

MEMORANDUM

TO: Administration, Operations, and Finance Subcommittee
Massachusetts School Building Authority

FROM: James A. MacDonald, First Deputy Treasurer, Chief Executive Officer
John K. McCarthy, Executive Director, Deputy Chief Executive Officer

DATE: October 6, 2017

RE: FY 2018 Finance Plan: Takeout of Commercial Paper, New Money, Refunding, and
Defeasance Authorization

Discussed below are the MSBA's financing activities planned for FY 2018. The actions include fixing out an interim borrowing, raising new funds for grants, reducing the cost of existing debt and a measure to strengthen our credit profile.

To date, the Massachusetts School Building Authority ("MSBA") has issued \$7.29 billion of "new money" bonds to support the MSBA's grant programs. Additionally, the MSBA has issued approximately \$2.98 billion of refunding bonds in order to reduce interest costs associated with previously issued bonds. As of October 1, 2017 the MSBA had \$5.75 billion bonds outstanding.

In addition, the MSBA issued \$450 million of Tax-exempt Commercial Paper ("CP") in 2015. The CP was backed by three Letters of Credit ("LOC"). The LOCs will expire in March 2018. Prior to their expiration the MSBA will need to take out (refinance) the CP. The initial authorization of the CP included an authorization to issue bonds to refinance the CP. It is expected this debt will be issued in January 2018. Staff is reviewing options to take out the CP and will provide the specifics at the December Board meeting.

Looking ahead to FY 2019 staff projects the MSBA will need to issue approximately \$500 million of new debt to provide funding for anticipated FY 2019 capital grants. Accordingly there is a debt authorization for \$500 million. This debt will not be issued until late FY 2018 or possibly deferred into early FY2019. At this time the specific type of debt to issue has not been determined. As spring approaches staff will review market conditions to determine the preferable type of debt to issue. Reestablishing a commercial paper will be one of the options considered at that time.

Staff continuously monitors potential savings from executing a refunding. The ongoing occurrence of low interest rates indicates the Authority may be able again to realize significant debt service savings through the issuance of refunding bonds on some of the Authority's outstanding callable debt.

At this time the 2011 Series B bond issue has the most potential for significant refunding savings. The 2011 issue had an original par of \$1.0 billion and a call date of October 2021. \$747.69 million of callable bonds are still outstanding. The bonds under consideration to refund carry 5% coupons, and one term bond has a 5.25% coupon.

At this time staff recommends that the Authority prepare for the execution of an advanced¹ refunding. Staff recommends an authorization to issue an aggregate principal amount up to \$750 million of refunding bonds in one or more series of refunding debt issuances. Staff recommends that a refunding go forward only if the net present value of a refunding is 6.0% or greater than the amount of the refunding bonds. The refunding will not take place until 2018 and is subject to market conditions.

As discussed in a separate board memo on procurements, the MSBA is reviewing investment banks submissions to provide underwriting services. After review of submissions a number of investment banks will be assigned to the pool of senior underwriters. From this senior underwriter pool several banks will be selected to serve as senior underwriters for the upcoming transactions.

Staff is also analyzing doing a portion of the CP takeout and refunding on a subordinate lien basis. This would be done to improve the MSBA senior coverage ratio. Calculated as required in our trust agreement, the MSBA's current senior coverage ratio is 2.33. However each of the rating agencies uses a somewhat different methodology to calculate coverage. Those methodologies result in lower ratios and at less than two times coverage. By issuing refunding debt on a subordinate lien basis the rating agencies would be able to calculate our senior coverage ratio at over two times coverage. Being greater than two times coverage is important in maintaining our current ratings. The downside of a subordinate lien is a higher interest cost of about 5-10 basis points required to issue the debt and a somewhat lower savings from the refunding.

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.

In addition to the debt authorizations staff is also requesting an authorization to defease² some existing debt. By defeasing debt the MSBA is able to improve its Debt Service Coverage Ratio ("DSCR")³ and be viewed as a stronger credit. The existing debt to defease are maturities in the 2015 Series C and the

1 An advance refunding consists of the issuance of a new bond issue with the proceeds placed in escrow to pay the debt service until the call date of the bonds being refunded. The bond proceeds are invested in highly rated investments, such as US Treasury or Agency securities. The bond trustee serves as the holder of the escrow and pays the debt service.

2 Defeasing debt is similar to an advanced refunding. The source of funds are sales tax revenues, not bond funds. The funds are placed in an escrow and are used to pay debt service as required. Like an advance refunding the escrow is invested in highly rated investments, such as US Treasury securities and generates interest income until used. The bond trustee serves as the holder of the escrow and pays the debt service.

3 A Debt Service Coverage Ratio is calculated by dividing annual revenue by highest annual debt service. The higher the ratio the better the credit profile. Each rating agency and many financial analysts calculate the ratio in slightly different ways.

2016 Series A debt issues. The specific maturities identified are in FY 2019 through FY2024 and total \$78.205 million. The cost of defeasing will be greater than \$78.205 million because in addition to principal, semi-annual interest will need to be defeased. This defeasance is projected to improve the MSBA's DSCR by approximately nine points from the current 2.33 to 2.42. The defeasance is planned to be completed before the MSBA's next meetings with the rating agencies expected in December.

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 the recent procurement process conducted for bond and disclosure counsels services in August 2017.

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

VOTED: To authorize the Executive Director to apply available moneys of the Authority to the cash defeasance of a portion of the Authority's outstanding Senior Dedicated Sales Tax Refunding Bonds, 2015 Series C (the "2015C Bonds") and a portion of the Authority's outstanding Senior Dedicated Sales Tax Bonds, 2016 Series A (the "2016A Bonds") in an principal amount not to exceed \$80,000,000, and in furtherance thereof the Executive Director, with respect to the cash defeasance, is hereby delegated all powers of the Authority under Section 3B of Chapter 70B of the Massachusetts General Laws.

VOTED: To authorize the Executive Director and such other officers of the Authority as the Executive Director may designate, acting singly, upon the advice of the Authority's bond counsel, to do all acts and things and to execute and deliver any and all documents, certificates and other instruments necessary or desirable in connection with the cash defeasance of a portion of the 2015C Bonds and the 2016A Bonds, including without limitation one or more defeasance escrow agreements, and one or more agreements providing for the investment of moneys made available for cash defeasance.

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

VOTED: The Executive Director is hereby authorized to provide for the issuance by the Authority of one or more series of Dedicated Sales Tax Bonds (the "Bonds") pursuant to Section 206 of the Trust Agreement dated as of August 1, 2005 (as amended, supplemented and restated, the "Trust Agreement") between the Authority and The Bank of New York Mellon Trust Company, N.A., as trustee (the "Trustee") in an aggregate principal amount not to exceed \$500,000,000, and in furtherance thereof the Executive Director, with respect to the Bonds, is hereby delegated all powers of the Authority under Section 3B of Chapter 70B of the Massachusetts General Laws.

VOTED: The Executive Director and such other officers of the Authority as the Executive Director may designate, acting singly, upon the advice of the Authority's bond counsel or disclosure counsel, to do all acts and things and to execute and deliver any and all documents, certificates and other instruments necessary or desirable in connection with the issuance of the Bonds, including without limitation a purchase contract providing for the sale of the Bonds, a preliminary and final official statement with respect to the Bonds, continuing disclosure agreements, and one or more supplemental trust agreements.

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

VOTED: To authorize the Executive Director to provide for the issuance by the Authority of one or more series of senior or subordinate Dedicated Sales Tax Refunding Bonds, (the "Refunding Bonds") pursuant to Section 207 of the Trust Agreement dated as of August 1, 2005 (as amended, supplemented and restated, the "Trust Agreement") between the Authority and The Bank of New York Mellon Trust Company, N.A., as trustee (the "Trustee") in an aggregate principal amount not to exceed \$750,000,000 for the purpose of refunding all or a portion of the Authority's outstanding Dedicated Sales Tax Bonds, 2011 Series B (the "2011B Bonds"), and providing for costs of issuance of the Refunding Bonds, and in furtherance thereof the Executive Director, with respect to the issuance of the Refunding Bonds and all other transactions contemplated hereby, is hereby delegated all powers of the Authority under Section 3B of Chapter 70B of the Massachusetts General Laws, provided that the present value of the aggregate debt service savings associated with the Refunding Bonds shall be at least 6% of the principal amount of the Refunding Bonds and provided, further, that the proceeds of the Refunding Bonds may be deposited in a refunding escrow.

VOTED: To authorize the Executive Director and such other officers of the Authority as the Executive Director may designate, acting singly, upon the advice of the Authority's bond counsel or disclosure counsel, to do all acts and things and to execute and deliver any and all documents, certificates and other instruments necessary or desirable in connection with the issuance of the Refunding Bonds and/or purchase or redemption of the 2011B Bonds, including without limitation a purchase contract providing for the sale of the Refunding Bonds, a preliminary and final official statement with respect to the Refunding Bonds, continuing disclosure agreements, one or more supplemental trust agreements, one or more refunding escrow agreements, and one or more agreements providing for the investment of the proceeds of the Refunding Bonds.