Best Practices for Cash Flow Borrowing for School Districts

Many school districts across Wisconsin engage in a process called cash flow borrowing each year. Given the cyclical nature of state aid and property tax revenues and the consistency of expenditures throughout the fiscal year, it may become necessary for a district to borrow for working capital. Districts are authorized under WI Statute 67.12(8)(a)1 to borrow money and issue tax and revenue anticipation promissory notes (TRANs).

HOW DOES A DISTRICT DETERMINE THE APPROPRIATE AMOUNT TO BORROW?

Cash flow forecasting plays an integral role in determining the funds necessary for districts to maintain sufficient liquidity during a given time period. The Government Finance Officers Association (GFOA) describes a cash flow forecast as an "estimate of cash receipts and disbursements (together, cash transactions) during a given time period. When used as a cash management guide, it can lead to the optimized use of funds as well as insure sufficient liquidity."

The GFOA recommends that districts consider the following when undertaking cash flow forecasting:

- All operating departments should be involved in developing reasonable expectations of timing and amounts of planned expenditures.
- The district's goals should drive the prioritization of expenditures. Further, fixed items such as payroll, employee benefits, insurance and debt service should have priority of cash demand over discretionary expenditures.
- Historical data should be used to measure activity of a cyclical nature, both for receipts and disbursements.
- Cash flow forecasts should be used to recognize the items and controls that influence the district's cash position. Districts should develop strategies to implement effective and efficient cash management techniques such as collecting receipts as soon as possible and managing disbursements judiciously.
- Forecasts should be made conservatively. Fluctuations may occur in both receipts and disbursements for a variety of reasons. The level of precision required in a forecast or tolerance for variance should be determined at the organizational level and not on an ad hoc basis.
- Forecasts should be updated on a regular basis, for example, monthly. The frequency of such updates is determined by the volatility of revenues and expenditures. Daily monitoring and recording of actual revenues and expenditures by major categories can greatly enhance the district's ability to prepare timely updates to the cash flow forecast.

Additional information related to cash forecasting is available at: http://www.gfoa.org/cash-flow-forecasts-treasury-operations.

ONCE A CASH FORECAST IS COMPLETE, HOW DO I DETERMINE THE ALLOWABLE BORROWING AMOUNT?

Federal law allows school districts to determine a borrowing amount and comply with rebate requirements of the tax code based on two calculations. First, the district must identify the working capital deficit. This figure is a cumulative deficit calculated at month end or on a weekly breakdown of projected cash position. The district can then add a reasonable working capital reserve (not to exceed 5% of prior year's actual working capital expenditures). The total equals the maximum permissible borrowing amount.

Districts that are issuing more than $5,000,000 for cash flow purposes or more than $15,000,000 of tax-exempt obligations during the calendar year must also comply with "safe harbor" provisions in order to be exempt from the rebate requirements of the Code. To comply, the district must have a cumulative cash flow deficit that is greater than 90% of the principal amount of its cash flow borrowing within six months of the date of issuance of the notes. School districts that have questions or concerns related to legally allowable borrowing amounts should contact bond counsel for advice prior to TRAN issuance.

WHAT OTHER FACTORS SHOULD DISTRICTS BE AWARE OF BEFORE CASH FLOW BORROWING?

Rating agencies, underwriters and investors analyze a number of factors related to cash flow borrowing when evaluating the issuance. The most common item reviewed is related to the practice of "rolling notes." Historically, many districts have issued tax and revenue anticipation notes that close prior to the maturity of the previously issued notes. In most cases, the district has sufficient cash on hand to repay the prior series before the new series is issued. Districts that do not have sufficient cash on hand for repayment are engaging in a practice called "rolling notes." This practice can have a significant impact on both the district's short and long term rating and may deter potential investors. Districts should do everything possible to refrain from rolling notes on an annual basis.

Other factors that are reviewed prior to TRAN issuance or purchase may include:

- Cash balance/receipts at time of repayment
- Predictability of revenues
- Timing of receipts
- Amount borrowed/receipts
- Reliability of beginning cash balance (typically compared to audited cash balance figures)
- Accuracy of past projections (previous year projections compared to actuals)
- Reasonableness of future projections
- Noteholder legal protections/segregation of funds

Additional detail related to these factors can be found in Moody's Investors Service's *Short Term Cash Flow Notes* Rating Methodology and Standard and Poors' *U.S. Local Government General Obligation Ratings: Methodology and Assumptions*.

WHAT ARE THE POTENTIAL FUNDING SOURCES?

Borrowing practices certainly vary across school districts and include issuance of TRANs, a line of credit with a local financial institution, or entering into a borrowing agreement with a local municipality. Determining which method is appropriate may depend on market conditions, as well as the school district's particular borrowing needs. School districts that are contemplating cash flow borrowing should contact their financial advisor for details related to borrowing options, challenges and opportunities.

For information related to cash flow borrowing, please contact **Michele Wiberg**, *Managing Director – Wisconsin Public Finance* or your WISC Portfolio Advisor at 1-800-783-4273.