

2008 Aid Anticipation Certificates for Minnesota School Districts

Frequently Asked Questions

1. What are Aid Anticipation Certificates?

Aid Anticipation Certificates (AACs) are a financial instrument used by school districts to borrow money to meet cash flow needs. Some of the key characteristics are summarized below.

- To issue AACs, a district must reasonably expect to have a cash shortfall at some time during the next fiscal year.
- Districts are allowed to borrow in anticipation of the receipt of future state aids, and the future state aids are pledged toward repayment of the certificates, with interest.
- AACs are tax exempt; that means that purchasers of AACs do not pay income taxes to the federal government or the state of Minnesota on the interest they receive.
- AACs are considered "general obligations" of the school district; this means that the district pledges to levy additional taxes if future state aids are not sufficient to repay the certificates.

2. How much can we borrow?

There are limitations in both state law and federal regulations on the amount borrowed through AACs. The primary limitation is essentially equal to the largest projected cash deficit in the district's operating funds during the next year, plus 5% of the expenditures in the previous year. Borrowing is also limited to 75% of the projected state aids for the next year.

In some cases, it may be beneficial for a district to borrow less than the maximum amount (e.g., to avoid making arbitrage rebate payments on the proceeds of the certificates or other debt issues).

3. When can we borrow funds?

AACs cannot be issued until the start of the fiscal year for which you are borrowing. So you cannot issue AACs in anticipation of fiscal year 2009 aids until July 1, 2008. The key date is the "closing date," which is the same date on which you will receive funds. You can approve and award sale of AACs in June of 2008, as long as the closing date is July 1 or later. The optimal time to award sale of AACs is generally from June through August. AACs can be issued later in the fiscal year, but doing so may reduce both the amount that can be borrowed and the repayment term.

4. When will we need to repay the certificates?

You will make a single payment of principal and interest on the certificates. The payment must be made no later than 13 months after the closing date, and no later than September 30, 2009.

5. What interest rate will we pay?

We will conduct a competitive sale of your AACs, so the exact interest rate will not be determined until the date of sale. For similar certificates sold early in February of 2008, districts generally paid interest rates of approximately 1.50%. Depending on the direction of interest rate trends between now and this summer, we would expect that rates on 2008 AACs would be lower than 2.00%.

6. Why is the interest rate so low?

There are three factors that help to make interest rates on AACs especially low. First, the tax-exempt status of the certificates reduces the interest rate. Second, AACs for Minnesota school districts may be included in the State Credit Enhancement Program, through which the State guarantees payment on the certificates; this makes the AACs a very safe and attractive investment. Third, the fact that the AACs are general obligations of the district also makes them very safe and attractive to investors.



7. What does it cost to issue AACs?

The primary cost of issuing AACs is the interest you will pay. But issuing AACs is a rather complex process, with many legal restrictions and requirements. To ensure that you meet all requirements, you will need assistance from several professional organizations. You will pay a fee to Ehlers (for analysis of your cash flow, preparation of an Official Statement, conducting a competitive sale, and closing), to a qualified bond attorney (for preparation of a legal opinion, resolution awarding sale, and other documents), to a paying agent (for invoicing you, processing your payment, and paying investors), and to your county or counties (for provision of information required for the official statement). The total of these fees will vary depending on the amount of certificates issued and other factors. For example, total fees would generally be approximately \$6,000 - \$6,500 for a certificate of \$2 million, and \$9,500 - \$10,000 for a certificate of \$4 million.

8. Can the district make a “profit” on the issuance of AACs?

Districts will not need to use all of the proceeds of their AACs for cash flow needs for the entire year, so they will be able to invest at least some of the proceeds for most or all of the term. In some circumstances, the interest that the district earns on the proceeds may be greater than the total of the costs the district pays – including both interest and the fees mentioned above. This is more likely to be true if the amount borrowed is relatively large and if the “spread” – between the rate the district receives on its investments and the rate it pays on its certificates – is relatively large. And it will only be true if the district is able to avoid making arbitrage rebate payments on the certificates. As a result, it is very important for your financial advisor to help you consider the arbitrage rebate implications of your certificate issue in the planning process.

9. What if I don’t expect to have enough cash to pay back the certificates in 13 months?

Many districts are in such a position - where they experience cash flow shortfalls at the same times every year. If your certificates are issued for a 13 month term, we will be able to issue certificates approximately 12 months later (in 2009), and you will receive the proceeds of your 2009 certificates before the payment is due on your 2008 certificates. So you will never have a “gap” of even a few days when you may be short of cash.

10. Will issuing AACs hurt our bond rating?

Generally no. Because of the State Credit Enhancement Program, all Minnesota school district bonds can qualify for a very high rating on their bonds (currently Aa2 from Moodys Investors Service, or AAA from Standard and Poors). For some districts, the rating agencies also show an “underlying rating” (i.e., the rating that would exist without the Credit Enhancement Program). The district’s financial condition and fund balance trends will affect this underlying rating. So the conditions that make it necessary for you to issue certificates – low or negative fund balances and cash balances – could affect your underlying rating. But the act of issuing certificates is not likely to have an effect. And even if your underlying rating is downgraded, the impact on the district will be very minimal.

11. How long does it take to issue AACs?

The total process – from preparation of an estimated cash flow schedule, through planning, sale, and receipt of funds – usually takes approximately two months. It may be possible to shorten this time slightly if the district needs funds sooner.

12. What are Tax Anticipation Certificates?

Tax Anticipation Certificates (TACs) are very similar to AACs, except that the district is borrowing in anticipation of receipt of **property taxes** for a **calendar year**, rather than **state aids** for a **fiscal year**. Otherwise, most of the same laws and restrictions apply. Most school districts receive relatively little property taxes in their operating funds, so most districts could not issue enough TACs to meet their cash flow needs. But the staff at Ehlers can help you consider both options.

13. How can I get more information?

Contact any of the following financial advisors on the Ehlers Education Team.

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