

Interim or Midyear Tax and Revenue Anticipation Notes (TRANS)

Resources and strategies for managing cash flow in times of state apportionment deferrals

Background

The recent early release of Governor Schwarzenegger's 2009-10 budget proposal underscores the severity of the state's budget and cash crisis, and establishes the governor's plan for closing what is now projected to be a \$41.6 billion shortfall for the remainder of the 2008-09 and the 2009-10 fiscal years. This is the most challenging budget in the state's history, and the governor's proposal uses a multitude of funding solutions and major spending reductions to address this crisis, including but not limited to revenue increases, categorical flexibility, borrowing, and cash management strategies such as deferrals. Because of the number of apportionment deferrals currently included in the budget language, the state's cash flow crisis has been transferred to all local educational agencies (LEAs).

On Thursday, January 15, 2009, the Governor's Office acknowledged that they are proposing an additional apportionment deferral of \$2.7 billion from July and August 2009 to September 2009. This proposed deferral would be in addition to legislation previously enacted that would delay from February 2009 to April 2009 the payment of \$2.6 billion in revenue limit and class-size reduction (CSR) funding. The January proposal would also be in addition to the governor's 2008-09 midyear proposal, which was introduced with the 2009-10 budget proposal and includes a deferral from April to July 2009. Although the latest proposed deferral has not been part of any of the budget documents released to date, the proposal was confirmed by the Department of Finance and the Legislative Analyst's Office.

Compounding this crisis for many LEAs is the recent notification from the State Allocation Board that the funding of construction apportionments for school districts and county offices of education, many of which were anticipat-

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ing funding through the Office of Public School Construction (OPSC), has been suspended.

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The purpose of a cash flow statement is to project the timing of receipts and expenditures so that an LEA can understand and meet its cash requirements on an ongoing basis, whether that is monthly or daily. The cash flow statement should indicate the LEA's liquidity and its ability to meet payroll and other current financial obligations. Because it excludes transactions that do not directly affect cash receipts and payments, the cash flow analysis is an analytical tool that should not be confused with the LEA's budget and fund balance.

State cash flow deferrals

As the state struggles with its own cash flow crisis, school district apportionments will be directly affected in the 2008-09 and 2009-10 fiscal years. Two deferrals have already been enacted into legislation, one through the 2008-09 Budget Act, AB 1781, and the other through emergency legislation ABX3 4. Further, the current budget proposal includes one additional deferral of the principle apportionment and CSR allocations as noted above, and a subsequent proposal to defer the 2009-10 July and August apportionments

LEAs should immediately review and evaluate their cash flow requirements and update cash flow projections for all funds in light of the deferral schedule provided in the table below. The table is an estimate based on discussions with the California Department of Education (CDE) and analysis of the governor's budget proposals.

Principal Apportionment Deferral Schedule:

Principal Apportionment	July 2008	September 2008	February 2009	April 2009	June 2009	July 2009	August 2009	September 2009
Enacted from emergency legislation ABX3 4	(100%)	100% of July 2008 paid in September 2008						
2008-09 Budget Act AB 1781			(50%)	50% of February 2009 paid in April 2009				
Governor's January budget proposal – no exceptions				(50%)		50% of Apr. 2009 paid in July		
P2 shift enacted in legislation 2002-03 – no exceptions					(100%)	100% of June 2009 paid in July 2009		
Proposed – no exceptions						(100%)		100% of July 2009 to Sept 2009
Proposed – no exceptions							(100%)	100% of August 2009 paid in Sept 2009

Class-Size Reduction Deferral	Nov 2008	Feb 2009	Apr 2009	July 2009	Totals in Millions
Allocations <u>before</u> the July deferral (including the February to April cash flow shift enacted in the 2008-09 Budget Act.)	25%	31%	44%	100%	1815.5
Proposed *	25%	31%	13%	31%	1815.5

*The final payment of 31% in July is a shift much like the P2 shift.

*Information provided by the California Department of Education (CDE).

Legal requirements regarding tax and revenue anticipation notes (TRANs)

Government Code Section 53852 states the following:

On or after the first day of any fiscal year a local agency may borrow money pursuant to this article, the indebtedness to be represented by a note or notes issued to the lender pursuant to this article. The money borrowed may be used and expended by the local agency for any purpose for which the local agency is authorized to use and expend moneys, including but not limited to current expenses, capital expenditures, investment and reinvestment, and the discharge of any obligation or indebtedness of the local agency.

Recommended Actions

Following are actions LEAs should evaluate and consider taking now to meet current payroll and other financial obligations.

Fiscal year 2008-09 midyear and 2009-10 full year tax and revenue anticipation notes (TRANs)

TRANs consist of short-term borrowing, up to 15 months for maturity, and may be issued under tax-exempt status. A TRAN can be issued for a single LEA, or pooled with other LEAs to reduce costs. The notes can be sold competitively or negotiated, depending on market conditions and credit issues.

For the purpose of this discussion, an interim or midyear 2008-09 TRAN should not be confused with a separate TRAN that may be needed to alleviate a 2009-10 cash flow deficit. Any 2009-10 TRAN would be a completely separate legal obligation and would be calculated separately from any 2008-09 interim TRAN. Each TRAN is calculated and based on the financial status and cash flow needs of a particular fiscal year.

Because of the timing and the potential that many LEAs will need cash flow solutions before the end of the 2008-09 fiscal year, FCMAT held discussions with fiscal advisors from Bank of America and reviewed alternative pooled TRAN structures that include multiple local educational agencies.

Information from the review indicates that a county office of education could stand in as an issuer for a pool of district notes. In this case, a county office of education would issue a single note via a public TRAN sale (offering) and use the proceeds to purchase the individual district notes. The county office of education would also pledge to intercept the districts' 2008-09 revenues to repay each district's TRAN and thus meet the combined total obligation. This pooled

offering would be less costly and provide a more efficient legal structure than individual TRANs for each district.

This option is only recommended for cash flow deficiencies related to the general fund; it should not be used in lieu of state matching funds for capital, construction or facility costs. Currently, TRANs in the market carry very low interest rates and it is estimated that the total transaction costs, including issuance costs, would not be more than 2%.

Other cash management strategies and time lines

Internal borrowing can provide a simple cash management solution, but only if cash is available in the LEA's other funds. External borrowing may require additional time because an LEA must go outside its own agency for funds. Options for cash management include the following:

- **Internal borrowing between district funds** is authorized by Education Code Section 42603, which allows LEAs to borrow temporarily between funds to address cash flow shortages. This situation will need to be assessed at least monthly and will depend on the LEA's spending patterns during the last four months of the fiscal year. This is the most common method used by LEAs; however, it works only if there is cash available in other funds.

This type of borrowing has several limitations. No more than 75% of the money held in any fund during the current fiscal year may be transferred. In addition, if the transfer is completed prior to the last 120 days of the fiscal year, the funds must be repaid by June 30 of the same fiscal year. If funds are transferred within the last 120 days of the fiscal year, repayment must be made prior to June 30 of the subsequent fiscal year.

- **LEAs may borrow from the county office of education in accordance with Education Code sections 42621 and 42622.** However, this option depends on the county office being willing and able to provide funds. Based on the current economic outlook, this may not be an option because county offices of education are monitoring their own cash balances and are often unable to accommodate these types of requests.
- **Education Code Section 42620 also allows LEAs to borrow from the county treasurer.** Under Article XVI, Section 6 of the California Constitution, the county treasurer must provide funds to an LEA if the LEA is not able to meet its obligations. However, the county treasurer cannot loan districts money after the last Monday in April of the current fiscal year. In addition, this type of borrowing requires the approval of the governing board by formal resolution. The loan cannot exceed 85% of the amount of money which will accrue to the school district or county

school service fund during the fiscal year, and repayment must be made from the first monies received by the LEA before any other obligation is paid. The advantage of having the county treasurer provide the funds is that the treasurer is able to take repayment directly from receipts prior to any distribution to the LEA.

Additional assistance

For additional assistance, LEAs should contact their respective oversight agencies or visit FCMAT's website at www.fcmat.org and submit an online request for assistance.

Disclosure

In an effort to assist LEAs, FCMAT contacted Bank of America to review alternative pooled structures for issuing interim or midyear TRANs. While FCMAT does not recommend or promote individual vendors, interested parties can contact Mr. Scott Gorzeman at (213) 345-4494 or via email at scott.gorzeman@bankofamerica.com.