

**BOARD FINANCE COMMITTEE MEETING MINUTES  
OCTOBER 6, 2008**

Members of the Board Finance Committee met on Monday, October 6, 2008, in the Dining Room of the Education Center, at 1516 Sycamore Street, Bethlehem, PA. Mr. McKeon, Chairperson, called the meeting to order at 6:30 p.m. The following school board members were present: Mrs. Michele Cann, Mrs. Judith Dexter, Mrs. Irene Follweiler, Mrs. Loretta Leeson, Mrs. Charlene Koch, Mr. Rosario Amato, Dr. Craig Haytmanek, and Mr. Benjamin Tenaglia. Also in attendance were Dr. Joseph A. Lewis, superintendent of schools; Mr. Stanley J. Majewski, Jr., assistant to the superintendent for finance and administration; Mr. Thomas Washington, assistant superintendent for human resources; members of the press and other interested citizens.

**COURTESY OF THE FLOOR** – Mr. Thomas Miller of 141 East Market Street, Bethlehem. He stated that he retired from the Banker's Trust Company twenty years ago as derivatives were making their way into the banking system. He is aware of their complexity. Sophisticated financial vice presidents of leading corporations apparently did not understand them or they were misrepresented. Bankers Trust Company was sued several times and generally settled out of court on these derivatives or credit swaps, whatever you want to call them.

About a year ago, Reading School District sued the financial people who sold them the swaps. He believes the onus is on the financial people to make sure there is full disclosure. The swaps are very complicated. The financial people should have some proof that they have shown a spread sheet to the people involved, showing the risk curve so that people actually knew what they could get into as far as losses were concerned. He asked if the district has given consideration to cutting the losses, getting out of the swaps. It can be done.

He referred to the current government bailout legislation in Washington and stated that most people do not know the government will be buying not only sub-prime mortgages, but the liabilities on the soured swaps. The citizens of this country are bailing financial organizations out that went into swaps that turned against them. He stated that we just have a miniature degree of risk.

Mr. Stephen Antalics of 737 Ridge Street. Mr. Antalics referenced gambling, and pretending to be able to foretell the future. He stated that the citizens of Bethlehem understand that the district had a loan based on upon a rate which was fixed and would not change. He chastised the administration for gambling with citizen's money.

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Mr. Antalics further stated that the administration gambled and lost rather than staying with fixed facts. He asked who would pick up the expense. He went on to say that the people who created this problem are getting away scot-free, and asked who will pay the price for bad judgement in Bethlehem?

Mr. Albert Gerra, 2702 Bockman Drive, Bethlehem. He stated finance was his life. He retired from Wall Street. He use to structure derivative swaps. When a salesman came in with a transaction, he would ask if there was competition. If there was no competition, the client suffered. He stated the transactions should not have been negotiated, but done competitively; however, that is hind sight.

If we go forward with bond offerings, derivatives, swaptions, anything like that, three counter parties should be contacted to get the best price. By not taking a competitive bid, you are taking the taxpayers dollars and giving it away to the counterpart. He referenced a Bloomberg article about one of the transactions that stated the fee was about ten times more than it should have been.

Things will get better, we should not panic. There will be a time to get out of these transactions, but this is not the time. He asked to have the details of the transactions put on the BASD website, and offered to analyze them for the district without charge.

**SWAPS AND DEBT DISCUSSION** – Mr. Majewski stated that the following Financial Advisors are in attendance to assist the board in making thoughtful choices with regard to the current situation involving swaps and the district's debt.

He introduced John Frey and Scott Shearer from Public Financial Management (PFM), and Steve Goldfield from Public Resource Advisory Group, (PRAG). Mr. Majewski stated that they are very experienced and knowledgeable in this area, and he believes they will help the board to better understand the transactions, what types of transactions Bethlehem has. In addition to get a better understanding of the market and some of the impact the market has on the district's transactions in order to discuss options.

A market update handout was distributed to the committee.

Mr. Goldfield stated that this presentation will be an open dialogue, and asked if there are specific questions. Hopefully they would have the answers with them. If not, they would get back to the committee.

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Mrs. Leeson stated that she would like to review exactly what the district has.

Mr. Goldfield reviewed the happenings that led to the current market state. He discussed variable rate bonds. Variable rate bonds are tax exempt weekly rate floaters. Due to the credit crunch, the variable rate market froze up. Up until this time the index had been very low, it averaged about 1.7 percent. It shot up from normal ranges to approximately 8. percent. Currently the district has six outstanding bond issues. Four of them have underlying variable rate bonds.

Mr. Tenaglia asked that the issues be identified.

Mr. Shearer replied that they were the 2003 Notes issued through the West Cornwall Township Municipal Authority, the 2005 issued through Bethlehem, 2007 Bethlehem issued, and 2007 issued through the Shippensburg Borough Authority. When adding up those four issues, the district has about \$200,000,000 of this variable rate exposure that resets off this index.

Mr. Shearer stated that the rates are beginning to come down. The underlying problem is that the markets are out of whack right now. It is not anything that anyone could have anticipated, and it is not something to structure a deal on for the next thirty years.

Mr. Goldfield described, in depth, what a Basis Swap is by using a PowerPoint presentation.

Mr. Amato stated that we are fortunate that we have fixed rate bonds and not variable.

Mr. Goldfield replied that we have variable rate bonds outstanding. The district has what is called a synthetic fixed rate. The synthetic is that we pay 3.8 percent and that is fixed, but we also have to pay the difference between what JP Morgan pays, and what we owe to the bond holders. He explained if the liquidity goes up the fixed rate goes up.

Mrs. Leeson questioned if the district has renewal liquidity risk?

Mr. Goldfield stated that the district has a five year renewal. This is very valuable for the district right now.

Mr. Tenaglia asked what our actual cash outlays were on both the variable rate for September on any of the three issues, and what we received on the Swaps to give us a net interest cost.

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Mr. Goldfield replied that they did not. They did not have the trustee's monthly statements. They were looking on a more global basis as to what the strategies were. September was not a good month for the district.

Mr. Shearer stated that the average variable rate for the month of September was 4 percent to 4.75 percent.

Mr. Tenaglia asked why the consultants thought there would be any significant change for the variable rate during the next few months.

Mr. Shearer replied that it is all based on the SIFMA Index. Depending on where SIFMA is resetting for October, there will probably not have low rates as in the month of September. The rate may be 6 percent to 7 percent if things do not start to come down to a more normal level. The rate is based on the SIFMA Index.

Mr. Goldfield stated that we do not know whether the variable rates are going to come down or not, and whether the district's Remarketing Agent is going to set the bonds closer to SIFMA. There are things to discuss with the board to try to manage the situation better, and there are things that there is no control over.

Mr. Amato asked if the district had never entered into Swap Agreements would the rates be different.

Mr. Goldfield replied that the rates would be higher because the district would have taken on various tax risks. We would have had a taxable index versus a tax exempt obligation. The district would have been paid in a reduction of the interest rate on the fixed rate of the Swap.

Discussion on whether the district would have been better off if they had not gotten into Swaps followed.

Mr. Amato stated he would like to see the figures if the district had not gone into Swaps and compare them to the figures as a result of the Swaps.

Mr. Shearer stated that the board will have to decide what road to take regarding the Swaps. The district's business is education; it should not have to worry about the market. If the district can tolerate it from a budget standpoint, a mileage faze in standpoint, maybe it would be better off.

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He stated that the district should not panic as there have been others worse off. The district can decide going forward to convert the Swaps to fixed rate deals. It will result in mileage increases. The district would have to purchase bonds at the termination value, but would borrow at a lower fixed cost so that the termination value is not going to be a penalty for how much was lost.

Mr. Shearer stated that various options will be presented for the board to decide what would be best.

Mr. Amato asked if the consultants would provide an analysis of both, if the district stayed conservative with Fixed-Rate financing versus Variable-Rate financing with Swaps.

Mr. Goldfield suggested the board take its time, get the analysis that is needed, and decide as a board where the district wants to go. The consultants will help decide how quickly the district can get there, and what needs to be watched. Until the time that the rates are palatable.

Mrs. Dexter asked for a better understanding of the presentation. What are we doing, there are two firms providing information, and a third is in the audience asking to speak?

Mr. Goldfield responded that both firms were asked to come in and provide some guidance regarding the Swaps and the district's debt situation. They are doing so pro-bono. It will be the board's decision whether to hire one or both of the firms.

Mr. Amato asked if the two firms have worked together. He was told that they are competitors and have never worked together before.

Mr. Shearer stated that some districts prefer to have two sets of financial advisors.

Mrs. Dexter asked what is the goal of the presentation.

Mr. Goldfield responded that it is the goal of this presentation to provide some solutions to board.

Mrs. Cann asked if the bond holders expect less than JP Morgan pays does the district pay less too?

Mr. Shearer replied that this was the case. At times, the cost was below the rate that was locked in. On average it is about the same. Right now there is a severe dislocation in multiple markets.

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Mr. McKeon stated we have two issues, one long term which is what is being addressed now, and we have a short term spike in interest which will have a severe impact on our budget. Theoretically, we are paying almost double what we have budgeted. We have to figure out where do we make the cuts in our budget to withstand the increase in the interest expense. We cannot not pay it. We can curtail other expenses.

Mr. Shearer stated that while there are long term solutions needed to be analyzed, there are also short term solutions to try to stop some of the losses. Some things can be done quickly.

Mr. Goldfield stated which ever firm is hired, the district should ask for budget impact.

Mrs. Leeson stated the state legislators have restricted how much we can charge basic millage rate. We are restricted to the cost of living. If we want to go beyond that, we would have to go to referendum. The probability the referendum would succeed is low. We do not really have the ability to just go out and tax.

Secondly, what we gained has been spent, even more than that has been spent. We are in a negative position. We have had to take out a TRAN Loan to pay our bills this summer. Our cash position is very poor.

We have cut \$6.5 million dollars out of our budget this year. Our financial position is a little more restricted.

Mr. McKeon called on the representative from RBC, Dan Burton, Director of RBC.  
Mr. Burton stated that he feels he should tell the board what is going on in the market.

RBC acquired Ferris Baker in June of 2008. The owner of FSA who insures our bonds is Dexia. Dexia received a \$6.5 billion loan from the Belgium government. They could not have continued to function without the loan. We are in the midst of a world-wide calamity of unprecedented proportions.

The institutional market does not believe FSA or Dexia is a viable entity. We cannot sell any FSA or Dexia paper at any rate at the moment. If the bonds cannot be re-marketed, they have to be put to Dexia to draw upon their standby bond purchase agreement. That rate is prime plus one. RBC is very concerned about FSA and Dexia's long term position since the district's entire \$222 million variable rate bonds are FSA/Dexia. This will put the district in a position where the rate will stay at 6 percent no matter what happens to SIFMA. He believes their is a clock is ticking quickly.

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Much discussion followed regarding FSA/Dexia, and how much time does the district have to make a decision.

Mrs. Follweiler questioned if no one is willing to buy FSA/Dexia paper, the district could essentially have to pay all \$220 million immediately.

Mr. Shearer stated that it would not have to be paid immediately. The district has to get prepared for a decision with respect to three deals in this situation.

Mrs. Follweiler asked if the consultants agreed that the worst case scenario would be the bank bond.

Mr. Goldfield replied that there are two quick solutions, either get a Letter of Credit which is costly, or go out and do a Fixed-Rate Bond Issue.

Mrs. Cann asked how a Letter of Credit would replace the need for a Fixed-Rate Bond.

Mr. Goldfield explained that a Letter of Credit gets broken down into two pieces; one is Dexia liquidity. If someone tenders the bonds on seven days notice, they will buy it just like Dexia would. The other is credit enhancement. That is what FSA gives. FSA gives AAA. A lot of people looked at Letter of Credit, liquidity, and Swap termination. A client of PRAG was paying 14 percent and got an FSA commitment that was pretty inexpensive, and early on when FSA was the only game in town, they chose to terminate their Swap, paid a \$90,000,000 Swap termination fee and issued Fixed-Rate Bonds.

Mrs. Dexter requested a five minute break.

Mr. McKeon adjourned the meeting for a five minute break.

The meeting reconvened at 8:50 p.m.

Mr. Goldfield stated that he thinks the next steps are to decide whether the committee wants one, or multiple firms working for them. It should be decided how the board wants the advice delivered to the public, and by whom. It should be determined what kind of reports the board would like to see.

It is his feeling the best way is for the consultants to show the board what they have done for other clients. There should be dialogue back and forth.

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The consultants would help the board to set objectives and goals. They would provide weekly reports, and have marching orders on how and when to start implementing when the market is correct.

Mr. Amato asked what type of proposals would be given.

Mr. Shearer stated that there are short term solutions that can be implemented rather quickly. He would like to come back as soon as possible, listing goals and objectives, long term items, and short term items. He stated that the first line of defense is to deal with the debt side.

Much discussion followed with regard to ways to proceed.

Mr. Goldfield stated that this should not be a crisis driven decision, but the administration should not deliberate for too long a period. Think about the options, and think about which of the options should the district execute, and what will have to happen to do so.

Mrs. Leeson stated the criteria from the board is that the district wants to stay solvent. The district might not have enough time to look at all the strategies.

Mr. Shearer stated we should start preparing the official statement so that it is ready if the market gets worse.

Mr. Amato stated that in order for the district to move forward the consultants have to come back to the administration with the options.

Mrs. Dexter asked what do the consultants see as a logical next step, and what time frame do they recommend for the committee to get together as a board to consider all of the things that may need to happen for the authorization of the financial advisor to do certain things, and the selection of a financial advisor, as well as the cost.

Mr. Goldfield responded that the administration should get the team on board as soon as possible. That is the most crucial. Consult with legal counsel, consult with the business office, come back to the board, make the recommendations, and start getting plan b, and plan c, and plan d going. Keep watching the market closely, keep following it, and keeping in constant dialogue with everyone to be able to make a decision as to what needs to get done.

Mr. Frey stated that all of the Swaps cannot be handled at once. You might need to do two or three different plans.

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Dr. Lewis stated that he and Mr. Majewski have a lot of confidence in the three consultants, and would recommend a team effort. He asked what the cost would be, and would a week be adequate time to come back to the board.

Mrs. Leeson asked if they would put what the cost would be in their proposals. She asked if there was a way to accept the proposal via e-mail and ratify it at a board meeting.

Discussion ensued with regard to the timeliness of hiring the consultants.

Dan Burton stated that the markets are so frozen you would not be able to do anything before next Monday. He recommends that the board hire a financial advisor.

Mrs. Follweiler stated that she has heard throughout the evening the “do not panic mode.”

Mr. Goldfield stated that the administration should move forward so that they will be ready to move.

The consultants left the meeting to discuss what their fees would be.

**FISCAL YEAR UPDATE** – Mr. Majewski estimated the additional cost of what we normally spend is about \$250,000 a week if the interest rates remain high. Mr. Majewski stated that we are solvent, and will have the cash to pay the bills for many months.

Mr. Majewski had anticipated having \$2.2 million more in revenue than we have right now. The timing of receipts is not what it has been. Another issue he is certain about is investment income. Interest rates are less than half of what they were last year. We were getting 4.4 percent last year on our investments. We are now getting 2.2 percent. We have changed our strategy and locking in with CD's. The CD's are within the 3, 3.1, 3.2 and 3.3 percent. We are hearing that the weakening in the economy will have interest rates dropping down. We will do the wise thing right now and anticipate another drop. We will try to lock in the best we can at some multiple month longer term issues.

Mr. McKeon stated that we have to look to start to cut expenses.

Mrs. Leeson stated we have an increase cost in the debt service, and we are down in our investments by \$1.2 million doll. Mr. McKeon is suggesting that we start making more cuts. She asked if that was where we are now.

Mr. Majewski stated he would appreciate guidance from the board as to what areas to make cuts is acceptable to the board.

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Mrs. Leeson stated she felt that the administration should make the recommendations to the board.

Mr. Majewski stated that if the administration knows what cuts are totally out of line it would save time rather than to go back and forth.

Dr. Lewis suggested that the administration make a lengthy list, and present it to the board.

Mrs. Cann suggests prioritizing the list.

Mrs. Koch stated that the cutting of transportation will more than likely affect the low income families.

Mr. Tenaglia questioned several expenditures.

The consultants returned to the meeting.

Mr. Shearer stated the consultants have come up with a not to exceed amount per firm of \$5,000. This would include both of them looking at the short term issues, and possible short term solutions, as well as the long term issues and long term solutions.

Mr. McKeon asked if there were any questions.

Mrs. Leeson stated that she feels that \$10,000 is a lot of money.

Mr. Shearer stated that he expects that the analysis and the help given will enable the district to save enough money so that their fees are not as big of a concern.

Mrs. Leeson stated that she wanted to thank RBC for alerting the district that there was a problem. She also thanked Mr. Majewski for getting everyone together. She also thanked the board for all of their efforts tonight. She stated that she appreciates it.

Mr. McKeon asked for a consensus from the committee as to whether to move forward.

The committee agreed to move on.

Dr. Lewis stated that the consultants could start the analysis.

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**AGENDA ITEMS** - The two agenda items authorizing the expenditure of 2007 bond funds for networking equipment at Broughal Middle School and Liberty High School will appear on the October 20, 2008, Regular Board Agenda for approval.

There was a discussion on whether to keep the committee meetings scheduled for October 13, 2008 on hold.

Mrs. Leeson suggested keeping the Curriculum Committee and Human Resources Committee to a half hour combined, have another Finance Committee Meeting, and move on to a Special Board Meeting.

The committee agreed to combine the Curriculum Committee and Human Resources Committee Meetings.

There will be a special Finance Committee Meeting at 6:30 p.m., and a Special Board Meeting at 7:00 p.m. on Monday, October 13, 2008.

Mr. McKeon adjourned the meeting at 10:17 p.m.

Minutes prepared by:

Confidential Secretary to the Assistant to the Superintendent for Finance  
and Administration