

## Interest And Sinking Fund - What Is It And Why Is It Important?

### Guidance

Always consult the bond covenants or loan agreement to determine the specific definition and requirements for Interest and Sinking Funds (I&S Funds) for each bond series you may have outstanding. This may or may not also involve consultations with your Financial Advisor and or bond counsel.

### Definition

The specific definition and requirement for I&S Funds are included in the bond covenants or loan agreement. The concept is both a legal requirement, and an economic requirement. The legal requirements define what is involved (i.e. how much, when, and from what source). The economic component is defined by a calculation based on the legal requirement (i.e. how much money to set aside).

A practical definition is that I&S Funds are temporary savings (created monthly or annually per covenants) so that funds are set aside and readily available to pay debt service when due.

Disbursements from I&S Funds for purposes other than to pay debt service are generally not allowed.

Note that covenants may require I&S Funds to be maintained “separate and apart” from all other funds and accounts. Since I&S Funds are for debt service payments only, it is extremely helpful to have separate accounting on the general ledger as well as maintaining separate I&S Funds in a separate bank account.

If other non-TWDB debt exists on parity (equal status) with obligations to TWDB, usually covenants would require all debts on parity to have similar requirements for I&S Funds.

If other non-TWDB debt exists which is NOT on parity with obligations to TWDB, then there may be differing I&S Funds requirements for each type of debt.

### Best Practices

At fiscal year-end, reporting of balances on hand in required I&S Funds should be reported in footnotes to the financial statements which are part of the Annual Financial Report (AFR). The format for reporting can vary, but generally should include basics such as the following:

	Series 2020 Revenue Bonds	Series 2018 Revenue Bonds	Series 2015 Revenue Bonds	Total I&S Funds Reported in Debt Service Fund
Actual Amount on Hand per Series	\$45,512	\$25,750	\$65,740	\$137,002
Required Amount per Series	\$45,000	\$25,500	\$62,500	\$133,000
Amount in Excess (Short) of Requirements	\$512	\$250	\$3,240	\$4,002

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As a best practice, disclosure of balances of I&S Funds should be reported separately in the AFR footnotes by type of indebtedness. Generally, the amounts required, the amounts on hand and any shortages or overages are reported. If shortages are reported, a comment may be included as to whether or not shortages have been corrected and current compliance exists

It is a best practice to create policy and procedures to create the proper funding and reporting of requirements for I&S Funds. For instance, the annual budget should be prepared timely each year, and include deposits for I&S Funds (i.e. funding for debt service payments). Appropriate policy and procedures can facilitate compliance over the life of the debt and preserve institutional knowledge to offset loss of expertise as staff changes over time.

### **Importance**

Lack of compliance with requirements for I&S Funds may indicate not only legal noncompliance, but an economic inability to pay debt service when due. The awareness of requirements, and the ability to comply with requirements, are extremely important for borrowers as well as current or potential lenders.

### **Noncompliance**

Covenants may provide guidance on how to restore compliance with requirements for I&S Funds. Normally, this would require “catchup” funding to meet at least the minimum monthly funding requirements.

### **Questions?**

Your Financial Advisor, bond counsel, and Financial Compliance should be able to assist as needed.