



City and Borough of Sitka

100 Lincoln Street • Sitka, Alaska 99835

MEMORANDUM

To: Mayor Paxton and Assembly Members
Thru: John Leach, Municipal Administrator *[Signature]*
From: Jay Sweeney, CFAO
Date: May 5, 2020
Subject: Refinancing of Bonded Indebtedness

Background

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.

For a Municipality to be able to refinance its loan from the AMBBA, that Municipality's governing body must pass a Resolution indicating its desire to do so. Passage of such Resolution then provide the AMBBA the legal authority to refinance portions of its outstanding public bonds by redeeming ("calling") old bonds and using the proceeds of a new bond issuance at reduced interest rates for the redemption.

Municipalities benefit from such refinancings because the debt service savings the AMBBA achieves in its refinancing are passed on the underlying Municipalities in the form of reduced interest and principal payments, reducing interest expense and reducing cash outflow.

Accordingly, The Assembly is being asked to approve several Resolutions – one Resolution per outstanding Loan (AMBBA bond issuance series). Passage of the Resolutions is required to participate in the AMBBA refinancing.

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 early pay-off looks economical. Alternatively, Municipalities can also request that the AMBBA consider calling bonds. A municipality can't compel the AMBBA to call outstanding bonds, however.

Refunding Versus Advance Refunding

Refunding is the technical name for the process of issuing new bonded debt at a lower interest rate to pay off older callable bonded debt at higher interest rates. Unless a Municipality has obtained all the cash proceeds from some other source to pay debt off early, most refinancing of bonded debt occurs through refunding.

Bonded debt which is not yet callable can still be paid off through a process called defeasment, which is achieved through advance refunding. In this process, new bonds are again sold at a lower interest rate but rather than paying off the old bonds immediately, the proceeds are placed into escrow. Enough proceeds must be placed in escrow to fully pre-pay all debt service up until the call date and all bonds to be called at the future call date.

Internal Revenue Service rules severely limit the ability of entities to issue tax-free

bonds to advance refund other tax-free bonds. As a result, most advance refundings are in the form of taxable municipal bonds.

The AMBBA 2020 Refunding and Advance Refunding

Multiple Municipalities have approached the AMBBA with requests to participate in a broad refunding of eligible bond issuances. The financial advisor of the AMBBA reviewed each issuance for each community to determine which of the issuances made economic sense to refund. A table of the results of the review is attached. Subsequent to the review, the AMBBA contacted eligible communities to determine whether they wished to participate.

Simultaneous to the actions of the AMBBA, Sitka approached the AMBBA, as a result of direction by the Assembly, to request that it consider an advance refunding of Sitka's various bond issues which were not yet callable. Other communities did likewise. As a result, the AMBBA and its financial advisor are actively considering an advance refunding, but only if bond market conditions make it economical, which has not yet occurred.

For Sitka, the bond issues which are callable and which will participate in the refunding are three tranches of Sitka's 2010 electric revenue bonds (\$29,125,000 total):

- \$6,305,000 in non-AMT bonds
- \$22,000,000 in Recovery Zone Economic Development bonds
- \$820,000 in Build America bonds

For Sitka, all other bond issuances which are not yet callable are being considered for the advance refunding, if it occurs. Not all outstanding bonds make economic sense to advance refund. The Sitka bonds which are candidates for advance refunding include the following:

- \$23,245,000 in 2013 electric revenue bonds (1st issuance)
- \$33,935,000 in 2013 electric revenue bonds (2nd issuance)
- \$ 2,885,000 in 2014 electric revenue bonds
- \$ 1,720,000 in 2013 harbor revenue bonds
- \$ 2,735,000 in 2011 general obligation bonds
- \$615,000 in 2012 refunding general obligation bonds.

Advance Refunding Subject to Favorable Market Conditions

For any refunding or advance refunding to take place, the interest rate environment needs to be favorable enough to result in an interest expense savings large enough to make the transaction worthwhile. The AMBBA Executive Director, and its financial advisor, and the underwriter jointly make the decision whether to execute a refunding or advance refunding ("going to market").

At the current time, market conditions favorable for the AMBBA to go to market for the refunding. Market conditions for the advance refunding, however, while close to being favorable, are not yet right for the AMBBA to go to market for the advance refunding. Nonetheless, the AMBBA is taking all required steps to be able to go to market for the advance refunding if conditions improve. One of those critical steps is obtaining Municipality concurrence through the passage of Resolutions.

Thus, the Assembly is being asked to consent to a future advance refunding if bond market conditions improve.

Fiscal Note

Effective Interest Rates and Savings Not Finalized Until Underwriting

The exact amount of savings and the effective interest rate(s) for the refunding and advance refunding can not 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.

As the CBS will be primarily engaging in a refunding and advance refunding, any additional proceeds which it would receive as a result of issuing at a premium will be limited to the additional bonds required to refinance the AEA loan. For other issuances, rather than receive additional proceeds, less refunding bonds will be issued than the amount being refunded.

Estimated Savings for Refunding and Advance Refunding

The savings from the refunding of the 2010 electric revenue bonds is estimated to be \$1,988,000 by the underwriter. At the present time, the candidate for refunding which presents enough of a savings to go forward are the \$22,000,000 in Recovery Zone Economic bonds (see attachment).

The savings for any potential advance refundings of the various candidate issuances

has not been determined with certainty by the underwriter. An analysis of the potential savings for advance refunding of various CBS bond issues was prepared by the AMBBA financial advisor in March 2020, and is attached.

Effect of Refundings on User Fees

Although the proposed refunding and advanced refunding 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 various Resolutions necessary to participate in these proposed refundings and advance refundings.