




City and Borough of Sitka

100 Lincoln Street • Sitka, Alaska 99835

MEMORANDUM

To: Mayor Paxton and Assembly Members

From: John Leach, Municipal Administrator 

Date: May 21, 2020

Subject: Refinancing of 1979 Alaska Energy Authority Loan

Issue:

The Alaska Municipal Bond Bank Authority (AMBBA) is currently taking steps to refinance a substantial portion of its outstanding publicly held bonds. As the AMBBA uses proceeds from its public bond issuances to loan to Municipalities, those Municipalities are being afforded a chance to work in conjunction with the AMBBA to refinance their loans from the AMBBA.

In conjunction with the refinancing of its outstanding publicly held bonds, the AMBBA is affording municipalities the ability to apply for new loans from the AMBBA which would be funded through the issuance of additional new AMBBA debt.

Accordingly, the City and Borough of Sitka has applied to the AMBBA for a loan to refinance the remaining balance of Sitka's 1979 loan with the Alaska Energy Authority. Passage of an ordinance by the Assembly is required to enter into the loan, and the accompanying ordinance serves this purpose.

Analysis:

Structure of AMBBA Debt and CBS loan agreements with the AMBBA

The AMBBA is a subdivision of the State of Alaska, Department of Revenue. The AMBBA was established to help smaller Municipalities in Alaska access bond markets that would otherwise be unavailable to small bond issuers. The AMBBA has specific statutory authority to issue general obligation bonds.

The basic functioning of the AMBBA is to sell bonds to the general public through underwriters, then lend the proceeds from its debt issuances to Alaska Municipalities

through loan agreements. As collateral for the loans, the AMBBA requires each Municipality to sell one single municipal bond to the AMBBA. The AMBBA then crafts debt repayment schedules for the loans it makes to mirror its own debt service obligations to the public. Thus, debt service payments made by Municipalities are used by the AMBBA to make its own debt service.

The bonds sold to the general public by the AMBBA are callable serial municipal bonds. This means that AMBBA bonds carry different interest coupons, and, mature at those dates specified in the serial structure. Callable means that the AMBBA can pay off the bonds early, but only according to specific rules set forth at the time of issuance. All AMBBA bonds are continuously callable after 10 years; before the 10-year anniversary, they can't be called. AMBBA bonds may be partially called, meaning some bonds in the serial, but not all, are paid off early.

As the proceeds of AMBBA bonds are lent to Municipalities and those Municipalities have repayment schedules that mirror the AMBBA's debt service, the ability of Municipalities to pay off their loans early is limited and may only take place according to stipulations set forth in their loan agreements with the AMBBA.

The calling of bonds and early pay-off of loans can be initiated either by the AMBBA, or, by Municipalities. The AMBBA has a contractual financial advisor who continually monitors interest rates in the bond market, and, who recommends to the AMBBA Executive Director and Board when bonding looks economical. While a municipality can apply to the AMBBA for a loan, municipalities can't compel the AMBBA to issue new public debt.

New Money Refinancing of AEA Loan

The CBS has a long-standing term loan with the Alaska Energy Authority. The loan was entered into in 1979, and, was refinanced in 1993 (in conjunction with a disaster assistance request tied to the APC mill closure) to extend its term to 50 years. The loan terms include semi-annual payments of principal and interest of \$307,037.96 at 4% interest.

Current interest rates lower than 3% make refinancing of this loan an attractive option, wherein it did not make economic sense to do so in the past. Accordingly, the CBS has applied to the AMBBA for additional bonded indebtedness ("new money") to refinance this old loan and reduce interest costs to the rate payers. The AMBBA has analyzed the loan and has agreed that enough savings will be achieved to make refinancing attractive.

In order to take on additional bonded indebtedness to pay off this older loan and achieve lower interest expense, passage of an ordinance is required.

Fiscal Note:

Effective Interest Rates and Savings Not Finalized Until Underwriting

The exact amount of savings and the effective interest rate(s) for the refinancing of the AEA loan cannot be known with certainty until the underwriter takes the bond issuances to market in New York. The underwriter has, however, estimated effective interest rates based on current bond market conditions, as well as a sensitivity analysis showing the effect on the proposed refunding if market interest rates rise or fall.

When a bond issuance is brought to market, the rate of interest to be paid on each bond in the serial is pre-determined well in advance. These rates are called bond coupon rates. Rather than adjusting coupon rates continuously to match ever-changing market conditions, bonds in the various serials in a bond issuance will be sold at either a premium or discount to the stated redemption value.

AMBBA bonds are often sold at a premium. When bonds are sold at a premium, the CBS gets extra bond proceeds it does not have to pay back to offset the higher coupon interest it pays. When this occurs, it results in the effective interest rate on the issuance which, in the case of a premium, will be substantially lower than the stated coupon rates.

Estimated Savings for AEA Loan Refinancing

The savings to be achieved by issuing new electric revenue bonds to refinance the AEA loan has also not been determined with certainty by the underwriter. The CBS Finance Department believes that refinancing the AEA loan could potentially save as much as \$50,000 in annual interest expense.

Effect Refinancing of AEA Loan on User Fees

Although the proposed refinancing of the AEA loan will result in significant interest rate and cash flow savings to the Municipality, staff does not intend to recommend user fee reductions at this time. Savings will instead be used to strengthen the financial health of enterprise funds by increasing their working capital, and, by potentially reducing the amount of future fee increases.

Recommendation

Staff recommends that the Assembly approve the accompanying Ordinance necessary to refinance its outstanding AEA loan.