KEY CONSIDERATIONS: DEVELOPING A SUCCESSFUL BOND IMPLEMENTATION STRATEGY

2018 ACBO FALL CONFERENCE

Introduction

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North Orange County CCD - Overview

NORTH ORANGE COUNTY
COMMUNITY COLLEGE DISTRICT

- Established in 1964
- District encompasses approx. 155 sq. miles
- Serves a population of over one million
- Approximately 56,000 Students enroll each term
- 2,646 total Employees
- Three (3) Campuses

Fullerton College

Cypress College

North Orange Continuing Education

Section I:
Bond Program Planning/Implementation

North Orange County CCD – Bond Overview

- North Orange County CCD has passed two (2) bond measures totaling $813 million in voter approved authorization.

Date	Measure	Voter Authorization	Remaining Authorization	Voter Approval %	Result
March 2002	X	$239 million	$0	57.40%	Pass
Nov. 2014	J	$574 million	$474 million	55.02%	Pass
Total		**$813 million**	**$474 million**		

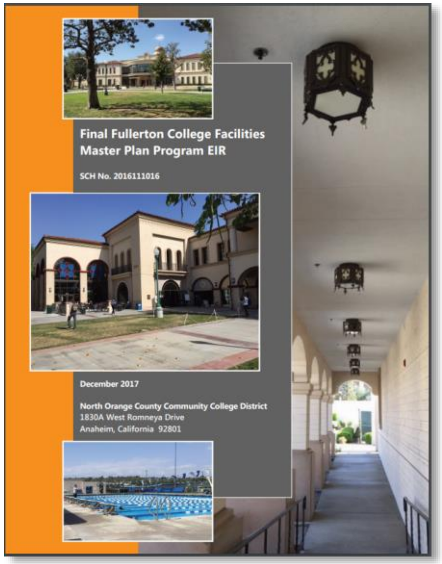
Key Points:

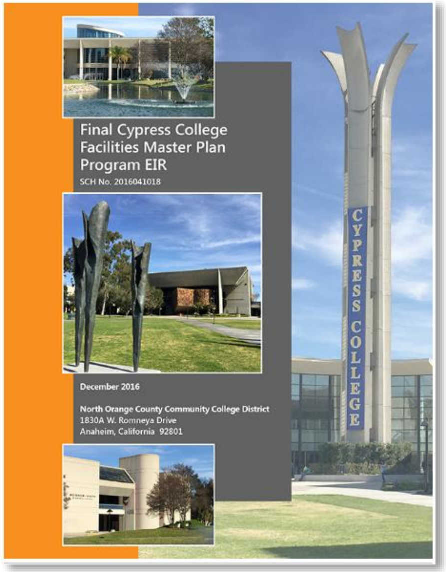
1. Planning Considerations / Challenges
2. Addressing Change
3. Cash Flow Planning

Long Range Capital Planning

1 Planning Considerations / Challenges

- Strategic Plan ("Big Picture") vs. Actual Implementation.
- Campus planning vs. District planning.
- Maintaining up-to-date Facilities and Educational plans.





Bond Program Implementation

2 Addressing Change

- **District-wide objectives vs. Campus level objectives:**
  i. Project Prioritization
  ii. Project scope
  iii. Integration

  – Updates to NOCCCD's educational and facilities master plan have adjusted timing of bond issuance and funding amounts.

- **Construction costs: Estimates vs. Actual**

  – Variance between preliminary cost estimates and final design often require adjustments to the timing and amount of funding needed.

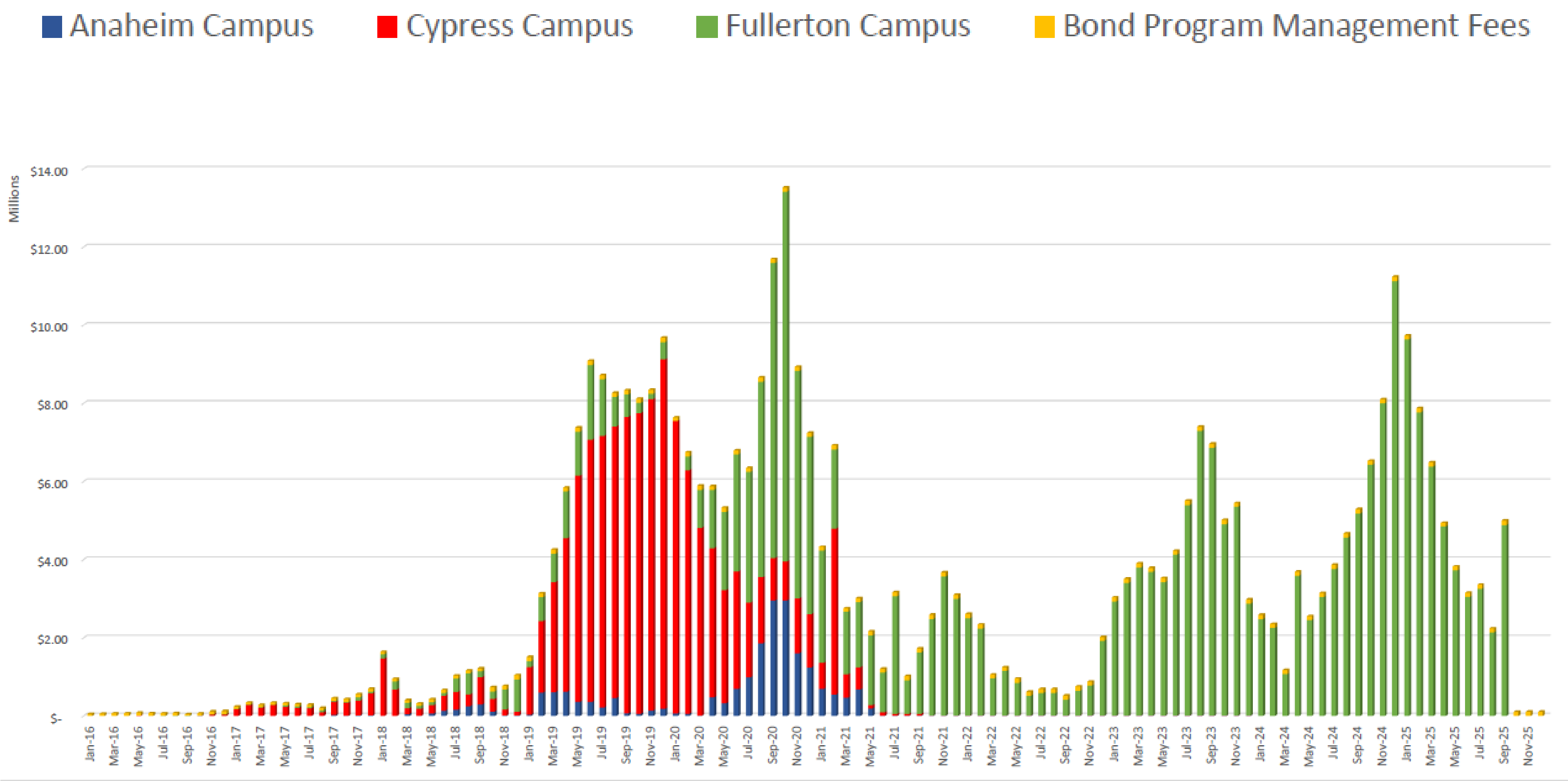
Timing of Issuance

3 Cash Flow Planning

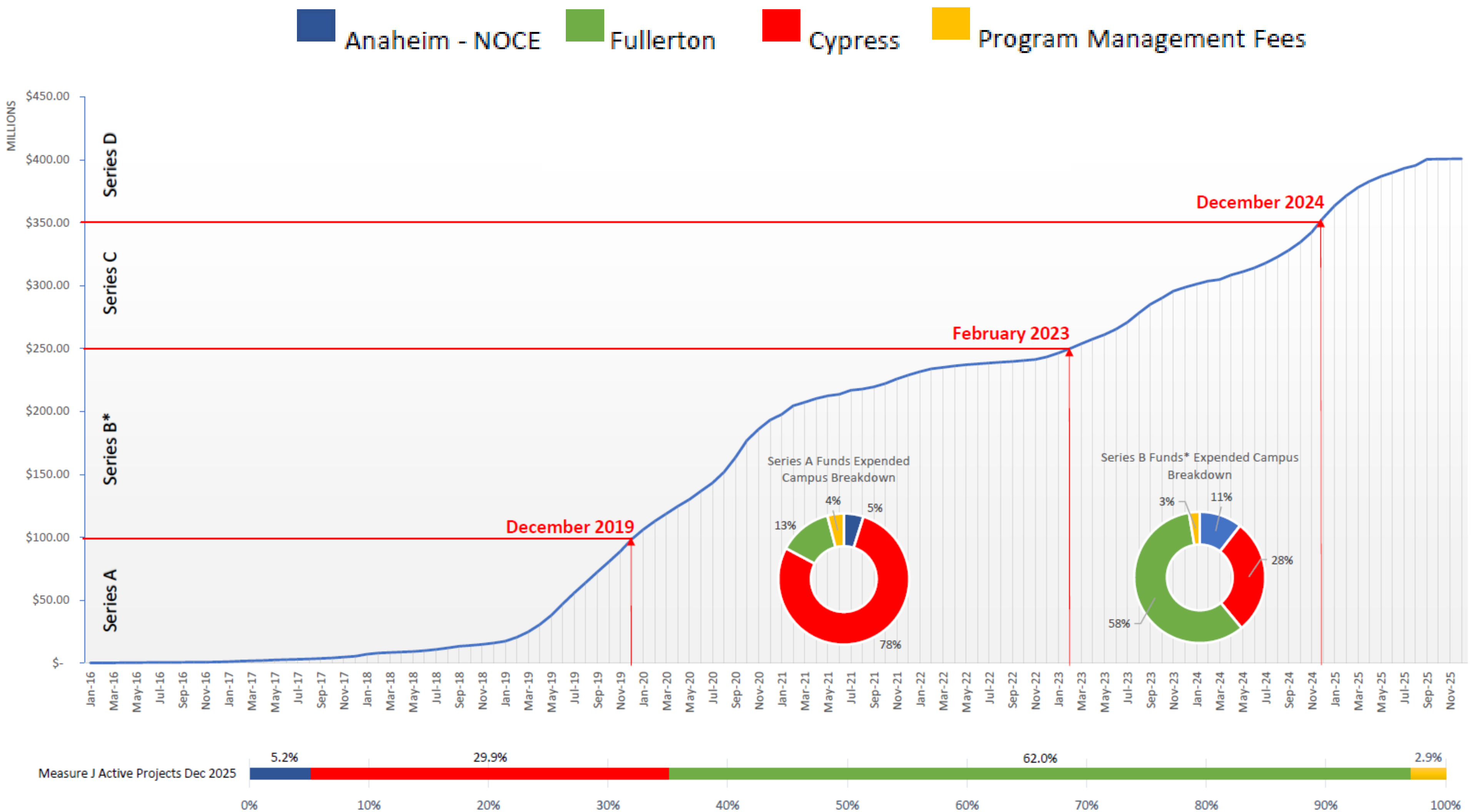
- **Timing for each bond issuance should be aligned with anticipated project expenditures.**

- **As the capital plan evolves over time, the bond program must adjust accordingly**
  - Maintaining tax rate commitments to voters.
  - Focus on minimizing the costs of borrowing while keeping the long term viability of the program in perspective.

District-Wide Cash Flow Projection



District-Wide Cash Flow Projection Cummulative Total



Section II:
Bond Issuance Strategy

Bond Assumptions

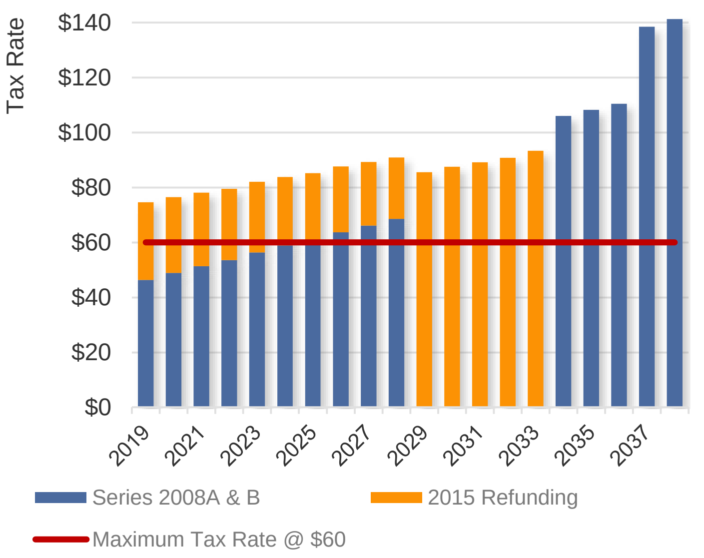
- Consider various structural features/underlying assumptions to calculate the bond measure amount and tax rate.
  - Tax rate – under Proposition 39 general obligation bond measures, the maximum tax rate is $25 / $100,000 of assessed value.
  - Number of issues – determined based on the anticipated cash-flow needs of the District.
  - Bond repayment term – generally 25 to 30 years.
  - Repayment ratios/interest costs.
  - Assessed value (AV) growth assumptions.

Bond Assumptions (continued)

- Establishing "Reasonable Expectations" for Expenditure of Bond Funds
  - 85% of proceeds in 3 years from date of issuance
  - Enter into binding contracts for 5% of proceeds within 6 months
  - Due diligence regarding projects
  - "Reasonable Expectation" standard
  - Due diligence for projects – shovel ready
    - DSA approvals
    - Construction Drawings
    - Project Budget Vetting
    - Track record in spending past bond issues
    - Competition for construction crews in region
  - 5 Year Rule (concurrency, size, 10/30/60/85, certificate)

Bond Assumptions – Avoiding Pitfalls

- If conservative bond assumptions are not utilized, the following could occur:
  - District not meeting statutory requirements (i.e. exceeding tax rate).
  - Unable to access remaining authorization.
  - Reliance upon expensive financing options (i.e. CABs and/or deferred amortization).
  - Will not have a fluid facilities program (i.e. interruptions & "stop-go's" on projects)
  - Extended duration of construction timeline (escalation of construction costs)



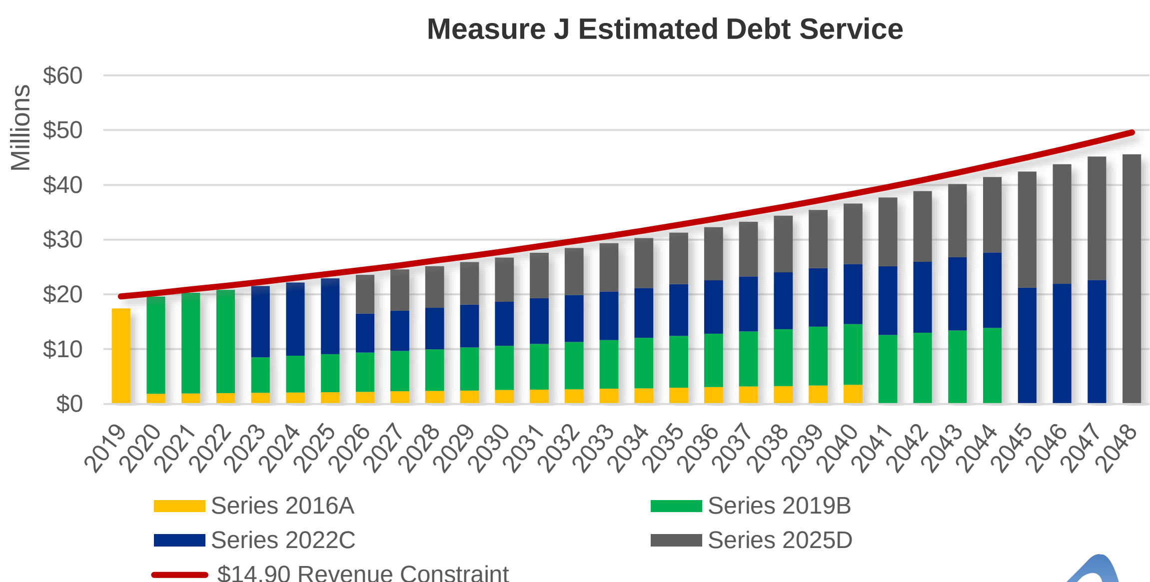
NOCCCD Measure J Case Study

Bond Assumptions

- Conservative assessed valuation growth projected at 3.25%.
- Adhere to pledged tax rate of $14.90 per $100K of AV.
- Utilize current interest bonds only.
- Maintain 25-year maturity term for each series.
- Provide cashflow flexibility to meet the project needs of the District.

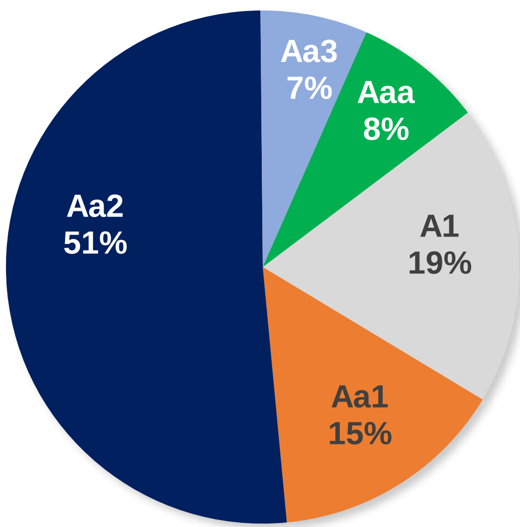
Proposed Issuance Schedule

Issue	Issue Date	Par Amount	Term
Series 2016A	6/16/2016	$100,000,000	25 years
Series 2019B	8/1/2019	160,000,000	25 years
Series 2022C	8/1/2022	160,000,000	25 years
Series 2025D	8/1/2025	154,000,000	23 years
Total		**$574,000,000**	



Credit Rating Strategy

California CCD Rating Distribution[1]



Broad Rating Factors	Factor Weighting	Rating Sub-factors	Sub-factor Weighting
Economy/Tax Base	30%	Tax Base Size (full value)	10%
		Full Value Per Capita	10%
		Wealth (median family income)	10%
Finances	30%	Fund Balance (% of revenues)	10%
		Fund Balance Trend (5-year change)	5%
		Cash Balance (% of revenues)	10%
		Cash Balance Trend (5-year change)	5%
Management	20%	Institutional Framework	10%
		Operating History	10%
Debt/Pensions	20%	Debt to Full Value	5%
		Debt to Revenue	5%
		Moody's-adjusted Net Pension Liability (3-year average) to Full Value	5%
		Moody's-adjusted Net Pension Liability (3-year average) to Revenue	5%

Source: Moody's Investor Services.

Common Issuer questions:

1. **How many ratings do I need?**
2. **What rating agencies should I use?**

Credit Rating Strategy

1 How many ratings do I need?

- Typically based on issuance amount
- **Key considerations:**
  - Increase investor base
  - Rating expectations of investors: institutional vs. professional retail

Issuance Amount	Number of Ratings to Consider
< $50 million	At least 1
$50 - $100 million	1 - 2
< $100 million	At least 2

2 What Rating Agencies should I use?

- **Key considerations:**
  - Consider rating history of the District
  - Do you have a split rating?
  - Are there factors inhibiting higher ratings?
    - Strength/weakness of geography and/or demographics

Rating Methodology

Financial Management Assessment: Moody's; S&P Global Ratings

SB 222 (Tax base focused): Fitch Ratings; KBRA Kroll Bond Rating Agency

Method of Sale

Competitive Sale

- Bonds are offered to multiple underwriters on a pre-selected day/time using an on-line bidding platform. Awarded to the lowest true interest cost (i.e. overall cost of funds).

Negotiated Sale

- Pre-selected underwriter and interest rates are negotiated between the underwriter and the District at the time of the sale. Ability to educate investors & respond to investor questions.

Private Placement

- Bonds are sold to a single or select number of investor(s). The securities are not available for sale on the open market.

Method of Sale - Characteristics

Competitive	Negotiated	Private Placement
Stable market	Volatile market	Shorter than 20 years
High rating	Infrequent issuer/new credit	Cost of issuance savings ▪ No official statement ▪ No rating ▪ No credit enhancement
Traditional bond structure	Not rated/low rating	Accelerated financing timeline
Frequent issuer/highly rated	Innovative bond features	
Limited pre-marketing	Complex credit history	
	Ample pre-marketing to investors	
	Mitigate Premium	

Section III:
Legal Perspective

MAINTAINING TAX-EXEMPT STATUS

1. **Private Business Use Test:** More than 10%* of proceeds of an issue or facilities finances with such proceeds are used for a private business (non-governmental) use. [If bond issues exceeds $150 million, flat $15 million cap on private business use test]

2. **Private Payment Test:** Present value of revenue received by District for use of facilities as payment must be less than 10%* of the present value of total debt service in bond issues which funded the facilities.

***10% for related use, 5% for unrelated use**

APPLICATION OF PRIVATE BUSINESS TESTS

1. **University Centers:** District must occupy portion of Center so that Center is a "school facility". If other colleges are 501(c)(3) entities, that is private use, and if public universities, not private use; food court, bookstore, ancillary private uses need the factored. Perhaps a combination of tax-exempt/taxable bonds

2. **Surplus Campus Facilities:** Private use measured over the life of a bond issue and on a bond issue, not project specific basis. Ergo the importance of tracking the expenditure of bond money by issuance. Just because one building is converted to private tenants may not signal a tax problem.

3. **Health and Wellness Centers:** Management contracts can create private use. The management contract to provide services and to manage the Wellness Center must satisfy the "qualified management contract" regulations.

IRS has safe harbor for management contracts which would not result in private use:

1. No portion of compensation can be based on <u>net</u> profits from the operation of the Wellness Center.

2. Compensation must be a <u>periodic fixed fee</u> – Stated dollar amount per month. Automatic CPI/ similar index adjustments permitted.

3. Incentive compensation (% of gross fee OK) so long as it is based on some standard that measured quality of services, performance or productivity (such as gym memberships, hours of usage, etc.) and not profitability.

THE 50 DAY RULE

- The private use rules impact long-term non-governmental use
- Short-term or incidental private use of bond financial facilities not a tax concern. (Public facilities open to public/ first come first served/ Civic Center Act.)
- Revenue production from tax exempt bond financed facilities is enhanced by appropriately recharacterizing long-term use as short-term use.
- Welcome to the 50 Day Rule
- The 50 Day Rule is the basis of convention center bond financing.

THE 50 DAY RULE – WHAT IS IT?

A contract for the use of bond-financed property by a private entity does not create private business use of the property if (a) the term of the use of the contract does not exceed 50 days, (b) the arrangement is a negotiated arm's-length arrangement, and compensation under the arrangement is at fair market value, and (c) the property is not financed for the principal purpose of providing the property for use by the private user.

APPLYING THE 50 DAY RULE : Long Term Exceeds Short Term

- Termination clause in long-term lease or contract.
- Because the 50 day limit does not have to relate to consecutive days, a district could:
  - Enter into a 4 year contract with a professional sports team to use district stadium or athletic fields for 10 days per year – not private use because only 40 total days. (6 year contract for 10 days per years is a violation because it is 60 days.)
  - Enter into multiple contracts with an unlimited number of private users so long as none of the contracts resulted in any user contractually permitted to use the facilities for more than 50 days during the term of the contract.
  - Common application- athletic facilities, gym/theater space by non-profit/community groups, use of dormitories for summer camps
- Can a 5 year contract for 10 days of use per year have an evergreen clause or be automatically renewed by its terms? Maybe- in jail deals where the marshal's contract had a rollover provision, IRS ruled that the rollover clause demonstrates that the property was financed for the principal purpose of providing the property for use by a private user. CCD’s use distinguishable.

SKIP PRIVATE ACTIVITY/ SPEND DOWN RULES – DO TAXABLE BOND

- No spend down requirements
- No arbitrage limits
- No bond term/useful life limits
- No private activity concerns
- No working capital issues

- BUT – must satisfy all Prop 39 State law tests.

TAXABLE BOND ISSUES

1. Tech Bond – Taxable bond avoids spend down requirements and investment of proceeds in non-AMT portfolio including mutual funds.
2. Taxable + Tax Exempt Combination Bonds
   a) Useful for large projects where you want full construction contract costs on deposit in Building Fund but worried about 3 year test.
   b) When amortizing taxable bonds cannot front load taxables. Need to amortize taxables and tax-exempt bonds relatively pro-rata for the first half term of the financing.

THREE RANDOM ISSUES

1. Warranties – If purchase an extended warranty as part of the purchase price of an asset, value of warranty is a capital expenditure. If warranty purchased separately, it is working capital and subject to 5% cap.

2. Recordkeeping – Tax certificate has variety of record keeping obligations, but need to track non-bond funds spent during 3 year period on capital projects.

3. Software – Furnishing and equipping of school facilities; class size, safety, information technology; active or passive validation of the ordering of the improvements.

Education Code Section 15108: An action to determine the validity of bonds and of the ordering of the improvement or acquisition may be brought pursuant to CCP 860. In such action, all findings, conclusions and determinations of the legislative body which conducted the proceedings shall be conclusive in the absence of actual fraud.

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