

MEMORANDUM

TO: Board of Directors, Massachusetts School Building Authority
FROM: John K. McCarthy
DATE: May 30, 2012
RE: Refunding Authorization

To date, the MSBA has issued \$5.89 billion of bonds to support the Authority's grant programs. As of June 30, 2012, the MSBA will have \$5.44 billion bonds outstanding, of which \$3.96 billion were issued with a ten-year par call. The nearest call date for any of the Authority's outstanding bonds is in August 2015 for the series 2005A bonds. As soon as 90 days prior to that call date, the Authority could exercise the call provision and execute a current refunding. Alternatively, the Authority may exercise the call through an advance refunding of bonds issued with a call. The Authority has not refunded any of the debt it has issued to date; however, the passage of time and the decline in interest rates from the date of original issuance has increased the savings associated with refunding some of the Authority's outstanding callable debt.

One of the most challenging aspects of executing a refunding is the determination of the timing of the transaction. Whereas the timing of a "new money" issuance is determined by the need to raise funds to assist with cash flow to support specific capital projects, the determination of the timing of a refunding issue is not directly linked to the need for cash flow to support the underlying capital projects. The opportune time to execute a refunding is more difficult to determine, as the issuer is executing the transaction in order to realize savings on the debt service associated with the original issuance of bonds being refunded rather than being driven to issue by the need to raise funds to continue to support capital projects.

While there are many factors that impact the savings from the refunding of debt, one consideration is the length of time between the execution of the refunding and the call date. Exclusive of the impact of inclining or declining interest rates in the future, as a general rule, the nearer an issue is to the call date the better the opportunity to refund debt and achieve significant savings. The increase in savings nearer the call date is due, in part, to the shorter average life of the refunding bonds as the call date approaches. As an example, in a similar interest rate environment if an issuer refunds 30-year debt after five years from the date of the original issue, the issuer would be issuing new 25-year debt. If that same issuer waits ten years to refund the original issue, it will be issuing only 20-year debt. In a similar interest rate environment, the 25-year debt carries a higher interest rate than 20-year debt, and thus the savings from a refunding can increase as the call date approaches and the average life of the refunding issue decreases.

Another critical factor impacting the savings associated with a refunding is the interest rate environment in which the refunding bonds are issued. The interest rate environment is critical because it impacts the rate of interest on the refunding bonds. As a general rule, the lower the interest rate that is applied to the refunding bonds, the better the opportunity to achieve savings from the refunding of the debt. There is therefore a constant balance that occurs in the analysis to include both the impact of waiting for the call date to approach and attempting to determine if the rates will increase, while also considering the estimated benefits of waiting for the call date to approach and being able to issue debt with a shorter final maturity.

Staff continuously monitors potential savings from executing a refunding. During recent months, the occurrence of historically low interest rates has begun to indicate that the Authority may be able to realize significant debt service savings through the issuance of refunding bonds on some of the Authority's outstanding callable debt. Due to the observation of this analysis, the Authority recently requested that

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members of the Authority's pool of seven qualified senior underwriters provide specific information and analysis associated with a refunding of the Authority's debt at this time. The underwriters have commented that the savings from a refunding in the current interest rate environment are greater today than in they would have been in previous years. The underwriters have also provided estimated ranges for the increase in interest rates that would need to occur in order to decrease the amount of savings from executing a refunding in the current interest rate environment. The analysis suggests that it is currently an opportune time for the Authority to take advantage of historically low interest rates in order to realize debt service savings on some of the Authority's outstanding debt.

At this time staff recommends that the Authority prepare for the execution of a refunding. Staff recommends an authorization to issue an aggregate principal amount up to \$1.2 billion of refunding bonds in one or more series of refunding debt issuances.

Staff recommends that three firms (Citi, Jefferies & Company, and J.P. Morgan) be designated as senior managers for these series of refundings. Each of these firms is a member of the Authority's pool of qualified senior underwriters, pursuant to an RFQ issued in 2009 and updated in September 2011. As mentioned above, each of these firms responded to the Authority's recent request for information for refunding debt. Additionally, each of these firms has provided ongoing refunding analysis over the past several months.