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DERIVATIVES

Oakland Runs a 'Swaption' to Bring Football Back to City

By Peter Heap

A derivatives transaction that short-circuits the inefficiencies of the taxable municipal market helped bring back the Raiders to Oakland, according to **GBR Financial Products Co.**

Using a "swaption" – a swap with a built-in option – the derivatives firm said it was able to save more than 100 basis points, or \$13 million to \$16 million, off the cost of issuing \$140 million of bonds. The debt sale will finance improvements being made at the 65,000-capacity stadium where the football team will now play. "It's very significant," said **Don Rice**, president and chief executive officer of GBR, referring to the size of the savings.

He said the deal was a good example of how derivative transactions can help municipalities cut borrowing costs by getting around market inefficiencies, such as the relatively high cost of issuing taxable municipal bonds.

"Swaps are very efficient," Rice explained, "By efficient I mean they tend to price to where, mathematically, a debt level should be."

He said that when there are unusual components in the bond market there is always a price inefficiency.

"The price inefficiency is greater when you get into less-traded markets like taxable municipals," he said. "In this current example, by being able to issue very short-term paper and then enter into a swap and get the fixed rate we were able to just be much more efficient because we didn't have to pay in effect premiums that are exacted with taxable municipals."

Rice also referred to GBR's recent forward swaption deal for **Dade County**, Fla., as another example of how issuers could use sophisticated financial techniques to save money. He added that many municipalities are unaware of the potential savings.

"What municipalities often don't realize is that there's a tremendous amount of option value embedded in their financing strategies. "Sometimes, especially if you are in a flexible swap-based structure, we say give us the right to put you in that at the level you think is attractive today and in return I will give you the 5%," Rice said.

The key, Rice added, is having a dialogue with clients and understanding their thinking and goals.

"By having that understanding and at the same time understanding lots of fairly complex structures that are available in the swap market, we can marry those two things to meet their objectives," Rice said.

'Swaps are very efficient... they tend to price to where, mathematically, a debt level should be,' says Don Rice, president of GBR Financial Products.

GBR's approach, he said, is to start with an issuer's savings goal – for example, to cut 5% off debt service costs – and then look at ways of unlocking cash.

"A lot of times when you are talking to municipalities they will say something like, 'If I could get 5% savings I would do this transaction or if interest rates were low enough I would lock that in,'" Rice continued.

For example, few municipalities would say they want to do a forward embedded payor option, which is the technical name for Dade County's deal, but many would jump at the chance to lock in a specific cost of funding today, Rice said.

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