September 25, 2024

To: Finance and Administration Committee

From: Darrell E. Johnson, Chief Executive Officer

Subject: Potential Refunding of the Measure M2 Sales Tax Revenue Bonds, Series 2010A (Taxable Build America Bonds)

Overview

The Orange County Local Transportation Authority currently has $250,000,000 in outstanding Measure M2 Sales Tax Revenue Bonds, Series 2010A (Taxable Build America Bonds). Due to the unique economics and associated risks of these bonds, staff is requesting approval to explore the potential refunding of the Series 2010-A Bonds.

Recommendations

A. Direct staff to pursue the issuance and sale of bonds to refund the Measure M2 Sales Tax Revenue Bonds, Series 2010A (Taxable Build America Bonds).

B. Authorize an exception to the three percent savings requirement, in accordance with the debt policy, and direct staff to proceed with the refunding if the savings are at least net neutral or greater.

C. Direct staff to return to the Board of Directors for approval of the draft financing documents required to issue and close the transaction.

Background

In 2010, the Orange County Local Transportation Authority issued $293,540,000 in Measure M2 Sales Tax Revenue Bonds, Series 2010A, also known as Taxable Build America Bonds (BAB). These bonds were issued to fund critical transportation and infrastructure projects in Orange County. As of now, $250,000,000 of these bonds remain outstanding. Introduced under the American Recovery and Reinvestment Act of 2009, which was in response to the effects of the Great Recession, BABs offered a 35 percent federal subsidy on interest payments, making them financially attractive by offsetting the higher interest rates typically associated with taxable bonds. Additionally, BABs appealed to a broader range of investors, including those who do not benefit from tax-exempt income, which was crucial for raising funds amidst economic uncertainties.

Discussion

Beginning in March 2013, the 35 percent subsidy was reduced due to sequestration provisions in the Budget Control Act of 2011. The subsidy is currently set at 33.005 percent through 2031. In 2022, there were concerns that the subsidy might be eliminated in its entirety due to the coronavirus (COVID-19) relief and federal deficit issues. As of now, there is no permanent solution to end these reductions, so the subsidy could potentially be cut completely until new legislation is passed. Refunding the bonds prior to the potential elimination of the subsidy provides a sound reason to consider refunding these bonds even if significant savings can't be achieved today.

The bond documents allow for an "extraordinary optional redemption" if Congress enacts a law that reduces the amount of the federal subsidy payments. Orange County Transportation Authority (OCTA) staff and legal counsel have determined that the reduction in federal subsidy payments due to sequestration qualifies as such an event. This provision enables the bonds to be refunded at a more favorable cost compared to the non-extraordinary optional redemption alternative. In recent months, several other issuers have employed similar language to refund their BABs.

Under the "extraordinary optional redemption" OCTA would be paying off the existing bonds at 100 basis points above treasuries and then re-issuing those bonds at current market rates. Currently, this structure is roughly equivalent to the cost of just keeping the bonds that are outstanding today assuming the subsidy stays intact at current levels.

To manage the uncertainty of federal subsidy payments, staff requests approval to refund the Series 2010A Bonds at a net neutral cost, instead of meeting the usual three percent savings requirement. While OCTA's debt policy generally requires a three percent savings, the Treasurer, with Finance and Administration Committee approval, can accept lower savings in certain cases. Staff seeks approval to move forward if the savings are net neutral or greater. Refunding the 2010 taxable bonds also offers OCTA future refinancing flexibility.

Approval of this item authorizes staff to pursue the refunding option but does not authorize staff to finalize the transaction. Staff will return to the Board later this calendar year with financing documents and to seek final approval assuming the refunding can take place at break-even or better pricing.

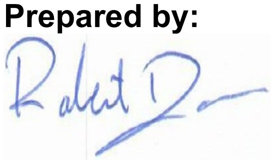
Summary

To address the uncertainty surrounding the timing and amount of federal subsidy payments and to secure future refinancing options, staff requests Board approval to proceed with issuing tax exempt refunding bonds. Staff will subsequently return to the Board for approval of the necessary financing documents required to complete the refunding transaction.

Attachment

None.

Prepared by:



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