PROCEDURES FOR REFUNDING DEBT

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Madison County Schools
AASBO Annual Meeting
May 7, 2015

Objectives

- Definition of a refunding
- The types of refundings
- The reasons for refundings
- Documents needed to record the refunding
- Required note disclosures

What is Refunding of Debt

Refunding – the issuance of new debt to repay old debt.

Current Refunding – New debt proceeds are used to repay the old debt immediately.

Advance Refunding – New debt proceeds may be placed with an escrow agent and invested until a date in the future when the monies will be used to pay principal and interest on the old debt.
Current Refunding

New debt proceeds are used to pay the old debt immediately.

GASB does not define “immediately”.

In practice, most – but not all, proceeds from new debt flow through an escrow agent. Often, this is due to the time required to notify bondholders that the old debt is being called. It is not uncommon for this to take 30-60 days.

IRS defines immediately as 90 days.

Advance Refunding

- Old debt is considered defeased if new debt proceeds are irrevocably placed with an escrow agent in a trust to be used solely for satisfying the payments of the old debt.

- There should be a written “Escrow Trust Agreement” simultaneously entered into with the new debt issue.

Reasons for Refunding

- Lower interest rates
- Extend maturity dates
- Revise payment schedules
- Modify restrictions contained in the old debt agreements
Items to Consider Refunding Warrants

- Difference in total cash flows of old debt and new debt

- Time Value of Money Perspective – Economic Gain or Loss Calculation – compares the present value of new debt service with that of the old

Parties to Consider Refunding Warrants

- Superintendent
- Board Members
- Financial Advisor
- Underwriter
- Bond Counsel
- Legal Counsel
- Chief School Finance Officer

Documents Needed for Review

- Final Official Statement
- Description of Sources and Uses (usually contained in the Official Statement)
- Semi-Annual Amortization Schedule of Old and New Debt
- Bank Statements for the Warrant Clearing Account and other applicable accounts
- Escrow Trust Agreement
Official Statement

Sources and Uses

OID vs. Underwriter’s Discount

How to Account for Each

- OID (Original Issue Discount) – shown as an Other Financing Use on the Schedule of Revenues, Expenditures, and Changes in Fund Balances

- Underwriter’s Discount – included with Warrant Issuance Costs as a debt service expenditure on the Schedule of Revenues, Expenditures, and Changes in Fund Balances

- OIP (Original Issue Premium) – shown as an other Financing Source on the Schedule of Revenues, Expenditures, and Changes in Fund Balances
Recording the Refunding (Fund Statements)

Issuance of Refunding Warrants

- Par Value of Warrants: $5,000,000
- Accrued Interest: 25,000
- Discount on Warrants: 200,000

Warrant Issuance Expenses:
- Underwriting Costs: $450,000
- Attorney's Fees: 50,000
- Insurance: 20,000
- Printing: 9,500
- Sub-total: $529,500

To Record Issuance of Refunding Warrants – Fund Statements

<table>
<thead>
<tr>
<th>Capital Projects Fund</th>
<th>Debt Service Fund</th>
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<tr>
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<td>Accrued Interest Payable</td>
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<td>Debt Service Expense – Issuance Costs</td>
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<td>OFU – Payment to Refunding Bond Escrow</td>
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<td>OFS – Issuance of Refunding Warrants</td>
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Calculation of Gain/Loss on Refunding

- Current Refunding
  - Reacquisition Price of Warrants = Principal Repaid plus any call premiums

  \textit{Does Not Include Portion Paid to Escrow that is Attributable to Interest!!}

Calculation of Gain/Loss on Refunding

- Advance Refunding
  - Reacquisition Price of Warrants = Total Amount Paid to Escrow

Required Note Disclosures

- General description of transaction
- The difference between the cash flows required to service the old debt and the cash flows required to service the new debt and complete the refunding
- The economic gain or loss resulting from the transaction
Example: Note Disclosure

Note – Long-Term Debt

The Board issued $12,400,000.00 in Refunding Tax Anticipation Warrants, Series 2013 dated February 1, 2013. The proceeds were used to advance refund the outstanding 2005-A Capital Outlay Tax Anticipation Warrants. Payments on the 2013 Refunding Tax Anticipation Warrants are to be made from the Debt Service Fund with special county-wide sales and use taxes.

Example: Note Disclosure (Continued)

Defeased Debt

On February 27, 2013, the Board issued $12,400,000.00 in Refunding Tax Anticipation Warrants, Series 2013 dated February 1, 2013 with interest rates ranging from 2.00% to 3.38% for an average rate of 2.88%. With the exception of the 2013 and 2014 maturities, the proceeds were used to advance refund the outstanding 2005-A Capital Outlay Tax Anticipation Warrants with interest rates ranging from 3.63% to 5.00%. The net proceeds of $12,309,570.32 were used to purchase U.S. government securities. These securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the 2005-A Warrants. As a result the refunded warrants are considered defeased and the liability for those warrants has been removed. The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $1,260,651.94.

As a result of the refunding, the Board reduced its total debt service requirements by $538,774.88, which resulted in an economic gain (difference between the present value of the debt service payments on the old and new debt) of $787,956.66.

Prior Year Defeasance of Debt (Note Disclosure)

- Include all advance refunding amounts in the same disclosure.
- Review the Refunding Official Statement and determine when the debt is to be retired.
- Maintain and monitor the bank statements for the escrow account.
- Do NOT just assume amounts will be retired according to the official statement or the original amortization schedule.
Note Disclosure

Prior Year Defeasance of Debt
In prior years, the (BOE) defeased certain warrants by placing the proceeds of the new warrants in an irrevocable trust to provide for all future debt service payments of the old warrants. Accordingly, the trust account assets and the liability for the defeased debt are not included on the (BOE)’s financial statements. At September 30, 20XX, the total of $________ of warrants outstanding are considered defeased.

(NOTE: Include this note until defeased debt is completely paid)

Other Related Topics

Additional Resources
- Amounts contributed by the BOE for refunding purposes.
- Amounts should be shown as “Payment to Refunded Escrow” – a component of Debt Service.

GASB 34 Full Accrual Statements

Other Legal Matters

Questions?

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