State Bond Commission
Guidelines for Review of Refunding Bond Applications

As state and local governments are faced with providing funds for vital services and infrastructure needs, refunding or restructuring of current debt obligations have become more frequent in the low interest rate environment. It is important that clear guidelines be established for the protection of the taxpayer and to ensure that any refundings undertaken will be for the long term benefit of the community as a whole. For this reason, state and local governments need to establish criteria to guide them in the decision whether to refund a given bond issue. The following are suggested criteria:

I. <u>Present Value Savings</u>

When compared to the outstanding par amount of the issue being refunded, a minimum acceptable present value savings should be realized when computed at the true interest cost ("TIC"). Depending on the term of the bonds and the call provisions, setting a present value savings target of % is optimal.

II. <u>Public Purpose</u>

The public purpose should be clearly defined. Refundings that extend or restructure debt for other than pure "savings" should be discouraged in order to preserve the bonding capacity for new projects. Such a restructure should only be acceptable when the original debt was structured to take advantage of short term interest rates and the extension does not exceed the original asset life.

Although the rating agencies do not look to the amount of the present value savings, they do put a red flag on those issues which show extremely slim savings. Of primary concern to them is the restructuring of an issue and the extension of the final maturity. They view the postponement of near term debt service to be a "distress refunding" which could well result in a downward rating revision. A major change in the rate of retirement of debt in the 5 to 10 year period constitutes a postponement of debt service. Such "distress refundings" should be discouraged.

III. <u>Original Asset Life</u>

In no instance should a refunding or restructure of debt be considered that extends the asset life or the original asset financed. For example, debt issued to build a public building which has an asset life of 20 years should not be extended beyond that.

IV. <u>Overall Effect of the Refunding/Restructuring on the Revenues Pledged</u>

Any financing plan under consideration should include evidence that future debt service payments do not exceed the maximum debt service currently being paid. Refinancings which increase the amount of debt service in future years only limit the amount of funds available to do future projects.

V. Cost

Costs associated with refundings are not recoupable in the issue. Therefore, careful attention should be paid to all cost of the issue. To be cost-effective, the savings after all expenditures should be at least 1 ½ times the cost of the issue. For example, gross savings of $1,000,000 on an issue costing $400,000 leaves a net savings of $600,000 which is 1 ½ times the cost.

The above criteria will be used as guidelines by the debt analysts in reviewing refunding proposals and do not constitute a rule of the Bond Commission. If the refunding proposal being reviewed does not meet the above criteria, it will be brought to the attention of the Director of the Bond Commission.

The appropriate threshold of savings that should exist for an economic refunding:

Months To Call	Minimum Present Value Savings to Refund
Zero to Twelve	Net Present Value Savings Greater Than Zero
Thirteen to Twenty-Four	Net Present Value Savings Greater Than 1.5%
Twenty-Five to Forty-Eight	Net Present Value Savings Greater Than 3.0%
Greater Than Forty-Eight	Net Present Value Savings Greater Than 5.0%