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Investment of Public School Funds

Raymond James Public Finance

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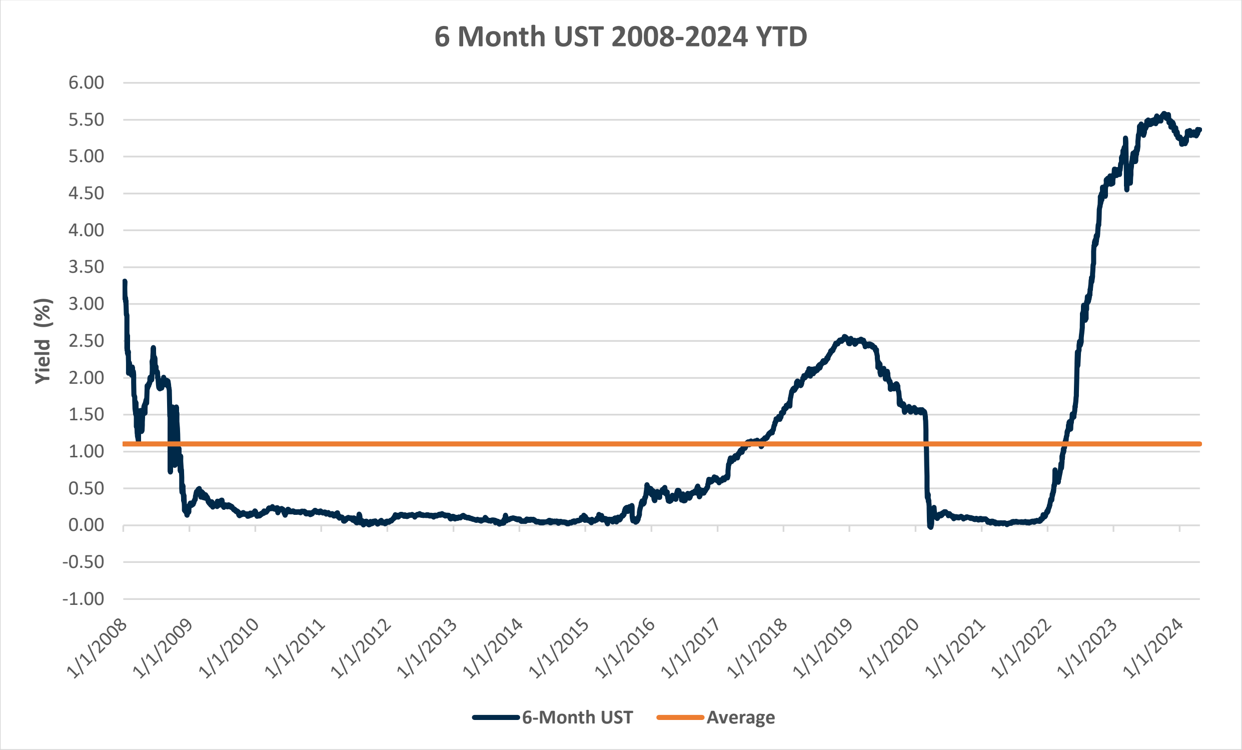
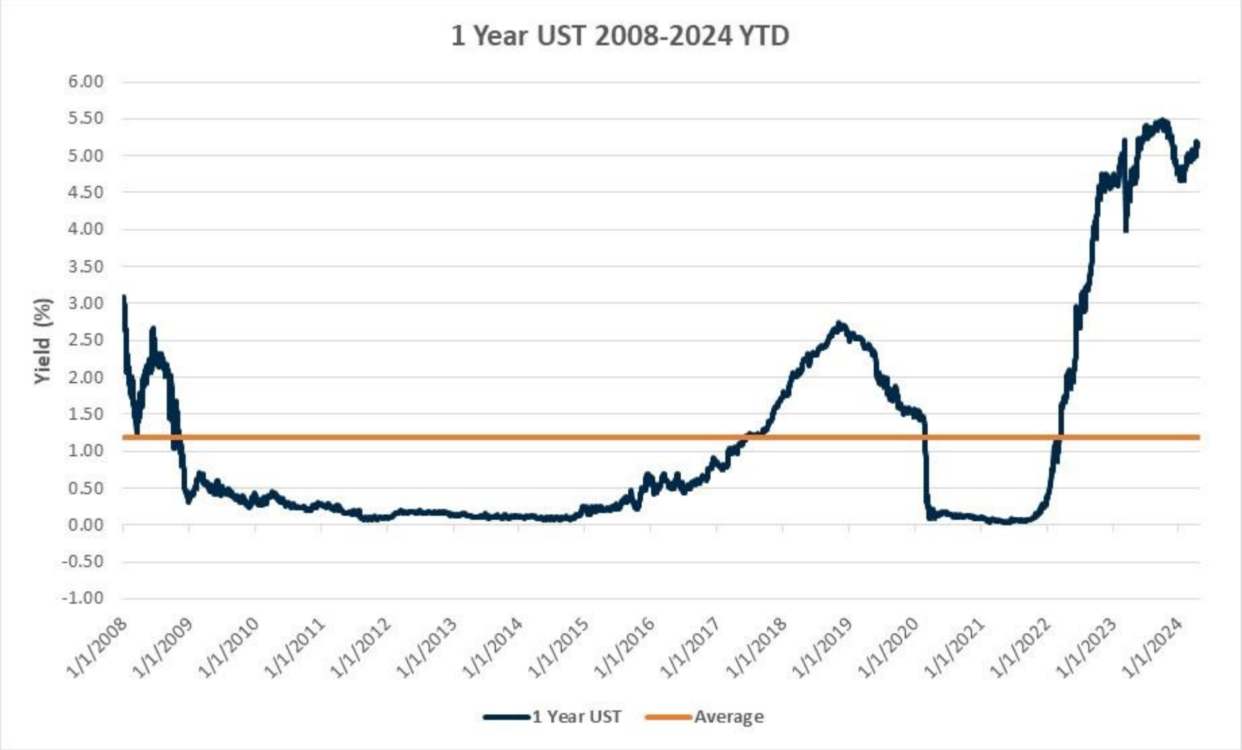
Section 1

OVERVIEW & EXAMPLES

Short-Term Yields Provide Investment Opportunities Not Seen In Decades





Types of Cash That Could Be Invested

Many different investment applications can be managed.

Most do not have restrictions, with the exception of bond proceeds.

1. General Fund reserves that you may not need throughout the year.
2. General Fund Money that you may need throughout the year – Ad Valorem taxes generally come in during January and February and are used throughout the year, providing an opportunity to invest funds that you have early in the year but may not need until later in the year.
3. Funds Associated with a bond issue – construction fund, debt service funds (if you pay monthly), and escrows when you refund bonds.
4. Capital Project Funds being held by your Board
5. Other money that you may not be using immediately, but have plans for at some point in the future.
   A. Lt. Governor's Grant Program Money
   B. Advancement In Technology Money

Example 1 – BOE Invests “Other” Cash

Bid Overview

Provider	**Yield**
Bidder 1	4.9722%
Bidder 2	4.9707%
Bidder 3	4.9689%
Bidder 4	4.9613%
Bidder 5	4.9575%
Bidder 6	4.9469%
Bidder 7	Pass
Bidder 8	Pass
Bidder 9	Pass

- BOE received grant money, which it intends to use in the near future for construction and invested it during the architectural and engineering phase of the project.
- Money will come due when construction commences and the Board needs the cashflow to pay bills associated with the construction project.
- **The yield of 4.97% will result in an additional $257,000 in earnings that can be spent on the project.**

Example 2 - BOE Invests Equivalent of 1 Month Reserve

Bid Overview	
Provider	Yield
Bidder 1	5.0471%
Bidder 2	5.0424%
Bidder 3	5.0414%
Bidder 4	4.0413%
Bidder 5	5.0384%
Bidder 6	5.0204%
Bidder 7	4.0642%

- BOE has a fairly certain funding outlook for the next year or so.
- With interest rates expected to fall over the next year or two, BOE decided to lock in the yield on most of its 1 month reserve by investing in US Treasuries with a fixed interest rate.
- BOE chose to have portions of the 1 month reserve coming due at 6 months, 12 months and 18 months.
- **The yield of 5.04% will result in earnings of approximately $1.81 million on money that the Board is required to hold.**

Example 3 - BOE Invests Proceeds From a Bond Issue

Provider	Yield
Bidder 1	5.1718%
Bidder 2	5.1679%
Bidder 3	5.1667%
Bidder 4	5.1641%
Bidder 5	5.1622%
Bidder 6	5.1581%
Bidder 7	Pass

- BOE is building a new high school and recently borrowed money to finance the construction.
- BOE worked with its project manager to get a spending schedule during construction.
- Raymond James matched these cashflow needs and structured investments that should provide liquidity at times when it is needed during construction.
- **The yield of 5.17% will result in earnings of approximately $3.01 million on money that the Board is required to hold.**

Section 2

ARBITRAGE

Why Does It Matter What Types of Funds You Invest

- Applicable state law differs depending on what types of funds you are investing.
- Additional IRS provisions apply to borrowed funds.
- Investment Options can differ depending on the type of fund being invested.

	General Funds	Borrowed Funds
State Law	§19-3-120 & §19-3-120.1	§11-18-21
IRS Considerations	None Generally	Yes
Differing Investment Options	Yes	Yes

What is Arbitrage?

After bonds have been issued, you have the opportunity to invest the proceeds during your construction period. Generally this is either in:

- An interest bearing money market account, or
- US Treasuries

The IRS provides a benefit to tax-exempt issuers. Since income from interest payments on the bonds is not taxed, investors are usually willing to provide a lower interest rate to issuers of tax-exempt bonds.

The IRS has rules in place to prevent the earning of arbitrage on tax-exempt bond proceeds.

What is arbitrage?

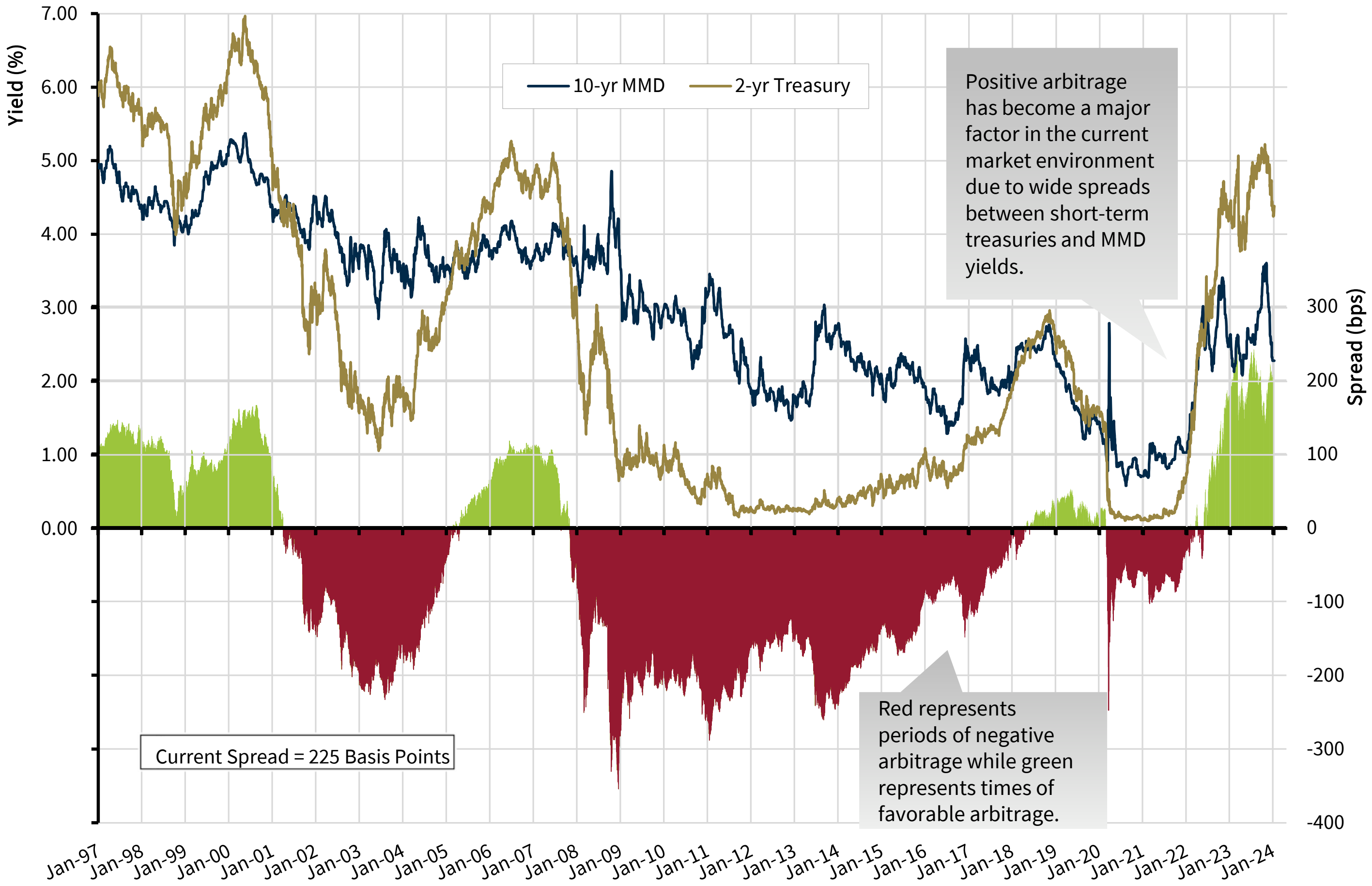
- The difference between the interest paid on your tax-exempt debt and the interest earned on any investment of the bond proceeds.

- Federal tax law restricts the yield that can be earned on the investment of bond proceeds to the bond arbitrage yield.

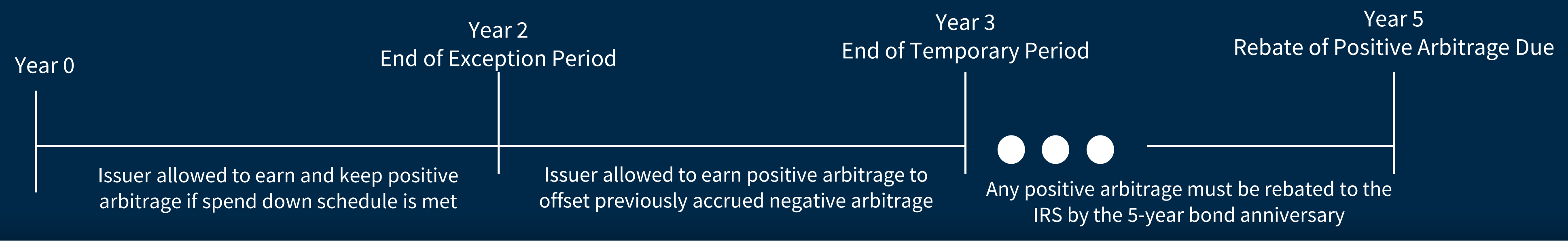
What is Arbitrage?

- Arbitrage in municipal bonds refers to the difference between the interest paid on tax-exempt bonds of an issuer and the interest earned in the construction fund when invested in securities like US Treasuries, interest bearing accounts, or money market funds.
- Federal tax law restricts the yield that can be earned by investing proceeds of an issuer's tax-exempt bonds to the bond arbitrage yield.

- Arbitrage can be caused in the market when the 2 year US Treasury Rate is higher than longer term tax-exempt rates (demonstrated below by 10 year MMD)
- The 2 Year UST would represent potential investment yields for issuers, while longer term tax-exempt rates demonstrate an issuer's potential arbitrage yield.
- Periods shown in red represent times when negative arbitrage is prevalent. Periods shown in green represent times when positive arbitrage is prevalent and issuers need to be concerned with earnings from an arbitrage standpoint.



Arbitrage and Rebate Basics



- Temporary Period (Usually 3-year capital projects) — Ability to invest bond proceeds at an unrestricted rate for 3 years after issuance of the bonds.
- Rebate — Computation should be conducted and if investment returns result in a higher rate than the arbitrage yield, the Issuer will owe the difference back to the U.S. Treasury after 5 years.
- Small Issuer Exemption —if Issuer issues less than $5 million in a calendar year then they are exempt from rebating any excess yield earned (Exemption increases to $15 million for School Districts).

1. **6-Month exception** requires the issuer to spend 100% of the proceeds within the first six months from the date of issuance.
2. **18-Month exception** requires the issuer to spend based on the below schedule:
   a) 6 months – 15%
   b) 12 months – 60%
   c) 18 months – 100%
3. **24-Month exception** requires the issuer to spend based on the below schedule:
   a) 6 months – 10%
   b) 12 months – 45%
   c) 18 months – 75%
   d) 24 months – 100%

Demand Deposit SLGS Overview

Feature	Demand Deposit SLGS
Issued As	One-day Certificate of Indebtedness
Maturity Length	One-day but they roll over automatically until redemption is requested
Interest Paid	Interest is capitalized every day on principal and prior accrued interest and paid at redemption
Interest Rate	Based on an adjustment of the average yield in the most recent auction of the 13-week Bill
Amount Offered	Minimum: $1,000 Maximum: None Does not have to be whole dollar amounts

Source: Treasurydirect.gov

- **What Are Demand Deposit SLGS?**
  - Variable rate securities backed by the full faith and credit of the U.S. government.
  - Have a maturity length of one day which are reinvested daily at the next day's rate.
  - Interest is reinvested and paid out upon redemption.
- **Procurement and Redemption Process**
  - Procured in the same manner as Time Deposit SLGS through the SLGSafe platform by the Issuer's paying agent.
  - Once purchased, the balance is automatically reinvested the next day until the Issuer asks its paying agent to submit a redemption request.
  - If withdrawing less than $10 million at one time, the Treasury only needs one business day's notice with the redemption request submitted through the SLGSafe platform.
- **Benefit of Demand Deposit SLGS**
  - Provides the Issuer with 24-hour liquidity similar to a money market account.
  - Allows the Issuer to potentially generate legally retainable positive arbitrage above the bond yield.
- **Considerations**
  - If the SLGS window closes while the Issuer owns Demand Deposit SLGS, the Demand Deposit SLGS will convert to a special 90-day certificate of indebtedness at the Time Deposit SLGS rate at the time of the SLGS window closure.
  - The Isser can still redeem the funds while the SLGS window is closed, but cannot reinvest or purchase new SLGS.

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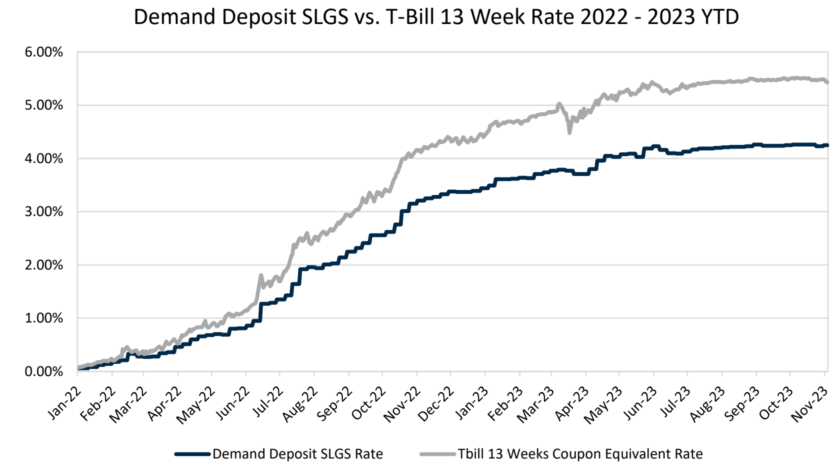
Demand Deposit SLGS Overview (Cont.)

- **Demand Deposit SLGS Pricing**
  - Priced off of the most recent 13-week T-Bill auction minus some spread.
  - Given these securities are priced at a level below the prevailing short-term taxable rate, these securities are treated like non-AMT tax-exempt municipal securities and are exempt from rebate.*
  - Current is 4.16%.
- **What Happens During a SLGS Window Closure?**
  - If the SLGS Window is closed while funds are invested in Demand Deposit SLGS, the Demand Deposit SLGS convert to normal Time Deposit SLGS with a 90-day maturity at the prevailing Demand Deposit SLGS rate at the window closure.
  - Even though the security is converted to a Time Deposit SLG, the Issuer is able to redeem this security early according to the Demand Deposit SLGS redemption rules without a penalty.



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Section 3

SAFE ACT OVERVIEW

What is the SAFE ACT?

- Created in 2001, the Security for Alabama Funds Enhancement Program ("SAFE Program") is established by Title 41, Chapter 14A, Code of Alabama 1975, as amended.

- It provides a uniform program for the security of public funds deposited with financial institutions in the State of Alabama, by:

  - Establishing an 8 member board to administer the program.

  - Placing certain requirements on financial institutions in Alabama who wish to qualify as a depository for public funds.

    - Requiring any bank or financial institution who accepts public funds to pledge eligible collateral to the State Treasurer for the SAFE collateral pool.

    - Requiring the entire SAFE collateral pool and each participating financial institution to stand behind each deposit.

  - Governing eligible securities for public funds.

Eligible Investments

For General Funds

- Eligible Investments for funds that are borrowed are generally governed by §19-3-120 and §19-3-120.1.

Eligible Investments	
Type	Details
Bonds or other interest-bearing obligations of the US government.	US must guarantee both principal and interest payments directly
Federal Land Bank Bonds	Bonds must be authorized under the Federal Farm Loan Act.
Bonds or other interest-bearing obligations of any state of the US.	
Certain GO bonds of any Alabama County	May not have been in default for the five years preceding the purchase of the bonds.
Certain GO warrants of any Alabama BOE	Code section says this must be secured by a pledge of a the three mill school tax, but also says it is a general obligation secured by the full faith and credit…

Eligible Investments

For General Funds (Continued)

- Eligible Investments for funds that are borrowed are generally governed by §19-3-120 and §19-3-120.1.

Eligible Investments	
Type	Details
Certain first lien real-estate secured obligations	Entire principal amount of the indebtedness must be controlled.
FDIC Insured Deposits	FDIC Provides $250,000 per depositor, per insured bank. Depositors may qualify for coverage over $250,000 if they have funds in different ownership categories.
Obligations of the African Development Bank	The ADB is a financial institution that funds projects that promote economic progress throughout the continent of Africa.

Eligible Investments

For Borrowed Funds

- Eligible Investments for funds that are borrowed are generally governed by §11-81-21. This Code Section was amended in 2022 by SB 178.

Eligible Investments		
Type	Details	Notes
Direct Obligations of the US Treasury	T-Bills, Notes, Bonds, and STRIPS, etc.	
Obligations of Certain Federal Agencies	• Farmers Home Administration • General Services Administration • US Maritime Administration • Small Business Administration • Government National Mortgage Association ("GNMA") • US Department of Housing & Urban Development ("HUD") • Federal Housing Administration ("FHA")	These obligations are included because each agency represents the full faith and credit of the United States of America.
US Dollar denominated deposit accounts and certificates of deposit	SAFE Act eligible checking accounts, CDs, money market accounts and other depository accounts.	Chapter 14A, Title 41 determines qualified public depositories.

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Eligible Investments

For Borrowed Funds (Continued)

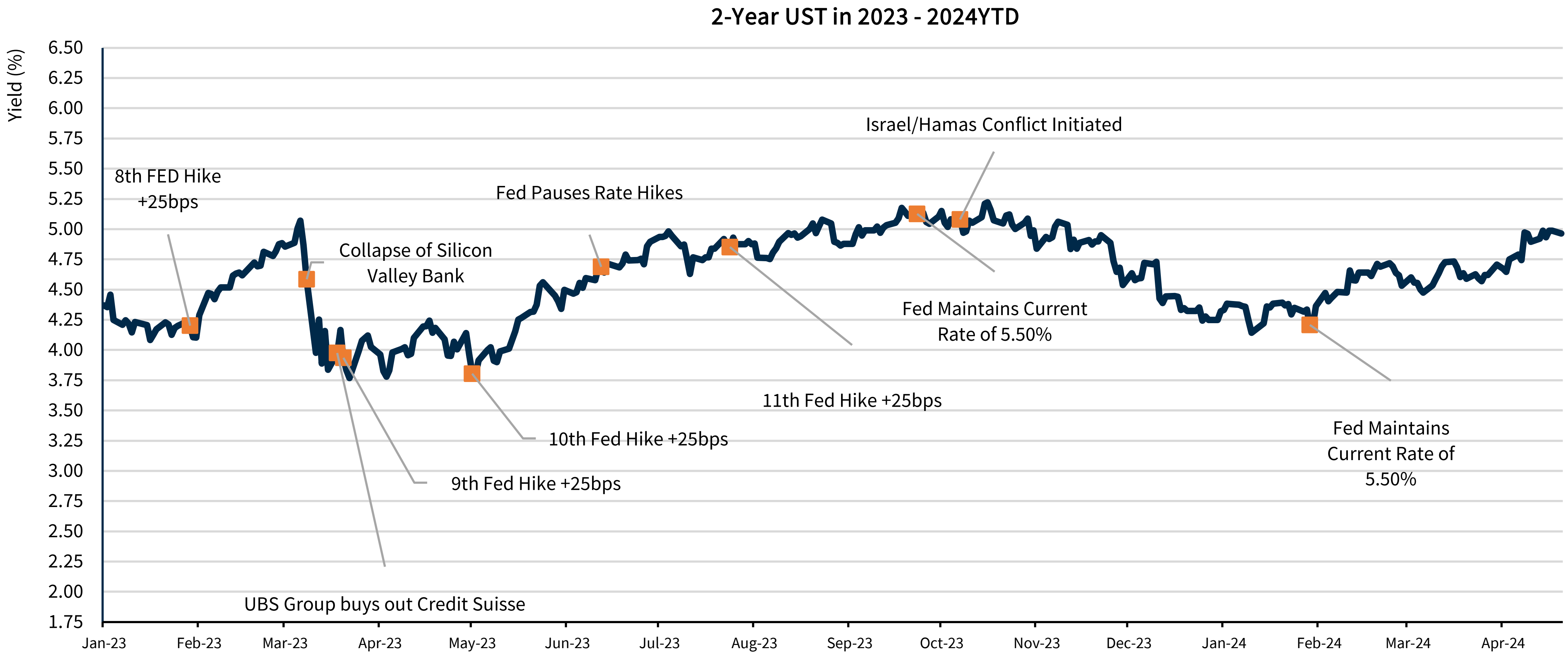
- Eligible Investments for funds that are borrowed are generally governed by §11-81-21. This Code Section was amended in 2022 by SB 178.

Eligible Investments		
Type	**Details**	**Notes**
Pre-refunded public obligations.	Obligations which have been refunded, are not callable, and are fully secured as to principal and interest by US Treasury Obligations.	"Pre-Re's" are bonds which have been refunded and have an established escrow for their repayment, which is invested in US Treasury Obligations.
Common trust or collective investment funds.	Pooled Investments are eligible under the SAFE Act as long as certain requirements are met at the pool level.	65% - In the first 4 types of investments above. 35% - FNMAs, FHLMCs, and other eligible agencies.
Municipal Bonds	Any bonds of the State of Alabama, bonds of any County in Alabama, and any bonds of any municipal corporation in Alabama.	Further clarified by the AG of Alabama to restrict to General Obligation Bonds, not Revenue Bonds.
Commercial Paper	Must have the highest credit rating at the time of purchase	Added from SB 178
Bankers Acceptances	A short-term issuance by a bank which guarantees payment at a later time.	Added from SB 178

Section 4

CURRENT MARKET YIELDS & PROCESS

Short-Term Rates Remain Close to Recent Highs



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Rate forecast

The Bloomberg consensus of economists predicts that rates will begin to steadily fall towards the end of Q2 this year.

Economist Consensus

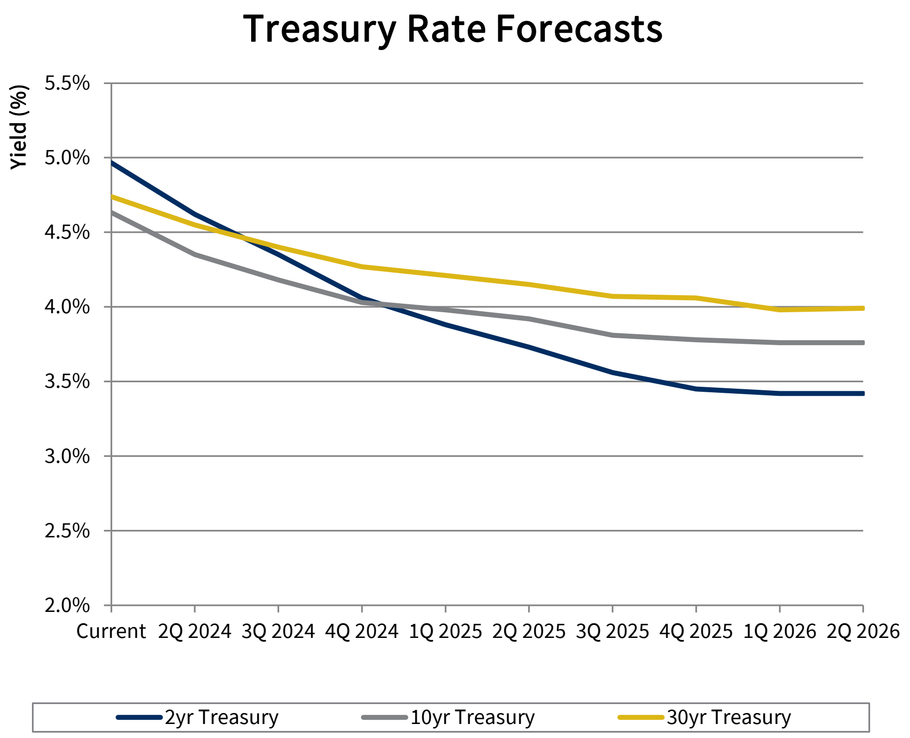
US Treasury	Current Rate	2024 Q2	2024 Q3	2024 Q4	2025 Q1	2025 Q2	2025 Q3	2025 Q4	2026 Q1	2026 Q2	Change from Current Rate to 2026 Q2
2 Year	4.97%	4.62%	4.35%	4.06%	3.88%	3.73%	3.56%	3.45%	3.42%	3.42%	-1.55%
Economists Surveyed		42	42	43	41	38	35	36	23	21	
10 Year	4.63%	4.35%	4.18%	4.03%	3.98%	3.92%	3.81%	3.78%	3.76%	3.76%	-0.87%
Economists Surveyed		47	47	50	46	42	39	42	27	25	
30 Year	4.74%	4.55%	4.40%	4.27%	4.21%	4.15%	4.07%	4.06%	3.98%	3.99%	-0.75%
Economists Surveyed		35	35	35	35	32	31	32	23	21	

*Source: Bloomberg as of April 22, 2024.

Bloomberg Consensus

	Current Rate	2024 Q2	2024 Q3	2024 Q4	2025 Q1	2025 Q2	2025 Q3	Change from Current Rate to 2025 Q3
Real GDP	3.40%	1.50%	1.30%	1.50%	1.80%	1.90%	2.00%	-1.40%
Consumer Price Index	3.50%	3.30%	3.00%	2.90%	2.60%	2.40%	2.30%	-1.20%
Unemployment	3.80%	3.90%	4.00%	4.10%	4.10%	4.10%	4.10%	0.30%
Fed Funds Target	5.50%	5.45%	5.20%	4.90%	4.55%	4.30%	4.05%	-1.45%
3-month SOFR	5.32%	5.24%	5.02%	4.68%	4.38%	4.09%	3.87%	-1.45%

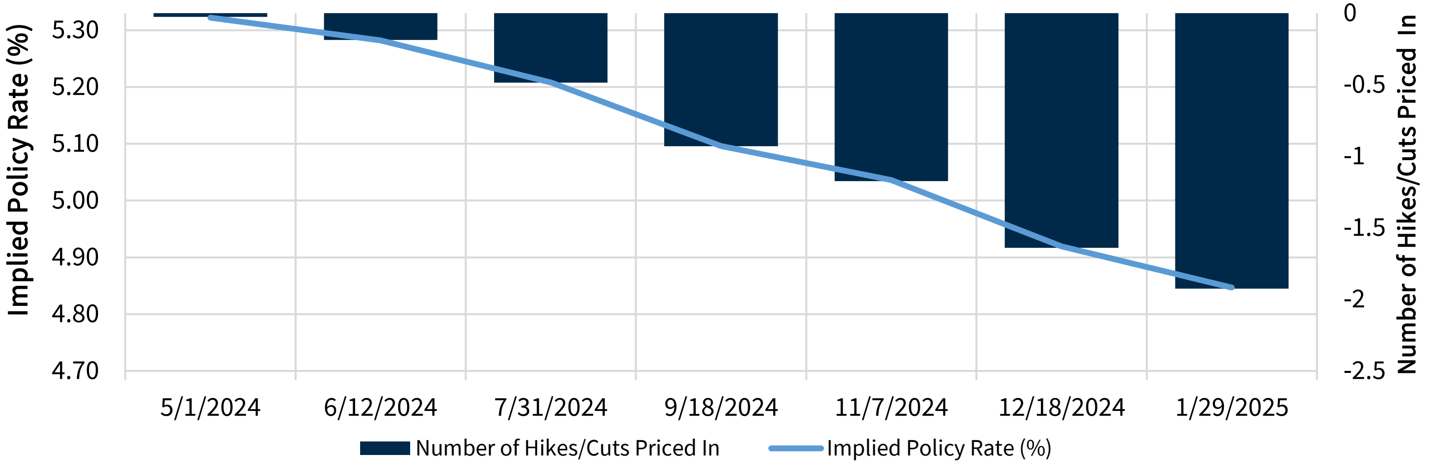
*Source: Bloomberg as of April 22, 2024.



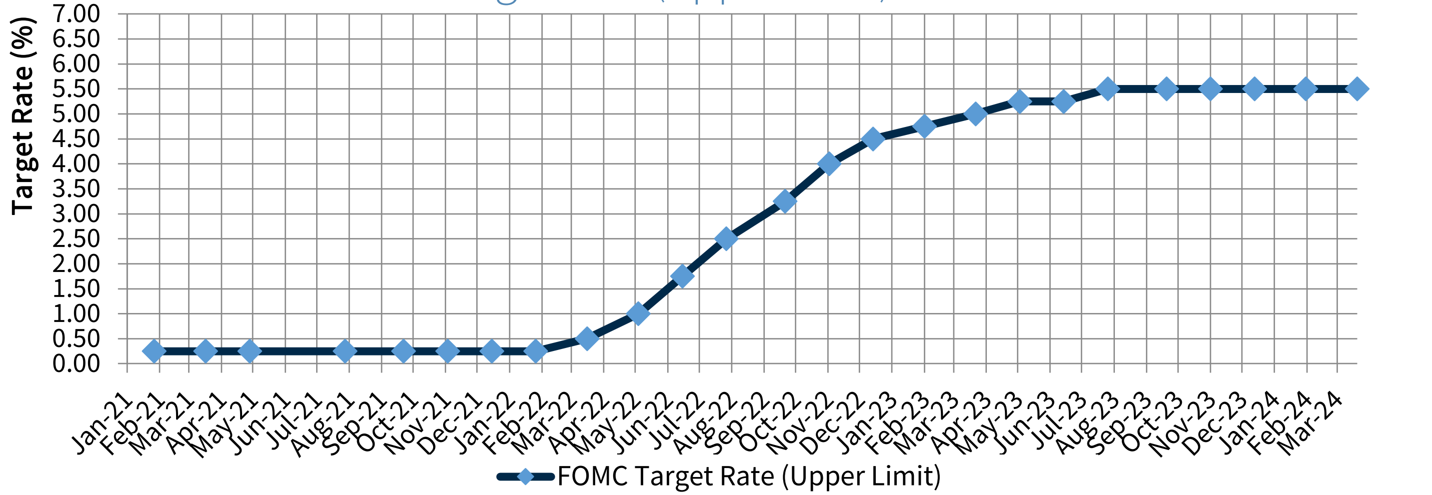
FED Funds Rate

The June 2023 FOMC meeting halted 10 consecutive rate hikes since the beginning of 2022. However, in July 2023 the Fed increased Fed Funds rate by 25 basis points. The September 2023 FOMC meeting paused rate hikes and continued this trend through the November, December, January, and March meetings.

Implied overnight rate & number of rate hike/cuts



FOMC target rate (upper limit) since 2021



Source: Bloomberg as of April 22, 2024

Process Overview

1. Determine What Funds You Might Want to Invest & Consider When You Might Need Liquidity
2. Raymond James Structures Cashflow Needs
3. Set Up & Fund Custodial Account that Will Hold Securities
4. Draft Term Sheet Sent to Potential Bidders
5. Receive Bids & Raymond James Confirms Bids are Conforming
6. Award Bid
7. Raymond James Works with Bidder to Ensure Settlement of Securities

Questions / Session Review

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QR Code For Session Review

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