Maximizing Construction Proceeds

MASBO Spring Conference

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Agenda

- Introduction – Why Is This Important?
- Construction Investment Best Practices
- Arbitrage

Why Is This Important?
• Most Interest Earnings Can be Used to Enhance your Construction Project
• Bond $ Comes in on One Date
• Normal to take Two Years to Spend the Dollars

Why Invest?

• Significant Additional Earnings can be Realized When Invested Properly

Investment Example

• $25 Million Dollar Project
• 2 Year Construction Period
• Average Weighted Average Maturity = 1.25 years
Investment Example

- $25 Million @ 1.70% x 1.25 = $531,250
  - Local Bank
- $25 Million @ 2.30% x 1.25 = $718,750
  - LGIP
- $25 Million @ 2.80% x 1.25 = $875,000
  - Fixed Rate Investments

Why Is This Important?

- IRS Restrictions (Arbitrage)
- State/District Restrictions
  - State Statute 118A
  - District Investment Policy
Construction Investment

Best Practices

Types of Bonds

- Voter Approved or Board Approved
- Tax Exempt or Taxable

Types of Bonds

- School Building Bonds
- Facility Maintenance Bonds
- Abatement Bonds
- Capital Bonds
- Certificates of Participation
- OPEB Bonds
- Current Refunding Bonds
Use a Segregated Account

- Imperative to prepare for IRS Audit
  - Calculation of Arbitrage
- Easier Internal Administration
- Easier Annual Fiscal Audit

Obtain a Draw Schedule

- Architect or Construction Manager
- Include Soft Costs
  - Engineering Fees
  - Architect Fees
  - Construction Administration Fees
  - FF&E
Update Draw Schedule During Project

- After Bids are Accepted
- Project Scope or Timing Changes
- Periodically Throughout

Select a Date to Pay Your Contractors

- You are in control of this date
  - Can be placed into bid documents/contracts
- Keep it to once a month
  - Day after Board Meeting
  - Specific Day of Month (Last Friday)
  - Specific Date of Month (30th)

Select Allowable Investments

- Use your Districts Investment Policy
- Limited to Statute 118A
- Safety
- Liquidity
- Yield
Diversify Your Investments

- **By Type**
  - Bank Product
  - Municipal Securities
  - U.S. Agencies or Treasuries

- **By Name**
  - Not all with same bank or same Issuer

**Draw Schedule**

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<thead>
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<th>Actual vs. Projected Expenditures</th>
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Investment Options

Non-Deliverable Certificates of Deposits
- Traditional FDIC Insured ($250K)
- Insured
- Collateralized (110% or LOC)
- CDARS/ICS
- Local Banks

Investment Options

Agencies and Instrumentalities
- Fannie Mae, Freddie Mac, Ginnie Mae, etc.
- Notes or Bonds that are not direct mortgages

Municipal Securities
- Taxable or Tax Exempt
- Selective on Call Date & Credit Quality

Investment Options

Savings Deposit Accounts (SDA)
- Liquid Money Market – But Limited Monthly Draws
- Money Market
- Term Series
- Varying Length
Execute Initial Investments

- Investments Maturing on Payment Date
- Maintain Adequate Liquidity
- Follow Diversification Plan

Monitor Investments

- Investments Made in Your Name
- Confirmations Received
- Collateral Pledged and Monitored

Reinvestments

- Examine Reinvestments Opportunities Monthly
  - Time of Payment
- Do Not Let Idle Cash Stay Liquid
- Look for Investment Swap Opportunities
Arbitrage

• Taking advantage of an imbalance, (spread or profit), in two different markets
• Often considered an “instantaneous” gain

Definition
Minnesota School Districts are allowed to sell debt issued as Tax Exempt.

- Districts are allowed to invest in the taxable market.

Two different markets:
- Tax Exempt
- Taxable

How it Comes Into Play for Minnesota School Districts

- Borrowing Money at a Tax Exempt Rate
  - Low Interest Rates
- Investing those Borrowed Dollars in the Free Market
  - Higher Interest Rates
- Difference, (Spread/Profit), equals Arbitrage

The IRS will ALLOW Districts to keep "some" arbitrage, but it is capped at a rate set when a District sells its debt:
- This is known as the Arb Yield.

The theory behind this restriction is to prevent Municipalities from taking advantage of its ability to sell tax exempt debt simply for the purpose of creating arbitrage.
- Districts need to have a PURPOSE and a reasonable expectation of USING the debt for projects or cash flow in order to issue the debt.

IRS Tax Code
• There are IRS exceptions where NO REBATE is due:
  o Small Issuer Exception
  o 6-month Expenditure Exception
  o 18-month Expenditure Exception
  o 2-year Expenditure Exception

• $15 Million Par Amount per Calendar Year
• $5 Million can be used for any purpose
• The amount that exceeds $5 million must be for school construction

QUESTIONS/CONTACT INFORMATION

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