WISCONSIN LEGISLATIVE AUDIT BUREAU
AUDIT SUMMARY

Report 97-23

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THE WISCONSIN DEVELOPMENT RESERVE FUND

The primary mission of the Wisconsin Housing and Economic Development Authority (WHEDA) is to provide loans for housing programs intended for low-income persons. In addition, WHEDA has been provided with $19.1 million in state general purpose revenue and segregated funds to manage various loan guarantee programs for farmers and small businesses that otherwise could not obtain conventional financing. The first of these programs was established in 1985. In fiscal year (FY) 1991-92, funding for all guarantee programs was consolidated to create the Wisconsin Development Reserve Fund. At the end of FY 1996-97, WHEDA managed 11 different guarantee programs within the Reserve Fund.

The Reserve Fund Balance Is Declining

Between FY 1991-92 and FY 1996-97, the Reserve Fund's expenses consistently exceeded revenues from investment earnings and participant fees. The annual deficit has ranged from nearly $735,000 to $1.9 million. As a result, the Reserve Fund's balance has declined by nearly 40 percent. As of June 30, 1997, the balance was $12.9 million. Administrative costs have represented the greatest share of expenses each year and have accounted for almost 60 percent of the Reserve Fund's total expenses since it was created. Other expenses include guarantee payments on defaulted loans and interest subsidy payments to borrowers.

Administrative Costs Are High and Need Better Documentation

Most of the costs to administer the guarantee programs are charged to the Reserve Fund through an allocation process. However, WHEDA's allocation process does not ensure that only necessary and appropriate costs are assessed to the Reserve Fund. For example, WHEDA allocates personnel costs based on employe estimates, rather than time sheets or other records of actual staff time spent on its various programs. If WHEDA believes employe time is the most reasonable measure for allocating its costs, it needs to improve its documentation efforts.

In addition, WHEDA's staffing levels and related costs appear to be high in comparison to those of commercial lenders and state agencies. Reserve Fund program staffing levels are equivalent to those of commercial lending institutions with significantly larger balances and loan activity, and WHEDA functions are also more generously staffed than those of state agencies. For example, while WHEDA and the Department of Commerce have comparable numbers of staff performing information technology functions, Commerce's information technology staff supports more than twice the number of employes WHEDA's does. In addition, WHEDA awarded annual lump-sum bonuses to nearly all of its employes. In FY 1996-97, these bonuses averaged more than $2,050 per employe and totaled $328,200, which was included in the administrative costs allocated to the Reserve Fund. WHEDA discontinued its bonus program as of December 1, 1997.

Investment Management Practices Need Improvement

While administrative costs have been a significant factor in the declining Reserve Fund balance, WHEDA's lack of sound investment policies and strategies and its limited oversight and monitoring of investments have limited investment earnings for the Reserve Fund. When state funding was initially provided for the programs, WHEDA took limited steps to increase investment earnings. Between 1985, when the first guarantee program was created, and FY 1992-93, the Reserve Fund's average rate of return was less than the return on the short-term pool of state and local funds managed by the State of Wisconsin Investment Board.

Although it did begin to direct attention to increasing investment earnings in FY 1993-94, WHEDA did not adequately evaluate the Reserve Fund's liquidity needs and the appropriateness of risks taken with new investments. Of particular concern is the FY 1993-94 purchase of collateralized mortgage obligation bonds, which were sensitive to changing interest rates and represented over 40 percent of the Reserve Fund's balance. Market conditions have required WHEDA to hold these securities longer than anticipated, which has limited its ability to pursue other investment opportunities as the Reserve Fund faces an increasing need for liquidity because of its declining balance.

Questions Surround the Future of the Reserve Fund

Program changes recently implemented by WHEDA, as well as changes enacted through the 1997-99 Biennial Budget Act, may extend the life of the Reserve Fund. However, even with these changes—which include the appropriation of $4 million for a new guarantee program and the consolidation of other existing guarantee programs into one broad small business program—we estimate that the Reserve Fund will be depleted in 10 to 12 years unless additional state funds are appropriated. WHEDA's ability to guarantee loans will be limited even sooner because of requirements that it maintain a reserve for outstanding guarantees. Furthermore, if loan default rates were to increase because of a deteriorating economy, or if a loan to the Taliesin Preservation Commission for the restoration and improvement of the former home of Frank Lloyd Wright, which WHEDA has guaranteed for $6.8 million, should go into default, restrictions on the Reserve Fund's guarantee authority will begin much earlier than our projection.

In any future consideration of additional state funding, the Legislature will need to take program activity and effectiveness into account. For example, in FY 1996-97, 72 percent of the Reserve Fund's administrative costs were for the various small business guarantee programs, yet WHEDA used just over one-half of its authority to guarantee small business loans, and there are similar federal programs and initiatives within the commercial lending industry. To help the Legislature assess the merits of its recent program changes, WHEDA will need to monitor and report on the effectiveness of these programs.

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