Debt Refinancing: An Alternate Source of Capital

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GIVEN THE BUDGETARY CONSTRAINTS most waterworks have in today's economy, they have a responsibility to take advantage of every opportunity available to lower expenses. Fortunately the same market conditions causing waterworks to tighten their belts have provided an opportunity for savings in the municipal-bond market.

According to an article in the Wall Street Journal, investors realized their "longest string of monthly gains in more than two decades in 2014" from Municipal-Bonds. (Kuriloff, 2014) Municipal-Bonds provide tax advantages to investors in certain tax brackets, which allow their lower interest rates to be comparable to some higher interest rate investments without these advantages. (Bodie, Kane, & Marcus, 2010)

A surge of investors into the municipal-bond market has come at the same time municipalities are pinching pennies and borrowing less, leaving fewer opportunities available for those investors. (Kuriloff, 2014) Interest rates paid on Municipal-Bonds have been lower over the past few years than they were for many earlier years. (Rates Over Time - Interest Rate Trends, 2015)

This market demand coupled with the low interest rates available to municipalities, has created an excellent opportunity for utilities to refinance older municipal debt secured at higher interest rates, at today's lower rates. Some waterworks have chosen to take advantage of this situation to refinance capital improvement debt. Doing this has lowered their annual expenses and put more revenue into the operating budget.

One such example is Arlington County, Virginia. They refinanced $100 million dollars through the Virginia Resource Authority (VRA) in 2014 to save $147,000 annually. (Arlington County Homepage, 2014) Although this is a significant savings, the impact may be much greater for smaller communities for which debt service represents a much larger proportion of their operating budget.

The Russell County Public Service Authority refinanced $3.64 million dollars in 2014 through the Virginia Department of Health's Drinking Water State Revolving Fund (DWSRF), resulting in an annual savings of $64,470. This amount is equivalent to 5.8 percent of the annual drinking water operations budget for the Russell County PSA.

However, waterworks sometimes have to pass up opportunities for savings in order to remain flexible enough to weather the financial storms of today's economy. The Town of Dublin, Virginia, chose to decline an offer from VRA to refinance waterworks debt that would have saved $110 thousand dollars in interest over the 23 year life of the bond, and $733 thousand dollars by reducing the length of the debt.

The Town of Dublin wisely passed on this offer because the reserve requirements would have left their "rainy day" fund too small to adequately respond to unexpected emergency expenses. The new debt would have also had higher payments in future years due to the back-loading structure of the debt. This would have forced the Town to restructure or pay off its other debt holdings in order to free up more money to make these higher payments.

One of the lowest rates in Virginia for refinancing waterworks debt is offered by the Drinking Water State Revolving Fund (DWSRF) administered by the Virginia Department of Health Office of Drinking Water, Financial Construction Assistance Program (FCAP). The DWSRF has been providing low interest loans and grants for drinking water infrastructure projects in Virginia since 1997. In 2014 the program began promoting the fact that it offers debt refinancing for local debt obligations related to drinking water infrastructure.

In order to be eligible, projects for which debt was incurred must have had a construction initiation date after July 1, 1993. The interest rate is set at the DWSRF core term rate, which is 1 percent below the Municipal 20 Year AA Revenue Bond Rate. This is typically between 1.5 percent and 2.5 percent for a term of 20 years. Local government owners of a publically-owned community waterworks are eligible. Private, state, and federally owned waterworks are not eligible for this refinancing opportunity.

Refinancing debt can be an easy way to improve the operating budget as long as it doesn't impact overall financial flexibility. Different sources of refinancing have different requirements for reserves and different credit rating restrictions. Waterworks should shop around for financial products that meet their individual needs and requirements. Some options waterworks may pursue for refinancing debt include: the Virginia Drinking Water State Revolving Fund (DWSRF), the Virginia Resource Authority (VRA), USDA's Rural Development Program, Commercial Banks, or (for wastewater related debt) the Clean Water State Revolving Fund administered by DEQ.

For more information about the Virginia DWSRF please contact Howard Eckstein in the VDH Office of Drinking Water at howard.eckstein@vdh.virginia.gov or 804-864-7507.

Works Cited

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