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Kurt Schuller, *State Treasurer*
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Managing Wisconsin's trust assets for public education.

AGENDA
May 17, 2011
2:00 P.M.

Board of Commissioners of Public Lands
125 S. Webster Street, Room 200
Madison, Wisconsin

1. Call to Order
2. Approve Minutes – May 3, 2011
3. Approve Loans
4. Request for Municipal Bond Purchase Authority
5. Proposed Legislation for Revenue Obligation Trust Fund Loans
6. Request for Normal School Fund Legislation Changes
7. Executive Secretary's Report
8. Adjourn

**BOARD MEETING
MAY 17, 2011**

**AGENDA ITEM 2
APPROVE MINUTES**

Attached for approval are the minutes from the May 3, 2011, board meeting.

Board Meeting Minutes
May 3, 2011

ITEM 1. CALL TO ORDER

Board Chair La Follette called the meeting of the Board of Commissioners of Public Lands to order at 2:10 p.m. Commissioner Van Hollen was not available for the meeting.

Present were:

Doug La Follette, Board Chair

Kurt Schuller, Commissioner

Tia Nelson, Executive Secretary

Tom German, Deputy Secretary

Richard Sneider, Loan Analyst

Secretary of State

State Treasurer

Board of Commissioners of Public Lands

Board of Commissioners of Public Lands

Board of Commissioners of Public Lands

ITEM 2. APPROVE MINUTES – April 19, 2011

MOTION: Commissioner Schuller moved to approve the minutes; Board Chair La Follette seconded the motion. The motion passed, 2-0.

ITEM 3. APPROVE LOANS

Executive Secretary Nelson said the loans had received legal review.

Municipality	Municipal Type	Loan Amount
1. Beloit County of Rock Application #: 02011145 Purpose: Finance capital improvements and equipment purchases	City Rate: 3.75% Term: 10 years	\$1,500,000.00
2. Galesville-Ettrick-Trempealeau County of Jackson And Trempealeau Application #: 02011142 Purpose: Refinance prior service pension liability	School Rate: 5.50% Term: 20 years	\$1,715,000.00
3. Plover County of Portage Application #: 02011144 Purpose: Finance road improvements	Village Rate: 3.75% Term: 10 years	\$1,000,000.00
4. Plum Lake County of Vilas Application #: 02011143 Purpose: Finance fire department pick-up truck and equipment	Town Rate: 3.25% Term: 4 years	\$50,000.00
TOTAL		\$4,265,000.00

MOTION: Commissioner Schuller moved to approve the loans; Board Chair La Follette seconded the motion. The motion passed, 2-0.

ITEM 4. EXECUTIVE SECRETARY'S REPORT

Executive Secretary Nelson reported that the agency's budget was approved by the Joint Finance Committee.

ITEM 5. ADJOURN

MOTION: Commissioner Schuller moved to adjourn the meeting; Board Chair La Follette seconded the motion. The motion passed, 2-0.



Tia Nelson, Executive Secretary

These minutes have been prepared from a tape recording of the meeting. The summaries have not been transcribed verbatim. Anyone wishing to listen to the tape may do so at the Board of Commissioners of Public Lands, 125 S. Webster Street, Suite 200, Madison, Wisconsin.

**BOARD MEETING
MAY 17, 2011**

**AGENDA ITEM 3
APPROVE LOANS**

Municipality	Municipal Type	Loan Amount
1. Calumet County of Fond du Lac Application #: 02011149 Purpose: Finance road resurfacing and refinance existing debt	Town Rate: 3.25% Term: 5 years	\$400,000.00
2. Clover County of Bayfield Application #: 02011150 Purpose: Purchase ambulance	Town Rate: 3.75% Term: 10 years	\$151,000.00
3. Kenosha County of Kenosha Application #: 02011151 Purpose: Refinance note anticipation notes	School Rate: 3.75% Term: 10 years	\$9,500,000.00
4. Randall County of Kenosha Application #: 02011148 Purpose: Finance road construction	Town Rate: 3.75% Term: 10 years	\$2,000,000.00
5. River Falls County of Pierce Application #: 02011146 Purpose: Finance road maintenance and construction	Town Rate: 3.25% Term: 2 years	\$100,000.00
6. Westby Area Counties of La Crosse, Monroe and Vernon Application #: 02011147 Purpose: Finance softball field renovation	School Rate: 3.75% Term: 10 years	\$438,000.00
TOTAL		\$12,589,000.00

**BOARD MEETING
MAY 17, 2011**

**AGENDA ITEM 4
REQUEST FOR MUNICIPAL BOND PURCHASE AUTHORITY**

Description of Request

BCPL staff is requesting authority to invest up to \$40 million in General Obligation Bonds issued by Wisconsin municipalities and school districts that have a credit rating of Aa or higher.

Summary Explanation

BCPL has the statutory ability to invest in bonds issued by the state as well as any town, city, county or school district within Wisconsin. The Board authorized staff to invest in State of Wisconsin General Obligation (G.O.) Bonds at the December 20, 2010, board meeting. Authorizing BCPL staff to also invest in municipal and school district bonds that are rated Aa or higher will offer additional opportunities to invest available funds at a good rate of return with very low risk.

Analysis

BCPL currently manages approximately \$860 million in trust fund assets, of which approximately \$575 million is invested in Trust Fund Loans to municipalities and school districts, \$50 million in State of Wisconsin G.O. Bonds, and \$235 million in the State Investment Fund.

The BCPL State Trust Fund Loan Program remains active, but loan demand has declined from the record levels of the past few years and is not expected to provide adequate opportunities to invest all of the money currently held in the State Investment Fund during the next fiscal year. There are three primary reasons for the reduced loan demand at this time:

- Certain federal interest rate subsidies expired at the end of calendar year 2010. Some communities accelerated their project timelines last year in order to take advantage of available subsidies. This reduced the total number of projects that will require funding during 2011.
- There is uncertainty at all local levels of government regarding budget matters at this time. Many local government officials are exercising caution with respect to borrowing for public projects.
- BCPL loan volume is historically much lower during the first 5 months of the calendar year. During the past three years, average monthly loan volume from January through May was \$9.2 million compared to \$18.6 million from June through December.

BCPL Trust Funds that are not invested in bonds or State Trust Fund Loans are held in the State Investment Fund, which currently pays interest at a rate of less than 0.15 % on Trust Fund deposits. Staff is concerned that such a large amount of money invested in SIF will result in lower future Trust Fund earnings, thereby reducing aid to public school libraries - the primary beneficiary of the BCPL managed Trust Funds.

In addition to the BCPL State Trust Fund Loan Program, Wisconsin Statutes Section 24.61(2) authorizes BCPL to invest Trust Funds in a number of different fixed rate instruments including "Bonds issued by the State of Wisconsin" and "Bonds issued by any town, village, city, county, or school district within Wisconsin."

In December 2010, the Board granted BCPL staff the authority to invest up to \$50 million in State of Wisconsin G.O. Bonds. However, the State has not issued any taxable bonds since that time and only a limited number of outstanding state bonds have been offered for resale on the secondary market. At this time, BCPL staff has been able to invest only \$10 million of the \$50 million original authority in state bonds. While BCPL staff is still optimistic that it will be able to purchase more state bonds, BCPL will need to expand its investment horizons beyond state bonds and Trust Fund Loans in order to obtain a better rate of return than currently offered through SIF.

BCPL staff believes that highly rated bonds issued by Wisconsin municipalities and school districts offer investment opportunities that diversify the trust fund portfolio and improves overall returns within acceptable risk parameters.

BCPL has a 140 year history of investing in the general obligation debts of Wisconsin communities and school districts. Actually, BCPL invested in municipal and school bonds before the State Trust Fund Loan program was enacted in the 1870s. While there are many similarities between originating loans and purchasing bonds issued by municipalities and school districts, there are important differences:

- The BCPL State Trust Fund Loan Program has the ability to intercept state aid payments in case of default, although to our knowledge this statutory protection has not been utilized. A bond default would create a situation where repayment would likely require legal action. Limiting the investment authority to bonds rated Aa or higher will reduce the likelihood of a default on a BCPL bond investment.
- Municipal bonds are more liquid than Trust Fund Loans; there is an active market in the buying and selling of these investments. Bond documentation contains mostly standard language accepted throughout the investment community, while BCPL is able to utilize our own documentation in State Trust Fund Loan Program.
- Interest payments are generally made twice per year, which may help level out the annual BCPL cash flow. Currently, BCPL receives about 90% of its income and principal payments in the last two weeks of March due to the statutory payment date of March 15 for the Trust Fund Loan Program.

BCPL staff is proposing this investment authority be limited to municipal bonds rated Aa or higher. This is the same rating as the State of Wisconsin bonds we currently hold, which means they should carry approximately the same level of risk. However, liquidity and trading volume in the debt of any individual community will tend to be lower than in the previously approved State of Wisconsin G.O. Bonds. As a result of this lower liquidity, the municipal bonds generally carry a higher yield than the state bonds which would be a benefit for our Trust Funds.

The vast majority of Wisconsin communities are rated A or are unrated. These communities are the primary market for the State Trust Fund Loan Program. Loan interest rates are set to be competitive for A-rated communities, since that is where most of our potential borrowers are situated. However, municipalities and school districts with higher credit ratings (Aa or Aaa) often obtain financing through the bond markets in order to obtain better rates. Rather than lower the interest rates on all loans for all borrowers through the State Trust Fund Loan Program, it makes more sense to selectively purchase bonds issued by higher rated communities. This broadens our market scope, keeps the yield on our investments up and diversifies our investment base.

There has been very little risk of default in the overall municipal bond market. In Wisconsin, the track record is even better. There has never been a default on a general obligation bond issued by a municipality or school district in the State of Wisconsin.

For all of the above reasons, BCPL staff is requesting authority to invest up to \$40 million in General Obligation Bonds issued by Wisconsin municipalities and school districts that have a credit rating of Aa or higher.

Proposed Resolution

NOW, THEREFORE BE IT RESOLVED, that the Board of Commissioners of Public Lands approves the purchase of up to Forty Million Dollars (\$40,000,000) of General Obligation Bonds issued by any town, city, county or school district within Wisconsin where the issuer has a Moody's rating of Aa or higher (or the equivalent rating from Standard & Poor's or Fitch) at the time of purchase. These purchases shall be made in accordance with Chapter 24 of the Wisconsin Statutes on such terms and conditions as the Executive Secretary determines to be reasonable and necessary. The Executive Secretary is authorized and directed to execute any documents reasonably necessary to complete such transaction.

**BOARD MEETING
MAY 17, 2011**

**AGENDA ITEM 5
PROPOSED LEGISLATION FOR REVENUE OBLIGATION TRUST FUND LOANS**

Earlier this year, the Commissioners received a letter from Senator Schultz and Representative Brooks discussing the possibility of legislation authorizing a new type of Trust Fund Loan that would not be a general obligation of the borrower. In response, BCPL staff prepared a letter for the Board to the legislators indicating that "...statutory changes which would authorize, but not mandate, the BCPL to invest in revenue-based loans secured by state aid, under terms and conditions established by the Board, would provide the Board the necessary authority to consider the Village of Necedah's contemplated loan requests. Properly drafted, this change in legislative authority would not undermine the constitutional authority and discretion of the Board nor would it force the Board to place Trust Fund assets at undue risk. The Board is prepared to support this change in state law and would like to work with you on the drafting of bill language."

To move the process along, BCPL staff has prepared a memo outlining suggested legislative changes to achieve the desired outcome and address some other minor "ministerial" statutory issues that are out of date or do not reflect changes that have occurred over time. The memo has been reviewed by an Assistant A.G. and she concurs on the suggestions. BCPL staff intends to meet with the legislators in the near future to begin work on bill drafting.

Proposed Resolution

NOW, THEREFORE BE IT RESOLVED, that the Board of Commissioners of Public Lands reiterates its support for statutory changes which would authorize, but not mandate, the BCPL to invest in revenue-based loans secured by state aid, under terms and conditions established by the Board and authorizes the Executive Secretary and her staff to work with the legislature on bill drafting.

**BOARD MEETING
MAY 17, 2011**

**AGENDA ITEM 6
REQUEST FOR NORMAL SCHOOL FUND LEGISLATION CHANGES**

Description of Pending Budget Legislation

The governor's budget eliminates a position funded by Normal School Fund earnings thus resulting in Normal School Fund earnings being distributed to the state's general fund as General Purpose Revenue. BCPL staff believes that this budget provision is inadvertently not in keeping with Article X of the Wisconsin Constitution regarding the Normal School Fund.

BCPL staff is requesting permission from the Board to work with the legislature in crafting legislation that would designate Normal School Fund earnings for appropriate higher education purposes in keeping with the original constitutional directive.

Historical Overview

The school fund benefitting the "normal schools" or teacher colleges was established in the Wisconsin Constitution in 1848. With funding from the Swamp Land Grant, the normal school fund started generating earnings in 1866 to support teacher colleges in Wisconsin. In 1964, almost one hundred years later, the Wisconsin State Colleges became the Wisconsin State Universities. One year later, in the Budget Bill (Act 163), the legislature added a provision to BCPL's statutes that provided that "...*all receipts from earnings on the normal school fund shall be paid into the general fund as general purpose revenue.*" Although the original normal schools were no longer called "normal schools," the institutions themselves remained and their mission with respect to higher education continued. Therefore, the legislature's act appeared to be an unconstitutional diversion of trust fund earnings.

For years, the Normal School Fund was managed passively with most of the principal invested in the State Investment Fund. During that time, the limited net earnings of the Normal School Fund rendered the beneficiary designation an almost inconsequential point.

However, starting in FY '05, BCPL staff invested the principal of the Normal School Fund in State Trust Fund Loans and State of Wisconsin general obligation bonds in the same manner as the Common School Fund. By 2009, the Normal School Fund was poised to start generating several hundred thousand dollars of distributable earnings per year. In the budget bill that year, the legislature adopted a provision which directed that most of the earnings of the Normal School Fund would be used for UW scholarships and environmental education for teachers, thus bringing the beneficiary designation of the Normal School Fund back into alignment with its original constitutional directive. However, the law still provided that any excess earnings of the Normal School Fund would be deposited in the general fund.

Proposed Budget legislation affecting Normal School Fund

The current proposed budget bill contains a provision (Section 866 of Assembly Bill 40) that deletes Normal School funding for the Department of Public Instruction's environmental education program thereby reinstating more of the diversion of Normal School Fund earnings to the general fund. BCPL staff believes that any additional earnings of the Normal School Fund should be distributed to the UW System as the successor in interest to the Normal Schools.

Proposed Resolution

BCPL staff respectfully requests permission from the Board to work with the legislature to craft legislation that will direct all net earnings of the Normal School Fund to designated recipients within the UW System

Whereas the Normal School Fund was established in Article X of the Constitution to benefit higher public education in Wisconsin;

Whereas Section 866 of the proposed budget bill would direct more Normal School Fund earnings to the general fund as General Purpose Revenue;

Whereas the Board of Commissioners of Public Lands believes that in keeping with Article X of the State Constitution, the earnings of the Normal School Fund should be dedicated to higher public education in the State of Wisconsin; and

Whereas the legislature has stated a commitment to not raiding segregated funds.

NOW, THEREFORE BE IT RESOLVED, that the Board of Commissioners of Public Lands hereby authorizes and directs the Executive Secretary to work with the legislature to craft legislation that would designate Normal School Fund earnings for appropriate higher education purposes in keeping with the original constitutional directive.