What GFOA is Warning on Alternatives to Advance Refundings.

WASHINGTON – The Government Finance Officers Association's federal liaison center is warning some members against using interest rate swaps and derivatives as alternatives to advance refundings.

In a recently published alert, GFOA noted that the tax law changes enacted in December prohibit the use of tax-exempt advance refundings as of Jan. 1, 2018. As a result, issuers are looking for alternatives.

"Issuers should work with their advisors to understand potential new risks and other considerations that may accompany these alternatives," GFOA said in the alert, adding it, "cautions many entities against entering into swap or derivative agreements."

The alert suggests that local and state officials rely on "the skills and expertise of bond counsel and municipal advisors in making financing or refunding decisions."

That's the approach that Timothy Firestine, chief administrative officer of Montgomery County, Md., plans to use.

"We will go through the normal dance with our advisors and decide," Firestine said, predicting that his underwriters will come up with new ways to refinance outstanding debt. "We will hopefully pick the best ones."

Several issuers interviewed said they are either waiting to current refund their bonds within 90 days of the call date, which is still permitted, or are considering doing taxable refundings, if they make economic sense.

Kenton Tsoodle, assistant finance director for Oklahoma City, Okla., said, "As vice chair of GFOA's debt committee, I feel we have a responsibility to make sure that issuers know that these tools could provide some benefits, but there are other considerations, other risks."

Tsoodle said he's considering a limited use of taxable refundings later this year in the $30 million to $35 million range as a substitute but will otherwise wait until outstanding municipal bonds qualify for a current refunding when they reach the 10-year call mark.

Advance refundings had been widely used in the municipal bond market until this year.

Florida saved $2.2 billion on a present-value basis since 2011 through 98 refunding transactions totaling $14.1 billion, Florida's Bond Finance Director Ben Watkins reported in December.

Municipal bond market experts say the alternatives aren't as useful.

The National Association of Bond Lawyers recently issued a four-page paper listing seven alternatives to advance refundings.

“All these other tools are interesting, but they are far less effective in my opinion,” Utah State Treasurer David Damschen, senior vice president of the National Association of State Treasurers, said in an interview. “None of them struck me as particularly compelling in comparison to advanced refundings.”

A half dozen municipal finance directors and state treasurers surveyed by The Bond Buyer said they are in no rush to use any of the alternatives.

Taxable advance refundings, however, are one of the top options the finance directors and treasurers said they considering.

The other options listed in the NABL paper include tax-exempt current refundings that occur within 90 days of the call date of the bonds to be refunded; a negotiated change in the interest rate or a waiver of call protection; and so-called “Cinderella Bonds” that are initially taxable and convert to tax-exempt bonds at a specified date.

The remaining options are more complicated and include swaps or derivative agreements that GFOA is cautioning against using.

“If you are getting into these, you better understand them and know what you are getting into,” said Bob Eichem, chief financial advisor of the City of Boulder, Colo. and a member of the GFOA debt committee.

“Of all the options I’ve seen, the taxable refunding option makes the most sense to me based on my risk appetite,” said Lisa Marie Harris, finance director and treasurer of the San Diego County Water Authority which serves 3.3 million people.

“It’s just a matter of doing the analysis and, in fact, the taxable market versus the tax-exempt market, the difference between the two financings is only like 17 basis points,” Harris said.

Harris said taxable refundings also make sense for mixed use facilities such as hospitals and airports which won’t have to calculate what of the refinancing is government-related and what part is business-related. It avoids legal issues and having to do arbitrage calculations, she said.

The San Diego County Water Authority did its last advance refunding in late 2015 for a savings of more than $10 million but doesn’t have any planned for 2018.

Instead, Harris said her water authority is working on a callable refunding for $203 million in pipeline bonds that were issued just over 10 years ago. “It’s current refundable, so I don’t have to consider all these fancy alternatives,” she said.

Likewise, Jennifer Brown, finance director for the City of Sugar Land, Texas said she’s waiting until the next 10-year call date on outstanding bonds before her next refinancing.

Sugar Land was among the many issuers that rushed to do advanced refundings before they were terminated as a part of the tax overhaul.

On Dec, 28 Brown closed an advanced refunding of a $98 million issue from 2011 for a surface water treatment plant. The refinancing is saving $600,000 annually in debt service, or $15 million in total, that can be returned to water customers through lower rates.

“I went ahead and fast tracked that one,” Brown said.

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