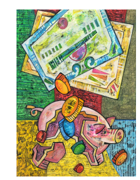
Santa Clara County Office of Education

Tax and Revenue Anticipation Notes
Sizing and Other Considerations



Government
Financial
Strategies
inc.

Presented by
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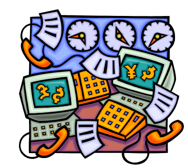
Goal

- Provide you with a better understanding of tax and revenue anticipation notes (TRANs), with a focus on how TRANs size is determined.

Agenda

- Tax & Revenue Anticipation Notes (TRANs)
  - Background
  - Sizing
  - Repayment (Pledge Amounts and Dates)



- Sample Sizing Spreadsheet
  - Walkthrough

Please Feel Free to Ask Questions

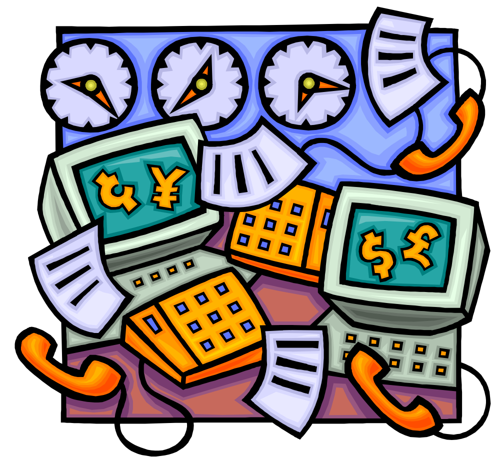
Medical science has yet to discover the bone in your head that makes you nod knowingly when you don't have a clue.

Background on TRANs

- Tax and Revenue Anticipation Notes
  - Short term debt used to finance cash flow deficits in anticipation of receiving taxes and other revenues.
  - Authorized by Section 53850 etc. of the Gov. Code.
  - No voter approval required.
- Under California law, TRANs are the only method allowed for working capital (operating funds) borrowings.
- Many districts have issued TRANs in the past.
  - In 2011-12, 12 County districts issued TRANs
  - Total par amount: $97,471,000
  - 5 in CSBA pool, 2 in another pool, 5 on own

TRANs Amount Determination

- Determine "Available Cash"
- Determine "Working Capital Reserve"
- Determine Available Cash "Low Point"
- Determine recommended TRAN size
- Review sizing with bond counsel



✔ ***Broadly speaking, the maximum TRAN size equals the low point plus the working capital reserve (equal to the lesser of 5% of last year's expenditures or last year's average cash flows). The TRAN amount may then reduced by 5-20% to be conservative.***

Calculating the Available Cash Balance

- **Treasury Regulations Section 1.148-6(d)(3)(iii)(A) provides:**

  – ***Available amount means any amount that is available to an issuer for working capital expenditure purposes of the type financed by an issue. Except as otherwise provided, available amount excludes proceeds of the issue but includes cash, investments and other amounts held in accounts or otherwise by the issuer or a related party if those amounts may be used by the issuer for working capital expenditures of the type being financed by an issue without legislative or judicial action and without a legislative, judicial, or contractual requirement that those amounts be reimbursed.***

Calculating Available Cash Balance (Cont.)

- **Available Amount includes all unrestricted cash.**
  - **General Fund**
    - » **Do you track restricted cash in the General Fund?**
  - **Cash in other funds if unrestricted, e.g. unrestricted reserve kept in Fund 17 - Special Reserve Fund.**
    - » **Categorical flexibility and Fund 14 Deferred Maintenance.**
- **Available Amount excludes restricted funds.**
  - **Externally restricted by statute e.g., grants and entitlements. For a description, see the California School Accounting Manual Procedure No. 305.**
  - **Internally restricted by resolution (with a caveat).**

Reasonable Working Capital Reserve

- **Working Capital Reserves are treated as unavailable.**

- **Treasury Regulations Section 1.148-6(d)(3)(iii)(B) provides:**
  - ***A reasonable working capital reserve is treated as unavailable. Any working capital reserve is reasonable if it does not exceed 5 percent of the actual working capital expenditures of the issuer in the fiscal year before the year in which the determination of available amounts is made. <u>For this purpose only, in determining the working capital expenditures of an issuer for a prior fiscal year, any expenditures (whether capital or working capital expenditures)</u> that are paid out of current revenues may be treated as working capital expenditures.***

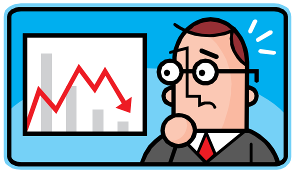
Reasonable Working Capital Reserve (Cont.)

- Method of calculating the working capital reserve is different for "small issuers."
  - A "small issuer" is a district that will issue during the calendar year no more than $5 million in TRANs and no more than $10 million of other tax-exempt debt for school facilities.
- Small issuers: working capital reserve = 5% of prior year's expenditures.
- Non-small issuers (i.e., large issuers): working capital reserve = the lesser of 5% of prior year's expenditures or average available cash balance in the prior year.

Calculating the Low Point

- The low point is the lowest available cash position during the fiscal year after the TRANs is issued.
  - For instance, in a cross fiscal year TRANs issued April 20, 2012, only available cash balances after April 20th until the end of the fiscal year are considered.

- For large issuers, bond counsel prefers you only look at the available cash position up to six months after issuance.



TRANs Sizing

- TRANs size equals the lesser of:
  - 85% of uncollected revenues (Government Code 53858)
  - IRS maximum (low cash position + working capital reserve)
  - Maximum amount identified in the authorizing resolution
  - District's desired TRANs amount
- TRAN sizing must be reasonable (as determined by the IRS) even if the district is a small issuer.
  - Projected cash flows must be based on <u>reasonable</u> assumptions.
    - » IRS goals at odds with school district goals.
    - » Examples--trigger cuts, State budget.

- Taxable TRANs avoid IRS concerns, but cost more.

Borrowed Money Must Be Repaid

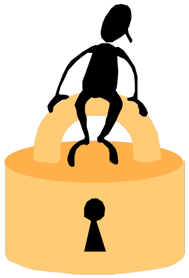
"I'd like to borrow just enough to get myself out of debt."

When Must TRANs Be Repaid?

- Pursuant to Government Code 53854,
  - TRANs are payable "not later than the last day of the fiscal year in which it was issued," or
  - in the following fiscal year "only from revenue received or accrued during the fiscal year in which issued, not later than 15 months after the date of issue."
- Common practice of TRANs maturities no longer than 12 months.
- Given the legal restrictions, government agencies need to issue a separate TRANs for each fiscal year.

Repayment Process

- Typically, a school district will pledge revenues received during the fiscal year and deposit such revenues into a repayment fund.
  - For example, a district could pledge to deposit 50% of the amount borrowed into the repayment fund in January 2012, and the remaining 50% plus interest due into the repayment fund in April 2012.

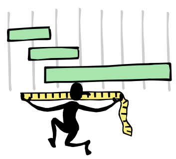


"Cross-Fiscal Year" TRANs

- TRANs are required to be repaid "from revenues received or accrued during the fiscal year in which issued."

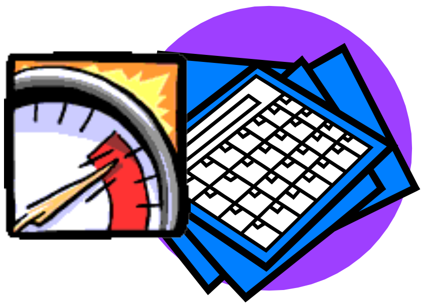
- Deferred State apportionment payments to be received in July/August/September 2012 (hopefully) are attributable to FY 2011-12 and therefore can be used to repay a FY 2010-11 TRANs.

- District would pledge to deposit deferred State apportionment payments and other 2011-12 revenues received in FY 2012-13 into the cross fiscal year TRANs repayment fund.



"Cross-Fiscal Year" TRANs Considerations

- Districts will need to prepare cash flows through pledge dates / TRAN repayment.
  - Need to specifically identify timing of receipts and disbursements of deferred revenues and expenses extending into the following fiscal year.
- Rating agencies will want an opinion from bond counsel that the deferred revenues are in fact attributable to the current year.



Complying with Federal Restrictions

- **Arbitrage**
  – **Borrow at low, tax-exempt rates (e.g., 0.70%).**
  – **Reinvest at higher taxable rates (e.g., 1.00%).**
  – **Difference between interest expense (excluding costs of issuance) and interest earnings is arbitrage.**

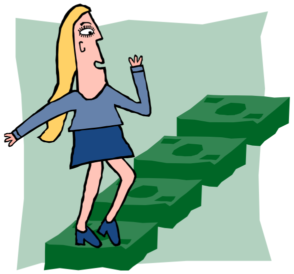
- **Internal Revenue Code (IRC) allows arbitrage earnings to be kept if rebate exception is met.**
  – **Small issuer exception possible for TRANs under $5M.**
  – **Spending exception to rebate requires TRANs proceeds to be spent within six months of issuance.**

✔ ***Market conditions do not suggest an incremental benefit to the General Fund from issuing a TRANs -- rather a cost.***

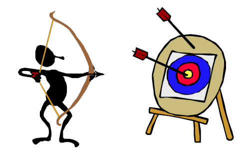
Important to Limit Cost of the TRANs

- Keep the borrowing term as short as necessary.
  - Less time paying interest.
  - Lower interest rate due to yield curve.

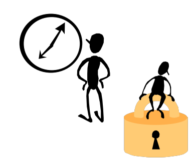
- Keep the TRANs size to only what is needed, not the maximum amount that can be legally borrowing on a tax-exempt basis.



Summary of View on TRANs

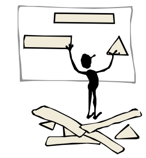


- **Sizing**
  - Sufficient to cover projected deficits in conjunction with interfund borrowing.
- **Term and Timing**
  - What period will TRANs cover?
  - Interfund borrowing may be able to cover part of the year.
  - When can we set aside cash for repayment?

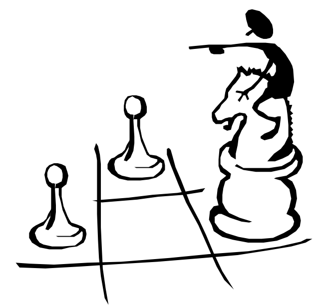


✔ ***If necessary, a district can issue a second TRANs in the same fiscal year to cover deficits should cash positions be significantly worse than projected.***

Ways to Issue TRANs



- **Issue TRANs through an established "pool."**
  - **Often economical for small issuers.**
  - **Minimizes costs to each agency, time and effort of participant school districts.**
- **Issue TRANs independently.**
  - **Often economical for large issuers.**
  - **Provides more flexibility.**
    - **Issuance timing.**
    - **Pledge and repayment dates.**



✔ ***Districts have a variety of historical approaches.***

✔ ***Independent issuance allows for the customized sizing, timing and term which may be particularly needed.***