LIBOR Based Index Bonds

This spring we sold LIBOR based index bonds to accomplish a refunding on behalf of one of our clients, a major Illinois issuer with superior credit ratings. LIBOR stands for London Inter-Bank Offered Rate. This structure has been used in municipal offerings for about a year although it has been used for some time in corporate finance. The basic financing plan was to issue variable rate bonds that were priced at percentage of Three-Month LIBOR plus a spread. In this case the percentage of the Three-Month LIBOR was 67%. The bonds pay interest quarterly. LIBOR based index bonds do not require a liquidity facility or remarketing agent because there is no “put” feature. That is, the bondholders do not have the right to present bonds to the issuer for payment prior to maturity, as is common with most variable rate bonds.

Concurrently, the issuer engaged in a swap agreement with a counterparty to exchange the variable rate interest payment obligation for a fixed rate interest payment obligation. The swap counterparty was selected through a competitive process.

As a part of the refunding transaction the issuer was able to receive a lump sum payment rather than achieving annual savings throughout the life of the bonds. The resulting debt service on the refunding bonds was substantially identical to the refunded bonds. The lump sum payment was helpful for the issuer because it could be used for an upcoming capital project. The bond issue was approximately $52.5 million and the upfront payment was $2.2 million. Because a swap is a derivative product the issuer adopted a debt derivative policy to be a guide in the use of derivatives. This is considered a best management practice.

The LIBOR based index bonds were attractive due to the flat nature of the yield curve, size of the refunding and the receipt of a lump sum payment to the issuer. As the yield curve changes this technique may not be as attractive in the future.

This type of financing is complicated and certainly not appropriate for every issuer. LIBOR based index bonds should be considered carefully in consultation with your independent financial advisor.

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Iowa News

Counties in Iowa have a new ability to issue Essential County Purpose Bonds for the construction and repair of roads and bridges. This authorization was extended to them by the 2007 Iowa legislative session. This has long been a concern for counties to issue any amount of debt for the construction and repair of roads and bridges as it fell under the General County Purpose portion of the law. During the legislative process, there was a provision attached to the bill that stated a project could be bonded for if it is tied to economic development. This means that counties will have to make a finding of economic impact on the issuance and expenditure of the bond money. Speer Financial stands ready to assist your county in developing a funding program for all of your county needs.