the general fund. Specify that any excess moneys that are not used to fund building projects would be transferred to the general fund. Create an appropriation under the Building Commission for the expenditure of these moneys. [Compared to 20-year bonds with a 3.5% interest rate, debt service (principal and interest) would be reduced by $35.2 million annually and interest costs over the life of the bonds would be reduced by $204 million.]

ALT A1	**Change to Base**
GPR-Transfer	$500,000,000

2. Transfer $1,000,000,000 from the general fund to the capital improvement fund to fund building projects authorized in the 2023-25 state building program. Specify that the moneys transferred would be kept separate from other moneys in the capital improvement fund and that all earnings on or income from the investment of the transferred moneys would be deposited in the general fund. Specify that any excess moneys that are not used to fund building projects would be transferred to the general fund. Create an appropriation under the Building Commission for the expenditure of these moneys. [Compared to 20-year bonds with a 3.5% interest rate, debt service (principal and interest) would be reduced by $70.4 million annually and interest costs over the life of the bonds would be reduced by $408 million.]

ALT A2	**Change to Base**
GPR-Transfer	$1,000,000,000

3. Transfer $1,500,000,000 from the general fund to the capital improvement fund to fund building projects authorized in the 2023-25 state building program. Specify that the moneys transferred would be kept separate from other moneys in the capital improvement fund and that all earnings on or income from the investment of the transferred moneys would be deposited in the general fund. Specify that any excess moneys that are not used to fund building projects would be transferred to the general fund. Create an appropriation under the Building Commission for the expenditure of these moneys. [Compared to 20-year bonds with a 3.5% interest rate, debt service (principal and interest) would be reduced by $105.6 million annually and interest costs over the life of the bonds would be reduced by $612 million.]

ALT A3	**Change to Base**
GPR-Transfer	$1,500,000,000

4. Transfer $2,000,000,000 from the general fund to the capital improvement fund to fund building projects authorized in the 2023-25 state building program. Specify that the moneys transferred would be kept separate from other moneys in the capital improvement fund and that all earnings on or income from the investment of the transferred moneys would be deposited in the general fund. Specify that any excess moneys that are not used to fund building projects would be transferred to the general fund. Create an appropriation under the Building Commission for the expenditure of these moneys. [Compared to 20-year bonds with a 3.5% interest rate, debt service (principal and interest) would be reduced by $140.8 million annually and interest costs over the life of the bonds would be reduced by $816 million.]

ALT A4	**Change to Base**
GPR-Transfer	$2,000,000,000

5. Take no action.

B. Pay off General Obligation Debt

1. Transfer $400,000,000 from the general fund to the bond security and redemption fund to defease or use a tender offer to pay off outstanding principal and interest on general fund supported general obligation debt.

ALT B1	**Change to Base**
GPR-Transfer	$400,000,000

2. Transfer $800,000,000 from the general fund to the bond security and redemption fund to defease or use a tender offer to pay off outstanding principal and interest on general fund supported general obligation debt.

ALT B2	**Change to Base**
GPR-Transfer	$800,000,000

3. Transfer $1,200,000,000 from the general fund to the bond security and redemption fund to defease or use a tender offer to pay off outstanding principal and interest on general fund supported general obligation debt.

ALT B3	**Change to Base**
GPR-Transfer	$1,200,000,000

4. Take no action.

C. Pay Off Tobacco Settlement Appropriation Obligation Debt

1. Provide $400,000,000 GPR in 2023-24 in the existing appropriation used to pay debt service on the appropriation obligation bonds issued to repurchase the rights to the state's tobacco settlement revenues for the purpose of defeasing or using a tender offer to pay off outstanding bonds.

ALT C1	Change to Base
GPR	$400,000,000

2. Provide $800,000,000 GPR in 2023-24 in the existing appropriation used to pay debt service on the appropriation obligation bonds issued to repurchase the rights to the state's tobacco settlement revenues for the purpose of defeasing or using a tender offer to pay off outstanding bonds.

ALT C2	Change to Base
GPR	$800,000,000

3. Provide $1,282,200,000 GPR in 2023-24 in the existing appropriation used to pay debt service on the appropriation obligation bonds issued to repurchase the rights to the state's tobacco settlement revenues for the purpose of defeasing or using a tender offer to pay off outstanding bonds. [This would reduce out-year principal and interest costs by $1,604.4 million over the life of the bonds.]

ALT C3	Change to Base
GPR	$1,282,200,000

4. Take no action.

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