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General Obligation Bonding Refunding Authority (Building Commission)

[LFB 2013-15 Budget Summary: Page 77, #2]

CURRENT LAW

The state may contract public debt in an amount not to exceed $1,775,000,000 to refund the whole or any part of any unpaid indebtedness used to finance facilities from tax-supported or self-amortizing general obligation bonds. Current law specifies that it is the intent of the Legislature that this refunding authority only be used if the true interest costs to the state can be reduced.

GOVERNOR

Increase the bonding authorization for refunding of any outstanding tax-supported or self-amortizing state general obligation debt by $2,010,000,000, from its current level of $1,775,000,000 to $3,785,000,000. These bonds could only be issued if the debt refinancing meets the current law requirement that the true interest costs to the state must be reduced.

DISCUSSION POINTS

1. 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 to pay off the 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.

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

3. 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.

4. Since 2001, the state has carried out structural refundings of $1,455.1 million in short term commercial paper and general obligation bond principal payments through the issuance of refunding bonds. Under these structural refundings, the state issued refunding bonds and used the proceeds on those bonds to make payments on current year principal due on its general obligation debt, or rolled over commercial paper that otherwise would have been paid off. These actions increased the average life of the debt refunded, and because the principal that would have been repaid was outstanding longer, the state incurred higher interest costs

5. DOA indicates that the $2.0 billion proposed increase in refunding bonding authority would be used to carry out economic refundings. DOA indicates that the $2.0 billion is an outside estimate of the potential amount of the state's $8.0 billion in outstanding general obligation debt that could be refunded. Using prior authorization, over the past ten years, the State has been able to realize more than $100 million of debt service savings (present value basis) by completing refunding transactions. Because future interest rates and the bonds which could be refinanced are unknown at this time, the amount and timing of any savings to the state associated with this refunding bond authority is unknown.

6. Because the refunding would be required to meet the test of having to reduce the true interest costs of the state, the proposed bonding could not be used to carry out a structural refunding similar to those carried out in recent years. However, depending on the spread between coupon rates of the bonds being refunded compared to the current market rates for those same maturities, it could be possible for refunding bonds to have a component of debt restructuring and still meet that test. That is, the overall interest savings associated with the spread between the rates on the existing bonds and the refunded bonds, could allow DOA Capital Finance to structure the refunding bonds amortization schedule so principal payments in the early years are lower than the amounts scheduled to be repaid under the existing amortization schedule of the refunded bonds. It may be possible to schedule the principal payments in this fashion and still generate true interest savings.

7. If the Committee is concerned that any of the $2.0 billion refunding authority could possibly be used to restructure the principal payments being refunded, the Committee could specify another test that would have to be met before the bonds are issued. The Committee could provide

that the refunding bonding could only be issued if the annual principal payment on the refunding bonds does not exceed the principal payments currently due on the bonds that would be refunded for the life of the refunding bonds. The current law true interest costs savings test would have to be met as well.

8. Another approach that could enhance legislative oversight would be to authorize a lesser amount of refunded bonds. If the Committee would provide $500,000,000 of refunding bonds, rather than $2,010,000,000 as under the Governor's recommendation, the administration could still do a sizeable refinancing. However, subsequent legislation would be required before it could undertake subsequent transactions, which would offer the Legislature an opportunity to assess the results of the initial refinancing.

ALTERNATIVES

1. Approve the Governor's recommendation.

2. Modify the Governor's recommendation by adopting one, or both, of the following:

a. specify that the refunding bonding could only be issued if the annual principal payment on the refunding bonds does not exceed the annual principal payments currently due on the bonds that would be refunded for any year the refunding bonds remain outstanding; and/or

b. reduce the amount of refunding bonds authorized in AB 40 by $1,510,000,000. Under this alternative, $500,000,000 of refunding would be authorized.

3. Delete provision.

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