

SALISBURY TOWNSHIP SCHOOL DISTRICT

Buildings, Grounds, Transportation, & Finance (Budget) Subcommittee Meeting Administration Building, Wednesday, January 30, 2008-7:00 P.M.

Board Members Present: Mr. Frankenfield, Mr. Giordano, Mrs. Heffelfinger,
Mr. Manz, Mrs. Miller, Mr. Pauloski, Mr. Reinsmith,
Mrs. Ziegler

Board Members Absent: Mrs. Feinberg

Also Present: Mr. Brackett, Mrs. Famularo, Ms. Morningstar, Dr. Wright,
Attorney Kevin Reid

I. Call to Order

The meeting was called to order by Mr. Reinsmith at 7:02 p.m.

II. Financing Plan Review-Scott Shearer, Public Financial Management

Mr. Shearer stated that this presentation will look at the cost and the overall debt planning of the High School Project/Facilities plan.

The District already knows the range of cost for the High School Project/Facilities (Phase I) plan to fall within a cost range of \$17 million to \$37 million. This discussion will estimate the cost of the project to be approximately \$32 million. The District has incurred \$17.7 million of “grandfathered” debt prior to Act 1, but has not yet issued it. The District will need to borrow approximately \$13 million of “non-grandfathered debt” to complete the project.

Dr. Wright stated that the plan is assuming the Board chooses to pursue Plan C or D. Plan B is similar to C or D. If the B, C, or D plan is chosen the District is looking at a cost of \$30 million or higher. Plan A would cost \$17 million. The District already authorized and incurred \$17 million of “grandfathered debt” from a few years ago prior to Act 1, as stated above.

Mr. Shearer explained that if the District wishes to take advantage of the “grandfather” status the District can raise millage above the Act 1 index. Mr. Reinsmith asked what was meant by the term “incurred” from a financial/legal aspect. Mr. Shearer stated that there are 3 steps to go through a debt process. The first is to authorize the debt, next is to incur it, and lastly issue the debt. Having it authorized and incurred is getting it approved by the state. It is on your debt statement and borrowing base. Attorney Reid added that incurring also means state filings have been approved by DCED (Department of Community & Economic Development). Once issued, the federal rules become effective. Mr. Shearer

II. Financing Plan Review-Scott Shearer, Public Financial Management (Cont.)

stated the timing for design/construction is 2008 through 2011. The District's goal is to complete the Facility for the 2011-2012 fiscal year. The financing goal is for the District to borrow the money as needed and phase in the millage impact over a 3-4 year period. Borrowing \$8.5 million in 2008 with a .84 millage impact for 2008-2009 year is currently budgeted. This enables the District to lock in the current low interest rates for a portion of the total debt issued. This would use part of the \$17 million "grandfathered debt". The District has passed a resolution not to raise the 2008-09 millage rates above the Act 1 Index, so it will not be able to take advantage of the grandfathered exception for this portion of the borrowing. Mr. Shearer stated that this plan will enable the District wants to avoid over- or under-borrowing for the project. By phasing in the debt in three stages to complete the entire financing for Phase 1 project, the District will experience interest rate risk. There is a probability that the rates will increase for long-term fixed interest rates in future years over current interest long-term interest rates.

Mr. Shearer presented an analysis of bond proceeds, uses of funds and estimated construction draws to determine how much to borrow and when to borrow. The High School Project/Facilities Plan will cost approximately \$30.2 million. The costs are broken down by month starting April 2008 through June 2011. The design phase will begin around April 2008. Construction is expected to start the summer of 2009 and be complete within 2 years. Capitalized interest (the use of some of bond proceeds towards debt service) will help to level out the millage impact. It is suggested that the District borrow \$8.5 million by June 1, 2008 which is generating the 0.84 mill impact for the 2008-2009 budget. In October 2009 the District will borrow the "non-grandfathered debt" of approximately \$13 million. When the \$13 million is exhausted then the District will borrow the last piece of the "grandfathered debt" for approximately \$9 million in 2010.

Dr. Wright addressed that the "non-grandfathered debt" will be in the middle because the District may be able to use the special education exceptions in the event the millage increase would push the District over the Act 1 index. Mr. Reinsmith asked how quickly bonds can be issued if the District needs to make adjustments in the timing of the issuance of debt. Mr. Shearer explained that the bonds can be issued quickly. A few months prior to exhausting the bonds he will revisit with the Board about the next piece to be issued. Dr. Wright stated that the last piece of the "grandfathered debt" would be adjusted to not borrow too little or too much. Mr. Pauloski inquired if the "grandfathered debt" is a fixed rate. Mr. Shearer stated that the only way it can be issued due to the "grandfathered" debt is by traditional fixed rate.

II. Financing Plan Review-Scott Shearer, Public Financial Management (Cont.)

Phase 2 projects are anticipated to begin in 2013 with an approximate cost of \$28 million. They are presented to give the District the overall budgetary impact. These projects will begin approximately in 2013 and continue until 2016. The total project cost is roughly \$28.8 million. Dr. Wright stated adjustments will have to be made every year on these estimates. Mr. Haller from D'Huy Engineering will be adjusting the capital plan annually to account for the new construction and changing conditions. Dr. Wright explained that consideration of Phase 1 is about Option C or D plus \$900,000 in number 7 priorities that were discussed in previous Operation meetings such as the alarm systems in the elementary schools and aging kitchen equipment, etc. Phase 2 consists of everything else that would need to be done to Harry S. Truman, Western Salisbury, Middle School, and the Administration building. Mrs. Miller asked if that included all numbers. Dr. Wright stated that most of the 7 priorities will be taken off once they are completed, but it does not include all numbers. Mr. Shearer stated that rating industries favor when School Districts look ahead to future cost. Phase 2 can be moved forward as the District determines to be necessary. The Board discussed the uses of the current outstanding debt, the meaning of local effort and reimbursement by the state for projects.

Phase 1 will cost about \$30 million and Phase 2 will cost about \$28 million which will cost the District approximately 7 mills total. To complete Phase 1 is about 3.3 mills. If the District goes with the other option of \$37 million for Phase 1 it would raise the total millage impact to approximately 8 mills. If the District goes with the smallest amount of \$17 million for Phase 1 the millage would go down to 2.11 mills. Mr. Giordano asked over how many years would be needed to phase in 7.5 mills. Mr. Shearer explained it would be about over 8 years. There are restrictions on how long the millage impact could be spread out. He is presenting the maximum length scenario. Mr. Pauloski stated that if this \$68 million plan is chosen the District would have increased their millage by a total of 6.97 per year just for the project, which is not related to salaries, benefits, or any other expense. Dr. Wright added that it also assumes there will be no other reassessment.

As discussed earlier, by financing Phase I of the projects over a multiple year period, the District may experience rising interest rate risk for future borrowings. This risk will apply to the \$13.0 million and the projected \$9.2 million borrowings. The cost of borrowing may increase or decrease by the time the debt is issued. Mr. Shearer is proposing a plan to lock in a low interest rate as soon as possible. Current interest rates for bonds are about 4.29% as opposed to a low point of 4.03 % since 1971. The historical average interest during this period has been 6.57% with a high point of 13.44%. As an illustration of this point, a 50 basis point movement in interest rate on a \$30 million bond issue will cost an additional \$2 million in interest cost over the life of the issue. Mr. Pauloski clarified that 50 basis points mean one half of one percent in interest rate.

II. Financing Plan Review-Scott Shearer, Public Financial Management (Cont.)

Mrs. Heffelfinger asked if it was possible to refinance some of the District's fixed rates since the rates are at a historical low. Mr. Shearer said the 1991 bonds cannot be restructured as established by their borrowing provisions. The 2003 bonds are authorized to be refinanced when the \$75,000 savings goal is achievable. The 2006 bonds have already refunded the 2001 issue. Regarding the 2003 refinancing, timing is a consideration since the District is seeking to issue the first \$8.5 million for Phase 1. Bank qualification will reduce the cost of borrowing. Mr. Shearer recommended that the District consider a Forward Starting Fixed Rate Swap to lock in the future interest rate and take advantage of the current low borrowing rates. The District would have variable rate bonds approved currently and enter into a contract with a swap counterparty, for example Citibank or Dain Rauscher, that would lock in a synthetic fixed rate for the life of the bonds. Under Pennsylvania law, the swap must be linked to a bond. The variable rate bonds will be approved now by DCED to conform to the Pennsylvania Local Government Unit Debt Act. The swap rate will be determined now, with a delayed settlement date linked to the bond settlement date. This transaction is recommended only for the \$13 million borrowing expected to occur in 2009.

Under this transaction the District will pay the swap counterparty the agreed-upon fixed swap rate, while the swap counterparty will pay to the District the variable rate, which can be based on either the SIFMA (Securities Industry and Financial Markets Association) Index or a percentage of LIBOR(London Inter-Bank Offered Rate) index. The District will then pay the variable interest debt service to the bond holders. A LIBOR swap bears more risk to the District because there is a risk that tax law changes can reduce the value of the tax exemption. The SIFMA swap bears less risk. The District can lock in an interest rate on the \$13 million, which would not be used until 2009. Theoretically, the return on a SIFMA swap would be 0. The benefit is the lock-in of interest rates, so that the District minimizes its risk. Over time, however, there may be periods when floating rates are lower than the fixed rate. At this time, the District would be paying more to the swap counterparty. When the variable rate rises above the fixed rate, the District will be receiving money from the swap counterparty to use for debt service.

Attorney Reid commented that in 2003 new legislation in Pennsylvania allowed governments and municipalities to do these types of transactions. The state set the guidelines requiring disclosure of the entire swap transaction to Districts, so they understand the risks of the transaction and develop strategies to mitigate those risks. Outlined are also events that may result in the termination of a swap agreement.

Mrs. Miller questioned what the benefit is to the counterparty swap. Mr. Shearer explained that the bank is not betting against the School District. Those funds are used for

II. Financing Plan Review-Scott Shearer, Public Financial Management (Cont.)

reinvestment in other fixed term investments at lower rate than what the School District is paying, thus making a profit. Mr. Shearer explained the swap floating rate index. LIBOR is a taxable index. The variable swap rate received by an issuer equals a percentage of LIBOR. With a LIBOR swap the issuer, in this case the District bears the risk that the tax law changes such that the tax exemption is eliminated or its value is reduced. LIBOR is a world-wide used index. It is a beneficial transaction with the swap counterparty as long as the marginal income tax rates stay the same or increase. If the District chooses the LIBOR curve it is taking a risk but will be compensating for taking that risk with lower fixed interest rates. SIFMA is less risky. The variable swap rate paid or received by an issuer equals the SIFMA Index. The SIFMA Index is a composite of approximately 250 variable rate issues in the municipal tax-exempt Market. (If an issuer's credit is strong and the bonds are non-AMT, the bond rate and the SIFMA Index will be approximately equal). Since 1985, SIFMA & LIBOR have averaged about the same percentage for performance. Over time they tend to average out.

Over a weekly or monthly basis they differ. SIFMA is more volatile and LIBOR changes weekly, but on average they are about the same. The District can base the decision on which to choose based on what they want to receive from the counterparty.

Dr. Wright stated if the swap counterparty option is chosen and the rate is locked in, is it similar to earmarking the \$17 million "grandfathered" debt which does not have debt service on it but the ability to grandfather it is locked in. Mr. Shearer stated that swap option would be different. Under the terms of the forward bond purchase for \$17 million, the District was able to authorize and incur debt in order to preserve a "grandfathered" debt exception under Act 1 without ever issuing that debt. If the District enters into a swap transaction, there will be a requirement to issue that debt at the future date. The advantage to the swap is the ability to lock in a rate today, while deferring payment for a period of time. If the District wishes to terminate the swap counterparty contract, there are two possible scenarios. The bank can pay the district to get out of it if the long-term interest rates are high or the bank can say the district needs to pay if the long-term interest rates are low. It is not known what the interest rates will be next year.

The District has to wait on the \$9 million on Phase 1 and assume interest rate risk. A swap transaction cannot be done on this piece as the forward bond purchase provides for only fixed rate debt.

Mr. Reinsmith re-stated why there were 3 pieces/phases to borrowing: most importantly, to ease the impact on the taxpayer, to control the budget, and to be able to adjust the third borrowing amount because it is too early to know the exact amount needed. The District

II. Financing Plan Review-Scott Shearer, Public Financial Management (Cont.)

will borrow as needed to avoid under- and over-borrowing. Mr. Shearer stated the state does not allow the District to have an outstanding debt of an amount of more than 225% of your borrowing capacity. Attorney Reid explained the way to calculate that amount is by taking the most recent 3 year revenue history and average that, then multiply that by 225%. If the amount is over 225% it would not be approved by the state. Mr. Shearer stated that as time goes on assuming your budget increase, the District's borrowing capacity will grow because of revenues and outstanding debts that are being paid.

Mr. Shearer shared an example list of other School Districts that have entered into fixed pay or interest rate swap. Between 2004-2006 the School Districts shown all chose LIBOR. The chart also showed in recent years School Districts are becoming more conservative and choosing SIFMA. LIBOR & SIFMA seemed to be chosen equally by School Districts for 2007 through the upcoming 2010 years.

School Districts always have the opportunity to terminate a swap contract without cause, but may involve a substantial "market-to-market" payment. The counterparty must give cause if it wishes to terminate a contract. Attorney Reid reminded the Board of the interest management plan and requirements of Act 23, which would outline all risks. The District is required to have bond counsel opinion. Mrs. Famularo questioned when the District would start payment of the interest rate swap. The payments would start at the effective date of the swap, although the swap document would be signed currently. Mrs. Famularo requested that Mr. Shearer provide a sample transaction for further review.

Dr. Wright stated that everything that needs to be done should be looked at comprehensively before it is presented to PDE. The Board will meet again March 3 to discuss construction and financing options available to District.

III. Other

Mrs. Famularo referenced the CSIU joint purchasing bid for diesel fuel that will be on the February agenda. CSIU will be moving up there bidding timeline for certain items. Mrs. Famularo is asking for Board approval at the next meeting to participate in the bid.

Mr. Reinsmith asked Mr. Brackett for an update on the progress of the stadium field. Mr. Brackett stated that pre-testing is complete. Dr. Wright added that a NPDES permit is not needed, so the process is expected to take 30-60 days. Mr. Brackett also said the pre-bid meetings have been conducted for summer projects other than the stadium field. All these bids are due February 7th. There are about 7-12 contractors to choose from per project. Dr.

Wright asked Mr. Brackett to verify that the selected contractors have all their appropriate clearances to meet new clearance requirements.

Building, Grounds, Transportation & Finance (Budget) Subcommittee Meeting
Wednesday, January 30, 2008 – 7:00 P.M.
Page 7

III. Other (Cont.)

Mr. Reinsmith asked if there are any further questions regarding the High School Project/Facilities plan to please address him and if need be he can direct the questions to the administration.

IV. Citizen's Comments

None.

V. March 3, 2008 Meeting

The goal for the March 3 meeting is to see what is needed to move forward with the project.

VI. Adjournment

Motion by Mr. Reinsmith, seconded by Mr. Pauloski to adjourn at 9:03 p.m.

Susan H. Famularo
Business Administrator
/jk