



STATE OF WISCONSIN

Notice of Listed **Material Information** #2001-07
Dated September 5, 2001

This document provides information which may be material to financial evaluation of the State of Wisconsin, however neither the preparation nor submission of this document constitutes a Listed Event pursuant to the State's Master Agreement on Continuing Disclosure.

Issuer: State of Wisconsin General Obligation Bonds

CUSIP Numbers: 977053, 977055 and 977056 Prefix (All)

Summary: Standard & Poor's has revised the outlook on the State's general obligation bonds from stable to negative. The bond rating is affirmed at AA. Attached is a **press release issued by Standard & Poor's Ratings Group.**

The undersigned represents that he is the Capital Finance Director, State of Wisconsin Capital Finance Office, which is the office of the State of Wisconsin responsible for providing Annual Reports and giving notice of Listed Material Events when notice is required by the State's Master Agreement on Continuing Disclosure.

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Research:

Wisconsin GO Bonds & CP Notes Rated 'A-1+' & 'AA'; Outlook Revised to Negative

Publication Date: 29-Aug-2001

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NEW YORK (Standard & Poor's) Aug. 29, 2001--Standard & Poor's today assigned its 'A-1'-plus rating to Wisconsin's \$92.26 million GO extended municipal CP due Oct. 1, 2001.

At the same time, Standard & Poor's assigned its double-'A' rating to the state's \$20 million GO bonds taxable (veterans program) series 2001E due Nov. 1, 2031. The CP and the GO bonds are expected to sell Sept. 11, 2001. The outlook on the GO bonds is negative.

In addition, Standard & Poor's affirmed its 'A-1'-plus rating on the state's outstanding CP debt.

Standard & Poor's also affirmed its double-'A' rating and double-'A'-minus rating on the state's outstanding GO and appropriation debt.

Standard & Poor's has revised the outlook on the state's GO and appropriation debt to negative from stable.

The outlook revision reflects the state's:

- Low reserve levels,
- Expected worsening negative GAAP fund balance,
- Limited financial flexibility, and
- Use of nonrecurring revenues to balance the current 2001-2003

biennium budget.

The rating is maintained at double-'A' due to budget actions (including expected vetoes) which substantially reduce the structural deficit, and legislative adoption of financial procedures which should, over this and the next biennium, rebuild reserves and create a permanent budget stabilization fund. Failure to eliminate the structural budget imbalance and show steady progress in building reserves over this and the next biennium could lead to a rating downgrade.

Downward revenue revisions to the revenue forecast of fiscals 2002 and 2003 put additional pressure on an already tight 2001-2003 biennium budget. As adopted by the legislature and incorporating expected veto recommendations by Gov. Scott McCallum, the budgeted ending general fund budgetary balance on June 30, 2003, would be less than the estimated \$198 million ending June 30, 2001, budgetary balance, and providing little financial flexibility if the state economy and related revenue trends worsen. The state's trend of budgeted drawdowns remains a continuing rating concern given already slim reserve levels, limited revenue, and expenditure flexibility.

Wis.' GO rating reflects the state's:

- GO pledge, for which debt service is a first charge on all state revenues;
- Diversified economy, including a large and diversified manufacturing sector;
- Trend of stable economic and employment growth;

- Moderate debt burden with above-average debt roll-off; and
- Modest future GO debt issuance.

Offsetting credit factors include:

- Planned drawdown of budgetary reserves and use of nonrecurring revenue to balance the 2001-2003 biennium budget;
- Limited revenue flexibility and already slim budgetary reserves due to prior tax cuts and rebates,
- Prior lack of legislative commitment to increase reserves;
- Increased two-thirds funding commitment to public education since 1997, which has resulted in decreased expenditure flexibility; and
- Negative GAAP fund balances which are expected to worsen through at least 2003.

The rating on Wis.' GO extendable municipal CP (EMCP) reflects the state's:

- GO pledge,
- Long-term credit strength and strong market access record, and
- Pre-existing GO bond authorization to provide liquidity for the

EMCPs.

Wisconsin expects to finish the June 30, 2001, biennium with an estimated \$198 million budgetary balance, including statutory reserves, which is equal to a slim 1.8% of appropriations. This is a decrease from the June 30, 2000, budgetary balance of \$439.6 million (4.2% of appropriations) and a substantial reduction from the ending June 30, 1999, budgetary balance of \$701 million (2.5%).

The 2001-2003 budget, including the effect of expected vetoes, includes \$450 million of nonrecurring tobacco securitization debt proceeds (up from \$350 in the introduced budget) to achieve balance. An additional \$132 million on nonrecurring revenues comes from federal medical reimbursements. While the use of nonrecurring revenues indicates fiscal stress and is a rating concern, the use of onetime revenues is expected for only the 2001-2003 biennium. Wisconsin has historically proposed conservative budgets. However, the state continues to face a significant challenge to operate within available revenues and build needed reserves. Due to state assumption of two-thirds funding of education since 1997, with no concurrent tax increases, Wisconsin's current budget has significantly less flexibility to adjust to economic and revenue fluctuations than it did in past bienniums. Consistent with the tight budget, the 2001-2003 biennium budget has no new taxes and no structural tax changes or reforms. The state's principal revenue sources continue to be the individual income taxes at 53% of general fund revenues and sales taxes at 34%.

The adopted 2001-2003 budget is noteworthy in initiating financial reforms and multi-year planning. It also signals a reversal of prior fiscal practices that created a structural imbalance. The willingness of both the executive and legislative branches to control spending and steadily build financial reserves will be the primary determinant of future state rating actions. A statutory mechanism is established to build long-term reserves by depositing 50% of any future state budget surplus into a budget stabilization fund. The target budget stabilization fund level is 5.0% of appropriations, which could potentially bring reserves close to 7.0% of budget when combined with an existing 1.2% statutory reserve (the statutory reserve will be increased to 2.0% by fiscal 2006). Reforms also include full disclosure in future state budgets of the GAAP deficit and any structural budget imbalance. The Wisconsin legislature also adopted state-level expenditure limitations tied to the growth in state personal income (education and debt service expenditures are exempted).

Wisconsin has a broad economic base that has experienced steady growth and limited cyclicity since the mid 1980s. A substantial, but slightly declining, manufacturing sector represented 21% of 2000 employment.

Diversity in the manufacturing sector is a key factor in the state's economic performance and contributes to its low cyclicalities. Service and trade sectors remain the driving force behind overall employment growth and provided 49% of total jobs in 2000, up from 45% in 1987. As with much of the Midwest, Wisconsin's tight labor market accounts for some of the slowdown of employment growth and contributes to historically low unemployment rates. The state's 2000 unemployment rate was 3.3%.

OUTLOOK: NEGATIVE

The outlook reflects the challenges facing both the executive and legislative branches to control spending, eliminate the structural deficit no later than the next budget cycle, and consistently build financial reserves. The ability and willingness of the state to do so will be the primary determinants of future rating actions. Continued reliance on nonrecurring revenues to balance state budgets would weaken the state's credit profile.