Legislative Fiscal Bureau
One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

June 3, 2011

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Administration -- Operating Notes Issuance Request under Section 16.405(3)

The Department of Administration (DOA) requests Joint Committee on Finance approval to issue up to $800 million in operating notes for the 2011-12 fiscal year. The request was received May 23, 2011, under the 14-day passive review provision in s. 16.405(3) of the statutes. As an objection was made, the request has been scheduled for consideration by the Committee under s. 13.10 of the statutes.

BACKGROUND

The general fund receives revenue and makes expenditures for programs funded with general purpose revenue, federal revenue, and program revenue. The general fund experiences repeated cashflow problems, which result from a continuing imbalance of general fund revenues and expenditures. This imbalance is due to the timing of general fund collections and payments of large aid amounts in the first half of each fiscal year.

DOA may request the issuance of operating notes if a cashflow deficiency in the general fund is anticipated. The Governor and the Secretary of DOA must sign such requests. In addition, the Secretary of DOA must notify the Committee in writing if DOA proposes to submit an operating note request to the Building Commission. If the Co-chairs of the Committee notify the Secretary within 14 working days that the Committee has scheduled a meeting for the purpose of reviewing the operating note, DOA is only able to submit the request to the Commission upon approval of the Committee. If the Co-chairs of the Committee do not notify the Secretary that a meeting to review the request has been scheduled, DOA may submit the request to the Commission as proposed.

The following table shows the amount of annual operating notes issuances since the first issue in 1983-84. As shown on the table, the state has issued operating notes in most of these years.

Operating Notes Issuance History
($ in Millions)

Fiscal Year	Amounts	Fiscal Year	Amounts
1983-84	$700	1997-98	$450*
1984-85	350	1998-99	350
1985-86	350	1999-00	0
1986-87	350	2000-01	0
1987-88	350	2001-02	800
1988-89	350	2002-03	0
1989-90	300	2003-04	400
1990-91	200	2004-05	0
1991-92	450	2005-06	0
1992-93	450	2006-07	0
1993-94	350	2007-08	600
1994-95	350	2008-09	800
1995-96	250	2009-10	800
1996-97	150	2010-11	800

* Two notes were issued in 1997-98, one dated July 1 for $300 million and a second dated November 12 for $150 million.

The Department of Administration has determined that the cash balances expected in the general fund in 2011-12 may not be sufficient for the state to meet its operating obligations in a timely manner and is, therefore, requesting approval to issue operating notes.

ANALYSIS

As noted, DOA is requesting authority for the issuance of up to $800 million in operating notes in 2011-12. It is intended that the proceeds from the issuance of the notes be deposited to the general fund. The state would make a number of sinking fund deposits to a trustee from February through May, 2012, and the notes would mature in June, 2012.

Three factors influence the decision by the administration on the amount of operating notes to issue. First, the maximum size of the notes issue is constrained by federal arbitrage regulations that require that the actual cash deficit equal at least 90% of the issuance amount, or the state must rebate interest earnings above the rate paid on the note. DOA estimates that the worst day cash balance will be approximately -$1,170 million in mid-August, 2011, if certain interest earning program revenue accounts are deducted, and -$678.9 million including those PR accounts.

The second consideration, relating to the minimum size of the notes issue, is that the operating notes should provide sufficient cash to avoid any payment delays. In this case, the estimated worst-day cash balance is compared to the maximum amount of monies that statutorily may be temporarily reallocated within available balances of the state investment fund to support the general fund's cashflow ($1.68 billion under the Joint Finance Committee's version of the budget).

At present, it appears that the worst-day balance, when PR accounts are excluded, is less than the statutory maximum on interfund borrowing.

The third factor involves a comparison of the interest cost of the notes and the investment earnings the state would accrue on the note proceeds. As a tax-exempt borrower, the state can often borrow at a rate lower than it would pay using interfund borrowing. In the absence of interest rates favoring operating notes over interfund borrowing, the state may choose not to issue a note or may issue a lesser amount. If interest rates favor operating notes over interfund borrowing, then a higher amount of notes would be issued, subject to the arbitrage regulations.

At current interest rates, there does not appear to be a savings associated with borrowing externally through the issuance of operating notes. Instead, the primary advantage to issuing operating notes is to provide a significant reserve of cash to support the general fund's cashflow, so that the operating note proceeds together with interfund borrowing will allow the state to avoid any payment delays. Based on current cashflow projections, it appears that the proposed operating notes could help avoid the possibility of payment delays in August and December, 2011, and is consistent with projections made during legislative deliberations on the 2011-13 budget bill.

If the Committee approves the request, the Building Commission would consider the operating notes request on June 15, 2011.

ALTERNATIVES

1. Approve the request.

2. Deny the request.

Prepared by: Layla Merrifield