Legislative Fiscal Bureau
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February 10, 1998

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Senate Bill 410/Assembly Bill 744: Bonding Authority for Refunding State Debt

Senate Bill 410/Assembly Bill 744 would provide additional bonding authority to the Building Commission for the refunding of the state's general obligation debt. SB 410 was introduced on January 20, 1998, and referred to the Joint Committee on Finance. An identical bill (AB 744) was introduced in the Assembly on January 27, 1998, and referred to the Joint Committee on Finance

SUMMARY OF BILLS

The bills would increase the bonding authorization for refunding tax-supported debt by $385 million and the authorization for refunding self-amortizing debt by $95 million. In addition, the bills would provide $25 million in additional discount sale of debt bonding authority. The effect of SB 410/AB 744 on the level of bonding authority available for refunding state debt is shown in the following table.

Refunding Authority Available
Under Current Law and Under the Bills
(in Millions)

Bonding Purpose	Current Amount Authorized	Remaining Amount Available	Proposed Additional Amount	Total Available Under SB 410/AB 744
Refunding tax supported general obligation debt	$1,740.0	$39.8	$385.0	$424.8
Refunding self-amortizing general obligation debt	180.0	4.2	95.0	99.2
Discount Sale of Debt	65.0	12.9*	25.0	37.9
Total	$1,985.0	$56.9	$505.0	$561.9

* Reflects proposed 1998 Series A bond issue.

ANALYSIS

Current refunding bonding authority is $1.74 billion in general fund supported bonding and $180 million in self amortizing bonding and $65 million in Building Commission discount sale of debt. The last increase in the level of the state's refunding was provided in 1995 Act 40: $100 million in general fund supported refunding authority and $15 million self-amortizing refunding authority. The state last issued bonds under this refunding bonding authority in February, 1996, when $104.8 million was issued.

Refinancing as a Debt Management Tool. The refinancing of debt is a debt management tool that can be used to replace an existing stream of debt service payments with an alternative stream of payments. In refinancing state debt, the state issues new general obligation bonds (the refunding bonds) and uses the proceeds of that bond issue for payments on outstanding debt (the refunded bonds). If the refunded bonds are callable, they are called and paid off shortly after the refunding bonds are issued in a current refunding. If the bonds to be refunded are not callable until a future date, then the proceeds of the refunding issue are held in an escrow account that will make all future debt service payments on the refunded bonds. All aspects of the refunding must comply with federal law.

Generally, debt is refinanced in either an economic refunding or a structural refunding, or a combination of those methods.

Economic Refunding. In an economic refunding, the new stream of debt service payments is designed to reduce the total cost of the outstanding debt and is typically undertaken to take advantage of reduced interest rates. No increase in debt service payments occurs in any year due to an economic refunding and debt service payments are reduced in some or all years during the life of the refunding issue. The transaction can be structured so that the debt service savings are realized equally in each year during the life of the refunding bonds or concentrated in the early or late years of the transaction.

Structural Refunding. In a structural refunding, the new stream of debt service payments can be higher or lower in a given year than under the current stream of payments. For example, the debt service payments in the early years of the refunding could be reduced while debt service payments are increased in future years. A structural refunding tends to increase the average life of debt. Bonds are outstanding longer and therefore, the interest costs tend to be greater.

Once refunding bonding authority has been authorized by the Legislature, it may be used for either the economic refunding of state debt or a combination of restructuring and economic refunding. For the refunding bonds issued in the past five years, it has been the intent of the Governor and the Department of Administration (DOA) to use the refunding authority for those issues to carry out economic refundings rather than structural refundings. The Building Commission has final approval at the time of sale on any refunding issue.

Staff from DOA indicate that the refunding authority provided under the bills would again be used for an economic refunding of the state's debt, because it is DOA's intention to make principal payments under the replacement stream of debt service payments at the same levels and term as the original debt service payment stream. In doing so, debt service payments for any given year during the repayment period would not be higher than the payments that would have otherwise occurred under the original debt schedule nor would the life of the debt be extended.

FISCAL EFFECT

The bills would provide the state with enough refunding bonding authority to refinance all of the state's possible outstanding refundable maturities. However, DOA indicates that under the market conditions that existed when the Department's fiscal estimate was prepared it was estimated that it would be advantageous to refinance as much as $188 million in outstanding state maturities. If market conditions improve further, the state could refund more than $188 million. However, the actual amount of debt to be refinanced under the authority provided in the bills will fluctuate with market conditions.

DOA's fiscal estimate indicates that based on recent market conditions, the potential present value savings from the estimated $188 million of debt that may be refinanced would total an estimated $5.75 million over the life of the refunding bond issue. Of this amount, an estimated 75%, or $4.3 million, would be attributable to refunding general fund supported debt, and 25%, or $1.45 million, would be attributable to refunding self-amortizing debt.

Present value represents the discounted value of the savings that would accrue in future years. A present value calculation is used to evaluate the savings amounts, because savings from the refunding issue can be realized in differing years depending on the structure of the issue. By calculating the present value of different patterns of savings, it is possible to compare refunding issues that have savings amounts generated at various times.

The actual dollar amount of savings in each year would depend on the interest rates and market conditions existing at the time of issuance, the structure selected for the bond issue and the fiscal years in which savings are scheduled to occur. Based on market conditions at the time the fiscal estimate was compiled, it is estimated that the refinancing of $188 million of the state's existing refundable bonds would result in savings of approximately $270,000 GPR and $90,000 SEG or PR annually in reduced debt service payments from the agencies' various debt service appropriations. If market conditions make it advantageous to refund more than $188 million, the level of savings associated with the lower debt service cost on the refunding bonds would likely increase.

Prepared by: Al Runde

MO# passage

2 BURKE	Y	N	A
DECKER	Y	N	A
JAUCH	Y	N	A
SHIBILSKI	Y	N	A
COWLES	Y	N	A
PANZER	Y	N	A
SCHULTZ	Y	N	A
ROSENZWEIG	Y	N	A
1 GARD	Y	N	A
OURADA	Y	N	A
HARSDORF	Y	N	A
ALBERS	Y	N	A
PORTER	Y	N	A
KAUFERT	Y	N	A
LINTON	Y	N	A
COGGS	Y	N	A

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