State of New Jersey

Department of the Treasury

For Immediate Release:
October 29, 2008

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Analysis Shows State Realized Net Savings of $41 Million in Bond Issues and Subsequent Restructuring

TRENTON – State Treasurer David Rousseau announced today that a recently completed analysis shows that New Jersey realized a net savings of $41.2 million by issuing auction rate bonds over a four-year period even after restructuring the portfolio into mostly fixed-rate bonds in the last year.

"Despite a collapse of the Auction Rate Securities (ARS) market this year, New Jersey was successful in both capitalizing on the debt service savings made possible when the ARS market was working properly, while minimizing the cost of exiting the market after auctions began failing last February," he said.

According to the Office of Public Finance analysis, performed at the Treasurer's request, New Jersey, through various authorities and agencies, issued $3.4 billion in ARS since January 2003 as an alternative to the issuance of fixed rate bonds. The borrowing funded projects for public schools, transportation projects, state facilities and other public priorities.

In conducting the cost/benefit analysis, the Office of Public Finance determined the average effective interest rate on the auction rate bonds between the time of each issuance and December 31, 2007 – just before the ARS rate resetting mechanism began to weaken in early January 2008, and began to fail outright in mid-February of this year. This rate was then compared to the rate on fixed bonds, if they had been issued as fixed rate on the same date. When applying this comparison across each borrowing by the five State authorities that issued auction rate securities between 2003 and 2007, the analysis shows that the State achieved $103.1 million in interest cost savings versus what it would have paid on fixed rate bonds.

As the State exited the market, it did incur costs to restructure its portfolio. Those costs, including fees to underwriters, bond counsel, financial advisors, swap terminations and other expenses, totaled $62 million, leaving the State a net savings of $41 million.

"Our analysis shows that prior to the historic fiscal crisis in our country, the auction rate securities were working as intended," Rousseau said. "They saved the State money. Through the hard and quick work of the Office of Public Finance and the issuing agencies, New Jersey was able to preserve a large portion of these savings while exiting the ARS market."

The bonds were issued through the New Jersey Economic Development Authority for School Facilities Construction; the New Jersey Transit Corporation Light Rail Transit System Project; and the Business Employment Incentive Program.. They were also issued through the New Jersey Transportation Trust Fund Authority; New Jersey Building Authority Revenue and the New Jersey Sports & Exposition Authority.

"Auction rate securities were an attractive bond issuance alternative at the time the State and its Authorities issued them due to the fact that they paid short-term interest rates but were long-term financing instruments," said Nancy Feldman, Director of the Office of Public Finance. "In nearly all cases, the short-term interest rates were lower than the fixed interest rates that could have been sold in the market at the time. Over a very long period of time, short-term rates are nearly always lower than long-term interest rates, so even though there have occasionally been spikes of short-term rates, over a 20-year bond issue they will produce debt service costs lower than fixed-rate bonds."

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