



Current Practices Governing General Obligation Bonds and Certificates of Participation Fresno County Office of Education

The Decision to Refund

February 2, 2010

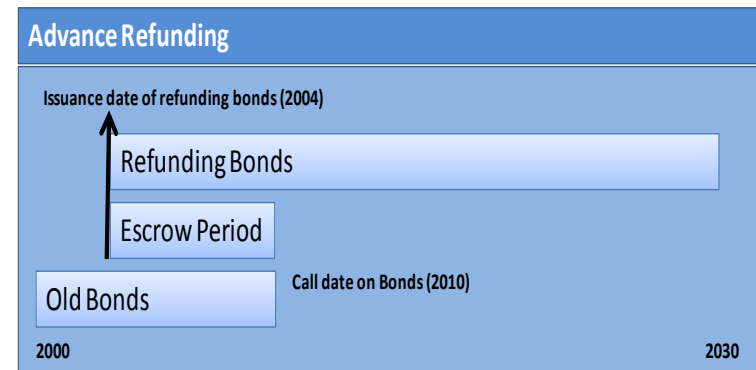
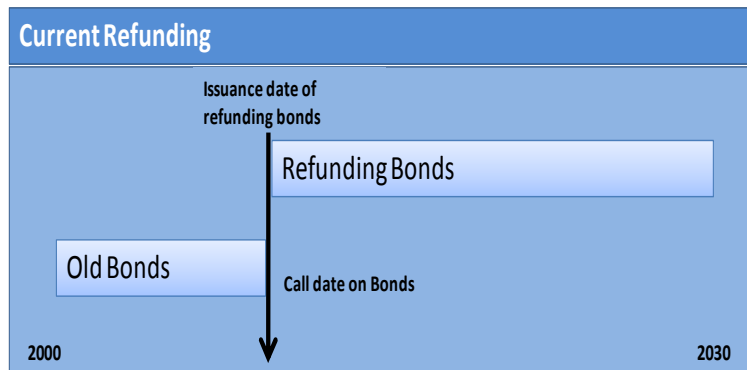
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Refunding Overview

- A refunding is “a procedure whereby an [issuer](#) refinances [outstanding bonds](#) by issuing new [bonds](#). There are generally two major reasons for refunding: to reduce the issuer’s [interest](#) costs or to remove a burdensome or restrictive [covenant](#) imposed by the terms of the bonds being refinanced.” Municipal Securities Rulemaking Board
- Type of refundable bonds
 - General obligation bonds
 - \$1 of gross debt service savings
 - Final maturity not change
 - Certificates of participation
 - No debt service savings or final maturity limitation
 - Lease revenue bonds
 - Variable rate demand obligations
 - Mello Roos Bonds
- Advanced or Current refunding
- The value of the redemption option.

Advanced vs. Current Refunding

- Current Refunding
- The new debt is sold in less than 90 days before the redemption date (call date) of the old debt.
- No limit on this transaction
- Advanced Refunding
- The new debt is sold more than 90 days before the redemption date (call date) of the hold debt.
- One time



Reasons to Refund

- Economic
 - Interest rate savings due to change in interest rates
 - General fund
 - Taxpayer savings
- Non-Economic
 - Covenant changes in legal documents
 - New requirements, increase flexibility
 - Restructure debt service payments
 - Cash flow adjustments, defeasance, change in use, overall change in debt service
 - Restructure of failed securities
 - Auction rate securities, variable rate demand obligations

The Refunding Environment

- Opportunities to refund outstanding bonds occur when there are significant changes in the market.
 - Changes in economics.
 - Changes in the municipal market
 - Changes in specific variables related to a particular sector.
- Refunding options develop most commonly in conjunction with interest rate changes.
 - For economic refundings, tax-exempt interest rates traditionally decrease allowing for a new issuance of bonds at lower interest rates.
- Refunding options develop as a bond debt matures.
- Non-economic refundings are ruled by factors others than interest rates.
 - Changes in economics and markets.

2010 Refunding Environment

- The economic downturn and credit crises dating from 3rd quarter 2008 have altered the tax-exempt markets.
- Interest rates have remained low due to a number of factors.
 - Federal Reserve committed to longer term low rates.
 - ARRA
 - Strong Treasury market
- Reduced availability for bond insurance has increased focus and scrutiny on the credit quality of issuers.
- There are substantial infrastructure changes.
 - Change in composition of investment firms – now banks
 - Change in available capital to the municipal market
 - Change in investor base and appetite
 - Introduction of new securities
- Tax-exempt volume for bond issues has been very low.
- Taxable BABs have reduced tax-exempt issuance with the effect of lower interest rates.

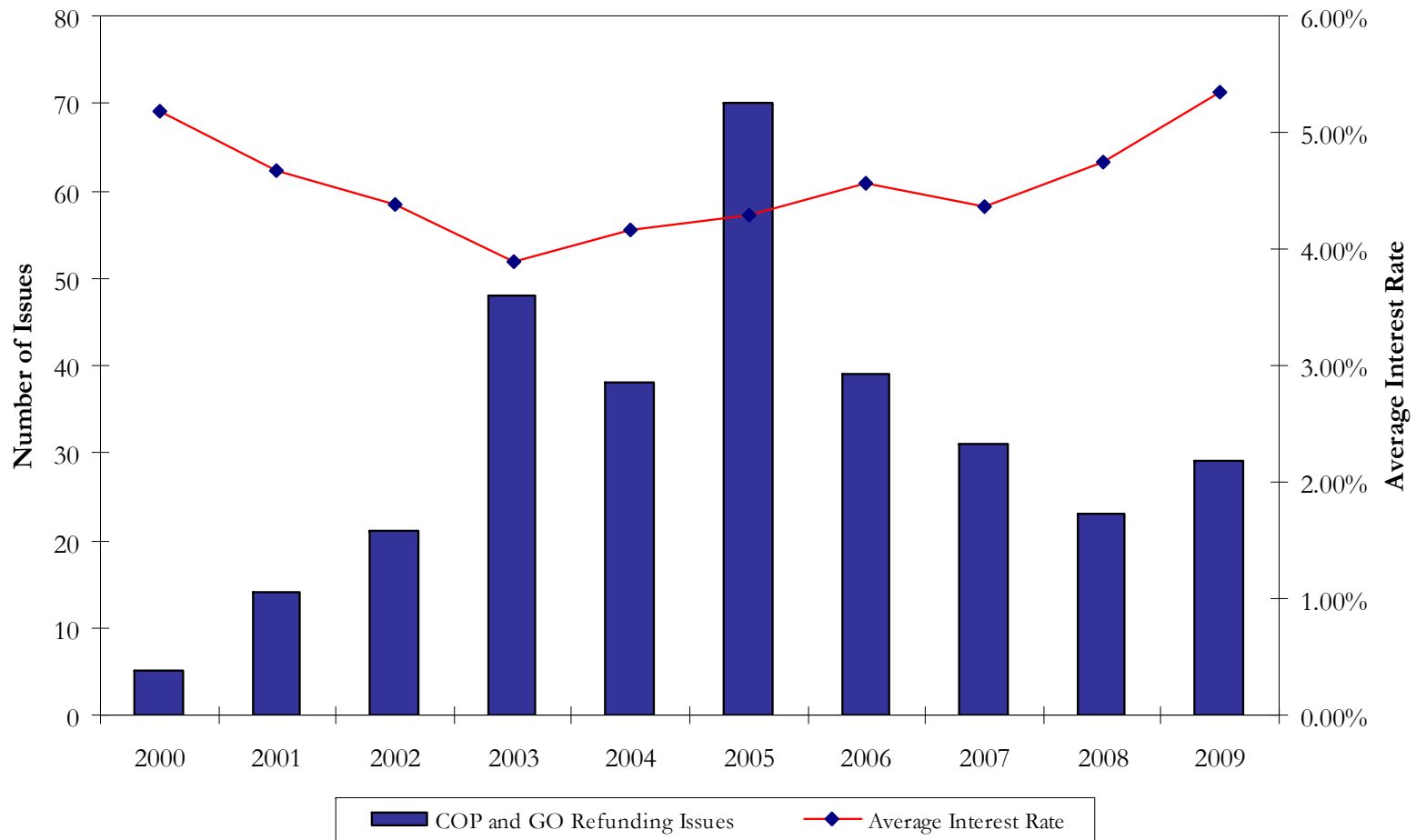


2010 Challenges for School Districts

- The credit crises and housing collapse have directly impacted most school district's assessed values and their tax rates.
 - Districts with new authorization are unable to issue bonds.
 - Districts with facility programs and financing underway are restricted.
 - Districts with completed programs and financings are facing higher tax rates.
 - Many District's have tax rates exceeding the Proposition 39 limit
 - \$60/\$100,000 AV for unified school districts
 - \$30/\$100,000 AV for elementary and high school districts
 - \$25/\$100,000 AV for community college districts
 - Many Districts are confronted with statutory debt capacity limits.
 - \$1.25% AV for elementary and high school districts
 - \$2.5% AV for unified school districts
 - Waiver Process



2000's Decade Refunding Environment



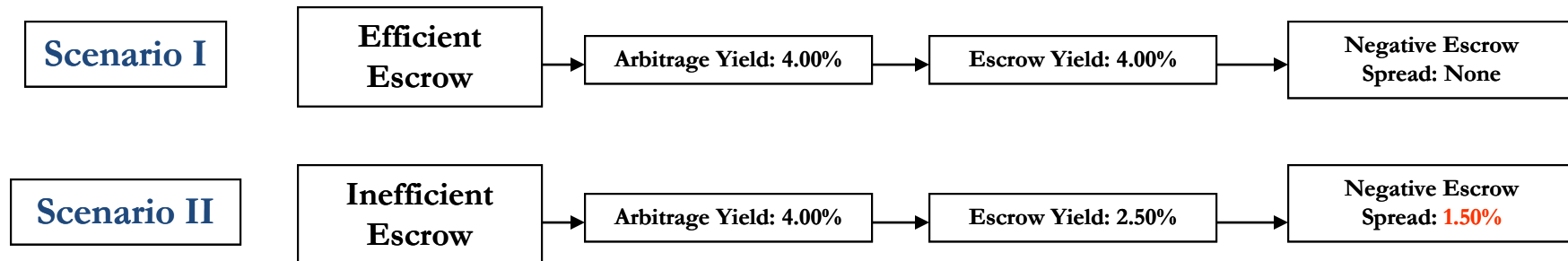
Source: *The Bond Buyer*



Certification of Participation Challenges

- Certificates of Participation (COPS) are payable from general fund revenues or parcel tax, redevelopment, developer or Mello-Roos fees.
- Certificates of Participation have been issued to augment facility funding needs.
- Certificates of Participation have been issued as a “bridge” financing with intention of state funds or future GO issuance.
- COPS are issued as
 - Fixed rate, callable, 30 maximum year maturity
 - Variable rate demand bonds
- As all District revenue sources have decline, COP debt service becomes a serious constraint on the general fund.
- District’s with VRDO’s face increase cost of credit, decline in credit, and frequently increased interest rates.

Refunding Escrow Issues (Negative Arbitrage)



What is Negative Arbitrage?

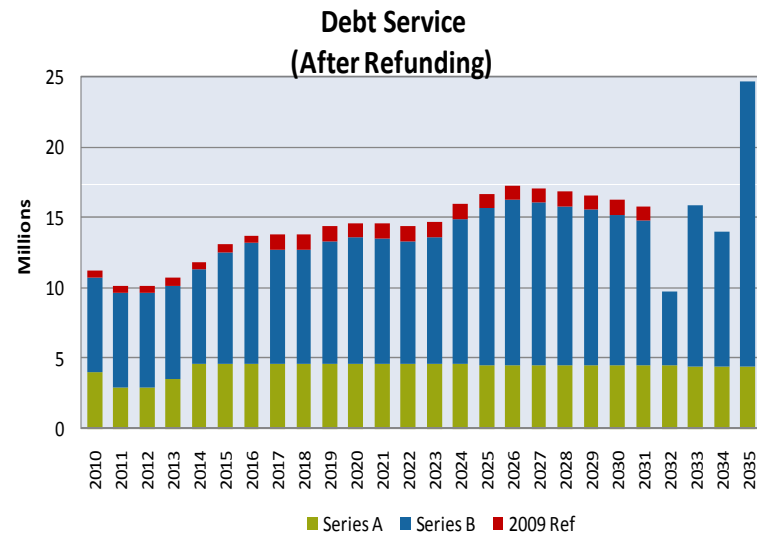
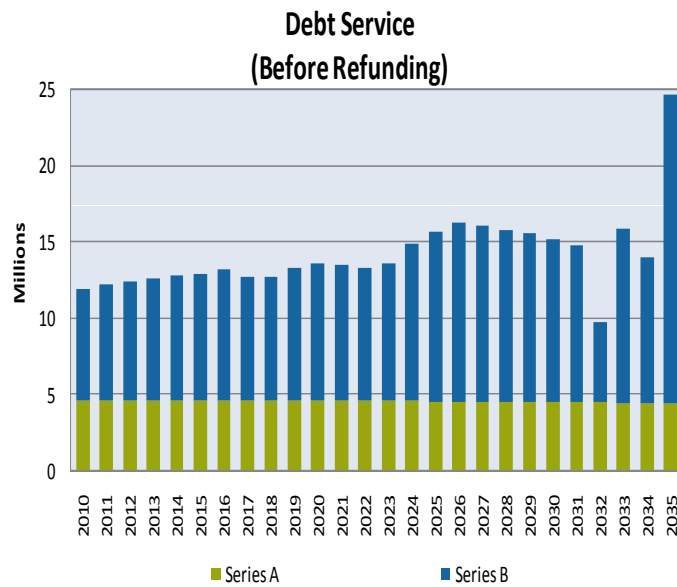
- Refunding bond proceeds are placed in an irrevocable trust account to defease the bonds being refunded to a particular date (optional redemption date or call date)
- The irrevocable trust earns interest to make the refunding economical to the school district
- If investment earnings during the duration of the irrevocable trust are less than the allowable earnings rate, the arbitrage yield, then negative arbitrage exists (scenario II above)
- If negative arbitrage exists, the school district issues more bonds than it otherwise should if an efficient escrow environment exists (scenario I above)
- As of January 21, 2010 bond issues with optional redemption dates after 2011 have substantial negative arbitrage given where short to mid term interest rates currently trade

Refunding/Restructuring Options

- Base Case I
 - District with 2002 and 2006 authorization. 2002 is complete with 3 series of bonds and 2006 has two series completed and needing final series 2009. Assessed values have declined 15% restricting the issuance of new money bonds to conform with the \$60 per \$100,000 tax rate of Proposition 39.
 - Solution
 - Refund/restructure short term bonds from the 2006 series, reallocating the debt service to later maturities
 - Refund bonds from the 2002 series for economic savings and to meet the \$1 of gross savings test.
 - Evaluate/use alternative structures including Capital Appreciation Bonds, convertible CABs, Build American Bonds.
 - Solution
 - Bridge financing
 - Bond anticipation note

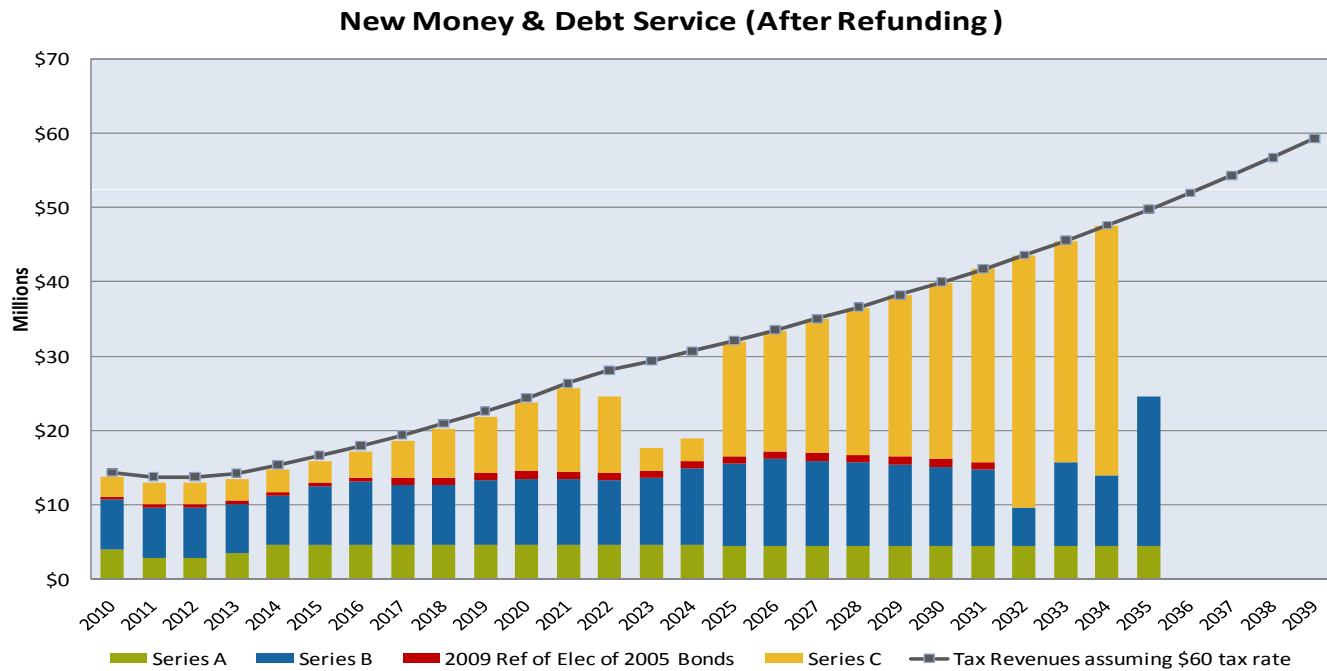
Refunding/Restructuring Debt Service

Examples



Restructured Debt Service with New Money

Example



Refunding/Restructuring Options

- Base Case II
 - District has four outstanding certificates of participation. All four were originally insured but now are rated one notch below the District's GO rating. Developer fees have vanished.
 - Solution
 - Determine current and advance refunding availability and financial feasibility of each refunding or combination of refundings. Depending on the interest rates of the COPS, debt service may be restructured to provide short term general fund relief.
- Base Case III
 - District has an outstanding variable rate bond (VRDO) with an letter of credit that expires in December 2009. The letter of credit provider has been downgraded and the District's bonds are now bank bonds.
 - Solution
 - Convert VRDO to fixed rate bonds

Refunding and Costs of Issuance

- Costs of Issuance (COI) are directly related to refunding savings.
- The greater the COI the less the refunding savings.
- There are usual and customary categories of costs for a refunding
 - Fees from three rating agency.
 - Verification agent validates numbers.
 - Underwriter's Discount includes expenses, take-down and management fee.

Expense

Bond Counsel

Disclosure Counsel

Financial Advisor

Rating Agencies

Verification Agent

Printer

Trustee/Paying Agent

Underwriter Discount

Insurance

Savings Thresholds

- Measurement of savings is important.
 - % of refunded par (after all costs) **savings**, in present value terms, of at least x% of the refunded debt
 - Issuers typically use a Present Value Savings target of between 3% and 5% of refunded par measured on a maturity-by-maturity or aggregate basis
 - “Gross” or “net” savings
 - For example, it is important to take into account the offset in savings from lower interest rates by the loss of any earnings on a debt service reserve fund
 - The yield on a debt service reserve fund is limited to the bond yield on the refunding bonds
 - Lowering the arbitrage rate on new bonds may require more arbitrage rebate, eating away some of the “net” savings
- Total dollar savings rule:
 - An issuer may impose an absolute minimum dollar savings as well
- “People in suits” rule:
 - The savings we realize should be significantly greater than the fees paid to the people who are offering to “help” us:

Non-Economic – Risk Thresholds

- For every refunding restructuring there are risk components.
 - Importance of meeting the \$1 of gross savings test
 - Analysis of the use of the bond call (asset) for an advance refunding.
 - Interest rate trends in relation to an advance refunding.
 - Refunding structure on tax rates – reduce or increase.

Refunding Summary

- Changes in the school financing landscape requires rigorous analysis to measure the risk and reward of any refunding transaction.
- Refundings have been the vehicle for many troublesome transactions in the past.
- Restructuring refundings must be evaluated for financial and legal risks.
- Creative short term solutions must fit with long term goals.
- Only one advance refunding allowed per bond issue.