MEMORANDUM

TO: Board of Directors,
Massachusetts School Building Authority

FROM: John K. McCarthy

DATE: November 12, 2014

RE: Defeasance and Refunding Authorization

To date, the Massachusetts School Building Authority ("MSBA") has issued $6.4 billion of "new money" bonds, and $300 million bond anticipation notes, to support the MSBA's grant programs. Additionally, the MSBA has issued approximately $1.7 billion of refunding bonds in order to reduce interest costs associated with previously issued bonds. As of November 30, 2014, the MSBA will have $5.5 billion bonds and $300 million BANs outstanding[1].

At this time, in order to realize savings, reduce the amount of MSBA debt outstanding, and enhance debt service coverage, staff recommends a defeasance of the two non-callable August 15, 2015 maturities of the 2005 Series A which, upon execution, will legally retire the MSBA's obligations with respect to these bonds. This will maximize the benefit of enhanced debt service coverage for outstanding MSBA bonds, and provide capacity to issue refunding bonds payable in fiscal year 2016 that had originally been scheduled to be paid in fiscal year 2031. To execute the defeasance, the MSBA will use non-borrowed funds to establish an irrevocable escrow account into which it will deposit enough proceeds from the purchase of U.S. Treasury securities to satisfy the remaining debt service on these bonds.

It is important to note that of the approximately $77.5 million the MSBA would allocate for this defeasance, the MSBA's trustee will have already set aside $24 million by November 30, 2014, and would be required to set aside the additional $53 million towards debt service on these bonds between December 2014 and July 2015 even absent this proposed defeasance, pursuant to the debt service funding requirements in the MSBA's trust agreement. Staff would intend to execute the defeasance in mid-December 2014 to early January 2015, and shortly before the proposed refunding.

Following the defeasance, only the August 2016 and August 2030 maturities would remain outstanding on the 2005 Series A bonds with a total par amount of $104.9 million, and staff recommends that those bonds be advanced refunded in the current interest rate environment in order to achieve debt service savings and enhanced debt service coverage. MSBA intends to structure the proposed refunding issue, which would be sold on a competitive basis, to have only one maturity in January 2016. As part of this transaction, staff anticipates that the remaining amount of the 2005 Series A debt service reserve fund of approximately $26 million would be released and deposited into the escrow fund established for the refunded bonds in order to reduce the size of the refunding issue. These actions would lower debt service in all fiscal years from 2016 through 2031. Most of the bonds being refunded carry 5% coupons and would be replaced with bonds that

[1] Of the bonds issued to date, approximately $3.8 billion of the bonds were issued with a ten-year par call. The nearest call date for any of the MSBA's outstanding bonds is in August 2015 for the series 2005 Series A bonds. As soon as 90 days prior to that call date, the MSBA could exercise the call provision and execute a current refunding. Alternatively, the MSBA may exercise the call more than 90 days prior to the call date through an advance refunding of the bonds. The MSBA has already advance refunded $1.8 billion of the 2005 Series A callable bonds. The passage of time and the decline in interest rates from the date of original issuance has increased the savings associated with refunding the remaining 2005 Series A callable debt.

have a much lower yield. Due to the acceleration of the principal repayment, the refunding would also lower the maximum annual debt service which in turn improves the debt service coverage ratio.[2]

Staff intends to engage Acacia Financial Group, Inc. to act as an independent financial advisor to the MSBA on the refunding and defeasance transaction. Acacia was one of the firms selected, through a procurement process in 2014, to assist the MSBA with debt management financial advisory services.

Bond Counsel for these transactions will be Mintz, Levin, Cohn, Ferris, Glovsky, and Popeo, P.C. Disclosure counsel will be Greenberg Traurig, LLP. Each of these firms was qualified pursuant to a procurement process conducted for bond and disclosure counsels services in February 2013, and have served in these roles for the MSBA since that time.

Staff discussed the proposed defeasance and refunding with the Administration, Operations and Finance Subcommittee ("Subcommittee") at a November 10, 2014 meeting, and the Subcommittee expressed unanimous support for both the defeasance and refunding. At this time, staff recommends that the MSBA continue preparations for the execution of a defeasance, and an advance refunding to be sold via a competitive bid process.

[2] The maximum annual debt service would be lowered in fiscal year 2024 by approximately $1.4 million. That reduction is equal to the interest on the August 2030 maturities.