

To : Board of Directors

Massachusetts School Building Authority

From: James A. MacDonald, First Deputy Treasurer, Interim Chief Executive Officer

John K. McCarthy, Executive Director, Deputy Chief Executive Officer

Subject: Defeasance of Debt to Improve Debt Service Coverage Ratio

Date: April 27, 2017

A key factor used by ratings agencies in evaluating MSBA credit is the Debt Service Coverage Ratio (DSCR)¹ on debt outstanding. The higher the DSCR, the stronger the debt issuer is viewed by the agencies. A high DSCR can lead to a high credit rating. A DSCR can be improved by either increasing the revenues used to calculate the ratio or decreasing the amount of debt service. Because MSBA revenues are almost exclusively in the form of sales taxes it is not practical to attempt to raise that factor in the DSCR calculation.

The Authority has limited the Maximum Annual Debt Service (MADS) by the debt structure in recent debt issues. In recent debt issues, the years with the highest debt service have had the principal coming due reduced. A second way to decrease MADS is to defease² existing debt maturing in the years with the highest MADS.

Staff is requesting an authorization to defease up to \$46.0 million of bond par amount in this fiscal year. The debt identified to be defeased matures in FYs 2018 to 2024. This would eliminate approximately \$54.6 million of debt service over those years at an estimated net cost of \$50.9 million. This would improve the DSCR by approximately .04. This defeasance plus an additional defeasance in FY 2018 is intended to keep MSBA's DSCR over 2.00 as calculated by the rating agencies. Maintaining a 2.00 DSCR is intended to retain our high credit ratings.³

¹ MSBA's Debt Service Coverage Ratio is calculated by dividing the amount of revenue for a recent 12 month period with data by the highest or Maximum Annual Debt Service (MADS) in any future year.

² Debt is defeased by placing funds (US Treasury securities) with an Escrow Agent (usually the Bond Trustee). The Escrow Agent then uses those funds to pay the debt service on the debt service payment dates. Funds placed with the escrow agent continue to produce interest income which reduces the amount required to be deposited in the escrow.

³ Currently MSBA senior debt is rated AA+ by Fitch and S&P. Moody's rates MSBA senior debt Aa2.