Managing Your Cash Flow

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Cash Management is Essential in Today's Economy - the Actions of the State Directly Impact K-12 School Districts

The Governor's Proposed Budget

- Estimates that the General Fund will end 2009-10 with a $6.6 billion deficit
  - Estimates that 2010-11 will end with a $18.9 billion deficit
- Relies on a variety of proposals and measures to be placed on the June ballot
- Anticipates total Prop. 98 spending to remain flat
  - From $49.9 billion in 2009-10 to $50 billion in 2010-11

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California's General Fund Cash Outlook

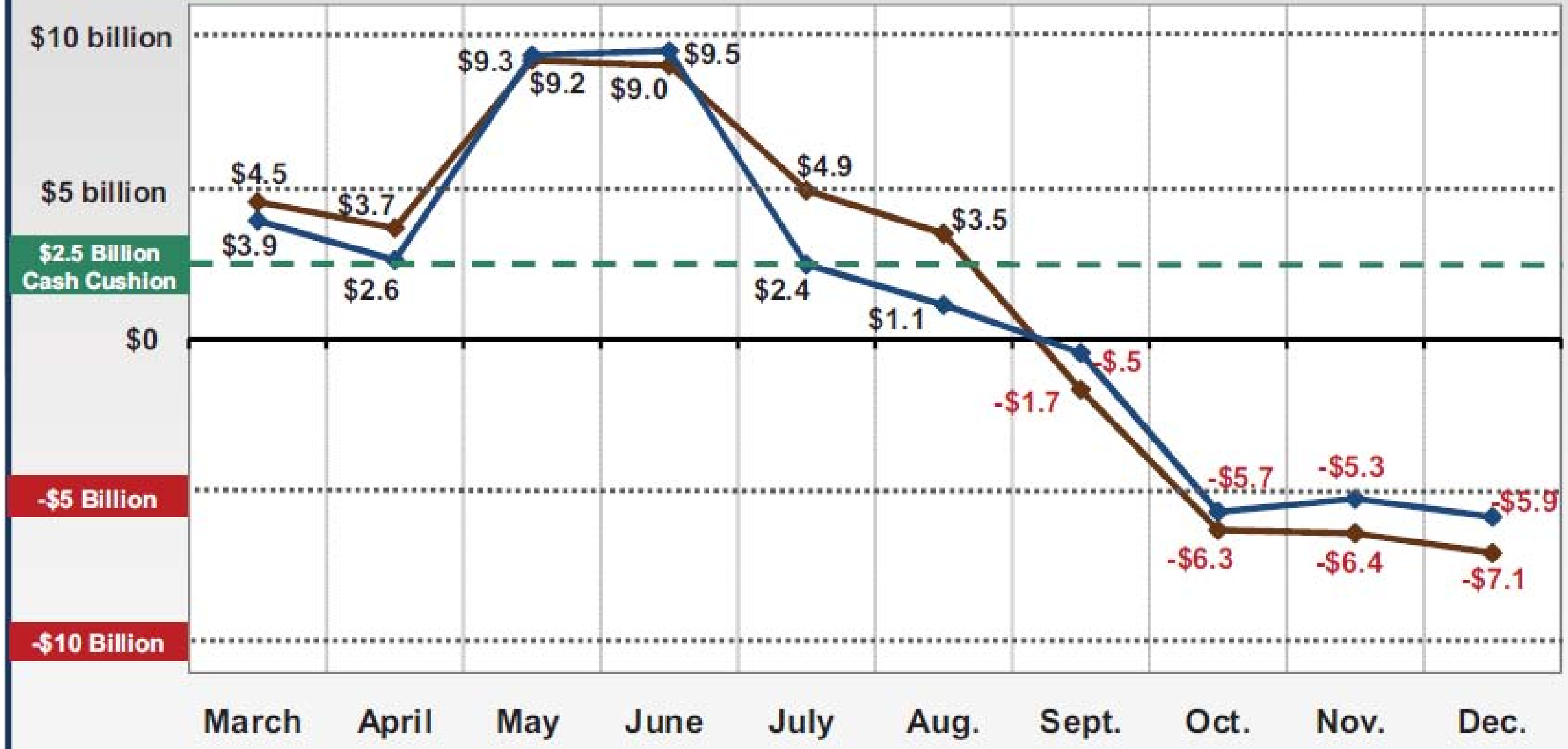
For the Months of March - December 2010

Based on Dept. of Finance Jan. 2010 Budget Data and Actual Receipts Through Feb.

(In Billions of Dollars -- Excludes 2010-11 External Cash Flow Borrowing)

Blue Line = Estimated Minimum Monthly Cash Balances Assuming Full and Timely Adoption of the Governor's Proposed Budget

Brown Line = Estimated Minimum Monthly Cash Balances with ABx8 5 Deferrals



California State Controller's Office

State Impact on K-12 Education

- Greater cash flow problems due to the amount and timing of deferrals
  - State funded capital projects are also impacted by a lack of available cash.
- Risks associated with assumptions in the Governor's Proposed Budget and access to capital markets
- The State has relied on deferring K-12 apportionments to preserve cash
  - Apportionments for 2009-10 deferred until after June 30, 2010

2010-11 Deferrals

- The overall level of K-12 deferrals is limited to $2.5 billion “at any given point in time”.
  - $2.5 billion July 2010 payment deferred for 60 days
  - $2.5 billion October 2010 payment deferred for 90 days
  - $2.5 billion March 2011 payment deferred until April 29, 2011
- These deferrals may be moved by 30 days (in either direction)

➢ *A Deferral Hardship Waiver is available, if a District is unable to meet its obligations.*

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State School Facility Program – Capital Project Funding

- Project approved after December 18, 2008 remain unfunded.
- As of the March 24 SAB meeting, approximately $376 million was allocated for funding for schools.
  - To be apportioned to projects on the Unfunded List, based on timing of approval.
- The State was expected to issue additional bonds this week.

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Key Questions to Consider Regarding Cash Flow Shortfalls

- What is “bridge” financing?
- What types of bridge financing are available to school districts?
- What should school districts consider before pursuing a bridge financing?
- When should school districts rely on bridge financing?

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What is “Bridge” Financing?

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Bridge Financing Defined

- Temporary borrowing
  - Intended to “bridge” the gap between expenditure requirements and the receipt of revenue or a permanent financing.
  - To be repaid from a known repayment source
  - 5 years or less

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Conceptual Operational Example

- State has deferred apportionment by 3 months and money is needed for payroll immediately.
  - Expenditure requirement = payroll
  - Known repayment source = State apportionment
  - Timing for receipt of repayment source = 3 months

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Conceptual Capital Example

- State has deferred allocation of New Construction Funding (with unfunded approval) for 6–18 months and construction is in progress with money due to the builder immediately.
  - Expenditure requirement = construction expenditures
  - Known repayment source = State New Construction Funding
  - Timing for receipt of repayment source = 6-18 months

What Types of Bridge Financings are Available to School Districts?

Short Term Operational Cash Flow Financings

- Interfund Borrowing
- County Treasury Loan
- Tax and Revenue Anticipation Notes

Interfund Borrowing

- Per Education Code Section 42603
- Temporary transfer from one fund to another to meet payment obligations
  - Must be repaid in same fiscal year

    OR

  - Repaid in the following fiscal year if the transfer is within the final 120 days of the fiscal year
- Repaid with interest
- Cannot exceed 75% of the money in the fund

➢ *Cheapest and easiest type of bridge financing*

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County Treasury Loan

- Per Article XVI, Section 6 of the California Constitution
- Meet with County Treasurer to see if private placement loan can be made from the County Pool
- Flexible loan, similar to a line of credit
  - Money transferred when needed
- Interest charged at the prevailing County Pool investment rate
  - Based on the amount actually transferred

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Tax and Revenue Anticipation Notes (TRANs)

- Per Government Code Section 53850 *et. seq.*
- Method for advancing property taxes and/or State apportionments
- Must be repaid from revenues attributable from the fiscal year in which the TRAN is issued
- Notes purchased by municipal investor

Short Term Capital Financings

- Grant Anticipation Notes
- Bond Anticipation Notes

Grant Anticipation Notes (GANs)

- Used to obtain money in advance of receiving grant funds
- Can be issued for projects which funds have been appropriated and committed
  - i.e., a district has been approved for funding AND a fund release
- Repayment obligation limited to the grant funding
- School districts are rarely able to use actual GANs because funds that have been appropriated are usually available to be spent.
  - May issue a technically different type of borrowing, and refer to it as a “GAN”.

Bond Anticipation Notes (BANs)

- Used when the tax base is not sufficient to issue bonds, but proceeds are needed
  - General Obligation Bonds or Mello-Roos Bonds
- Repaid from the proceeds of a future bond issuance
- Bond market may require the district to make interest payments

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Example:
Plumas Lake School District BAN

- Rapidly developing community
- The District formed Mello-Roos Districts to fund new schools
- Began new school construction before slow down in housing market
- Mello-Roos tax base was not sufficient (with coverage) to issue a sufficient amount of Mello-Roos bonds to fund the school construction
- Issued BANs to be repaid in 5 years from taxes from new development

Example:
Santee School District BAN

- The District had $60 million in GO Bond authorization
- Had State Modernization and New Construction Allocation
- Assessed value declined and GO Bonds could not be issued within tax rate limitations
- Issued BANs to obtain money for projects to keep promises to voters
  - To be repaid from GO Bonds when assessed value grows sufficiently

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Long Term Capital Financings Used as Bridge and/or Permanent Financing

- Capital Leases
- Certificates of Participation
- Lease Revenue Bonds

General Provisions Related to Long-Term Debt

- Secured by a district’s general fund
  - Provides an investor certainty of repayment
- Can be structured with a wide range of flexibility
- Legal authority derived from California court cases
  - Designed to avoid classification as indebtedness for purposes of Article XVI, Section 18 of the California Constitution
- Voter approval NOT required

Capital Leases

- Traditionally used for capital projects under $1 million with a term of 10 years or less
- Sold to a single investor at a single interest rate
- Ability to prepay
  - May be certain restrictions (prepayment penalty, prepayment limited to interest payment date)

➢ *The ability to prepay enables this type of financing to be used as a bridge.*

Certificates of Participation (COPs)

- Traditionally used to provide long-term financing for facilities
- Sold to a multiple investors with interest rates for each maturity
- Should resemble a commercial lease (as viewed by Bond Counsel)
  - Need to be structured as long-term debt with the ability to prepay

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Lease Revenue Bonds

- Similar to a COP
  - In terms of purpose, process and structure
  - Distinction relates to the legal form of borrowing

Using COPs and Lease Revenue Bonds as a Bridge Financing

- The ability to prepay enables these to act as bridge financings
- Can use “capitalized interest” to delay repayment
  - Borrow enough to meet interest payment obligations
    - If tax-exempt, limited to 3 years
- Flexible term and repayment structure
  - e.g., 30 year term prepayable anytime, interest only payments, etc.

Example:
Chawanakee USD Bridge Financing COP

- In progress on high school construction project
- Approved for financial hardship funding from the State
  - 100% project funding
- State halted allocation of new construction funding
- District's COP was structured to bridge the receipt of State funds
  - 30 year financing, prepayable anytime

What Should School Districts Consider Before Pursuing a Bridge Financing?

ALL BORROWINGS MUST BE REPAID AND WITH INTEREST

You cannot have a bridge to nowhere!!!

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Repayment Sources

- State Apportionment
- State or Federal Grants
- General Fund
- General Obligation Bonds
- Mello-Roos Special Taxes
- Developer Fees
- Redevelopment Pass-Through Funds

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Financial Planning Questions

- Is there truly a need for a bridge financing?
  - Can the expenditure of funds be delayed until revenue is available?
- What is the reliability of the anticipated repayment source?
- How will interest costs be funded?
- What is the back-up plan in the event that the repayment source is not available or insufficient?
  - Future market conditions are unknown

Debt Structure Considerations

- Interest Rates
  - Fixed, variable, step
- Redemption/Prepayment Provisions
  - Call protection, prepayment premium
  - Cost of reducing or eliminating prepayment restrictions
- Length of Capitalized Interest
- Financing Term
  - The shorter the term the lower the interest rate, but higher the annual payment

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Credit Enhancements Can Impact Borrowing Costs & Viability of a Financing

- Credit Rating
  - Must demonstrate that a financing can be repaid
- Bond Insurance
  - Insurers typically avoid construction and take-out risks
  - Generally not available for bridge financings in the current financial market
    - ➢Single insurer that is able to be selective

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When Should School Districts Rely on Bridge Financing?

Bridge Financing Can Be Used if a Short-Term *Cash Flow* Problem is Identified

- If it is not permanent funding shortfall
- After an evaluation of benefits
  - e.g., take advantage of a grant, in progress on construction and costly to stop, to mitigate for difficult market conditions
- After an evaluation of risks
- If a revenue source is certain
- If the district and board understand the cuts that would be necessary in the event the revenue does not materialize.

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Recommendations for Pursuing a Bridge Financing

- Obtain a clear understanding of the timing and need for project funding (cash flow analysis)
- Evaluate the timing, availability and certainty of revenue sources
- Analyze the impact of bridge financing costs on the overall project cost
- Prepare a concrete back-up plan in the event the bridge repayment source does not materialize
- Identify district repayment goals and financing structure options to meet such goals
- May consider establishing a debt policy

Questions?

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