Prior Lake - Savage Area Schools (PLSAS) Background on Planned Debt Structure for Proposed Building Bonds

The Prior Lake-Savage Area School Board is considering a referendum that would include a request for voter approval of bond funding for construction projects. A standard part of that process includes working with the district's financial advisors, Ehlers, on exploring options to structure the debt based on the district's unique circumstances.

After reviewing different options with Ehlers, the School Board agreed to pursue a combined approach that uses two different types of bonds, with payments "wrapped around" existing debt. The benefits of this approach:

- The tax impact in the early years is substantially lower than if only one type of bonds were used.
- The resulting tax impact of the new debt increases at the same time prior debt is being paid off, thus reducing the net impact of the increase.
- It helps level off the overall tax impact of all of the district's debt on taxpayers over the term of the bonds.
- The higher-interest rate bonds mature first, thus reducing their long-term impact on total cost.

When packaged and used judiciously, this combined approach enables growing districts with high existing debt to spread payments over both time and a growing population.

<u>Additional detail on the bonds being used</u>

There are two primary forms of municipal bonds that school districts can use to finance major capital projects – current coupon bonds and capital appreciation bonds. With both types of bonds, there are usually a series of "maturities," with potentially a different interest rate for each maturity. With either type of bond, the district will be selling fixed-rate bonds. Once the bonds are sold, the interest rates and payment schedules are fixed for the life of the bonds and payments will never increase. It is likely that the district will have an opportunity to reduce payments at some future date by refinancing the bonds at lower interest rates.

Current Coupon Bonds

- Bonds are issued in $5,000 increments; purchasers pay (and district receives) approximately $5,000 for each bond.
- District pays interest to all bondholders every six months until maturity.
- At maturity, district repays bondholders the face value of $5,000 for each bond.
- This type of bond accounts for over 90% of building bonds issued by Minnesota school districts.

Capital Appreciation Bonds (CABs)

- Bonds are issued in face value of $5,000 each; purchasers pay (and district receives) a discounted price, reflecting the present value of the $5,000 payment at maturity.
- District pays no interest on the bonds until they mature; interest is "accreted" and added to the original principal amount every 6 months.
- At maturity, district pays bondholders $5,000 per bond, including the original principal amount plus the accreted interest.

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- This type of bond allows districts to postpone payments further into the future, and is most often used by growing school districts with relatively high existing debt, like PLSAS.
- This type of bond allows districts to reduce the impact on taxpayers and shift more of the payments to the years after the existing debt is paid off.
- CABs carry higher interest rates than current coupon bonds of the same maturity; difference varies based on market conditions and maturity schedules, but is often between .25% and 1.00%.

At the June 26 meeting, Ehlers presented two debt structuring options to the Board. Option 1 included current coupon bonds only, and Option 2 included a combination of current coupon bonds and CABs. Option 2 reduced the tax impact of the bond issue in the first three years by almost 40% by delaying some payments until later years. The tradeoff is that it increased total estimated tax levies for the bonds over all years by an estimated $9.4 million, or 5.8%. The Board selected Option 2.

Option 2 has since been adjusted to account for the final list of projects agreed to by the Board. The adjusted plan includes $45.5 million of CABs and $63.8 million of current coupon bonds.

There have been some well-publicized national stories about financial problems resulting from school districts issuing CABs. Most of these stories occurred in California, where some districts issued CABs with a single maturity 30 or more years in the future, which results in a total cost many times greater than the amount borrowed. Furthermore, some of these districts had no concrete plans to raise the funds to make the payments on the CABs.

The proposed use of CABs by PLSAS is very different from these stories.

- Because CABs carry higher interest rates than current coupon bonds, the plan is structured with the CABs maturing first – in 2022-31 – and the current coupon bonds maturing later. This limits the additional costs resulting from the higher interest rates and the accretion of interest on the CABs.
- As required by Minnesota law, when the district sells the bonds, it will set tax levies equal to 105% of the principal and interest payments on the bonds for all years. This ensures that the district will have sufficient funds to make all payments on the bonds.