

C.A.S.H. 26<sup>th</sup> Annual Conference on School Facilities

**Beyond the Bond**  
**Keeping the Promise for School Facilities**

Room# 317/318  
Wednesday, March 2, 2005  
9:00 a.m. - 10:30 a.m.  
Sacramento Convention Center

**WORKSHOP #21**

**FINANCE 101: INTRODUCTION TO SCHOOL  
FACILITY FINANCE**

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## C.A.S.H. 26th Annual Conference

### *FINANCE 101: Introduction to School Facility Finance*

#### Presenters

Dawn Vincent  
Stone & Youngberg LLC



Kenn Young  
Riverside County Office of Education



Celeste Davis  
Morgan Stanley & Co. Incorporated



March 2, 2005

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## What is Debt Financing?

Mechanism for obtaining money today through an agreement to repay the money over time with interest

Pledge of expected future stream of income *or* general fund pledge

Through debt financing School Districts may:

- Acquire land
- Construct/improve buildings
- Install improvements and facilities
- Acquire equipment
- Fund working capital



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## How Does It Work?



School Districts raise funds by issuing debt in the municipal market

Investors make loans to School Districts by purchasing the debt (Bonds, Certificates of Participation, Leases)

Most School District debt generates tax-exempt interest

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## How Does It Work?

Investors accept lower interest rates on tax-exempt debt



**Example:**

3.65% tax-exempt interest rate = 6.15% equivalent taxable yield for investor in 35% tax bracket

A School District's borrowing cost is lower than similar debt issued by banks and corporations (taxable debt)

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## Who Buys Debt?

### Individuals/Retail Investors

- Investors seeking wealth protection and tax free income

### Institutional Investors

- Mutual Funds
- Insurance Companies
- Banks
- Financial Institutions

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## How is Debt Sold?

**Competitive Sale/Public Sale:** The sale of debt to the bidder (Underwriter) presenting the best bid at a predetermined time and place



**Negotiated Sale:** The sale of debt in which an Underwriter is hired early in the process to buy and market an issuer's debt

**Private Placement:** The direct placement of debt with one or a few investors

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## Financing Timeline

<u>Day</u>	<u>Task</u>
1	School District decides to finance a project
10	Finance Team is selected and assembled
15	Revenue stream securing the debt is identified and analyzed
21	Staff and the Finance Team determine the debt structure
28	Legal and disclosure documents are crafted



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## Financing Timeline

<u>Day</u>	<u>Task</u>
38	Credit ratings/bond insurance secured (if applicable)
45	Board approves the legal and disclosure documents and authorizes the debt issuance
52	Underwriter begins marketing the debt to investors (Negotiated Sale)
59	Underwriter commits to buy the debt from School District
75	Transaction is closed and the project is funded

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## The Financing Team

### Bond Counsel

- Provides the legal opinion stating that debt is *exempt* from federal and state income taxes (California)
- Provides legal parameters and guidelines to School District and Financing Team
- Drafts legal documents pursuant to which debt is issued



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## The Financing Team

### Financial Advisor

- Advises and assists in the formulation/ execution of financing plans
- Does not purchase or underwrite debt
- Role or necessity of financial advisor depends on
  - (1) the needs of the School District,
  - (2) the method of sale chosen and/or
  - (3) the complexity of the financing



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## The Financing Team

### Underwriter

- Purchases debt with the intent to resell to investors
- In a negotiated sale the underwriter is hired early in the process and assists the other members of the financing team
- In a competitive sale, the Underwriter simply delivers a sealed bid on the date of sale offering to purchase the debt at fixed interest rates and prices



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## Other Players

- Disclosure Counsel
- District Counsel
- Trustee
- Underwriter's Counsel
- Rating Agency
- Title Company
- Special Tax Consultant
- Market Consultant
- Developer
- Appraiser
- Credit Enhancer
- Dissemination Agent

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## Financing Documents

**Bond Indenture/Trust Agreement**

- Basic security document for debt

**Bond Purchase Agreement**

- Sets forth terms and conditions of debt sale to Underwriter



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## Financing Documents

**Official Statement**

- Provides disclosure information to investors
- Marketing / Sales document

**Continuing Disclosure Agreement**

- Required by Securities and Exchange Commission's Rule 15c212
- Annual Filings

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## The Bond Funds

**Project Fund**  
Amount needed per construction bid or acquisition cost

**Reserve Fund**  
Required to protect the investor against a revenue/payment shortfall



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## The Bond Funds

### Capitalized Interest Fund

Used to pay interest on the debt for a specified period of time

### Costs of Issuance Fund

Fees and expenses associated with the sale of debt including:

- Bond Counsel
- Disclosure Counsel
- Ratings
- Bond Insurance
- Absorption Study (CFDs)
- Dissemination Agent
- Trustee/Fiscal Agent
- Appraisal (COPs, CFDs)
- Title Insurance (COPs)
- Special Tax Consultant (CFDs)
- Preliminary and Official Statement Printing
- Underwriter's Discount

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## The Rating Process

A strong underwriting team with historical knowledge of the issuer as well as product knowledge can be invaluable in guiding you through the credit review process



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## The Rating Agencies

### The Spectrum of Ratings

The rating agencies:

- Moody's Investors Service
- Standard & Poor's
- Fitch Ratings

What ratings mean:

- A differentiation of credit quality
- Credit risk evaluation

There are rating ratings to determine the major rating categories such as A, AA, AAA for S&P and A1, A2, A3 for Moody's

Credit Risk	Moody's	Standard & Poor's	Fitch
Investment Grade			
High Quality	Aaa	AAA	AAA
High Quality Only (Strong)	Aaa	AA	AA
Upper Medium Credit (Strong)	A	A	A
Medium Grade	Baa	BBB	BBB
Non-Investment Grade			
Speculative	Baa	BB	BB
Highly Speculative	Baa	BBB	BBB
Lower Speculative	Baa	BB	BB
Nonpayment Default	C	D	D
Default	C	D	D

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## Credit Enhancement

Credit enhancement improves the credit ratings on the bonds thereby lowering the cost of borrowing for the issuer

Types of credit enhancement:

- Bond insurance
- Letter of Credit (Variable Rate/Commercial Paper)
- Lines of credit



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## Types of Credit Enhancement

Credit enhancement is used to improve the credit quality of a bond issue in order to increase the marketability of the security and obtain lower interest rates

Credit Enhancement	Bond Insurance
Type of Enhancement	
Provider	Bond Insurers: AMBAC, FISC, FSA, MBIA and XL Capital
Description	Guarantees debt service payments
When Used	Primarily on long-term, bond-like bonds
Premium	Cost that is not calculated as a % of total debt service over the life of the bond
Term	Term of the bonds
Credit Impact	Mostly raises AAA/AA+ ratings, effective if insurable provider

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## Purchasing Credit Enhancement

Getting the Most for Your Insurance Premium Payment

### When Does Bond Insurance Make Sense

- It is beneficial to purchase bond insurance to the extent that the present value savings from the lower interest rates are greater than the cost of purchasing the bond insurance



What does purchasing bond insurance make sense?	
<b>The Facts - Uninsured Bonds</b>	
Par Value Amount	\$ 80,000,000
Unwinding Period	10Y
Average Interest Rate	4.50%
Total Cash Service (over the life)	\$ 17,075,000
Present Value of Cash Service	\$ 9,825,490
<b>Option One - Purchase Bond Insurance</b>	
Cost of Bond Insurance (over the life)	\$ 175,800
Unwinding Period	10Y
Average Interest Rate	4.50%
Total Cash Service (over the life)	\$ 17,075,000
Present Value of Cash Service	\$ 9,729,190
Present Value Savings	\$ 1,096,290
Cost of Bond Insurance	\$ 175,800
<b>Benefit of Bond Insurance</b>	<b>\$ 920,490</b>

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<b>Common Financing Options</b>
(and not so common)
<ul style="list-style-type: none"> <li>• General Obligation Bonds</li> <li>• Lease Financing/ Certificates of Participation (COPs)</li> <li>• Mello-Roos Special Tax Bonds</li> <li>• Qualified Zone Academy Bonds (QZABs)</li> </ul>
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<b>GO Bonds</b>
<p>Long term obligation (25 to 40 years)</p> <p>Secured by an <i>Ad valorem</i> tax on all taxable property with the School District's boundary</p> <p><i>Ad valorem</i> taxes create new revenue stream</p>
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<b>GO Bonds</b>
<p>Unlimited ability to raise taxes provides investors with greatest security and lowest borrowing cost</p> <p>School Facilities Improvement Districts (SFID) can be formed by School Districts to tax only a portion of their territory</p>
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## GO Bonds

### Proposition 39

Approved by voters in November 2000

Lowers required voter approval threshold to 55%

Establishes a maximum tax rate (per \$100,000 of assessed value)

- \$30 for elementary and high school districts
- \$60 for unified school districts
- \$25 for community college districts

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## GO Bond Uses

Bonds issued pursuant to the 2/3's voter approval may finance

- land acquisition
- purchase or construction of new school facilities
- renovation and repair of existing school buildings
- permanent improvements to school grounds

Bonds issued pursuant to Proposition 39 approval may finance

- All projects eligible for financing under 2/3's voter approval PLUS
- Furnishing and equipping of school facilities
- Lease of real property for school facilities

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## Upcoming Election Calendar

### Date of Election

Any Tuesday\*  
March 8, 2005\*  
June 7, 2005\*  
November 8, 2005\*  
June 6, 2006  
April 11, 2006\*  
November 7, 2006

\* May not be available for bond elections conducted pursuant to Proposition 39.

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**Certificates of Participation**

Long term obligation (up to 30 years)

No voter approval is required to issue a COP

COPs may be used to finance:

- Construction and acquisition of school facilities
- Purchase of equipment (relocatable, buses, computers)
- Refinancing of existing leases

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**Certificates of Participation**

COPs are secured by lease payments made by the School District for the use of the facilities or equipment

Generally COPs are secured by the School District's general fund - no new revenue source is created

Can be used as a form of "bridge financing" prior to receipt of State funds or GO bond proceeds

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**Certificates of Participation**

COPs can be structured with a blended pledge of funds/revenues - General Fund, Mello-Roos and RDA Pass-Through

COP transactions can be structured and sold within 75 days

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## What is Mello-Roos?

Senator Henry Mello and Assemblyman Mike Roos co-authored the Mello-Roos Community Facilities District Act of 1982

The Act authorizes the creation of community facilities districts ("CFD"), levy of special taxes and issuance of special tax bonds

CFDs are voter approved (landowner or registered voter) and create new tax revenues

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## Mello-Roos Special Taxes

Special taxes levied within a specific geographic area

Special taxes levied according to Rate and Method of Apportionment (RMA)

The RMA sets forth manner in which special taxes are levied (e.g. per acre, parcel, building square footage or zoning designation)

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## Mello-Roos Special Tax Bonds

Special Tax Bonds are secured by special taxes levied within CFDs

Long term obligation (up to 30 years)

Generally sold to investors without credit ratings or enhancement

Require significant lead time prior to bond sale

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## Mello-Roos Uses

CFDs may fund a wide variety of projects

- Land Acquisition
- Relocatable structures
- Building construction and improvements
- Pay-as-you-go facilities and services
- Furniture
- School Buses
- Equipment (5 year useful life)



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## QZABs

A Federal tax credit bond program created by Congress in 1997

Designed to increase graduation rates by rehabilitating facilities and upgrading equipment/technology

Facilities located in empowerment zones/ enterprise communities or 35% of student body qualifies for free/reduced price lunches



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## QZABs



QZABs are taxable and are generally privately placed with banks

QZAB loans are interest free, only principal payments are required

Investors receive the federal tax credit in lieu of interest payments

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## QZABs

Requires private business partnership contribution of at least 10% of the QZAB amount

Since 1998, \$425 million has been allocated to California school districts

\$99.256 million available to California (2004-05)



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## Financing 101 Summary

- Talk to your peers about their financing experiences
- Conduct due diligence *before* selecting your team
- *Carefully* evaluate unsolicited proposals
- Review *your* legal and disclosure documents
- Ask questions - *utilize your financing team*
- Contact your local COE or tap professional resources (e.g. CASH, CASBO and CDIAC)

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## Questions and Great Answers



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## The Presenters



**Kenn M. Young**  
Deputy Superintendent  
Riverside County Office of Education

Kenn Young is the Deputy Superintendent of the Riverside County Office of Education. Before coming to RCOE (ARCO), he was serving as the Deputy Superintendent of the Lake Sharrow Unified School District. In the field of public education, Kenn has also been an Assistant Superintendent of Business Services and the Manager of Facilities, Maintenance, and Operations. Preceding his employment in California's school system, he spent 19 years in the field of civil engineering, 14 of which he was president and CEO of a Southern California based engineering construction firm that specialized in building roads and highways.

Between 1998 and 2003, Kenn was instrumental in securing over \$300 million in State funding to meet the Lake Elsinore school district's growing school facility needs. He also coordinated the acquisition of over 200 acres of land for new schools in the District.

He is a native of Southern California. He is chairman of the CASBO Eastern Section CEO committee and he is also a member of the Board of Directors of CASH. Kenn has also chaired several school district boundary committees and district budget committees.

**Riverside County Office of Education (RCOE)**

Riverside County Office of Education is a service agency providing fiscal and administrative services, training, support and services to 22 local school districts representing over 270,000 students across the County. RCCE also provides direct instruction to 50,000 students in special programs.

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## The Presenters



**Dawn Vincent**  
Managing Director  
Stone & Youngberg LLC

Ms. Vincent has worked in municipal finance since 1985, joining Stone & Youngberg in 1989. Her efforts at the firm have focused on general government and land-secured transactions for California school districts and public agencies. She has been involved on 200 California financings totaling over \$2.5 billion since joining the firm. Ms. Vincent has served as both an investment banker and financial advisor to cities, counties and school districts. She has structured financings for public agencies that have issued debt for a variety of capital improvement projects secured by general and special taxes, general fund leases, tax increment, and special assessments. Ms. Vincent graduated with honors from the University of Santa Clara and has completed graduate studies at the University of Iowa. She is a member of the California Debt Investment Advisory Commission and Debt Technical Advisory Commission.

**Stone & Youngberg LLC**

Founded in 1931, Stone & Youngberg LLC is the largest and most active regional investment bank in California with an exclusive commitment to providing financial services to public agency clients. Stone & Youngberg is owned and operated by its 21 managing directors, all of whom are actively engaged in the firm. The firm has 255 employees among its offices in San Francisco, Los Angeles, San Diego, Connecticut, Virginia, Phoenix and New York. In 2004, Stone & Youngberg served as lead manager on 153 bond issues totaling over \$3.2 billion and had secondary market trading volume exceeding \$5 billion. The firm's website is [www.syllc.com](http://www.syllc.com).

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## The Presenters



**Celeste E. Davis**  
Executive Director  
Morgan Stanley & Co. Incorporated

Ms. Davis has over 19 years of experience in public finance having begun her municipal finance career in 1986. She joined Morgan Stanley in 1997 as a senior banker covering a number of major issuers in the State of California. Ms. Davis' scope of practice includes the State of California, counties, cities, school districts, and special districts. Ms. Davis has an extensive background in the issuance of certificates of participation, general obligation bonds, special tax bonds, and various revenue bonds. Prior to her career in municipal finance Ms. Davis worked as a trader for a large money center bank. Ms. Davis' experience also includes over three years spent as a financial consultant with one of the "big six" public accounting firms, where she passed the uniform CPA examination. Ms. Davis received her Bachelor of Science degree in Management and Economics from Boston University and her MBA degree in Finance from the University of Southern California.

**Morgan Stanley & Company, Inc.**

Morgan Stanley is a global financial services firm with one of the securities industry's largest total consolidated capital positions. The combination of the Firm's three powerful and distinctive businesses — securities, asset management and credit services — creates a global powerhouse with unmatched origination and distribution skills and a unique balance between institutional and individual investor capabilities. The Firm employs 52,812 people in 600 offices in 28 countries worldwide. Morgan Stanley's Public Finance Department is fully integrated within the Firm's Fixed Income Division, which incorporates all bond market sectors.

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## Useful Websites

### Rating Agencies

Fitch Investors  
Service, L.P.  
(800) 753-4824  
[www.fitchiv.com](http://www.fitchiv.com)

Moody's Investor  
Service  
(212) 553-0300  
[www.moody.com](http://www.moody.com)

Standard & Poor's  
Ratings Group  
(877) 299-2569  
[www.standardandpoors.com](http://www.standardandpoors.com)

### State, Federal and Regulatory Websites

California Debt and Investment  
Advisory Commission  
(916) 653-3269  
[www.treasurer.ca.gov/cdiac](http://www.treasurer.ca.gov/cdiac)

California State  
Treasurer's Office  
(916) 653-2995  
[www.treasurer.ca.gov](http://www.treasurer.ca.gov)

MSRB  
(703) 797-6600  
[www.msrb.org](http://www.msrb.org)

Securities and Exchange Commission  
(800) SEC-0330  
[www.sec.gov](http://www.sec.gov)

### California Municipal Professionals' Websites

Jones Hall, LLP  
[www.joneshall.com](http://www.joneshall.com)

Orrick, Herrington & Sutcliffe, LLP  
[www.orrick.com](http://www.orrick.com)

Stradling Yocca Carlson & Rauth  
[www.sycr.com](http://www.sycr.com)

Stone & Youngberg LLC  
[www.sylc.com](http://www.sylc.com)

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