

Connecticut bond premiums best for capital projects



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Denise L. Nappier
Connecticut State Treasurer

As state treasurer, I am charged with managing the state's bonding programs in a manner that minimizes the cost of the borrowing we undertake. And where there are opportunities to get more bang for our buck, so to speak, then I will fight for it. I am proud to say that during my administration, Connecticut has saved \$995 million by refinancing bonds to lower interest rates.

There is a tool in our financial tool box, known as bond premiums, which we could use more efficiently for the state's general obligation bonds in order to meaningfully chip away at our overall debt levels, thereby reducing future debt service costs and saving taxpayers money. But we need legislative action to do it.

Bond premiums are an upfront payment by investors to the state in exchange for the state paying a higher stated interest rate on a given bond — in essence, extra cash to the state in addition to the bond's face value. Today, bond premiums are being used to pay current interest on outstanding bonds.

That money can be put to better use. Which is why I am calling for passage of legislation, as I have done in the past, to require that premiums on general obligation bonds be used to fund capital projects already authorized for bonding. My proposal would lower overall debt levels over time and reduce future debt service costs.

We calculate that had we been able to use premiums for capital projects on our last \$300 million general obligation bond sale, we could have reduced the size of the sale to \$267 million. While we would not have received \$37.7 million in up-front funds to apply to our debt service budgets, we would have reduced overall debt service over the next 20 years by \$49.3 million — a net savings of \$11.6 million.

So the legislation I propose makes sense, especially because similar rules are already in place with the state's other bonding programs for transportation improvements, the Clean Water Program and the University of Connecticut. In these sales, premiums are used to fund capital projects, thereby reducing the size of the bond issue.

Ultimately, the timing and structure of the bonds issued under my watch directly correlate with what the market demands. Bond premiums are a market phenomenon in low interest rate environments that result from investors' demand for bonds with higher interest rates to avoid certain consequential provisions in the federal tax code.

Given the extended period of low interest rates that we've seen in recent years, and the expectation of a rise in interest rates going forward, investors continue to seek this bond structure. However, once interest rates rise, bond premiums are expected to become less of a factor in the market. In the meantime, it would be ill-advised to recognize or budget savings from premiums before they are actually realized.

Currently, the use of premiums to replace funds already budgeted to reduce debt creates savings in the General Fund debt service account that can be used for expenses unrelated to bond repayments, as authorized by the General Assembly. Critics have said this practice amounts to using bond proceeds to pay for daily operating expenses. While I believe this is a mischaracterization, in any event my proposal would end General Fund budget savings resulting from premiums.

Passage of this measure is the right thing to do to minimize the cost of debt for the benefit of not only current taxpayers, but also future generations as well. I urge taxpayers to call on their elected representatives to support this common-sense proposal.

Denise L. Nappier is state treasurer of Connecticut.

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