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: April 07, 2020
Subject: Summary of Recent Financial Transactions

The MSBA recently executed:

1) An Escrow Restructuring related to the 2012A and 2016B bonds (previously defeased in May 2018),

2) A Defeasance of outstanding bonds in the following series: 2012A Refunding Bonds, 2012B Refunding Bonds and 2015D Refunding Bonds; and

3) Termination of Guaranteed Investment Agreement with FSA related to the debt service reserve fund associated with the 2012A and 2012B Refunding Bonds

A brief explanation of terms:

1) An **Escrow** is an account established to deposit proceeds of either MSBA cash or bond proceeds resulting from a defeasance or an advance refunding.

2) A **Defeasance** is the payment with available cash in advance of the call or maturity date of a series of outstanding MSBA bonds. The cash funds an **escrow** (unless the bonds are currently callable and paid off entirely) that serves to pay the debt service for the remaining time it is outstanding until it matures.

3) An **Advanced Refunding** is the refinancing of outstanding debt for interest rate savings and/or restructuring an overall debt portfolio (sometimes for budgetary relief). Up until recently (prior to the Tax Reform Act of 2017) the MSBA, like other governmental issuers, took advantage of issuing tax-exempt advanced refunding bonds. In more recent times, the 10-year Treasury Rate (the benchmark for the taxable market) has been very low as compared to MMD (and tax-exempt rates) enabling governmental issuer to execute taxable advanced refunding transactions (not prohibited) for substantial savings (the MSBA did so last November, resulting in a NPV savings of $135 million and 18%, with a gross debt service savings of approximately $9 million annually. In comparison, a **Current Refunding** is a refunding of outstanding bonds at their call date and do not require an **escrow.**

4) **Arbitrage rebate** is interest earnings that pursuant to IRS regulations for tax-exempt bonds is in excess of allowable earnings and must be "rebated" to the IRS. Arbitrage rebate must be tracked for bond proceeds, including debt service reserve funds and moneys in an escrow related either to a defeasance or an advance refunding (because the prior bonds have not matured and the escrow earns interest).

5) **SLGS** are **State and Local Government Securities**, which are securities available to governmental issuers by subscription.

Restructuring of the Escrow Agreement related to the MSBA's 2012A and 2016B Bonds that had been Defeased in May 2018

In a review of the MSBA's portfolio of debt and anticipated arbitrage rebate payments, it was discovered that the escrow related to these bonds had been structured with 0% securities (SLGS) in order to restrict additional interest earnings. In re-evaluating this escrow, it was determined that the yield at the time was not required to be restricted, and therefore, in order to earn back some amount of interest earnings that otherwise would have accrued to the benefit of the MSBA (in the form of a smaller cash contribution originally required to fund the defeasance escrow), the MSBA redeemed the 0% SLGS in the escrow and replaced them with interest earning SLGS. This resulted in approximately **$242,000** of cash released back to MSBA that otherwise would have been foregone, due to the fact the escrow could have been sized at the time of the May 2018 defeasance to account for those interest earnings and as a result would have required less cash to fund the escrow sufficiently at that time.

Defeasance of 2012A, 2012B and 2015D Bonds

This was a planned cash defeasance (similar to those executed in the past) and we received authorization from the Board for a maximum amount of $150 million. The MSBA's policy in structuring a cash defeasance has been and is to target outstanding bonds with high coupons in the years in which debt service requirements are the most significant. In addition to that goal, and related to this transaction, an arbitrage rebate payment of approximately $2 million would have been due to the IRS in February 2020 on the 2015D Bonds (as was reported to the Board at its February meeting). Again, in a review of the original rebate analysis associated with these bonds, it was determined that the MSBA had the flexibility to extend the required payment date until December 2020. By doing that, it created a window in which MSBA could utilize the planned defeasance to reduce the upcoming rebate payment, as well as completely eliminate the rebate payment that would be due in 2025 (approximately $3 million). This was achieved by incorporating some of the 2015D Bonds as a part of the planned defeasance (which also fit the criteria above of high coupons and in maximum annual debt service years). In addition to the overall debt service savings achieved by retiring $150 million in outstanding bonds with available cash, MSBA reduced the amount of rebate required to be paid in December 2020 by approximately **$300,000.** This is a result of the new defeasance escrow related to the 2015D bonds being funded with lower yielding investments, as well as a $50 million reduction in the amount of outstanding

2015D bonds as they were defeased. Additionally, the MSBA eliminated the rebate payment that otherwise would have been required in 2025 of **$3 million** (because the interest earnings on the new escrow over that time period will now be low enough to offset the positive earnings above the allowable bond yield).

Termination of the Guaranteed Investment Contract with FSA related to the 2012A and 2012B Refunding Bonds

Due in part to current market conditions, FSA proposed to terminate its GIC with MSBA (paying 4.8% interest) in exchange for a cash payment equal to the present value of all remaining scheduled cash flows under the GIC. The cash payment would be determined by a discount of the remaining cash flows based on the 10-year USD Swap Rate plus a spread of .20%. The MSBA worked with Omnicap to assist it with determining the fairness of the pricing as well as confirming the pricing at termination. MSBA also worked with its Bond Counsel, Mintz Levin, to determine that the full amount of the premium (or gain) paid on the termination of the GIC could be fully retained due to the fact that both the 2012A and 2012B Bonds have significant negative arbitrage associated with the outstanding bonds. On the day scheduled for termination (Monday, March 23), the market moved in MSBA's favor and the actual premium received **($78.6 million**) was higher than had been anticipated ($73 million). Additionally, should the MSBA issue a taxable advanced refunding in connection with its planned new money issuance, the outstanding 2012A and 2012B bonds are very attractive as refunding candidates due to their ability to be called in 2022. Therefore the $200 million in principal of the GIC released by the termination could be used to downsize the refunding transaction, or in the event a reserve is required, the MSBA could retain the difference between the amount of the required reserve and $200 million. The termination of this GIC at this point in time also eliminates any future risk of non-performance by the GIC provider due to financial stresses that might negatively impact its ability to pay the full amount of the interest that otherwise would have been due MSBA to its maturity (2030). The provider had previously been downgraded, triggering a requirement at that time to post collateral securing the principal of the GIC (which had been in place up until the termination of the GIC.

Upcoming New Money/Potential Taxable Advance Refunding Transactions

Depending upon market conditions, the MSBA anticipates issuing new money bonds in May/June timeframe. If market conditions stabilize, at this point the 10-year treasury rate is still favorable to execution of a taxable advanced refunding. However, the MSBA will seek Board authorization at the April Board meeting to also allow it to secure either a Line of Credit and/or issue Bond Anticipation Notes to allow for an interim short-term financing until such time as markets stabilize sufficiently.