Senate Bill 1133
Use of General Obligation Bond Premiums to Fund Capital Projects

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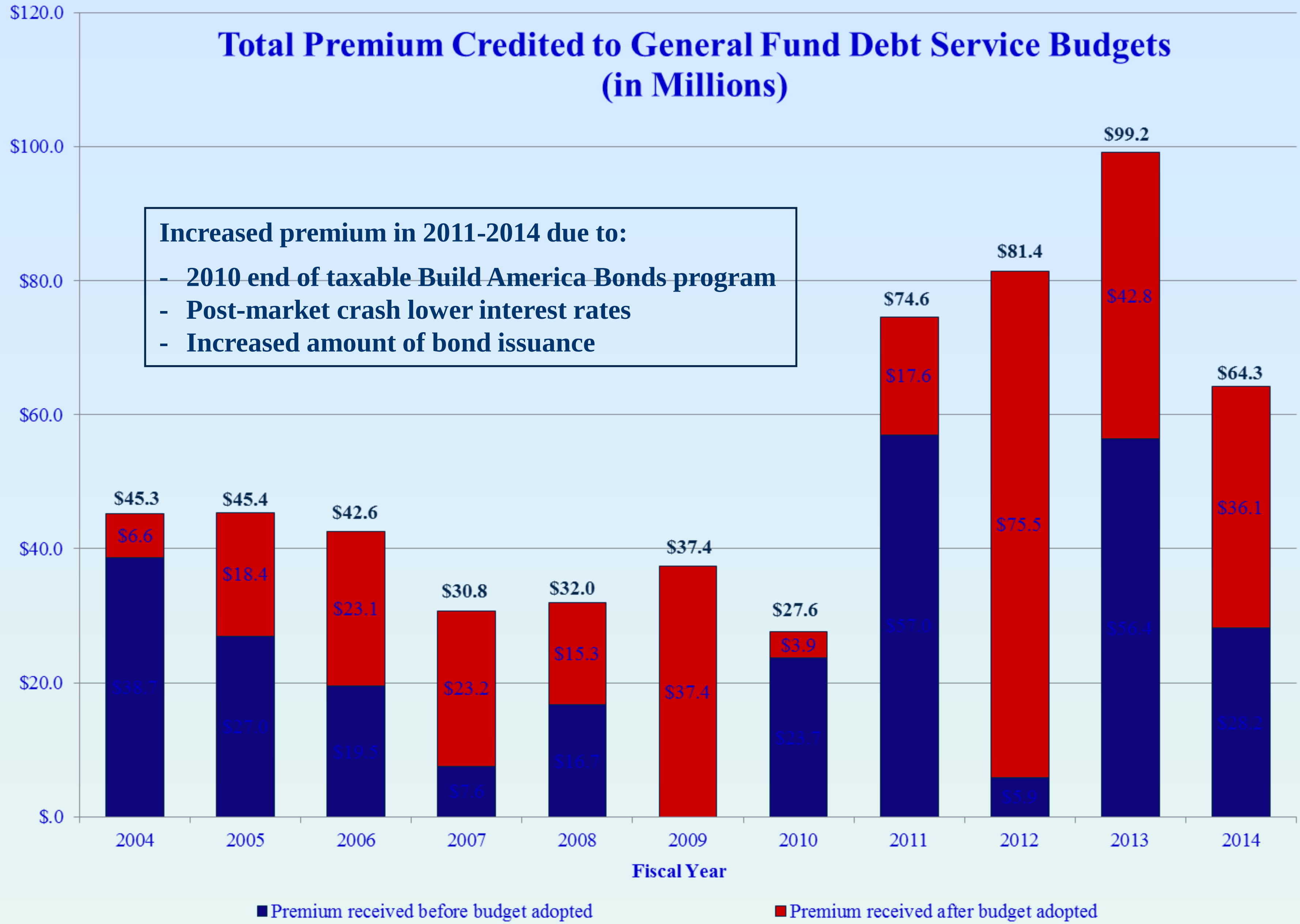
April 21, 2015

Current Use of Bond Premiums

- Cost of issuing GO bonds
- Up to 18 months of interest payments on GO bonds

Impact

- Contributes to lapses in the debt service line item by replacing General Funds budgeted to cover interest payments on GO bonds



Total Premium Credited to General Fund Debt Service Budgets
(in Millions)
Increased premium in 2011-2014 due to:
- 2010 end of taxable Build America Bonds program
- Post-market crash lower interest rates
- Increased amount of bond issuance
$120.0
$100.0
$80.0
$60.0
$40.0
$20.0
$.0
$45.3
$6.6
$38.7
$45.4
$18.4
$27.0
$42.6
$23.1
$19.5
$30.8
$23.2
$7.6
$32.0
$15.3
$16.7
$37.4
$37.4
$27.6
$3.9
$23.7
$74.6
$17.6
$57.0
$81.4
$75.5
$5.9
$99.2
$42.8
$56.4
$64.3
$36.1
$28.2
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
Fiscal Year
Premium received before budget adopted
Premium received after budget adopted

Benefits of Proposed Change

Funding Capital Projects Already Authorized for Borrowing

- Lowers amount State borrows for authorized capital projects
- Reduces outstanding GO debt
- Decreases future debt service costs
- Conforms use of GO premiums to the State’s other bonding programs (Special Tax Obligation, Clean Water and UConn bonds)

Example of Impact

Actual Bond Sale

Current Law

- $300 million actual bond sale – December, 2014
- $300 million in projects funded
- $37.7 million of premium received up front and used to pay interest on GO bonds, contributing to General Fund debt service lapse
- $442.8 million in total debt service due over 20 years
- Net debt service after accounting for premium received is $405.1 million ($442.8 million less $37.7 million)

Example of Impact *(Continued)*

Under SB 1133:

- **$267 million bond sale-amount, debt issued reduced $33 million, or 11%**
- **$300 million in projects funded – same**
- **$0 million of premium used to pay interest on GO bonds**
- **$393.5 million in debt service due over 20 years**

Example of Impact *(Continued)*

Summary

Debt outstanding would be reduced from $300 million to $267 million leading to a savings of $11.6 million over the 20 year life of the bonds.

Total Debt Service (Current Law)	**$405.1 million**
Total Debt Service (Proposal)	**$393.5 million**
Net Savings	**$ 11.6 million**

What are Bond Premiums?

- An up-front payment by investors to the State in exchange for the State paying a higher stated interest rate on a given bond compared to market rates.

- The premium amount is equal to the difference between the higher interest rate and what would have been paid at market rates.

Why do investors want to buy bonds with a premium structure?

- Market phenomenon in a low interest rate market that results from investors' wanting to purchase bonds with higher interest rates to avoid certain negative provisions in the federal tax code.
- Higher coupon premium bonds are less sensitive to rising interest rates making them more liquid and easier to sell.
- Once interest rates rise, bond premiums are expected to become less of a factor in the market.

Summary

- Bond premiums are prevalent in the municipal bond market.

- Using premiums on GO bonds to fund capital projects to <u>reduce</u> the State's high debt levels and future debt service costs:

    - Represents a better practice in the efficient management of the State’s public finance program in a low interest rate environment

    - Consistent with responsible borrowing and stewardship of public resources

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Questions?

Appendix

- Glossary of Bond Terms
- Bond Pricing Basics

Glossary of Bond Terms

"Par" is the face value of a bond and represents the amount of principal that must be paid at maturity.

"Coupon Rate" is the annual rate of interest payable on a bond expressed as a percentage of the principal or face amount of the bond.

"Yield" on the bond is the amount of return an investor will realize on a bond taking into account the coupon rate and price.

"Issue Price" of a bond is calculated based on the coupon rate that bond pays and the yield on the bond.

Glossary of Bond Terms *(Continued)*

“Par Bond” price paid for the bond is the same as the face value. For example, for a bond with a par value of $1,000, the price of that bond is also $1,000.

In addition to par, a bond can also sell at a “Premium” or a “Discount.”

“Premium Bond” the price paid for the bond is <u>greater</u> than the 1,000 face value.

“Discount Bond” the price paid for the bond is <u>less</u> than the $1,000 face value.

Bond Pricing Basics

Par Bond - the yield is equal to the coupon rate.

Premium Bond - the coupon rate is higher than the yield and represents the overall return to the investor incorporating the higher price that they pay for the bond initially.

Discount Bond - the coupon rate is lower than the yield and represents the overall return to the investor incorporating the lower price that they pay for the bond initially.

Bond Pricing Basics *(Continued)*

Example – 10 Year Non-Callable

$1,000 Face Value Bond

Type of Bond	Price	Coupon	Yield
Par	$1,000	3.00%	3.00%
Premium	$1,171	5.00%	3.00%
Discount	$957	2.50%	3.00%