Testimony of Denise L. Nappier
Treasurer of the State of Connecticut
SUBMITTED TO THE FINANCE, REVENUE AND BONDING COMMITTEE
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Good morning Senator Fonfara, Representative Berger, and members of the Finance, Revenue and Bonding Committee. Thank you for the opportunity to provide testimony on Senate Bill 1133, *An Act Concerning the Treatment of Bond Premiums Under the State General Obligation Procedure Act.*

I strongly urge the Committee's support of this bill, and I commend its leadership for bringing it forward. This proposal represents a compelling opportunity to more effectively manage our State's debt that will ultimately help protect and strengthen the State's creditworthiness -- a policy objective on which, I believe, we readily agree. The question is <u>how</u> we can best achieve that objective in order to serve the long-term best interests of our State and its citizens.

Today I will discuss the policy implications of using bond premiums in the manner contemplated by the bill – and that is to reduce overall debt levels and long-term debt costs. My remarks will precede a more detailed, but brief PowerPoint presentation on bond premiums by Sarah Sanders, Assistant Treasurer of Debt Management for the State Treasury, and Josh Nyikita (NICK – ah – ta), Managing Director from Acacia (AH – KAY – SHAH) Financial Group, an independent financial advisory firm that assists the State on its bonding program.

Under Senate Bill 1133, premiums on General Obligation Bonds -- which we commonly referred to as GO Bonds -- would be used, after payment of costs related to issuing these bonds, to <u>fund</u> previously authorized capital projects. In this way, the amount of bonds that would need to be issued to fund a given set of projects would be reduced.

Bond premiums are upfront cash payments to the State by investors in exchange for the State paying a higher interest rate on a given bond.

Each time my office issues bonds, we first analyze market conditions to determine how to structure bonds so the sale is a success. In a low-interest environment, as has been the case for several years now, investors prefer to buy bonds with higher interest rates, and thus are willing to pay a premium to avoid certain federal tax consequences.

So, to maximize our bond sales, when the market demands it, we include bonds that offer a premium pricing component.

To illustrate how premiums work, here is a personal finance analogy: Take, for example, a car dealership that offers a customer a financing package of either $1,000 cash back for a 3% interest rate on a loan, or no cash back and a loan at a rate of 1.5%. That $1,000 cash back is similar to a premium payment in exchange for the payment of a higher interest rate over the loan term.

When evaluating the economics of both transactions, the net impact is virtually the same. In other words, the present value of the total payments over the life of the higher interest loan, less the cash back, is equivalent to the present value of the total payments of the lower interest loan with no cash up front.

Taking the analogy further, under current state law, the $1,000 cash back is earmarked by the borrower to pay interest on the car loan over the next 18 months.

But a better use of that $1,000 would be to use it to help pay for the price of the car so the consumer borrows less. This would lower the amount of debt and lower the monthly car payments.

The car analogy is essentially what Senate Bill 1133 would do -- use the GO bond premiums to fund capital projects, which in turn would reduce the State's high debt levels and future debt service costs.

Our GO bond program is by far the largest bond program my office manages and therefore it generates the most bond premiums.

This bill will make our GO program conform with our other smaller bond programs for transportation, UConn, and Clean Water – where premiums are used to fund capital projects and thereby reduces the dollar amount of bonds issued.

The legislation I propose is in the best interest of current and future generations of taxpayers. It represents a best practice for the use of premiums in a low interest rate environment, and is consistent with responsible borrowing and stewardship of public resources.

With that said, I strongly recommend passage of this bill, but with an amended effective date of July 1, 2017. This would allow the State time to adjust to the new practice from a budget perspective.

Thank you for the opportunity to comment on the broader implications of this bill. Through you, Senator Fonfara, I now would like to turn the floor over to my Assistant Treasurer Sarah Sanders for a brief PowerPoint presentation.