Cash Flow Management: Accessing Liquidity

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Liquidity in Times of Crisis: Pressure & Pressure Release Valves

Potential Liquidity Pressure

- In times of crisis, such as the current COVID-19 environment, Florida School Districts may face **unique cash flow pressures**
  - Delay of normal revenue collections (e.g., extended payment deadlines for taxes and fees)
  - Loss of economically sensitive revenues
  - Increased expenses related to crisis management and recovery, which may be reimbursed through CARES Act
  - Potential Reduction of State Budget for Schools
  - Reduced student enrollment

Potential Pressure Release Valves

- Reserves
- Interfund borrowings
- Forbearance of debt payments
- Delayed payment of planned expenditures (e.g., pension contributions, payroll taxes, capital)
- Debt financing
  - Bonds or notes to fund capital expenditures, perhaps funding previously expended and/or future pay-as-you-go projects with debt
  - **Cash flow notes** funding non-capital (a.k.a., working capital) expenditures

Overview of Tax / Revenue Anticipation Notes

- Cash flow notes are **short-term, interim** financing tools used to bridge brief periods of cash shortfalls
  - Typically issued by municipal and state governments that need to manage a revenue / expenditure timing imbalance (e.g. seasonal, large revenue stream vs relatively even distribution of expenditures)
  - On occasion, may also reflect deficit financing

Overview of Tax Anticipation Notes

- Florida State Law Provisions:
  - S. 1011.13 F.S. authorizes short term borrowing (up to one year) for operating expenses in anticipation of receipt of operating (general fund) tax revenues.
  - Two kinds of loans authorized:
    1. during the year in which the deficit will occur, to be repaid from revenues received during such year.
    2. during the 60-day period prior to the beginning of the fiscal year, with loan proceeds escrowed until July 1 (rarely used).
  - State law requires compliance with Federal tax law, so borrowing must be tax exempt.
  - Loan amount cannot be more than 80% of estimated tax receipts.

Overview of Tax Anticipation Notes

- Federal Tax Law Provisions:
  - Use of Proceeds:
    - Must be used for working capital purposes to fund "cumulative cash flow deficit"- unfunded expenses after exhausting all other available revenue sources.
    - Can treat 5% of the prior year's general fund expenditures (excluding repayment of the prior year's TAN if applicable) as "unavailable". Such amount is treated as a "reasonable working capital reserve".
  - Rebate Exception
    - 6-Month Rule: An issuer can keep any positive arbitrage investment income on the proceeds of the TAN's if:
      i. It spends the gross proceeds of the TAN's within 6 months (proceeds are treated as spent only after all other available revenues have been spent), or
      ii. The cumulative cash flow deficit financed by the TAN's exceeds 90% of the proceeds of the TAN's within 6 months. Most issuers rely on the 1st alternative.
  - Overissuance Rule
    - TANS must not be issued earlier than necessary or in an amount larger than necessary or be outstanding longer than necessary. Failure to comply with IRS rules could lead not just to rebate liability for failure to meet the 6-month rule, but also to loss of tax exemption. Important to reach the estimated "cumulative cash flow deficit"- that is evidence that there was no overissuance.

Overview of Revenue Anticipation Notes

- Florida State Law Provisions:
  - S. 1011.14 F.S. authorizes obligations (RAN's) of up to one-year maturity, which maturity may be extended up to four additional times so long as final maturity is not more than 5 years after initial issuance. Extension can be in form of series of one-year public or private note sales, or a loan that is "extended" by initial lender for up to 4 additional one-year periods.
  - Purpose
    - capital, similar to uses for non-voted capital outlay millage.
  - Must budget to retire the note in full within one year from "budgeted revenues accruing on a current basis" even if issuer chooses to extend all or part of it.
  - Limit on issuance
    - one-fourth of operating revenue received in prior fiscal year-(no logic to this limit).
  - S. 1011.15 authorizes RANS to remediate emergency hazardous conditions in school buildings in anticipation of receipt of capital outlay funding under structure similar to the RANS authorized under S. 1011.14, except that statutory limit on total issuance under S. 1011.14 does not apply.
  - RANS can be issued as short-term financing in anticipation of the issuance of longer-term COP's, to be retired from the proceeds of the COP's.

Overview of Bond Anticipation Notes

- Florida State Law Provisions:
  - Section 215.431 authorizes school boards to issue short term bond anticipation notes (BAN's), once the issuance of general obligation bonds or sales tax revenue bonds (half penny sales surtax bonds under S. 212.055(6) or local government infrastructure surtax revenue bonds under S. 212.055(2)) has been authorized and approved by voter referendum. Can be useful if interest rates are currently high.
  - Can be a private draw-down bank loan or a public sale. Must be repaid within 5 years of the referendum approval date, though can be issued for a short term and rolled over.
  - Security is the promise to pay from the proceeds of long-term bonds. Can also pledge the sales surtax or ad valorem debt service millage as a back up security in case bonds cannot be issued. Better way is to agree to make a future pledge prior to maturity of BAN's if bonds cannot be issued. Back up pledge should not be given at the time of issuance of ad valorem BAN's.

Overview of Commercial Paper

- Series of short-term notes with maturities of up to 270 days, which can be rolled over for maturities of 30 to 270 days.
- Backed by pledge of revenues such as voter approved sales surtax.
- Needs liquidity and credit support such as a bank letter of credit. Not many banks provide LOC's.
- Suitable for a large accelerated construction program for a district with solid credit rating.

Should I use short-term debt financing and, if so, how should I issue it?

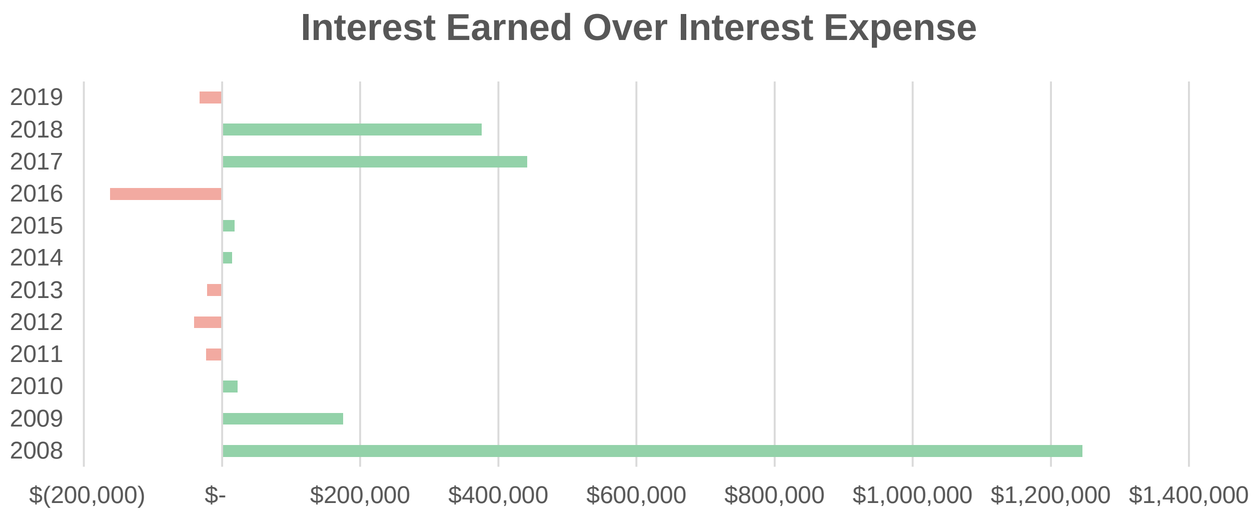
TANs and RANs: Benefits and Considerations

BENEFITS

- Allows localities to finance working capital expenditures
- Interest rate is tied to the short-end of the yield curve, which historically is low

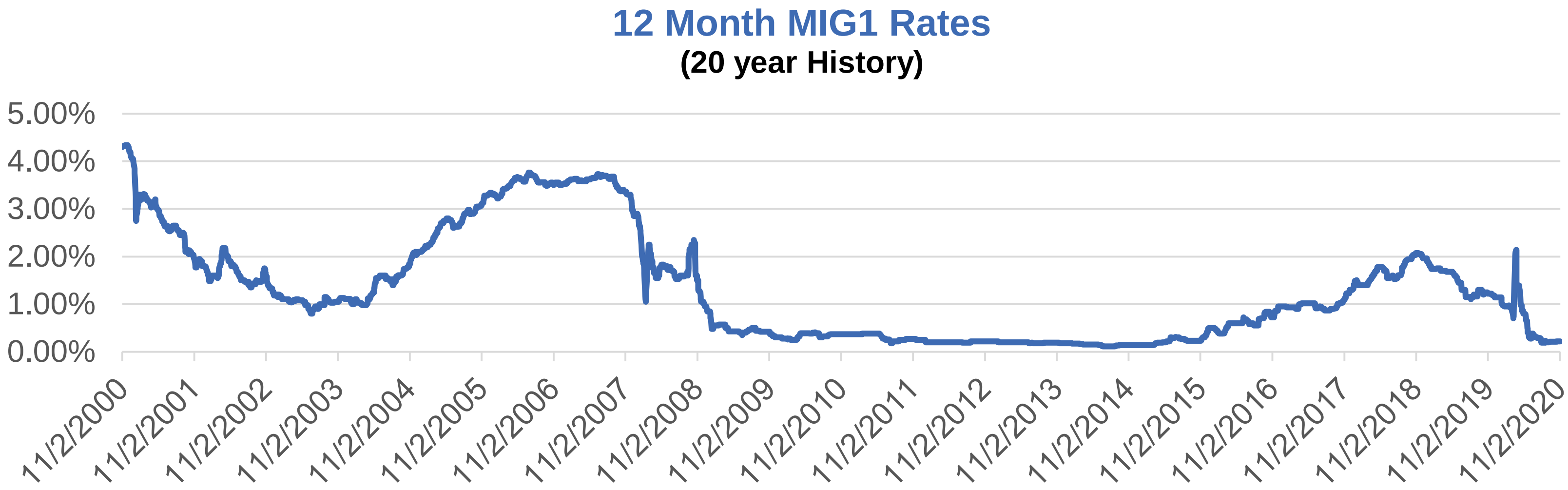
CONSIDERATIONS

- **Interim** financing tool, which requires repayment; not a long-term or permanent solution to funding shortfalls
- Consult your financial and legal advisors



Indicative Interest Rates (1 Year; Tax-Exempt Proxy)

Indicative Rate Basis	12 Month MIG1 Rate
Maximum	4.34%
Average	1.31%
November 2, 2020	0.22%
Total Interest per $10M @ 11/2/20 Rates	$22,000



Notes: Indicative rates only, actual rates will vary based on market conditions, individual credit and structural considerations, sale method, and interest rate mode. Yields shown do not include costs of issuance. Rates are based on the MIG1 rates published daily by Thomson Reuters which measure rates from on short-term note issuances, with maturities from 1 to 14 months, with a rating of MIG1, the highest possible short-term rating from Moody's. MIG1 rates are a good proxy for public sales.

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TAN Cash Flow Analysis

- Review of actual (prior Fiscal Year) and projected (budget year) cash flows
- General Fund only
  - Includes all cash and investments (short AND long term)
  - Can exclude interfund transfers if required to pay back to other fund
  - Break up November in projected cash flows to find max deficit
    - Max deficit generally occurs in 2nd or 3rd week in November
    - Daily cash flows are helpful, but not required
- Historical Working Capital Reserve
  - 5% of prior year expenditures (not including repayment of prior year's TAN, if any)
  - Less than average beginning fund balance for prior Fiscal Year
- Max Borrowing Amount
  - Cash flow deficit
    - Plus working capital reserve
    - Plus premium
    - Plus investment earnings
  - Needs to be less than that amount to be tax-exempt
- Positive Arbitrage Avoiding Rebate
  - Must have hit deficit
  - Consider working capital reserve "unavailable" for such purpose
  - Safe harbor – working capital reserve treated as "available"

Sample Cash Flow Schedule

The School District of Broward County, Florida
Summary Statement of Monthly Cash Receipts and Disbursements

	JUL	AUG	SEP	OCT	NOV (1-16)	NOV (17-30)	DEC	JAN	FEB	MAR	APR	MAY	JUN	JUN	JUN	TOTAL
	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	PROJECTED	VARIANCE	
Opening Cash & Investment Balance	283,992	452,211	361,948	313,127	170,135	77,799	155,993	873,700	784,376	706,910	622,104	545,595	432,140	319,779	112,361	
RECEIPTS:																
Federal	78	20	340	5,072	-	758	238	221	4,683	250	304	694	1,129	(2,448)	3,578	24,750
State Revenues:																
FEFP-State	64,695	58,989	87,135	59,532	29,766	30,989	59,649	59,135	58,790	58,620	59,050	58,228	82,713	80,929	1,784	767,686
Workforce	6,470	6,470	6,470	6,470	3,235	3,235	6,470	6,470	6,470	6,470	6,470	6,470	6,470	6,470	-	77,643
Other Categorical-State	25,259	25,230	25,310	25,621	28	25,503	39,258	25,674	25,766	25,781	25,695	25,945	6,004	29,753	(23,749)	319,875
All Others-State	644	48	166	12,930	3	1	(13,759)	70	3	30	3	0	0	141	(141)	500
Total	97,068	90,737	119,082	104,554	33,033	59,727	91,619	91,349	91,029	90,902	91,218	90,644	95,187	117,293	(22,106)	1,165,704
Local Revenues:																
Ad Valorem Taxes-Local	-	211	159	(7)	-	107,168	805,671	23,669	30,308	18,415	27,200	15,960	27,997	34,023	(6,026)	1,062,666
Miscellaneous-Local	3,654	2,607	39,329	(20,904)	2,459	3,543	4,848	6,783	2,606	9,149	2,494	(1,282)	297	(2,436)	2,734	66,258
Interest-Local	685	653	921	700	0	285	387	986	955	1,132	615	729	-	(2,118)	2,118	11,000
Transfers In	4	5,082	25	4,156	37	2,109	35,729	10,221	4,437	5,596	6,272	1,982	1	55,229	(55,228)	122,099
Total	4,342	8,553	40,434	(16,055)	2,496	113,105	846,635	41,657	38,306	34,292	36,580	17,389	28,295	84,697	(56,402)	1,262,023
2019 Note Proceeds	160,130														-	-
TOTAL RECEIPTS	261,619	99,310	159,855	93,571	35,529	173,591	938,492	133,227	134,019	125,444	128,102	108,726	124,612	199,542	(74,930)	2,452,477
DISBURSEMENTS:																
Salaries and Benefits	53,151	114,551	160,935	164,722	98,700	72,457	175,199	169,753	147,697	164,731	156,556	194,925	55,005	35,158	19,847	1,757,218
Vendors	40,249	75,022	47,742	71,841	29,165	22,939	45,888	52,798	63,485	45,519	49,705	27,256	37,779	14,544	23,235	684,964
Transfers Out	-	-	-	-			(303)	-	303	-	(1,650)	-	(40)	4,399	(4,439)	4,399
2019 Note Payment	-	-	-	-			-	-	-	-	-	-	162,000	162,000	-	
TOTAL DISBURSEMENTS	93,400	189,573	208,676	236,563	127,865	95,397	220,784	222,551	211,485	210,250	204,611	222,181	254,744	216,101	38,643	2,446,581
Ending Cash & Investment Balance	452,211	361,948	313,127	170,135	77,799	155,993	873,700	784,376	706,910	622,104	545,595	432,140	302,008	303,220	(1,212)	
Less Working Capital Reserve (5%)	(113,072)	(113,072)	(113,072)	(113,072)	(113,072)	(113,072)	(113,072)	(113,072)	(113,072)	(113,072)	(113,072)	(113,072)	(113,072)	(113,072)	-	
Total Balance	339,138	248,875	200,054	57,062	(35,274)	42,920	760,628	671,304	593,838	509,031	432,522	319,067	188,935	190,147	(1,212)	

Source: The School District of Broward County, Florida - Tax Anticipation Notes, Series 2020 Official Statement.

Execution Considerations

METHODS OF ISSUANCE – PROS & CONS

Public Sale (e.g., negotiated or competitive)	**Direct Placement** (e.g., placement with bank)	Through a credit facility such as a **Line of Credit**
PROS:	**PROS:**	**PROS:**
• Traditionally lower rates • More tolerance for lower credits	• Can be executed quickly • Flexible terms (e.g. draw down features, redemptions) • Lower COI (compared to public sale)	• Can be executed quickly • More flexible deal terms • Lower COI; Carry addl. fees
CONS:	**CONS:**	**CONS:**
• Requires offering document • Higher cost of issuance (COI) • Typically sold with ratings	• Traditionally higher rates (compared to public sale) • Limited access for lower rated credits	• Traditionally higher rates (compared to public sale) • Usually variable rate • Limited access for lower rated credits

Execution Considerations

VARIED METHODS OF ISSUANCE

Public Sale (e.g., negotiated or competitive)	**Direct Placement** (e.g., placement with bank)	Through a credit facility such as a **Line of Credit**

- Publicly sold notes are typically rated
  - Ratings based on the short-term ratings scale
  - Ratings methodology varies by agency, but may include assessment of
    - Monthly cash flow analysis
    - Predictability and timing of the pledged revenues
    - Issuer's long-term rating
    - Whether or not funds used for repayment are segregated and/or set-aside throughout the year
- Publicly sold notes include monthly cash flow projections in the disclosure document

Short-Term Ratings Scales

Moody's	S&P	Fitch
MIG1	SP-1+	F1
MIG2	SP-1	F2
MIG3	SP-2	F3
MIG4	SP-3	

Rating Agency Views on Cash Flow Borrowing

- Generally cash flow borrowing is utilized to even out an issuer's regular cash flow requirements
  - An issuer who might receive the majority of its revenue from property taxes once a year, may have normal cash flow shortage during the fall months when property taxes are due
- Rating Agencies typically do not view cash flow borrowing as a credit weakness
  - Particularly when its either a regular requirement (noted above) or it's used infrequently in extraordinary times (like a pandemic) to ensure sufficient liquidity exists to meet payroll or other obligations
- Cash flow borrowing could be indicative of credit weakness when:
  - Annual borrowings increase year-over-year (due to liquidity or reserve declines)
- Rating Agencies view cash flow note borrowings or interfund borrowing similarly, particularly when interfund borrowings are time bound with a repayment schedule in place

How do Rating Agencies Evaluate Cash Flow Borrowing?

- A short-term rating is applied similar to bond anticipation notes, but the short-term rating does not always correlate to the long-term underlying rating
- Analysis includes:
  - Evaluation of the legal pledge (i.e. GO, Priority Lien, Appropriation)
  - Whether there are any statutory set aside dates prior to maturity (do funds go into a lockbox?)
  - Coverage on the set aside dates (if any) and final maturity provided by the dedicated receipts to repay the notes and any alternate liquidity available
  - Comparison of projected cash flow and coverage to actual information (what's the variance)
- The primary documents reviewed are monthly cash flow projections for recently completed fiscal year (actual), current fiscal year (actual to-date plus projected), and projected for the next fiscal year
  - Assumptions of the underlying cash flow will be discussed (i.e. revenue and expenditure growth)
  - Year-over-year deviations in cash flow, if any

Other Options – Long-term Debt Obligations

- Liquidity can also be accessed through the issuance of longer-term debt obligations (e.g. Bonds)
- Planned pay-as-you-go projects that are eligible for financing can be paid for out of bond proceeds, reserving the cash for liquidity.
  - Recently spent dollars for projects eligible for financing can still be captured after the fact with the approval of a reimbursement Resolution (dollars spent within 60 days of approval)

Other Options – Self-Help Options

- Internal Liquidity
  - Remove restrictions placed voluntarily (e.g., self-imposed reserve levels)
  - Discuss changes to restrictions imposed by others (e.g., bond covenants)
- Forbearance Agreements with Existing Lender(s)
  - Requires resolution of governing authority and written agreement to terms by lender(s)
  - Often requires opinion from bond counsel
  - May require filing with Internal Revenue Service, depending on terms of the forbearance

Continuing Disclosure Considerations

- Issuers subject to continuing disclosure undertakings should be aware that any liquidity issue or solution may trigger disclosure obligations. These can arise from:
  - Payment defaults
  - Non-payment related defaults
  - Draws on Reserve Funds
  - Incurrence/Amendment of Financial Obligations or agreement to covenants, defaults etc. that affect security holders

Questions?

Contact Us!

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