



PMATM

ICCCFO Fall Conference

Debt-Related Best Practices for
Community Colleges



Tammie Beckwith Schallmo

Senior Vice President, Managing Director



Steve Adams

Director

October 3, 2024



Current Debt-Related Best Practices as They Relate to...

- ▶ Educating the Board of Trustees
- ▶ Financial Policies and Procedures
- ▶ Credit Rating
- ▶ Call Features on Bonds
- ▶ Reimbursement Resolution
- ▶ Method of Sale
- ▶ Parameters Resolution
- ▶ IRS Reasonable Expectation Tests
- ▶ Arbitrage Rebate Exceptions

Educating Board Members



Educating Board Members

- ▶ With a Board election every two years (and the possibility of Board appointments in between), the level of Board member knowledge about a community college's debt may vary significantly



Educating Board Members

▶ Best Practices

- ▶ Include a discussion about the College's existing bonds in new Board member orientation
- ▶ Hold a “Bonds 101” review for the Board annually
 - ▶ Topics may include call features (and corresponding refunding opportunities), debt levy versus debt paid from operating funds, borrowing capacity, and bond market dynamics



Financial Policies and Procedures



Financial Policies and Procedures

- ▶ The adoption of certain financial policies and procedures help a community college:
 - ▶ Maintain transparency with the public
 - ▶ Assist in continuity as Boards and administration change over time
 - ▶ Manage its resources as effectively as possible
 - ▶ Achieve a strong credit rating



Financial Policies and Procedures

- ▶ Key policies include:
 - ▶ Fund balance policy
 - ▶ Debt management policy, which also addresses continuing disclosure practices and compliance with SEC and IRS requirements
 - ▶ Investment policy



Financial Policies and Procedures

- ▶ Key procedures include:
 - ▶ Maintain a master facilities plan with needs and funding sources identified
 - ▶ Update and present long range financial projections to the Board at least annually
 - ▶ Provide a report on investment holdings to the Board of Education at least quarterly
 - ▶ Present year-to-date revenues and expenditures versus budget to the Board on a monthly basis



Financial Policies and Procedures

▶ Best Practice

- ▶ Make sure certain financial policies and procedures are in place at your community college
- ▶ Review annually to ensure process and reporting are in compliance with policy

Credit Rating



Credit Rating

- ▶ A bond rating is an alphabetical and/or numeric symbol used to give relative indications of credit quality of a bond issue
- ▶ Bond ratings play a prominent role in the municipal bond market. A rating is almost obligatory for the sale of any major bond issue in the public market



Credit Rating Scales and Definitions

	<u>Moody's</u>	<u>S&P</u>	<u>Fitch</u>	<u>Kroll</u>		
Investment Grade	Aaa	AAA	AAA	AAA	Extremely strong capacity to meet financial obligations.	
	Aa1	AA+	AA+	AA+	Very strong capacity to meet obligations.	
	Aa2	AA	AA	AA		
	Aa3	AA-	AA-	AA-		
	A1	A+	A+	A+	Strong financial capacity but susceptible to adversity.	
	A2	A	A	A		
	A3	A-	A-	A-		
	Baa1	BBB+	BBB+	BBB+		
	Baa2	BBB	BBB	BBB	Adequate financial capacity but adverse conditions will lead to weakness.	
	Baa3	BBB-	BBB-	BBB-		
Non-Investment Grade	Ba1	BB+	BB+	BB+	Non-Investment Grade Speculative	
	Ba2	BB	BB	BB		
	Ba3	BB-	BB-	BB-		
	B1	B+	B+	B+	Highly Speculative	
	B2	B	B	B		
	B3	B-	B-	B-		
	Caa	CCC+		CCC+	Extremely Speculative	
	Ca	CCC	CCC	CCC		
	C	CCC-		CCC-		
				DDD	CC	Default
				DD	C	
	D	D	D	D		



Credit Rating

▶ Best Practice

- ▶ Review and implement policies and procedures that are best for a rating outcome prior to needing a rating review for a bond issue
- ▶ With the help of its municipal advisor, a community college should prepare a comprehensive presentation for a discussion with a rating agency



What is a Rating Surveillance Call?

- ▶ Provides a rating agency with an opportunity to make sure a credit rating does not become “stale”
 - ▶ Accountability to the investor community
 - ▶ Regulations and policy require at least a “passive” review annually
- ▶ Frequency of “active” surveillance may vary, but it is typically at least once every couple years
- ▶ The community college is provided with a list of questions
 - ▶ It’s important to be responsive
 - ▶ Typically given a couple weeks to prepare for the call



Rating Surveillance Call

▶ Best Practices

- ▶ Treat surveillance calls like a rating presentation for a bond sale
 - ▶ Talk the analyst through your written responses (eg: power point)
- ▶ Review the College's most recent rating report and be prepared to address any inconsistencies
- ▶ Consult with your municipal advisor as soon as you receive the email or phone call requesting the surveillance call

Call Features on Bonds



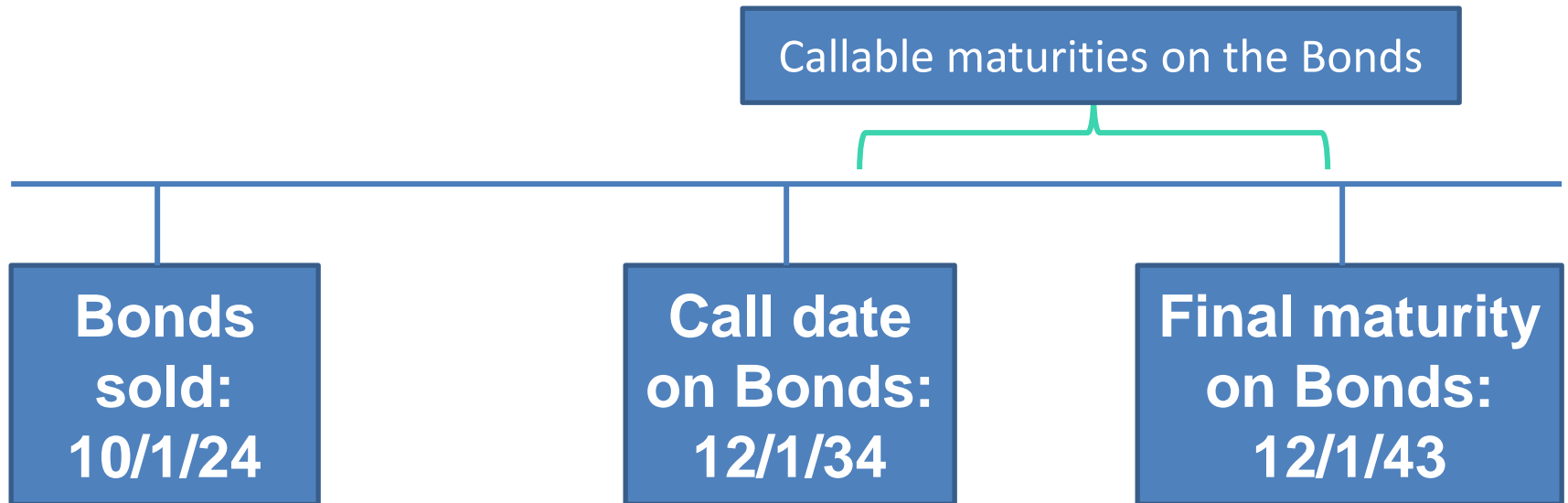
Refunding Bonds

- ▶ Section 3A-13 of the Community College Act allows refunding bonds to be issued, subject to Board approval, to refinance previously authorized bonds
- ▶ Under most circumstances, the refunding bonds do not require further approval by the public as long as the refunding bonds are issued pursuant to the prior authorization
- ▶ Refunding bonds are issued for the following reasons:
 - ▶ To reduce debt service payments like a home mortgage refinancing
 - ▶ To restructure payments



Refunding Basics

- ▶ Municipal bonds are not immediately callable (i.e. eligible to be paid off and reissued)
- ▶ The call date is the date on which the College can pay off the remaining principal of its bond issue





Refunding Basics

▶ Advance refunding

- ▶ Refunding bond issue that closes 91 or more days in advance of the call date
- ▶ Refunding proceeds invested in an escrow until the call date
- ▶ The U.S. tax code does not allow for a **tax-exempt** advance refunding

▶ Current refunding

- ▶ Current refunding bonds need to close within 90 days of the call date
- ▶ At this time, U.S. tax code allows for multiple tax-exempt current refunding's



Call Dates

▶ Best Practice

- ▶ Know the call dates on your College's outstanding bonds
 - ▶ Enables you to be proactive about opportunities to lower debt service
 - ▶ Helps you plan for future bond issues

Reimbursement Resolution



“Look Back” Period

- ▶ The IRS allows community colleges to reimburse itself with tax-exempt municipal bond proceeds for previously paid expenditures
- ▶ There is a 60 day “look back” period
 - ▶ The Board of Trustees must adopt a reimbursement resolution not later than 60 days after the expenditure is paid
 - ▶ Such resolution must include the maximum principal amount of bonds expected to be issued and a description of the project
 - ▶ Preliminary expenditures, including architect’s fees may be reimbursed, regardless of when it was incurred



Reimbursement Period

- ▶ The College must issue bonds within the later of 18 months after the date the expenditure was paid or 18 months after the property financed by the expenditure was placed in service
- ▶ No later than three years from the date of the expenditure



Reimbursement Resolution

- ▶ Best Practice
 - ▶ Once a community college has decided to issue tax-exempt bonds to finance capital projects, it should consider bringing a reimbursement resolution to the Board of Trustees for approval

Method of Sale



Sale Type

PUBLIC OFFERING



- ▶ The Issuer and financial advisor prepare an official statement
- ▶ Underwriter that will resell the bonds to investors is selected via a competitive or negotiated sale
- ▶ Issuer obtains a bond rating
- ▶ Requires disclosure counsel to review the official statement
- ▶ Will likely have a lower interest rate, but will have higher costs of issuance

DIRECT PLACEMENT



- ▶ No official statement, rating, underwriter or disclosure counsel is required
- ▶ A term sheet is sent out to banks and other local units of government that will provide a proposal to purchase the bonds directly
- ▶ The interest rate is typically higher than a public offering but may result in a lower overall financing cost since some costs of issuance are avoided
- ▶ This process has typically proven to be effective for relatively smaller bond issues paid off with a shorter amortization



Types of Public Offerings

NEGOTIATED SALE



- ▶ The Issuer preselects a broker-dealer as underwriter
- ▶ This firm sells the bonds to investors

COMPETITIVE SALE



- ▶ The Issuer engages a municipal advisor to manage the bond issuance process
- ▶ Underwriter selected via a competitive sale in which multiple bids are received to purchase the bonds
- ▶ The winning bidder sells the bonds to investors
- ▶ The bidder with the lowest true interest cost is selected



Choosing the Method of Sale

A competitive sale is appropriate when:

- ▶ Issuer has a strong underlying credit rating at least in the “A” category
- ▶ General obligation bonds or full faith obligations (e.g. alternate revenue bonds or debt certificates)
- ▶ Structure does not include special features that would require extensive explanation to the market
- ▶ Issuer is frequently in the market and/or issue size is conducive to attracting investors

A negotiated sale is appropriate when:

- ▶ Issuer has a credit rating lower than “A”
- ▶ Bond insurance is unavailable
- ▶ Debt structure is complicated
- ▶ Issuer wants input in how bonds are allocated among underwriting firms and/or the types of investors to be reached
- ▶ Other factors exist that the issuer, in consultation with its municipal advisor, believes favor the use of a negotiated sale process

Source: Selecting and Managing the Method of Sale of Bonds (February 2014), Government Finance Officers Association (Best Practice).
See the following webpage: <http://www.gfoa.org/selecting-and-managing-method-sale-bonds>



Method of Sale

▶ Best Practice

- ▶ Consult with the College's municipal advisor about which method of sale should be selected for your bond issue

Parameters Resolution



Parameters Resolution

- ▶ A Board of Trustees may authorize a parameters resolution for the sale of its bonds
 - ▶ Delegates the approval of the sale to administrators and/or Board members
- ▶ The resolution is valid for six months after adoption
 - ▶ Provides a community college with the ability to adjust its sale date
 - ▶ If after six months bonds have not been sold, the Board may adopt a new parameters resolution



Parameters Resolution

- ▶ The resolution sets forth several parameters, including:
 - ▶ Maximum total annual and total par amount
 - ▶ Maximum annual debt service payment
 - ▶ Maximum interest rate
 - ▶ If for a refunding, a minimum present value savings level



Parameters Resolution

▶ Best Practice

- ▶ A Board of Trustees should adopt a parameters resolution for the sale of municipal securities
 - ▶ Provides the College with ultimate sale timing and method flexibility

IRS Reasonable Expectation Tests



IRS Reasonable Expectation Tests

- ▶ When issuing **tax exempt bonds**, the College should consider the following IRS requirements:
 - ▶ The College must reasonably expect to spend or contractually obligate 5% of a bond issue within six months of issuance
 - ▶ The College must reasonably expect to spend 85% of the bond proceeds in three years
 - ▶ The College must diligently spend the bond proceeds
- ▶ During the aforementioned 3-Year “Temporary Period,” bond proceeds may be invested at materially higher yields than the bond yield



Construction Draw Schedule

- ▶ **Best Practice:**
 - ▶ A community college should work with its architect and/or construction manager to establish an estimated monthly draw schedule as soon as possible
 - ▶ Doing so will enable your municipal advisor to determine whether the bonds may be sold all at once per IRS rules, and whether the College can qualify for one or more exceptions from arbitrage rebate (see next section)

Arbitrage Rebate Exceptions



Arbitrage Rebate

- ▶ Arbitrage generally refers to investing tax-exempt proceeds in certain taxable investments that provide higher investment yields than the yield paid on the tax-exempt bonds
 - ▶ The Federal government is providing a subsidy through lower borrowing costs and forgoing tax revenues so the College should not get a double benefit through arbitrage
- ▶ Arbitrage profits
 - ▶ Generally, have to be paid to the Federal government
 - ▶ Payment of arbitrage profits to the Federal government is called “rebate”
 - ▶ Every five years and at the final retirement of all the Bonds, Issuer must pay (or rebate) arbitrage profits to the Federal government
- ▶ Certain exceptions
 - ▶ Spending down all proceeds within certain time frames/meeting spending benchmarks



Arbitrage Considerations

- ▶ With higher short-term investment rates, be mindful of the potential to earn arbitrage on bond proceeds
- ▶ Spend down requirements for arbitrage rebate purposes differ from the benchmarks for tax exemption
 - ▶ Even if all the arbitrage spend down requirements cannot be met, keep track so the excess is not spent
 - ▶ \$15 million small issuer exception for community college construction issues to be exempt from arbitrage rebate



Arbitrage Considerations

▶ Best Practices

- ▶ Understand the general rules regarding arbitrage rebate
- ▶ Engage your municipal and investment advisors to prepare analysis that will help the College satisfy IRS requirements and maximize interest earnings



Questions? Contact Us



Tammie Beckwith Schallmo
Senior Vice President, Managing Director
PMA Securities, LLC
tschallmo@pmanetwork.com
630-657-6446



Steve Adams
Director
PMA Securities, LLC
sadams@pmanetwork.com
618-230-8051



Disclosure

This presentation has been prepared by PMA Securities, LLC for informational and educational purposes to units of local government without regard to any particular entity's investment objectives, financial situation or means. The content of this presentation is not to be construed as a recommendation, solicitation or offer to engage in an issuance, or to buy or sell any security, financial product or instrument, or to participate in any particular trading strategy in any jurisdiction in which such an offer or solicitation, or trading strategy would be illegal. Nor does it constitute any legal, tax, accounting or investment advice or services regarding the suitability or profitability of any security or investment. PMA and its employees do not offer tax or legal advice and any entity should consult with its own tax and/or legal advisors before making any tax or legal related investment decisions.

Although the information contained in this presentation has been obtained from third-party sources believed to be reliable, PMA cannot guarantee the accuracy or completeness of such information. It is understood that PMA is not responsible for any errors or omissions in the content in this document and the information is being provided to you on an "as is" basis without warranties or representations of any kind. The analysis or information presented in this presentation is based upon current market conditions which are subject to change. There is no guarantee that the projected yield will be realized and the actual yield will depend on the available investment product and market conditions at the time of investment.

This presentation is solely intended to suggest/discuss potentially applicable financing applications or investment strategies. Any terms discussed herein are preliminary until confirmed in a definitive written agreement. Although market value, market analytics and other information contained in this presentation have been obtained from third-party sources believed to be reliable, PMA cannot guarantee the accuracy or completeness of such information. No representation is made that any results indicated herein will be achieved. Changes to any prices, levels, or assumptions contained herein may have a material impact on results. Any estimates or assumptions contained herein represent our best judgment as of the date indicated and are subject to change without notice. Examples are merely representative and are not meant to be all-inclusive. All investments mentioned herein may have varying levels of risk, and may not be suitable for every investor. Investment in securities involves risks, including the possible loss of the amount invested. In addition, past performance is no indication of future results and the price or value of investments may fluctuate. Asset allocation does not assure or guarantee better performance and cannot eliminate the risk of investment losses.

Securities, public finance services and institutional and municipal advisory brokerage services are offered through PMA Securities, LLC. PMA Securities, LLC is a broker-dealer and municipal advisor registered with the SEC and MSRB, and is a member of FINRA and SIPC. PMA Asset Management, LLC, an SEC registered investment adviser, provides investment advisory services to local government investment pools and separate accounts. All other products and services are provided by PMA Financial Network, LLC. PMA Financial Network, LLC, PMA Securities, LLC, and PMA Asset Management, LLC (collectively "PMA") are under common ownership.