MEMORANDUM

To:	Board of Directors, Massachusetts School Building Authority
From:	John K. McCarthy, Executive Director
Date:	May 28, 2014
Subject:	Recommendation for Next Debt Issuance - Bond Anticipation Notes ("BAN"s)

This information in this memorandum is a follow up to information that was presented to the MSBA's Administration, Operations and Finance Subcommittee on May 12, 2014.

To date, the Massachusetts School Building Authority ("MSBA") has issued a par amount of approximately $6.4 billion of "new money" bonds to support the Authority'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 May 1, 2014, the MSBA had a par amount of approximately $5.6 billion bonds outstanding.

During Fiscal Year 2014, the MSBA has paid out an average of $12 million New Program grants each week. Staff anticipates that a total of approximately $623 million New Program grants will be paid in Fiscal Year 2014. The primary funding source for the New Program grants has been the proceeds from the 2013 Series A bond issue that closed in July 2013. The MSBA sold a par amount of $549 million through the sale of the 2013 Series A Bonds. Based on the project cash flows for the New Program grants, staff anticipates expending the last of 2013 Series A bond proceeds during the next few months. As of the close of business on May 1, 2014, $15.3 million of the 2013 Series A bond proceeds were unexpended. All of the remaining 2013 Series A proceeds are allocated for specific projects, and will spend down over the next few months as districts submit reimbursement requests through the MSBA's Progress Payment System to receive grant payments.

As anticipated in the MSBA's financial planning for Fiscal Year 2014, as the 2013 Series A proceeds reach full expenditure, the MSBA will begin using unrestricted sales tax revenues[1] to make New Program grant payments until the MSBA receives proceeds from the next debt issuance. In Fiscal Year 2014, the MSBA anticipates allocating approximately $100 million of unrestricted sales tax revenues towards pay-as-you-go funding of grants paid through the Progress Payment System. Accordingly, staff is recommending that the MSBA begin preparations for the next issuance of debt to support the projects in the capital pipeline in order for the timing of the receipt of the proceeds from the next debt issuance to align with the MSBA's goal of spending down approximately $100 million of unrestricted sales tax funds for pay-as-you-go funding of grant payments.

For the next debt issuance, staff is recommending that the MSBA issue $300 million of Bond Anticipation Notes ("BANs") in order to take the opportunity to realize the benefit of the low interest rates, and strong investor demand, on the very short end of the yield curve. A BAN is a short-term, and temporary, financing mechanism that will be retired with the proceeds of a longer-term bond issue when the BAN matures. As a short-term financing mechanism, a BAN with a one year maturity can be expected to have a very low debt service cost in the current interest rate environment for an issuer with the MSBA's credit quality and market access. In addition to the low debt service cost, another benefit of issuing a BAN at this time is that the issuance of the BAN is not anticipated to affect the MSBA's senior lien debt service

[1] The total projected FY14 year-end balance available is estimated to be approximately $160 million. Additionally, dedicated monthly SMART sales tax collections will make additional funds available for pay-as-you-go funding as part of the FY15 finance plan. It should be noted that inherited program grant (Prior Grants and annual Waiting List) payments, and the MSBA's operating expenses, are also paid from unrestricted sales tax revenues.

coverage ratio.[2] Currently the MSBA's senior lien debt service coverage ratio is calculated by the MSBA to be 2.10. The issuance of BANs rather than a long-term debt issuance for the upcoming transaction will allow for the projected growth in MSBA's School Modernization and Reconstruction Trust ("SMART") collections, as estimated by the Commonwealth's consensus tax revenue estimate for fiscal year 2015[3], to further strengthen the MSBA's debt service coverage before the next long-term debt issuance.

As part of this recommendation, staff is also seeking an authorization to issue the bonds that will be necessary to redeem the BANs when they mature in a year. The authorization to redeem the BANs is important because investors and rating agencies may consider the authorization to issue the debt that will redeem the BANs as part of the credit review process, and the authorization is also required by the MSBA's Trust Agreement.

The proceeds from the BAN sale are expected to provide sufficient funds for the MSBA to make Progress Payments for approximately six months. The MSBA's Fiscal Year 2015 budget includes an assumption that the MSBA will make a total of approximately $610.6 million New Program grant payments during the fiscal year. The MSBA estimates it will allocate approximately $135 million of unrestricted SMART sales tax revenue towards the New Program grant payments in Fiscal Year 2015. The allocation of unrestricted SMART sales tax revenue towards grants will continue to strengthen debt service coverage through a reduction of the amount of debt issued to support projects in the capital pipeline. Staff does anticipate seeking an additional debt authorization later in the fiscal year to issue additional BANs, or to re-establish the MSBA's commercial paper program, in order to fund the balance of grant payments to be made in Fiscal Year 2015 that are not financed through this initial BAN sale or the unrestricted SMART sales tax revenues. The specific timing and amount of additional borrowing in Fiscal Year 2015 will be determined later in the fiscal year following an analysis of actual grant payment cash flows and performance of sales tax collections during the fiscal year.

The BANs will be issued via a competitive bid process. The final determination of the date of the sale will depend upon the pace of the requests from districts for grants through the Progress Payment System during June, and the anticipated calendar of other issuers raising funds in the market. At this time, staff expects to price and close the transaction no later than the end of July 2014, and may accelerate the timeline of the sale dependent upon the pace of grant payments and market conditions.

Staff has assigned Acacia Financial Group, Inc. to act as an independent financial advisor to the MSBA on this BAN transaction. Acacia was one of the firms selected, through a procurement process earlier this year, to assist the MSBA with debt management financial advisory services.

Bond Counsel for the issue will be Mintz, Levin, Cohn, Ferris, Glovsky, and Popeo, P.C. Disclosure counsel for the issue will be Greenberg Traurig, LLP. Each of these firms has been qualified to provide the services to the MSBA pursuant to a procurement process conducted for bond and disclosure counsel services in February 2013.

If the vote for the transaction is authorized, staff would anticipate providing the Board with an update on the results of the BAN transaction at the meeting of the Board on July 30, 2014.

---

[2] Debt service coverage is a ratio that compares the revenue available to pay debt service to the amount of debt service required during a year. The coverage ratio established by the Additional Bonds Test calculation in the MSBA's Trust Agreement is a critical factor for parties evaluating the MSBA's credit quality, as it is utilized as an indicator of an issuer's ability to pay the debt service on the bonds. Higher debt service coverage ratios are viewed favorable by rating agencies, credit analysts and investors.

[3] On January 14, 2014, the Secretary of Administration and Finance, and the Chairs of the House and Senate Committees on Ways and Means announced a consensus on the tax revenue estimate for FY15. The FY15 consensus tax estimate included an estimate of $771.5 million for the SMART fund, which reflects a projected increase of 5.9% over the estimated collections of $728.3 million for FY14.