Operating Cash Flow Borrowings State Aid Notes, Tax Note and Lines of Credit

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Challenges

- Mismatch in timing of Budgeted Revenues to Budgeted Expenditures
- May, but does not necessarily, indicate a budget deficit or a structural deficit
- Seasonality of expenditures, and tax and federal revenues

Contributing Factors

- Three of 11 state aid installments are received after school year ends
  - Two are received after fiscal year ends and accrue back
- Portion of budget derived from state aid compared to property taxes
- Split or December only tax levy
- Size of fund balance
- Portion of budget tied to federal funds

Exacerbating Factors

- Declining fund balance
- Structural deficit
- Uncertainty about enrollment; declining enrollment
- MPSERS contribution rates
- Date School Aid budget becomes final
- Large budget surprises
  - Boilers and other big ticket repairs
  - Chargebacks or federal grant issues
  - Prorations
  - Judgments

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Every District's Cash Flow Looks Different

- Depends on factors on prior two slides

- Three general groupings for timing of peak shortfalls
  - August, September and October (before 1st State Aid payment)
  - August through January or February (Before December tax levy receipts)
  - June, July and August (if fund balance is small or declining)

Other Patterns

- Shortfalls are steady, throughout the year, or peak in fall, winter and summer
- Building, August through December, before declining
- Periodic, short negative cash dips (actual or possible)

Three Types of Borrowing

- State Aid Notes
  - Most common
- Tax Anticipation Notes
  - Relatively uncommon post school finance reform
- Lines of Credit
  - Used where need is short, or episodic or contingent

May be used separately or in combination

Sizing Under State Law

SAN:	Not to exceed 70% of State Aid not yet received or pledged in current Fiscal Year (MFA more restrictive)
	Not to exceed 50% of State Aid for next Fiscal Year
TAN:	Not to exceed 75% of taxes yet to be received in Fiscal Year
	Not to exceed 50% of taxes yet to be received in next Fiscal Year Set asides required
Line of Credit:	Not to exceed 30% of state aid

Tax Treatment

- Tax Exempt
  - Bank Qualified
  - Non-Bank Qualified

- Taxable

Federal Tax Considerations

Tax Exempt v. Taxable

- If district will issue more than $10 million in tax exempt obligations during the calendar year, the cash flow borrowing may not be designated as a "qualified tax exempt obligation" (**QTE**) for purposes of certain deductions by bank purchasers. Therefore banks are often interested only in buying **QTE**-designated obligations.
  - If doing bank RFP, important to note this status
  - Michigan Finance Authority doesn't care if notes are QTE

- If a line of credit is used, each draw may constitute a separate borrowing for **QTE** purposes.

- Lines of credit usually bear interest at a relatively low variable rate of interest.

- For ease of administration, and to avoid exceeding the **QTE** limit (or to avoid a breach of promise to other bondholders not to exceed the limit), we recommend that lines of credit be entered into on a taxable basis.

Federal Tax Considerations

Sizing Cash Flow Borrowings Under Federal Tax Law

- The standards are the same for all tax exempt cash flow borrowings.
- The maximum borrowing does not exceed:
  - I. The district's maximum projected cash flow deficit in a 12 month period

    plus
  - II. 5% of the prior fiscal year's general fund expenditures **("reasonable working capital reserve")**

    plus
  - III. Costs of issuance of the obligation

Federal Tax Considerations

Arbitrage Considerations

- Rebate of the earnings on the note proceeds in excess of the yield on the borrowing **(“arbitrage rebate**”) is required on tax exempt borrowings unless an exception is satisfied.

- No rebate required if:
  - District issues less than $5 million in tax exempt obligations during calendar year.
  - Within six months after issuance, District (a) achieves actual cash flow deficit equal to 90 % of amount borrowed or (b) actual cash flow deficit plus reasonable working capital reserve equal to 100% of amount borrowed while the obligation is outstanding.

Types of Buyers

SANS

- Michigan Finance Authority
  - August pool
  - Application by the end of June
  - One year notes (more recently, some options on duration)

- Bank purchase
  - Direct placement
  - RFP optional
  - Competitive Sale
  - Customized timing and maturity

Types of Buyers

TANS

- MFA: one-off transaction – no pool
- Competitive or direct placement with bank
- Allows customized timing and maturity

Types of Buyers

Lines of Credit

- Bank issues line to district
- Usually a bank with which district has a significant depository relationship.
- Revolves, customized timing, draws and maturity.
- We usually do taxable, variable rate.

Prerequisites

Qualified Status with Treasury

- Annual filing by December 31
- May file later if audit filed with State before 12/31
- Even deficit district (in any fund) may obtain if approved deficit elimination plan.

OR

Prior Approval of Treasury (Long Form Application) (approximately 2 weeks)

Line of Credit requires separate long form approval (5 weeks) in addition to qualified status.

AND

If borrowing over $5 million and placing with bank, need rating waiver from State for SAN, TAN or Line of Credit.

Michigan Finance Authority Process

- Application and authorizing resolution by late June
- Cash flow (required form), budget and audit
- Final sizing in July
- Purchase contract in early August
- Delivery about August 20

Choices: Set asides or no set asides
Number of set asides
Maturity Date (from set options)

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Bank Purchase

- Timing is flexible
- Cash flows, budget, audit
- Other terms depend on bank
- May approach one bank, circulate RFP or publish notice of sale
- Whitehall process

Line of Credit

- Treasury application filed after authorizing resolution
- Cash flow for sizing, but less limiting
- May or may not be fee at closing, or fee for undrawn amounts
- May require automatic debit for payments
  - Budget
  - Audit
  - Maintain accounts
- May be additional covenants from bank
- One-year term; “renewal” requires repeat of whole process
- May approach one or more banks or use RFP. Competitive sale not recommended.

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Cash Flows

- Format
  - Treasury requires use of its format
  - Whitehall format
- Show note payoff
- Monthly at a minimum, weekly is best
- MFA requires weekly for worst month.
  - Always check balance at mid-month before state aid, especially in 3 payroll month

Questions

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