

The Impact of Changing Interest Rates On City of Milwaukee Revenues and Expenditures

Scope

Comments are limited to the impact on City debt expense and interest earnings. Other indirect impacts related to the cost of City services, growth in tax base, etc, are ignored here.

Conclusion

The movement of interest rates significantly affects both City interest earnings and expenses, but currently in the short term, these impacts tend to offset each other. The lasting impact of interest rate changes are driven by the trend in longer term (> one year) City debt outstanding and related longer term market interest rates. Over the past four years, longer term GO debt outstanding and related market interest rates have declined slightly.

As market interest rates, City debt and investment balances change this outcome can likewise change substantially. Active monitoring of these and other factors are required to minimize the net cost of capital to the City while maximizing its return on investment.

Analysis

1. Currently, City interest expense (\$28.4 million) greatly exceeds interest earnings (\$1.8 million) because the amount of outstanding City debt¹ (\$1,123 million for 2009) exceeds by a factor of five the City's average investment cash balance (\$239 million). See Charts 1 and 2.
2. The City normally issues over \$100 million in longer term debt annually, comprising about 70% of total City debt. See Chart 3. Therefore, there exists a continuing base of annual City interest payments ranging from about \$27-\$28 million annually for such longer term debt.
3. The greatest year to year change in City interest expense is due to changes in short term (<1 year term) Revenue Anticipation Note (RAN or "cashflow") borrowing. In the past four years, RAN debt has grown from \$241 million in 2006 to \$344 million in 2009. In spite of this growth, City RAN interest payments have actually declined sharply from \$8.7 million in 2006 to \$1.4 million in 2009 (minus 84%). This is due to major market interest rate declines - from 3.5% in 2006 to 0.5% in 2009. See Chart 4.
4. The City of Milwaukee invests its working capital in short term Treasury notes, CDs and the State Investment Pool (LGIP) among other instruments, providing for General Fund interest earnings. Comparing City interest rates on its investments versus its debt interest rates, City investments have attracted consistently higher interest rates than City borrowing rates. Since 2006, short

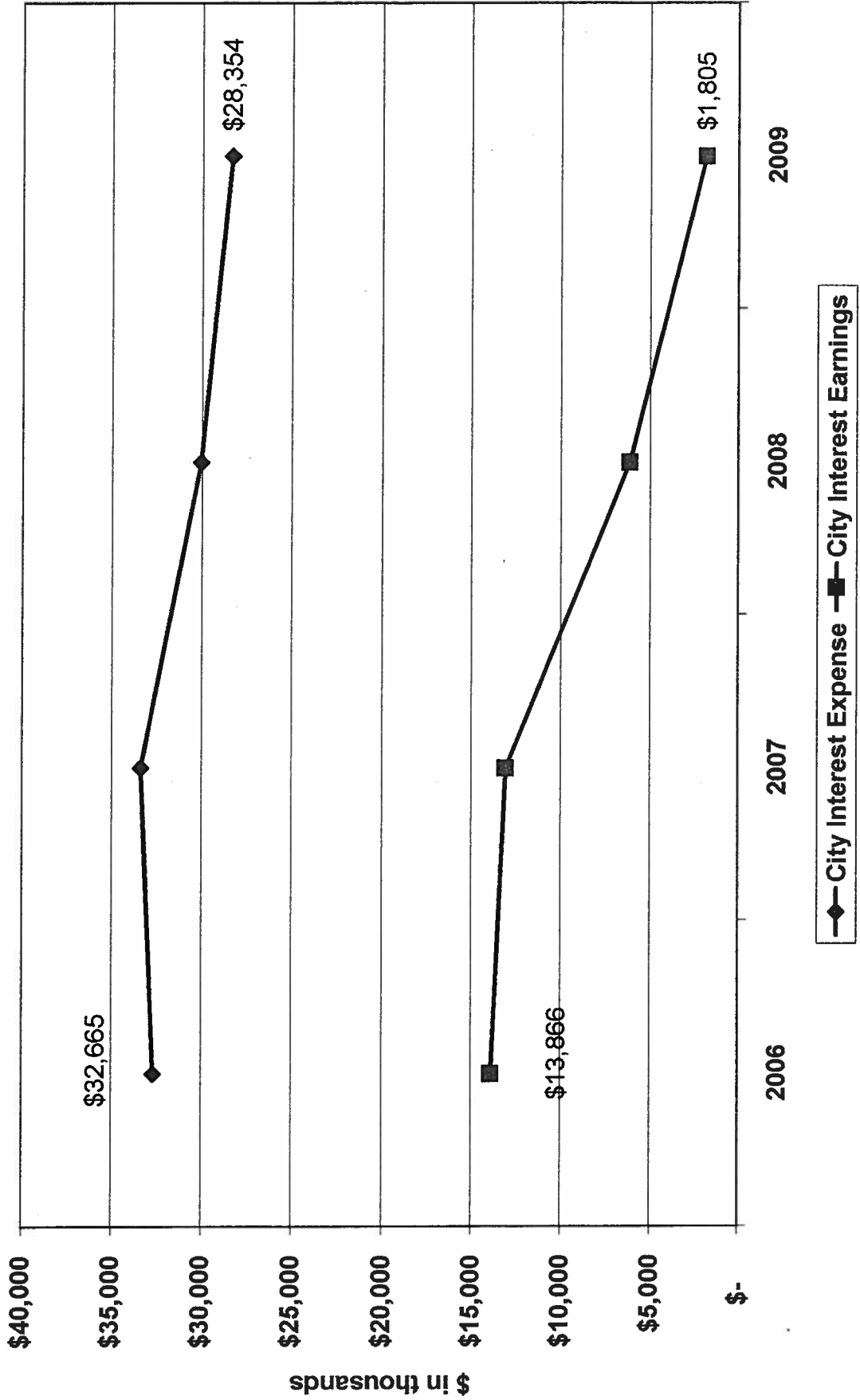
¹ Includes all City GO debt outstanding plus total City RAN (cashflow) borrowing.

term City interest earnings rates have generally exceeded its short term borrowing rates by 40%-50%. See Chart 5.

5. However, since 2006, City short term RAN debt outstanding has grown much faster than City of Milwaukee investment balance. Current City short term RAN debt outstanding (\$344 million in 2009) exceeds City investment balance (\$239 million) by about 40%. See Chart 6
6. The higher rate of interest attracted by City short term investments is largely offset by the higher amount of short term City debt outstanding. See Table. Assuming the ratio of City short term investment balances and rate of return versus City short term borrowing debt and borrowing rates remain about the same, changes in short term rates will have little net immediate impact on City finances.
7. Over the longer term, trends in the amount of longer term debt and the direction of longer term market interest rates will determine the lasting impact on net City interest costs. Over the past four years, both City longer term debt levels and longer term interest rates have declined slightly.

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Chart 1: City Interest Expense & Earnings



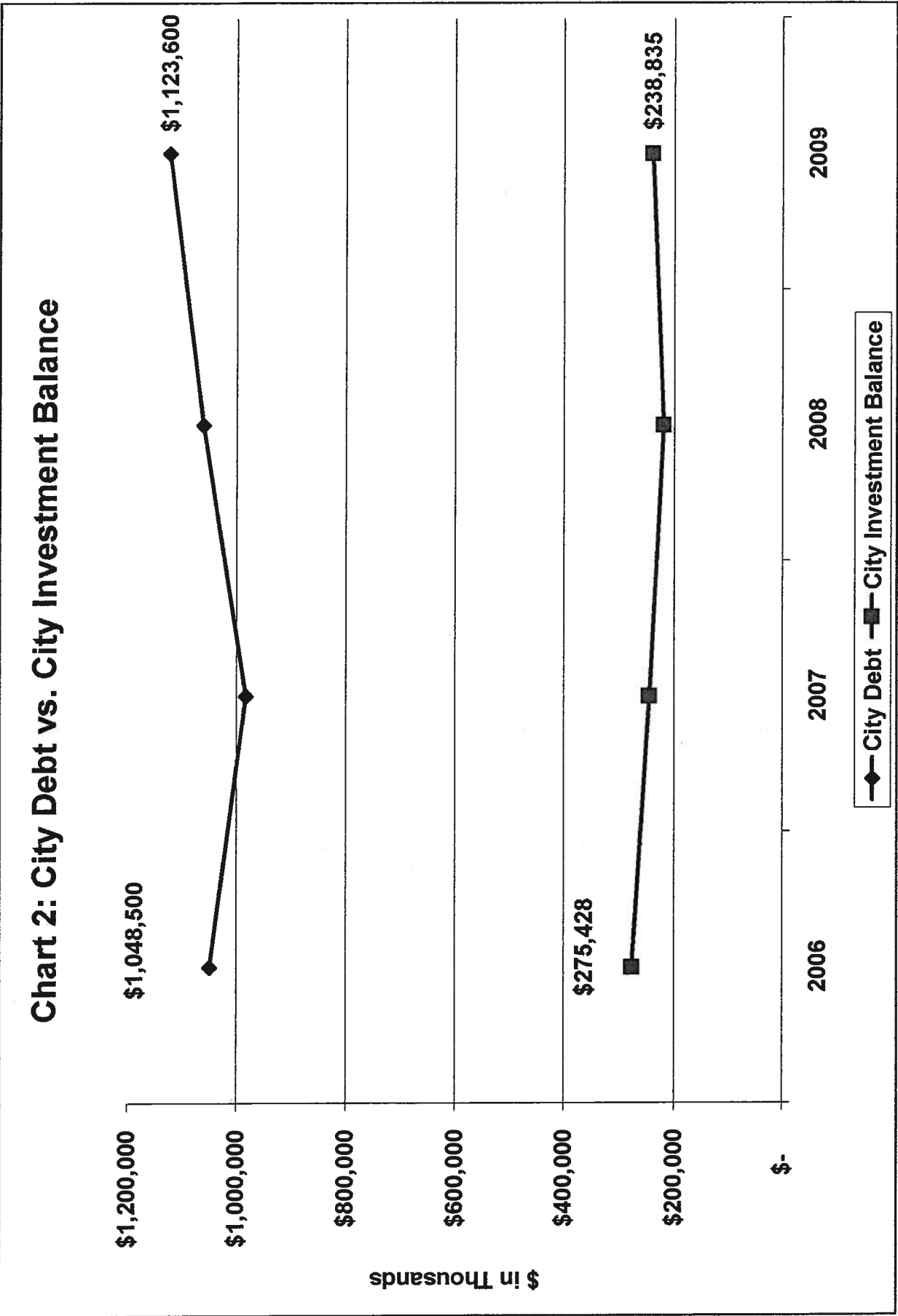


Chart 3: City Debt: Short (<1 Yr) vs Longer Term Debt

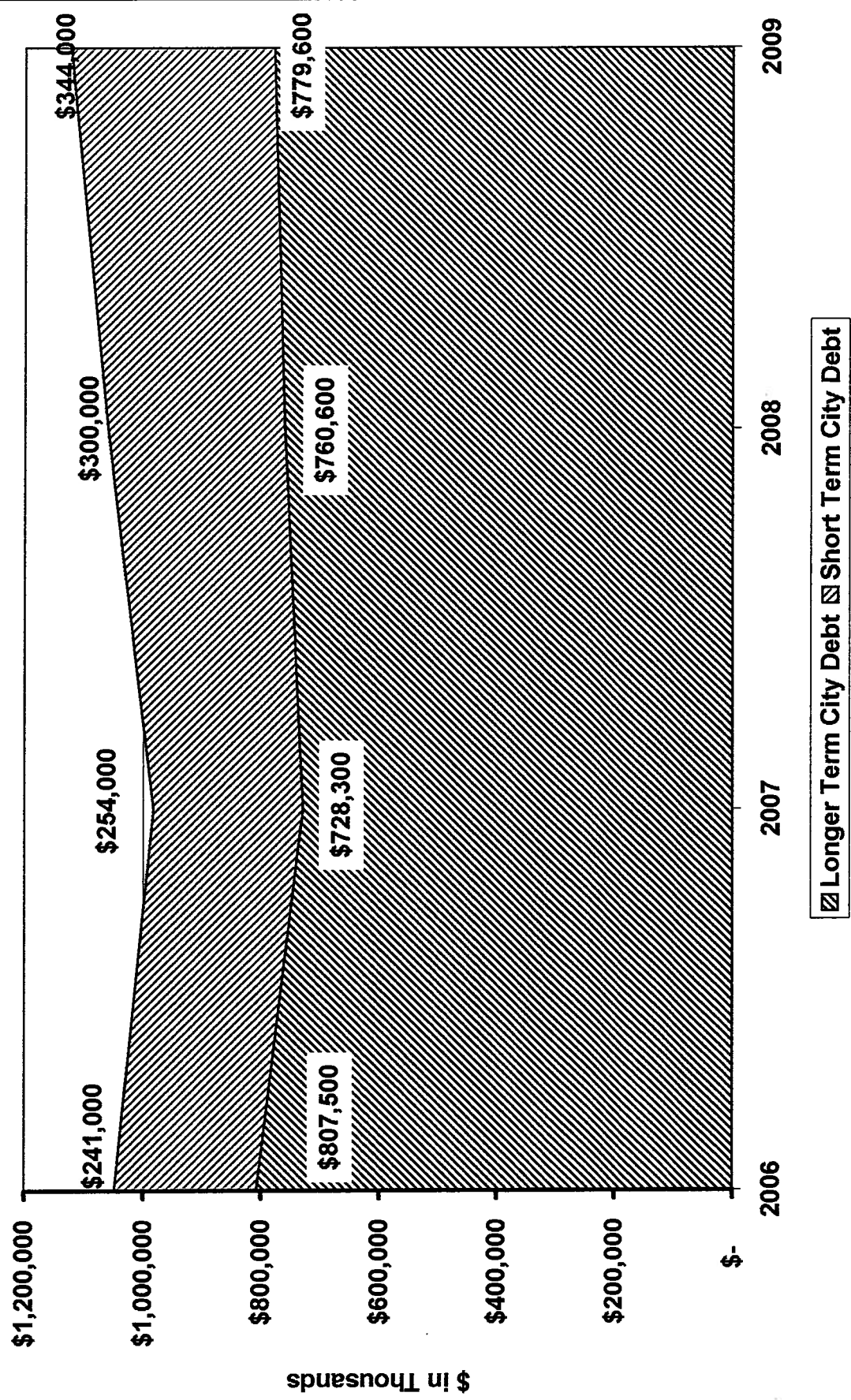


Chart 4: City Short Term RAN Debt vs. RAN Interest Cost
 (\$ in 1,000's)

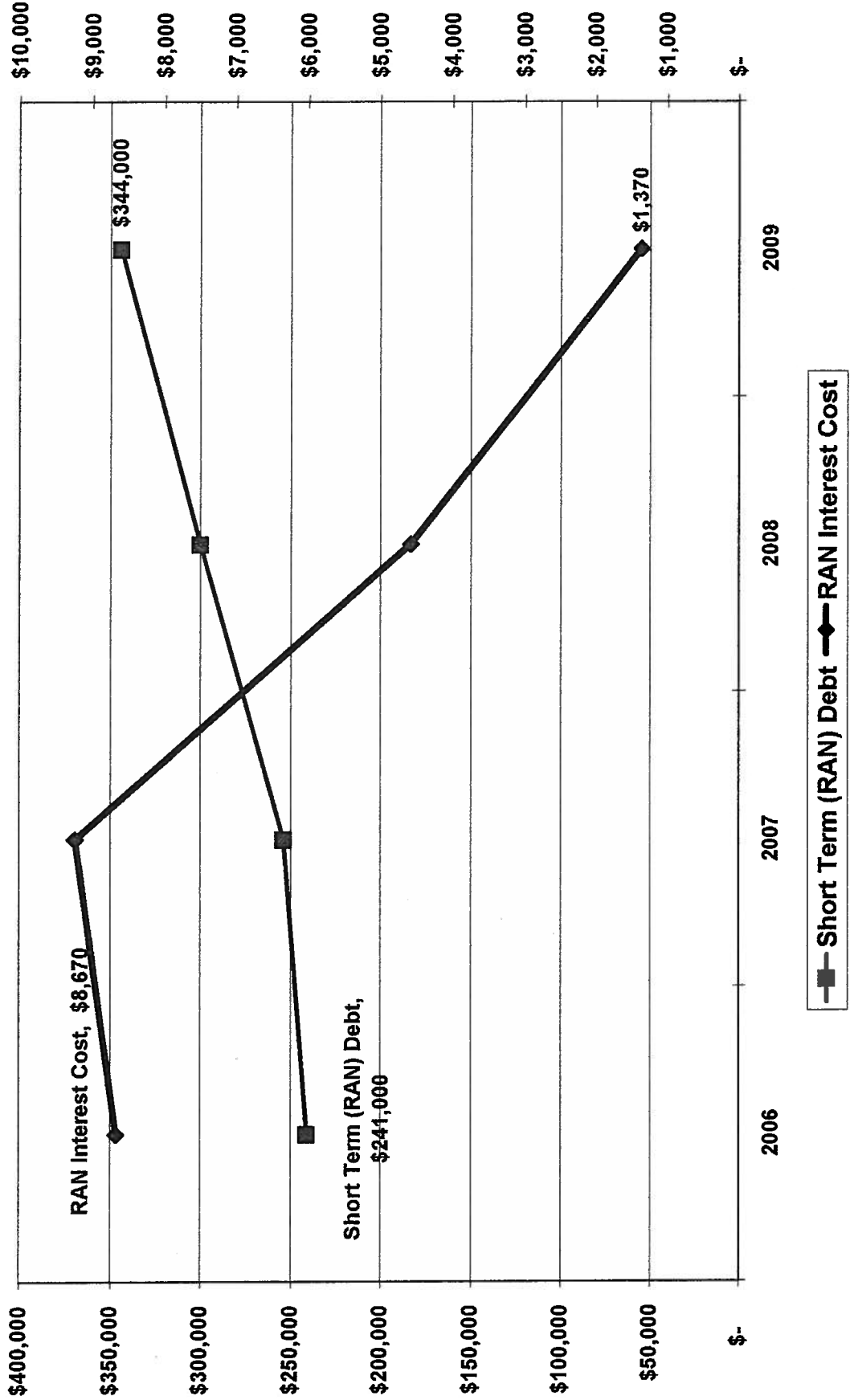


Chart 5: City Short Term Investment vs. Borrowing Rates

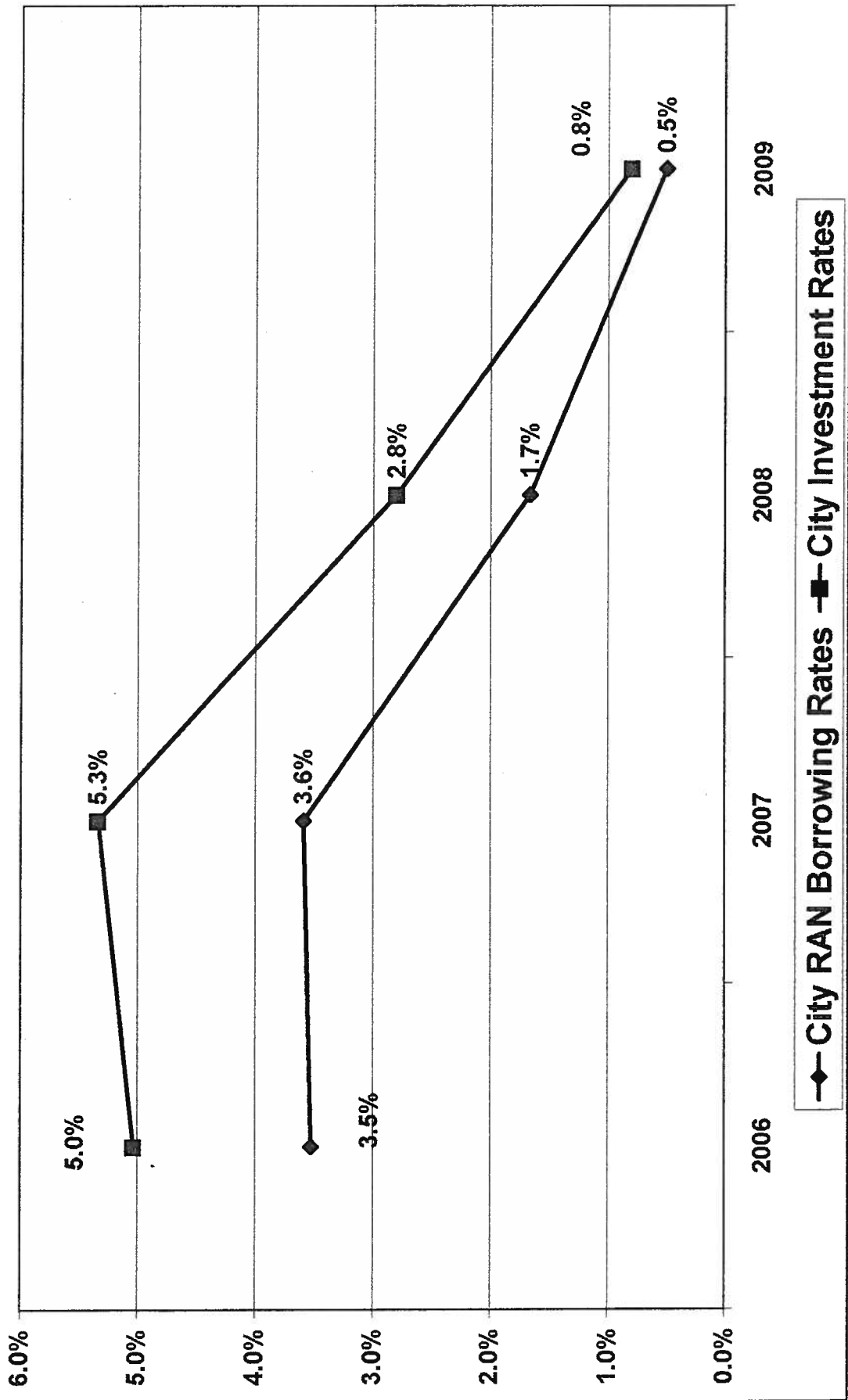
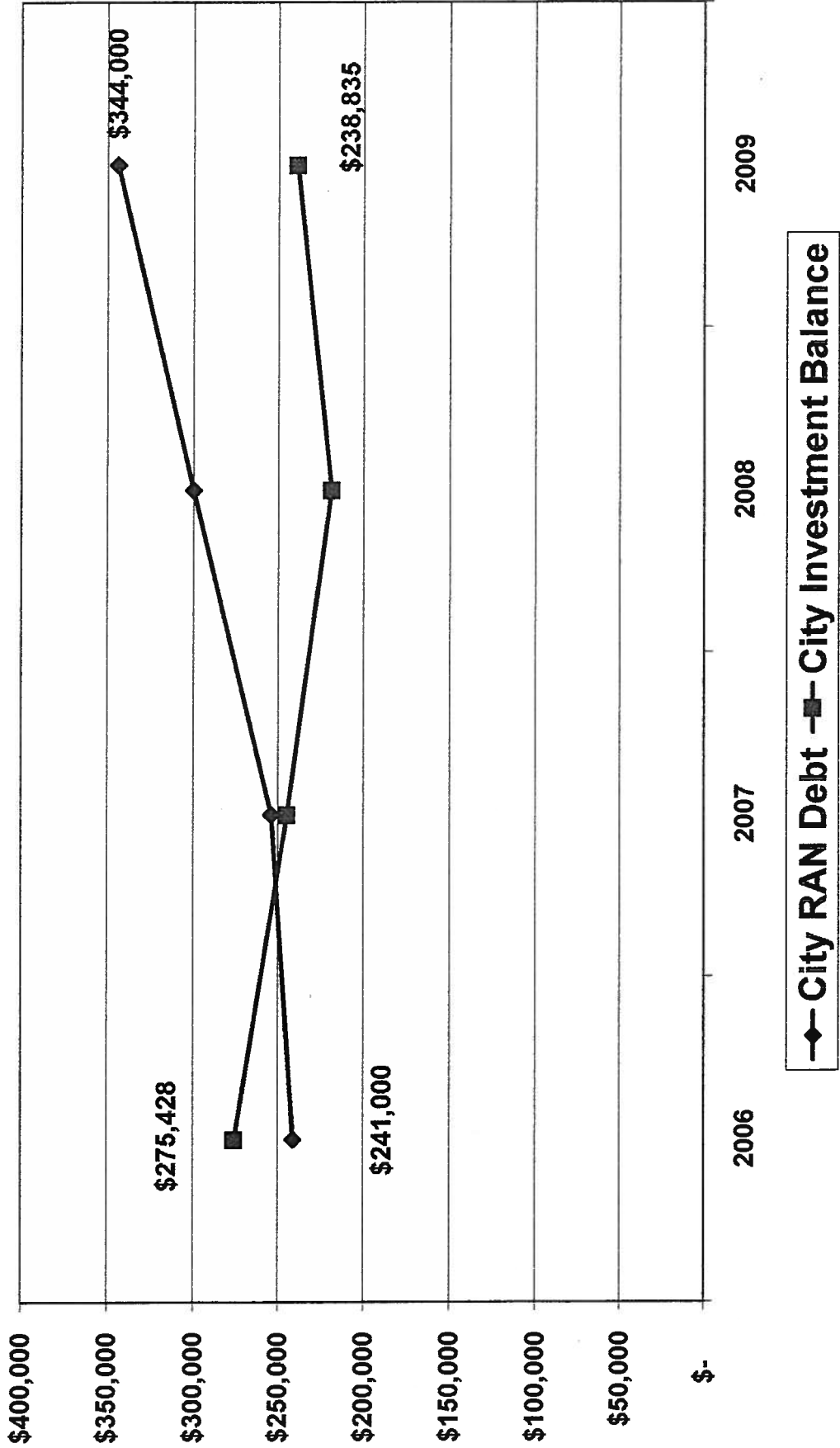


Chart 6: City RAN Debt vs City Investment Balance
(\$ in 1,000's)



◆ City RAN Debt ■ City Investment Balance

