



Wisconsin's Public Finance Authority

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On October 1, 2019, the Wall Street Journal reported¹ that the Public Finance Authority's (PFA) bonds had the most reports of impairment (indicating bad or risky debts) of any lender in the municipal bond market.² Since 2010, the PFA, an independent unit of government in Wisconsin, has issued billions of dollars in bonds to finance private and public projects, which are mostly located outside of Wisconsin.³ The Legislative Reference Bureau has seen many questions relating to the PFA and its operations. This issue of LRB Reports provides an overview of several aspects of the PFA, including what it is, what it does, its relationship to the Wisconsin state government, and the state's liability for PFA debts.

What is the PFA?

The PFA is a unit of government that issues debt to public and private entities, for projects within or outside the state. The money for the issuance of debt comes from other entities and individuals, not the PFA. Generally, these financial instruments are called “conduit bonds,” since the PFA, and organizations like it, serve as the conduit from the creditors to the borrowers (see next section for a more detailed description of conduit bonding).

The Wisconsin Statutes describe the PFA as a “unit of government, and a body corporate and politic, that is separate and distinct from, and independent of, the state and the political subdivisions which are parties to the agreement.”⁴ In other words, the PFA is an independent governmental entity, which draws its powers and structure directly from the statutes and its founding document.

Section 66.0304 of the Wisconsin Statutes empowers the PFA; however, the PFA was not specifically created in the statutes. Instead, the statutes authorize two or more political subdivisions to create a commission which can issue conduit bonds. Only one such commission can be created. The City of Lancaster, and Adams, Bayfield, Marathon, and Waupaca Counties agreed to create such a commission, the PFA, with a Joint Exercise of Powers Agreement.⁵ These local units of government have little say in the operation of the PFA. According to the *Milwaukee Journal Sentinel*, the five participating local units of government received \$26,000 each from the PFA from 2010 to 2017.⁶

1. Heather Gillers, “Popular in Wisconsin: Cheese, the Packers and...Risky Bonds,” *Wall Street Journal*, October 1, 2019, <https://www.wsj.com>.

2. A “report of impairment” indicates that an asset's stated value is greater than its recoverable amount. In other words, the face value of the bonds is greater than the revenue that the PFA is likely to recover from its borrowers.

3. Public Finance Authority, “Financial Statements and Supplemental Schedules, Years Ended December 31, 2018 and 2017,” 16.

4. Wis. Stat. § 66.0304 (3) (a).

5. Amended and Restated Joint Exercise of Powers Agreement Relating to the Public Finance Authority, Public Finance Authority, signed by Wisconsin Assistant Attorney General F. Thomas Creeron III, September 30, 2010. Accessed from Clark County, Washington, <https://www.clark.wa.gov>.

6. Jason Stein and Patrick Marley, “Little-known Wisconsin finance authority draws scrutiny for debt deals worth billions,” *Milwaukee Journal Sentinel*, October 14, 2017.

Under the Joint Exercise of Powers Agreement, the PFA is governed by a Board of Directors. Four of the seven directors are nominated by the Wisconsin Counties Association. The League of Wisconsin Municipalities, the National League of Cities, and the National Association of Counties each nominate one of the remaining three directors. These four groups reportedly received approximately \$74,500 each in 2016 from the PFA.⁷

The PFA has issued bonds for projects in 44 states⁸ and has the authority to lend money for projects outside the country, as long as a borrower or co-borrower is incorporated in the United States.⁹ At the end of 2018, the PFA's conduit borrowers had \$10.4 billion in outstanding bonds, up from \$9.1 billion in 2017.¹⁰

What are conduit bonds?

A bond is a certificate, provided to an individual or entity that lends money to a government or business for a set period of time, with the promise that the government or business will repay that money plus interest. In conduit lending, a government entity issues bonds and conveys the proceeds to a different entity, the actual borrowers, for use on a specific project. The revenues from the borrower's project are used to repay the bondholders.¹¹ The conduit for the bonds, in this case the PFA, generates fees from issuing and administering the bonds.¹² For example, for a recent \$24.1 million bond for charter school construction in Colorado, the PFA receives an issuance fee of \$42,050 and attorneys' fees.¹³

There are tax advantages to conducting borrowing and lending through the conduit of a state or local entity. The PFA's conduit bonds typically fall under the federally defined category of "private activity bonds."¹⁴ In a private activity bond 10 percent or more of the proceeds of the bond are for private business use or 10 percent or more of the repayment/security of the bond is from private business property.¹⁵ Interest on qualified private activity bonds issued by state and local entities are exempt from federal income tax.¹⁶ A private activity bond qualifies for tax exemption when it is used for a qualifying activity, including airports, sewage facilities, high-speed rail, and some manufacturing facility expansions.¹⁷

7. Stein and Marley, "Wisconsin finance authority draws scrutiny."

8. "Nationwide Reach with PFA," Public Finance Authority, <https://pfauthority.org>.

9. Wis. Stat. § 66.0304 (11) (bm).

10. Public Finance Authority, "Financial Statements and Supplemental Schedules," 16.

11. A lawyer for the Wisconsin Counties Association described conduit bonds in a memorandum found in the [drafting file for 2009 Wis. Act 205](#): "Serving as a conduit issuer, the entity [read: PFA] would issue bonds on behalf of a private entity to the marketplace for purchase by private lenders/investors . . . The collateral to support such 'conduit' financings are typically the real property itself being financed . . . and in some cases revenue pledges from the private entity." Memorandum from Andrew Phillips in the [drafting file for Senate Bill 399](#) (Part 1), Wis. Legis. Reference Bureau, Madison, Wis, 2.

12. In the PFA's case, those fees are authorized under [Wis. Stat. § 66.0304 \(4\) \(h\)](#).

13. [Limited Offering Memorandum](#) from the Public Finance Authority, (September 24, 2019).

14. [26 U.S.C. § 141](#).

15. [26 U.S.C. § 141 \(b\)](#). The projects the bonds will fund must meet a series of conditions, including falling into one of the bond types listed in [26 U.S.C. § 141 \(e\) \(1\)](#).

16. [26 U.S.C. § 103](#).

17. [26 U.S.C. §§ 142, 143, 144, 145, 150, 1394, 1400U-3](#). Steven Maguire and Joseph S. Hughes, Congressional Research

When a bond is tax exempt, borrowers can offer to pay less in interest while still offering bonds that are attractive to lenders. For example, in 2018, high-grade municipal bonds offered yields of 3.53 percent per year, while AAA corporate bonds offered yields of 3.93 percent per year.¹⁸ These bonds are attractive despite the lower yield because they reduce the interest by the amount of income tax lenders would have to pay.¹⁹

Importantly, the conduit entity requires no initial or operating capital of its own, and incurs minimal liability for defaults. All capital is raised from the bondholders and the liability is incurred by the actual borrower.

In a more involved form of lending, the PFA offers an Asset Ownership Program, where the authority issues bonds and the proceeds of which are used to purchase capital assets. The PFA hires operators for those assets, which are typically the previous owners. For example, after acquiring the Maryland Proton Treatment Center,²⁰ the PFA hired Maryland Proton Treatment Center, LLC to operate its eponymous clinic.²¹ Unlike with regular conduit lending, the PFA directly receives the proceeds of its owned assets, which are used to repay bonds. In 2018, the PFA reported \$36.8 million in net revenue for services at the four proton therapy cancer treatment clinics the authority acquired in 2017 and 2018.²² Once the bonds are repaid, ownership of the assets returns to the original owners.

At the end of 2018, the PFA had \$587 million in total assets, including \$423 million in capital assets.²³

History of the PFA

The history of the PFA can be traced to California. In 1988, the California State Association of Counties and the League of California Cities, along with several California counties, sponsored the creation of the California Statewide Communities Development Authority (CSCDA).²⁴ Like the PFA, the CSCDA conducts billions of dollars in conduit bonding, although CSCDA-funded projects must be located in California.²⁵

Service, Private Activity Bonds: An Introduction (2018). “Industrial Revenue Bond,” Wisconsin Economic Development Corporation, <https://wedc.org>.

18. Council of Economic Advisors, Economic Report of the President (2019), Table B-42.

19. For a more detailed explanation of the tax-exempt bonds’ appeal, see Maguire and Hughes, Private Activity Bonds: An Introduction, 3–4.

20. Andrea K. McDaniels, “Maryland Proton Treatment Center more financially stable after \$277.4 million bond sale,” *The Baltimore Sun*, September 5, 2018.

21. The clinic pays the operator \$2.6 million annually plus an additional 2 percent per year and a 10 percent bonus. Public Finance Authority, “Financial Statements and Supplemental Schedules,” 28.

22. The clinics are located in Florida, Alabama, Maryland, and New Jersey. The housing project is located in Colorado. Public Finance Authority, “Financial Statements and Supplemental Schedules,” 7.

23. Public Finance Authority, “Financial Statements and Supplemental Schedules,” 3.

24. Amended and Restated Joint Exercise of Powers Agreement Relating To The California Statewide Communities Development Authority, (June 1, 1988). This agreement was created under Cal. Gov’t Code §§ 6500 to 6599.3, the Joint Exercise of Powers Act (§ 6500.1).

25. MGO Certified Public Accountants, “The California Statewide Communities Development Authority: Independent Auditor’s Report, Financial Statement, and Supplementary Information,” June 30, 2015, <https://emma.msrb.org>, 10.

Until recently, the CSCDA's day-to-day operations were conducted by HB Capital Resources, Ltd.²⁶ Today, Bridge Strategic Partners operates the CSCDA. In 2004, CSCDA sought permission from California's legislature to issue bonds for projects outside the state, but that effort failed.²⁷ Five years later, Wisconsin Senator Pat Kreitlow proposed 2009 Senate Bill 399, which ultimately allowed for the PFA's creation. The drafting file for this bill indicates that the bill was drafted with the participation from the Wisconsin Counties Association, the League of Wisconsin Municipalities, the National Association of Counties, and the National League of Cities.²⁸

SB 399 passed both houses of the legislature unanimously, and was enacted as 2009 Wisconsin Act 205.

As previously noted, Act 205 did not create the PFA specifically, but authorized two or more political subdivisions to create a commission for the purpose of issuing "conduit bonds." The City of Lancaster and Adams, Bayfield, Marathon, and Waupaca Counties used that authority to execute a Joint Exercise of Powers Agreement on June 30, 2010, which created the PFA.²⁹

Since the PFA's inception, the specific statutes governing it have been altered three times. 2011 Wisconsin Act 32 allowed the PFA to lend to projects in U.S. territories, use bonds for refinancing projects, and purchase bonds from other Wisconsin agencies and political subdivisions, among other changes.³⁰ 2011 Wisconsin Act 239 expanded the types of entities that can give the PFA permission to lend in states/territories other than Wisconsin.

2013 Wisconsin Act 20 allowed the PFA to purchase bonds held by any state and allowed the PFA to lend internationally.³¹ Wisconsin Health and Educational Facilities Authority (WHEFA) and Wisconsin Housing and Economic Development Authority (WHEDA) originally had rights of first refusal on bonding that could have been issued by them. 2013 Wisconsin Act 20 eliminated those rights.

A provision in 2017 Wisconsin Act 59 (budget act) would have given the PFA's authority to acquire property by condemnation,³² but that section, along with all others in Act 59 relating to the PFA, were vetoed by Governor Scott Walker.³³

Following the creation of the PFA, HB Capital provided staffing and conducted oper-

26. MGO Certified Public Accountants, "California Statewide Communities Development Authority," 11.

27. Steven Verburg, "Tax-free deals across US for church schools and birth control clinic thanks to Wisconsin," *Wisconsin State Journal*, December 26, 2013.

28. Drafting file for 2009 Wis. Act. 205, Wis. Legis. Reference Bureau, Madison, Wis.

29. Amended and Restated Joint Exercise of Powers Agreement, Public Finance Authority.

30. 2011 Wis. Act 32, sections 1720d to 1720s.

31. 2013 Wis. Act 20, sections 1266 to 1269.

32. 2017 Wis. Act 59, section 585h (vetoed).

33. Office of the Governor, "Governor's Veto Message," September 21, 2017, 43–44.

ations for the PFA.³⁴ HB Capital and its owners created GPM Municipal Advisors in July 2014, which now conducts operations for the PFA. In 2017 and 2018, GPM charged \$6.2 million and \$7.3 million in service fees, respectively.³⁵

Wisconsin's liability for PFA debt

The PFA's net position, a measure of assets minus liabilities,³⁶ has been negative for the entirety of the PFA's existence. It ended 2018 with a net position of negative \$44.1 million, largely due to \$37.3 million in expenses for the asset ownership program.³⁷ The previous low was negative \$9.5 million in 2017. This position is not reflective of the health of the PFA's bonds, but PFA financial statements note that "over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the PFA is increasing or decreasing."³⁸

The PFA contracts specifically note that their bonds "do not constitute a general obligation of the authority or a debt or pledge of the faith and credit of the state of Wisconsin or any political subdivision thereof. The principal of and interest and premium, if any, on [PFA bonds] are payable solely from the revenues and funds pledged for their payment."³⁹ The authorizing section of the Wisconsin Statutes also specifies the same indemnity.⁴⁰ In other words, neither the state nor the political subdivisions contracting to create the PFA are liable if borrowers cannot repay the bondholders.⁴¹ The borrowers are responsible for all repayment.

However, the PFA cannot be dissolved unless the payment of its outstanding bonds is provided for, subject to the PFA's Joint Exercise of Powers Agreement and the attorney general's approval.⁴² Furthermore, as provided in Wis. Stat. § 66.0304 (12), the state pledges not to limit, impair, or alter the rights and powers of the PFA unless the PFA discharges its bonds and obligations or the bondholders are otherwise provided for. Similar pledges exist for local exposition districts, local professional baseball park districts, local professional football stadium districts, local cultural arts districts, the Wisconsin Aerospace Authority, the Wisconsin Health and Educational Facilities Authority, the Univer-

34. Jeannette Neumann, "Wisconsin Issuer Roils Muni Field," *The Wall Street Journal*, June 3, 2011, <https://www.wsj.com>.

35. Public Finance Authority, "Financial Statements and Supplemental Schedules," 24. GPM also serves as the PFA's agent for its capital assets, incurring \$100,000 annually in fees from the revenues of the four proton therapy cancer treatment clinics the PFA acquired in 2017 and 2018.

36. The net position is an entity's total assets and deferred outflows of resources minus its liabilities and deferred inflows of resources. Office of the Washington State Auditor, "4.2.8 Net Position," *BARS GAAP Manual*, <https://www.sao.wa.gov>.

37. Public Finance Authority, "Financial Statements and Supplemental Schedules," 2012–2018.

38. Public Finance Authority, "Financial Statements and Supplemental Schedules, Years Ended December 31, 2017 and 2016," 4.

39. Limited Offering Memorandum from the Public Finance Authority, (June 13, 2019).

40. Wis. Stat. § 66.0304 (9).

41. Wis. Stat. § 66.0304 (9) (c).

42. Wis. Stat. § 66.0304 (2) (b) and (4m).

sity of Wisconsin Hospitals and Clinics Authority, and the Lower Fox River Remediation Authority.⁴³

These types of pledges are more circumscribed than the “moral obligation” pledges the state has used⁴⁴ when it would like to provide some assurance for bonds or debts without violating the Wisconsin Constitution.⁴⁵ In a typical moral obligation pledge, the legislature requires the submission of a bill to appropriate money to cover deficits in bond servicing funds and “expresses [the legislature’s] expectation and aspiration that, if ever called upon to do so, it shall make this appropriation.”⁴⁶

Overall, it is unlikely that the Wisconsin state government, its member municipalities and counties, or the PFA itself is liable if PFA projects no longer provide enough revenue to repay its bonds. The PFA’s agreements and relevant statute sections appear to largely indemnify government bodies.⁴⁷ In order for borrowers to pursue the PFA, they would likely need to have a claim under securities law (i.e. negligence or fraud in bond offering documents), or other tort.

Although the state appears to not be liable for the PFA’s debts, it is possible that a large default could have repercussions for state and local governments’ ability to finance future projects with bonds. For instance, in Michigan, Detroit’s bankruptcy in 2013 suppressed demand for bonds across the state, even though many affected governments weren’t at fault.⁴⁸ Risk in one sector of the municipal bond market drives up prices across the market, which occurred in Wisconsin in 2011.⁴⁹

Interaction with Wisconsin state and local government

Although independent, the PFA interacts with Wisconsin state and local government in several ways:

- The attorney general had to approve the Joint Exercise of Powers Agreement to create the PFA.⁵⁰
- Amendments to the PFA agreement do not need the attorney general’s approval, unless the agreement requires it or the amendment adds a member to the agreement.⁵¹
- The attorney general also must approve a resolution to dissolve the PFA.⁵²

43. Wis. Stat. §§ 114.73, 229.53, 229.76, 229.832, 229.851, 231.11, 233.23, and 279.11.

44. For example, these pledges are used for local exposition districts, like the Wisconsin Center District (Wisconsin Center, UW-Milwaukee Panther Arena and Miller High Life Theatre) Wis. Stat § 229.50 (7).

45. Wis. Const. art. VIII, §§ 3, 6, and 7.

46. See, for example, Wis. Stat § 229.50 (7).

47. Wis. Stat. § 66.0304 (9).

48. Brian Chappatta, “Detroit Slows Michigan Sales to Fewest in a Decade: Muni Credit,” *Bloomberg*, September 8, 2013.

49. Nathaniel Popper, “‘Conduit’ muni bond defaults draw scrutiny,” *Los Angeles Times*, June 14, 2011.

50. Wis. Stat. § 66.0304 (2) (a). See Amended and Restated Joint Exercise Agreement, Public Finance Authority, p. II–18.

51. Wis. Stat. § 66.0304 (2) (b).

52. Wis. Stat. § 66.0304 (2) (b).

- The PFA is required to submit an annual audit to the secretary of the Department of Administration and the Legislative Audit Bureau. However, the PFA's board of directors can instead decide to perform audits biennially if they agree to do so by a unanimous vote.⁵³
- If a PFA-financed project is located in Wisconsin, bonds may not be issued until all of the political subdivisions in which the project is located approve the project financing.⁵⁴ A political subdivision refers to any city, village, town, or county in Wisconsin. For projects located in other states, the approval of only one political subdivision is required. For other states, a political subdivision is defined as "any city, village, town, county, district, authority, agency, commission, or other similar governmental entity in another state or office, department, authority, or agency of any such other state or territory of the United States."⁵⁵
- The PFA must notify the Wisconsin Department of Revenue when it issues a conduit bond.⁵⁶
- In the original version of the law (2009 Wisconsin Act 205), bonds issued for projects in Wisconsin that fell under the Wisconsin Health and Educational Facilities Authority's purview⁵⁷ required approval from that authority.⁵⁸ Likewise, money for economic development projects and housing projects in Wisconsin require approval from the Wisconsin Housing and Economic Development Authority.⁵⁹ Those approval requirements were eliminated by 2013 Wisconsin Act 20.
- The validity of a bond can be challenged in circuit court within 30 days of the PFA adopting a resolution to issue the bond or the contract between the PFA and the entity seeking funds being executed.⁶⁰
- The federal government caps the volume of certain types of federally tax exempt private activity bonds⁶¹ that can be issued in a state in each year.⁶² The Wisconsin Economic Development Corporation (WEDC) manages that volume cap for projects in the state.⁶³ As a result, PFA-funded projects in this state that use a volume capped bond-type require WEDC approval.
- As noted in the PFA's agreement,⁶⁴ meetings of the board of directors are subject to Wisconsin's open meetings law.⁶⁵

53. Wis. Stat. § 66.0304 (10).

54. Wis. Stat. § 66.0304 (11) (a).

55. Wis. Stat. § 66.0304 (1) (f).

56. Wis. Stat. § 66.0304 (5) (e). A list of these bonds can be found at Wisconsin Department of Revenue, "Individual Income Tax Conduit Revenue Bonds," <https://www.revenue.wi.gov>.

57. Wis. Stat. § 231.01 (7).

58. 2009 Wis. Act 205 Section 3.

59. 2009 Wis. Act 205 Section 3.

60. Wis. Stat. § 66.0304 (11) (c).

61. For a breakdown of which activities are capped, and therefore subject to WEDC approval, see Table 2 in Maguire and Hughes, Private Activity Bonds: An Introduction, 11–12.

62. 26 U.S.C. § 146.

63. Wis. Stat. § 238.10.

64. Section 3, paragraph D. See Amended and Restated Joint Exercise of Powers Agreement, Public Finance Authority.

65. Wis. Stat. §§ 19.81 to 19.98.

Wisconsin's oversight of the PFA may increase soon. On October 7, 2019, 17 Wisconsin senators and representatives sent a letter to Senator Robert Cowles and Representative Samantha Kerkman in their capacity as cochair of the Joint Legislative Audit Committee.⁶⁶ The letter asks them to instruct the Legislative Audit Bureau to begin an audit of the PFA's "decision making, its management or risk, its compliance with all applicable statutory provisions, and the quantity and distribution of its proceeds." ■

66. Members of the Wisconsin Legislature, letter dated October 7, 2019, <http://www.thewheelerreport.com>.