Interest and Sinking Funds - What is it and why is it important?

Guidance

Always consult the bond covenants or loan agreement (covenants) to determine the specific requirements for an Interest and Sinking Fund. This may or may not involve consultations with your financial advisor and/or bond counsel.

Definition

An Interest and Sinking Fund is a requirement some bond covenant and loan agreements may contain. The Interest and Sinking Fund is used as a source to pay principal and interest over the life of the debt.

Deposits

An Interest and Sinking Fund is a savings account that, in most instances, requires monthly deposits to be set aside only for payment of debt service (principal and interest). The specific covenants will establish the applicable requirements for funding of an Interest and Sinking Fund.

Withdrawals

Debt service payments (principal and interest) are paid using funds saved over time in the Interest and Sinking Fund. Upon full payment of the associated debt, any funds remaining in the I&S Fund may be used for other lawful purposes. Withdrawals for purposes other than debt service payments are not authorized.

Accounting and Banking Requirements for Interest and Sinking Funds

Even if not required in the covenants, a usual best practice is to keep the Interest and Sinking Funds in a bank account separate and apart from all other accounts. Similarly, even if not required in the covenants, a usual and best practice is to keep the funds accounted for separately on the general ledger of the borrower. That way, there is a one-to-one relationship between a bank statement and an accounting maintained in the borrower's accounting records *(i.e.* general ledger).

Borrowers with Multiple Interest and Sinking Funds

For larger borrowers with many I&S Fund requirements, as long as the covenants allow for it, the funds may be kept in a single bank account. If this practice is allowed and used, it is most important to have accurate supporting calculations to assure that the proper amount is on hand in order to pay debt service timely and in full. Most often, banking institutions will provide "sub-account" tracking so that each I&S Fund matches one to one with a corresponding amount in the general ledger.