Refunding and Reorganizing Your Agency's Debt Obligations

CDIAC Conference
Debt 3: Debt Administration

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What is a refunding?

- A Refunding is the issuance of debt using the proceeds from that debt to retire or provide debt service on previously issued bonds (defease)
  - For accounting purposes, once a refunding is executed, the refunding transaction is on the issuer's books and the refunded transaction is removed from the issuer's books
- Refundings are done to:
  - Provide debt service and/or present value savings
  - Remove or change a bond covenant (ie: old documents did not permit surety policy in the DSRF, get rid of additional bond test)
  - Change the mode or term of a bond (ie: fixed to variable, weekly reset to longer put/term mode, extend the maturity, etc.)

Does a refunding have to issue new tax-exempt bonds?

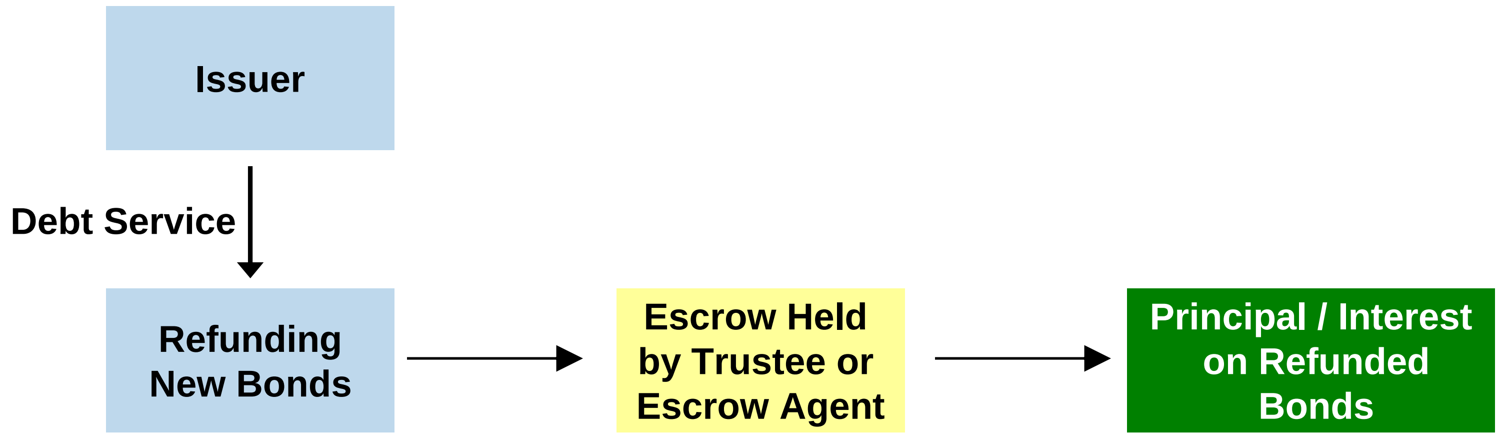
- No, refunding of tax-exempt debt does not have to be done with tax-exempt debt!
- Tax-exempt debt can be refunded/defeased with:
  - Tax-exempt debt
    - Fixed Rate
    - Variable
    - Forward Refunding
  - Cash on Hand
  - Taxable debt
    - Fixed Rate
    - Variable

Types of Refundings under Tax Law

- **“Advance Refunding”**
  - New debt is sold more than 90 days before the redemption date of the old debt
  - In general, a bond can only be advance refunded once
    - Exception for bonds issued prior to January 1, 1986
- **“Current Refunding”**
  - New debt is sold less than 90 days before the redemption date of the old debt
  - There are no restrictions on the number of current refundings

Mechanics of a Refunding

- Refunding Bonds are issued to:
  - Pay scheduled principal and interest on old bonds until the call date
  - At the call date, the principal of the old bonds is paid to investors, plus a call premium, if applicable
  - At that point, only the new (or refunding bonds) are outstanding



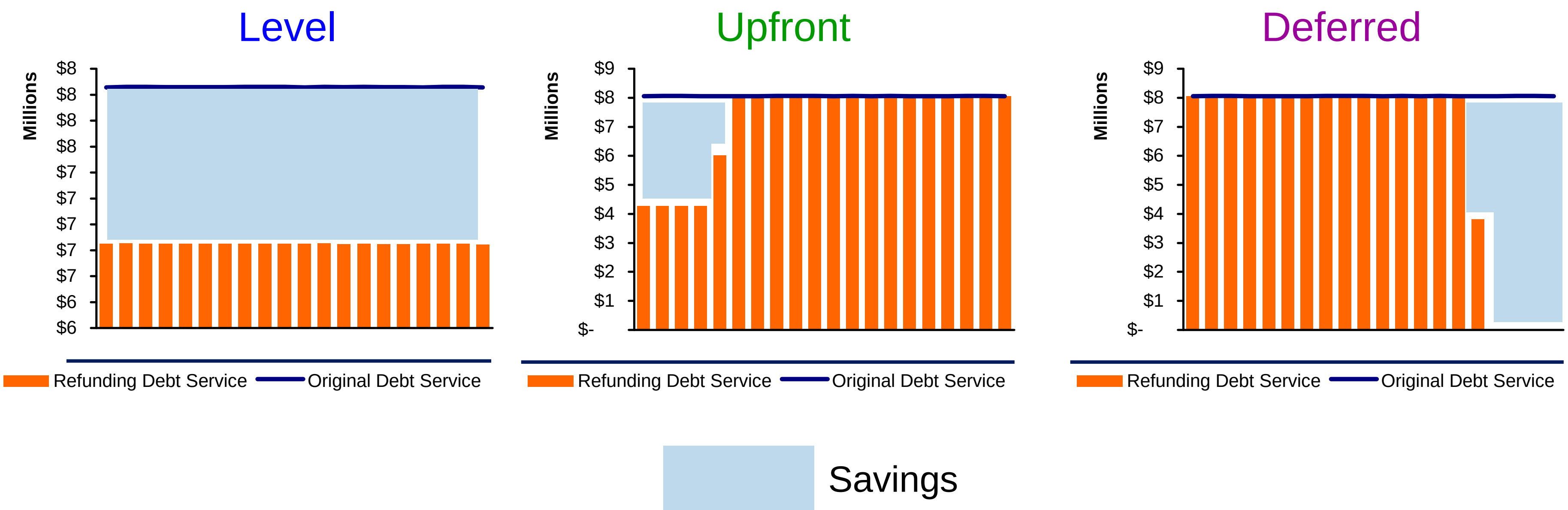
A large portion of the bond proceeds of a refunding issue are invested in a portfolio of securities, called an ESCROW, which is structured to have principal and interest payment dates occur on the same dates as the principal and interest payments of the refunded bonds.

Refunding Example – Sources and Uses

SOURCES AND USES OF FUNDS		
2011 Refunding Bonds		
Sources:		
Bond Proceeds:		
	Par Amount	36,330,000.00
	Net Premium	1,584,288.90
		37,914,288.90
Uses:		
Refunding Escrow Deposits:		
	Cash Deposit	0.96
	SLGS Purchases	37,625,145.00
		37,625,145.96
Delivery Date Expenses:		
	Cost of Issuance	125,000.00
	Underwriter's Discount	161,337.77
		286,337.77
Other Uses of Funds:		
	Additional Proceeds	2,805.17
		37,914,288.90

Savings Structures (Generally)

- Level - equal annual savings through maturity (most common and most conservative)
- Upfront – near term savings with remaining debt service equal to prior debt service
- Deferred – maintains prior debt service in the near term and shortens final maturity



Escrows

- If interest rates on the escrow securities are lower than the refunding bond yield there is "negative arbitrage"
  - More refunding bonds must be sold to make up for the lower earnings rate
  - Can impact issuer's ability to reach savings targets
- If interest rates on the escrow securities are higher than the refunding bond yield, there would be "positive arbitrage"
  - Under tax law, the escrow yield is reduced to be $\leq$ the bond or arbitrage yield
- Escrow Investments and how you get them:
  - SLGs (State and Local Government Securities)
  - USTs (Treasuries)
  - GICs (Guaranteed Investment Contracts)

Refunding Example – Escrow Cash Flow

ESCROW CASH FLOW

2011 Refunding Bonds

Date	Principal	Interest	Net Escrow Receipts	Present Value to 10/03/2011 @ 0.5564673%
1/1/2012	2,703,689.00	47,122.15	2,750,811.15	2,747,077.08
7/1/2012	635,693.00	95,380.56	731,073.56	728,055.47
1/1/2013	2,696,638.00	94,435.70	2,791,073.70	2,771,839.14
7/1/2013	603,959.00	91,064.90	695,023.90	688,319.04
1/1/2014	30,985,166.00	89,856.98	31,075,022.98	30,689,854.26
	37,625,145.00	417,860.29	38,043,005.29	37,625,145.00

Escrow Cost Summary

Purchase date	10/3/2011
Purchase cost of securities	37,625,145.00

Target for yield calculation	37,625,145.00

Discussion Items

- Refunding uses up a call option which is a valuable asset
- How is savings measured
  - Cashflow
  - %PV
- Use it or lose it savings
- Gross vs. Net Savings
  - Effect of lowering/changing the DSRF earnings rate
- Competitive vs. Negotiated sale for refundings
- Unwinding swaps – How that can affect the refunding
- Effect of discount/premium on savings structure
- Call Options
  - Actual – ie: 10 year par call
  - Hidden – ie: lower coupons
- Tax Complications:
  - Transferred Proceeds
  - Multipurpose Allocation