WRITTEN ONLY

TESTIMONY BY WESLEY K. MACHIDA
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STATE OF HAWAII
TO THE SENATE COMMITTEE ON JUDICIARY AND LABOR
ON
HOUSE BILL NO. 1185, H.D. 1

March 19, 2015
9:30 A.M.

PROPOSING AN AMENDMENT TO ARTICLE VII, SECTION 13, OF THE HAWAII CONSTITUTION, TO AMEND THE TIMING OF MATURATION FOR GENERAL OBLIGATION BONDS

House Bill No. 1185, H.D. 1, proposes to amend the State Constitution by requiring the first principal installment of general obligation (GO) bonds and reimbursable GO bonds to mature not later than one year from the date of issuance.

The Department has concerns with this bill. The Department agrees that amortizing principal to start not later than one year from the date of issuance will reduce total financing costs when compared against starting the principal amortization in the fifth year and may be financially prudent, especially when structured with stand-alone new money bond issuances. However, amending the State Constitution to require the first principal installment of GO bonds to mature not later than one year (versus five years) would:

1) increase the debt service in years one through four for all bonds issued as principal payments would now be required in those years;
2) negatively impact the State's debt service savings in years one through four for refunding transactions, as principal amortization would be required to start in year one; and

3) limit the State's flexibility should there be debt service peaks or desire for debt service relief in years one through four, as principal could not be structured to start after the peak years or in years in which budget relief is sought.

The rating agencies may also view this as a negative as the Department would have reduced budgetary flexibility. The State would not be able to defer principal amortization for a reasonable period of time (currently not later than the fifth year) to address potential budgetary issues in the short term. Under the current State Constitutional parameters, the rating agencies have noted as a strength in their rating reports the State's rapid amortization of debt which is currently based on a maximum 5 year principal delay and 20 year maturity. The Department appreciates the Legislature's intent to constitutionally mandate a lower cost financing structure for the issuance of general obligation bonds. However, we believe that the flexibility to begin principal amortization no later than the fifth year after the bonds are issued provides the State with the necessary flexibility to structure the repayment of the bonds based upon budgetary and market conditions at the time the bonds are issued.

As an alternative, the Department suggests meeting with the Committee's staff to consider an amendment to Article VII, Section 13, of the State Constitution, to exempt refunding GO bonds and refunding reimbursable GO bonds from the requirement that "All general obligation bonds for a term exceeding two years shall be in serial form maturing in substantially equal installments of principal, or maturing in substantially equal installments of both principal and interest". This requirement results in inefficiencies in issuing refunding general obligation bonds. The elimination of such constraints for refunding will provide the State with more opportunities to find savings and structure long term debt more efficiently, and is also consistent with the Legislature's intent to create a lower cost financing structure. New Money GO bonds will continue to be structured with level debt service as required by the State Constitution.

Thank you for the opportunity to provide testimony on this measure.