

MEMORANDUM

TO: Board of Directors, Massachusetts School Building Authority
FROM: James A. MacDonald, First Deputy Treasurer, Chief Executive Officer
John K. McCarthy, Executive Director, Deputy Chief Executive Officer
DATE: March 27, 2018
RE: FY 2018 Finance Plan: Defeasance Authorization

As has been discussed in the past a Debt Service Coverage Ratio (DSCR)¹ is a major factor in a determination of the credit strength and credit rating of the Authority. There are three tools to manage and improve a DSCR. The first is to structure a debt issue to limit maturity in years that would cause a significant lowering of the ratio. A second is to refund existing debt to reduce debt service in critical years. The third is to use non bond proceeds (unrestricted sales tax revenues) to defease existing debt.

Structuring debt service can only occur at the time of a debt issue. The tax law signed into law in December significantly reduced the way issuers could refund debt. A method called advanced refunding² is no longer permitted under federal tax law. Now under federal tax law, an issuer must wait until the call date to refund the debt with tax exempt proceeds. The MSBA does not have any callable debt until FY 2022. This leaves defeasance as the only tool to use to manage coverage ratios in the near term, and a defeasance at this time will provide more structuring flexibility when the MSBA issues the next long term bonds.

Staff has reviewed defeasance options and portions of the 2012 Series A, 2013 Series A, 2015 Series B debt, and 2016 Series B issues can be defeased to provide a significant improvement in the DSCR. The defeasance of \$112.9 million of debt would decrease senior MADS by \$12.2 million and overall MADS by \$2.8 million. The senior DSCR would be improved from approximately 2.42 to 2.51. The overall DSCR would be improved from approximately 2.15 to 2.17. The defeasance would lower annual debt service for FY 2018 through 2038 in the aggregate by \$159.3 million. The estimated cost of the securities for the defeasance escrow to pay the debt service at maturity or the call date, if applicable, is approximately \$126.4 million.

The defeasance is planned to be completed before the MSBA's next meetings with the rating agencies expected in June.

¹MSBA's Debt Service Coverage Ratio (DSCR) is calculated by dividing the amount of revenue for a recent 12 month period by the highest or Maximum Annual Debt Service (MADS) in any future year. The specific methodology to calculate DSCR differs among the rating agencies and other analysts. The higher the ratio the stronger the issuer is viewed by analysts.

² An advance Refunding consists of the issuance of a new bond issue with the proceeds placed in escrow and used to pay the debt service until the call date of the refunded bonds. The proceeds are invested in highly rated securities such as US Treasury and Agency securities. The trustee holds the securities and pays the debt service on the refunded bonds.