

# How governments manage debt

## Tools available to help lower payments

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**T**he Geneva School District 304 Board is in the midst of figuring out the best way to lower its debt payments, considering options that include abatement, refunding and defeasance.

Such terms have meanings that might elude the public, but units of government rely on these mechanisms to restructure and pay down public debt, officials said.

Sugar Grove, for example, refunded – or refinanced – its 2006 \$8.5 million bond issue to build the police station and extend Municipal Drive.

“It’s going to save us money,” Village President Sean Michels said.

And that is exactly its function, said Kevin McCanna, president and owner of Speer Financial Inc., a public finance consulting firm. McCanna explained refunding, abating and defeasance.

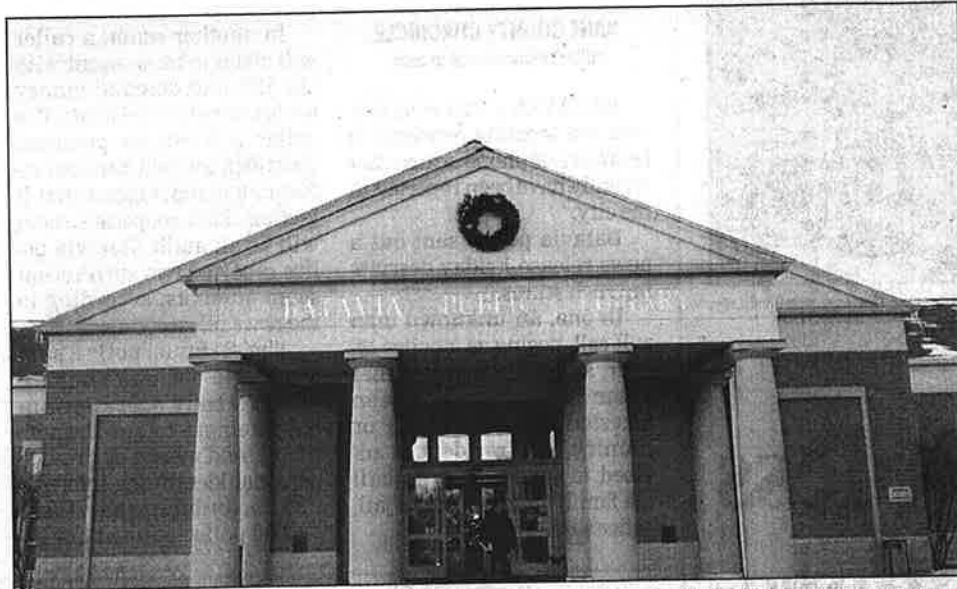
Refunding is a method of restructuring debt that is being used more often lately because of the turndown in the economy, McCanna said. Abatement is using excess cash to reduce a debt payment, and defeasance is setting money aside to pay off a debt, he said.

“Refunding is the same as refinancing a mortgage to a lower rate to save money,” McCanna said.

Many public bonds were sold in 2005 and 2006, when economic growth still was expected, McCanna said.

“They were in a hot, growing area, subdivisions opening, and all of a sudden it’s not happening,” McCanna said. “And the debt service was scheduled to be increasing a little each year because of anticipated new homes ... and sales tax growth.”

McCanna said many taxing bodies take that debt and extend it a few years, which



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Since 2011, the Batavia Public Library has been refunding bonds originally sold in 1998 and 1999 to build the new library. Instead of just refinancing and extending out more debt, however, the original \$8.8 million issue and the new issue will be paid off in 2018.

sometimes is called “scoop and toss,” which is managing debt by extending it for a longer term, he said. But that negative connotation is generally not accurate because the crash in 2008-09 changed the economy so drastically, McCanna said.

“Adding a few years because the economy cost you several years of growth ... it’s not bad adding a few years,” McCanna said. “Instead of paying it off in 15 years, you’re going to pay it off in 20 years. ... Adding 20 years, now that’s something else.”

But not every refunding extends loans. In Sugar Grove’s case, the bond issue still will be paid off in 2016, but at a lower interest rate. That also was the case for the Batavia Public Library, which did refunding on the original \$8.8 million bond issue for the new library, library Director George Scheetz said.

The loan or bond issue was done in two installments in 1998 and 1999, he said. By getting better interest rates, Scheetz said they shaved off more than \$450,000 in interest on the loans, which will be paid off on time in 2018.

“For three years in a row, 2011, 2012 and 2013, they were the big refunds, \$150,000 a year,” Scheetz said.

Geneva District 304’s fi-

ancial advisers offered several scenarios for dealing with its \$301 million debt. Doing nothing would boost loan payments to nearly \$25 million by 2018, something officials want to avoid.

At a recent meeting, school board members talked about the options with the goal of flattening out the debt payments to reduce their impact on taxpayers.

One of them is abatement, which means it is going to take money in excess of \$15 million in the education fund to lower the debt payment for the year. McCanna said abating is another tool governments use to reduce debt payments.

“Abating means they have money on hand, and they are looking at their current tax levy,” McCanna said. “Part of this year’s tax levy is reduced by the cash on hand.”

District 304 already has been using abatement to control debt payments. Board member Bill Wilson said officials abated \$8.2 million and are on target to abate \$5.9 million more.

“We’re trying to keep them [debt payments] at \$15 million,” said Donna Oberg, District 304’s assistant superintendent for business services. “Drawing out that debt an additional four years

would be a cost to us. But by putting something aside, we can use some of that money to restructure those bonds.”

Sugar Grove Administrator Brent Eichelberger said the village does abatement with nonhome rule sales tax to pay for the Municipal Drive project.

“If we did not abate, it would go on the property tax rolls,” Eichelberger said. “So [we] are abating the property tax levy.”

Oberg said District 304 transfers its reserves to its bond and interest fund.

“Instead of having the county clerk levy the whole dollar amount, she is reducing it by the amount we have set aside,” Oberg said. “When the bond payments come due, we take that, along with the tax levy we have collected, and make that payment.”

The third financing tool District 304 has at its disposal is called defeasance, where the district sets money aside every year for the bonds’ principal reduction. McCanna said defeasance is the equivalent of setting up an escrow account that can be invested and set up to pay the loan as it comes due.

“Then they don’t have to worry about how the loan is going to get paid,” McCanna said.