Kern County Superintendent of Schools

Managing Outstanding Debt

Government Financial Strategies

Presented by Lori Raineri
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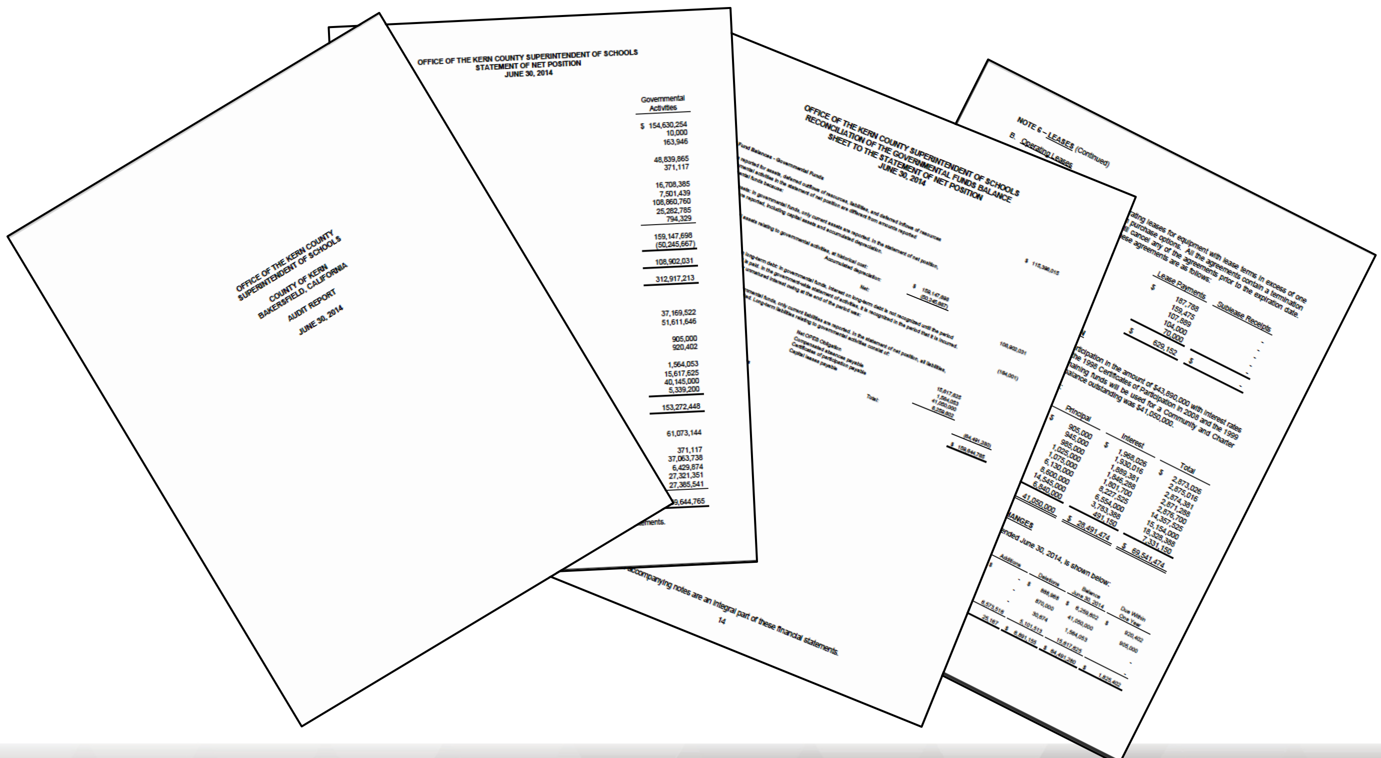
Presentation materials provided for distribution to class participants and are not meant to stand alone without the class discussion.

What Debt Does the District Have

- The Audit Report is the place to start
    - Superintendents: do you read *the Statement of Net Position* and the *Notes*?



Administration of Outstanding Debt

- Tax-Exempt Securities Compliance
  - Arbitrage Rebate Rules
  - Continuing Disclosure to the Securities Market
  - Maintaining Credit Ratings/Bond Insurance

- Management
  - Accounting
  - Execution of Original Plan
    - Budgeting – Payments and Payment Dates
    - Tax Rates & Tax Roll Preparation
  - Refinancing/Refunding Options
- Other
  - Procedures and Policies
    - Investment Policy Development and Implementation?

✔ *Post-Issuance Compliance Checklist (GFOA and National Association of Bond Lawyers):*
www.gfoa.org/sites/default/files/u2/PostIssuanceCompliance.pdf

Arbitrage Rebate Rules Compliance

- Arbitrage occurs when one borrows at one interest rate and invests the proceeds at another - therefore, there can be both positive and negative arbitrage.

- The general rule is that positive arbitrage, calculated every five years from the date of issuance until the proceeds are spent, must be "rebated" to the Federal Government within 60 days of the five year date.

Arbitrage & Rebate (Cont.)

- Exceptions:
  - Small issuer - depends on type of public agency, when debt issued, and type and amount of debt issued
  - Expenditure exceptions - depends on timing and amount of expenditures
  - ✔ *The exceptions apply to project funds, but have varied applicability to other potential funds (e.g. debt service reserve fund and debt service payment fund)*

- Potential Penalties For Non-Compliance - payment of rebate amount owed, interest penalties, bonds deemed taxable

Disclosure & Continuing Disclosure

- Under Federal law, underwriters may not purchase or sell publicly offered municipal securities unless they determine that the issuer will file continuing disclosure.
  - To make this determination, underwriters require the issuer to sign a continuing disclosure certificate, which sets forth the requirements for filings.
- Any Official Statement associated with a publicly offered municipal security must disclose every instance in the previous five years in which the issuer failed to materially comply with its continuing disclosure obligations.
- Failure to disclose can lead to the SEC filing charges.

Continuing Disclosure

- Covenant to annually provide certain information to the bond market.

- Applies to publicly issued securities sold after July 2, 1995.

- The exact continuing disclosure requirements for each issue are contained in the continuing disclosure certificate.

- Small issuer exception - the issuer will have less than $10 million in tax-exempt debt outstanding after the issue.
  - Bonds issued before July 1, 2009 - obligation is to provide required information upon written request.
  - Bonds issued on or after July 1, 2009 - must file financial documents with EMMA (http://www.emma.msrb.org)

EMMA®
Electronic Municipal Market Access
A service of the MSRB

Continuing Disclosure – Significant Events

- In addition to the annual continuing disclosure requirements, the continuing disclosure certificate also lists certain "significant" events that must be disclosed if they occur.
- There is no "small issuer" exception to the significant event disclosure requirement.
- Typical events that must be disclosed include payment delinquencies, bond calls, rating changes, etc.
- For bonds issued prior to December 1, 2010, significant events must be disclosed within a reasonable period of time.
- For bonds issued on or after December 1, 2010, significant events must be disclosed within ten days.

Penalty for Non-Compliance

- Penalty for Non-Compliance
  - The fact of non-compliance must be disclosed for debt issued during the following five years
    - May make the borrowing less attractive to underwriters and investors, and therefore more costly

- GFOA Best Practice - *Understanding Your Continuing Disclosure Responsibilities*

Maintaining Credit Rating/Bond Ins.

- Rating agencies and bond insurers require that entities rated or insured respond to requests for information, or they can rescind the rating or the policy.
- Simple answer: respond to rating agencies and bond insurers that the District has contract with.
- Be careful about requests for information that are from other rating agencies and bond insurers than selected by the District.
- Do not share non-public information.

Accounting

- Once a year . . .
  - Review the “funds flow” in the underlying documents.
    - For most bonds, this will be found in a “Resolution Authorizing the Issuance of Bonds”
    - For most certificates of participation financings, this will be found in a “Trust Indenture”.
  - Review the relevant sections of the California School Accounting Manual.
  - Discuss with District’s external auditor.
  - Discuss with with trustee or paying agent.
  - Confirm accounting practices is consistent with legal and practical requirements.

Execution of Original Plan

- Budgeting – Payments and Payment Dates
- Tax Rates & Tax Roll Preparation
- Other?

- Wisdom from Will Rogers
  - There are three kinds of men:
    - The ones that learn by reading.
    - The few who learn by observation.
    - The rest of them have to touch an electric fence.

Refinancing / Refunding

- In general, bonds can be refinanced (i.e. refunded); however, there are often limitations

- Many bond issues carry "call" (i.e. prepayment) protection
  - The bonds may not be prepaid for a certain amount of time (the call protection period), or not at all, and may have prepayment premium/penalty requirements

- There is an inverse relationship between the amount of call protection and the interest costs. Generally speaking, the longer the call protection and/or higher the prepayment premium, the lower the interest costs (and vice versa)

Advance vs. Current Refunding

- Bonds can be refinanced by issuing refunding bonds
- "Current Refunding" - refunding bonds issued no more than 90 days before the call (i.e. prepayment) date
  - Bonds may be "current" refunded an unlimited number of times
- "Advance Refunding" - refunding bonds issued more than 90 days before call date
  - Federal tax law allows a bond to be advance refunded only <u>once</u>
  - An advance refunding is more complex than a current refunding, and therefore issuance costs are often higher

Minimum Required Savings

- The refinancing process requires staff time and Board action
- The new refunding bonds often have a first call date which is further out into the future
- Therefore, it is advisable to consider the appropriate thresholds required to begin and complete the process
- In the municipal finance industry, the thresholds are commonly based on the present value savings as a % of the amount of principal being refunded

Procedures and Policies

- Review business procedures
  - File questions to review with external auditor
  - Familiarity with what others do
    - Evaluate costs
- Check policies
  - Many districts have adopted CSBA standard policies which are in conflict with practice or requirements of the securities outstanding

Investigation is Becoming More Frequent

- Who knows who Al Capone was?


Chicago Sunday Tribune

FINAL EDITION

JURY CONVICTS CAPONE

omas A. Edison Dies in Sleep at 84

DEATH PAINLESS FOR MAN WHO LIGHTED WORLD

Family at Bedside When End Comes.

INDIAN SUMMER

Kill Matt Kolb, Northwest Side Gambling Czar

GANG MONARCH GUILTY ON 5 TAX FRAUD COUNTS

Faces Possibility of 17 Years in Cell.

SUMMARY

Annual Administration – Simple Summary

- Pay On Time Every Time
- Communicate
  - Investors
  - Rating Agencies
  - Other?
- Comply with the Law
- Manage the Debt Down

Generals Prepare for the Last War

- "Those who cannot remember the past are condemned to repeat it."

  - From the *The Life of Reason*, George Santayana

- "I'm not lost for I know where I am. But however, where I am may be lost."

  - From *Winnie the Pooh*, A.A. Milne