CITY OF NORWALK
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M E M O R A N D U M

To: Common Council
From: Henry M. Dachowitz
Subject: Expected Refunding of Bonds Expected to close in September 2020
Date: July 14, 2020

A refunding of City bonds is similar to a refinancing of a home mortgage – when interest rates decline, new bonds are issued at a lower interest rate cost and the proceeds (the new funds raised) are used to redeem (pay off) the existing bonds which carry a higher interest rate cost. This is done before the bonds mature and are paid off.

Normally a bond can only be refunded if it is callable. In this case the call (a type of option) allows the issuer of the bonds (e.g. Norwalk) to "call the bonds back" from its holders and retire them early **before** their maturity. This would usually only occur if interest rates decline. Investors, on the other hand, want to keep their bond investments with higher interest rate coupons as market interest rates decline.

This call feature is subject to negotiation between issuers and buyers when bonds are sold – a common compromise is that a call option is available to issuers once the bonds are ten years old.

An Advance Refunding occurs when an issuer desires to refund bonds (due to a decline in interest rates) **before** the bond is callable (usually before the 10 year anniversary). In that case, the bond proceeds of the newly issued bonds are invested very conservatively such that when the old existing bonds **are callable**, the proceeds plus their investment earnings are sufficient to pay back the old bondholders.

The Tax Cuts and Jobs Acts of 2017 (signed into law by President Trump on December 22, 2017) eliminated Advance Refundings of tax-free bonds.

However, the current markets are unique – I have not ever seen this in my career.

Normally the interest rates paid by taxable securities, such as US Treasury Bonds, are higher than the interest rates on tax-free bonds (such as Norwalk's bonds). This is because when Municipal Issuers pay interest, the holders of those bonds are not required to pay tax on that tax-free interest. Consequently municipal issuers can issue bonds at a lower interest rate cost than equivalent taxable bonds. The municipality's interest costs are being subsidized by the Federal Government.

In today's markets, the interest rates on taxable debt are LOWER than the interest rates on Tax-Free Municipal Securities. Consequently we can issue new Taxable Bonds in advance of the call dates of the existing bonds, invest the proceeds, pay off the existing bondholders on their call dates, and not violate any rules against Tax-Free Advance Refundings.

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Our Financial Advisor and Investment Bankers have identified about $44MM of outstanding Norwalk bonds (including those issued by the Norwalk Water and Pollution Control Authority – WPCA) where we can refund the existing bonds and achieve significant savings

As of July 1, they calculated we could issue about $44MM of new bonds at a True Interest Cost (TIC) slightly above 1% (1.0018%) which would achieve a Present Value Savings in excess of $2.9MM or 6.66% on the amount of bonds refunded. Industry standards do not permit a refunding unless a minimum of a 3% savings is achieved.

PV Savings on a refunding are calculated as follows:

The amount of interest being paid on the older, higher interest rate bonds is calculated for each payment date and compared to the lower interest payment for the new bonds. The differences (savings) achieved by these lower rate payments are then Present Valued (discounted) to calculate its worth in a lump sum today.

So the entire refunding was estimated to save the City $2.9MM over the life of all these refunded bonds. Obviously the final numbers will be different based on actual market conditions when we price the transaction, but I expect the savings to be at least $2.25MM.