BOARD FINANCE COMMITTEE MEETING MINUTES
NOVEMBER 24, 2008

Members of the Board Finance Committee met on Monday, November 24, 2008, in the Dining Room of the Education Center, at 1516 Sycamore Street, Bethlehem, PA. Mr. Eugene McKeon, Chairperson, called the meeting to order at 6:03 p.m. The following school board members were present: Mrs. Michele Cann, Mrs. Judith Dexter, Mrs. Irene Follweiler, Mrs. Loretta Leeson, Mrs. Charlene Koch, Dr. Craig Haytmanek, Mr. Rosario Amato, 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; Mrs. Anne Morton, assistant director of business affairs; Mr. Scott Shearer from Public Financial Management; Mr. Jens Damgarrd from Rhoads and Sinon; members of the press and other interested citizens.

COURTESY OF THE FLOOR Mr. Steven Antalics stated his concerns with Courtesy of the Floor being held at the beginning of the meeting.

Lori Stom of 525 W. Union Boulevard, Bethlehem, PA, 18018. Ms. Stom is a classroom teacher at the SPARK Pre-Kindergarten Program. She stated she would like to share information with the board regarding the program.

DISCUSSION OF CURRENT BOND ISSUES – Mr. Jens Damgarrd introduced himself and gave a brief presentation regarding his position as an attorney with Rhoads and Sinon. His area of expertise is in finance law. His firm represents over 100 school districts throughout the commonwealth, and hundreds of local government units that are borrowing money for various public projects. He has the experience to assist the board in their current situation. There are a lot of different options for the district to consider. The documentation that is required is something that he has drafted in many similar situations. He stated that it will be a pleasure to act as the district's bond counsel.

Mrs. Dexter asked how much response time he would have if a call is made? Does he have backup for himself if he is out of town? How does his firms fees compare with other firms?

Mr. Damgaard stated he is one of seven attorneys within his firm. If he is not available one of the others would be available whenever the district feels it would be appropriate. He stated they like to come meetings where there is important discussions being held. Many times they will have a Resolution prepared for the board's consideration for adoption. Someone will be at the meetings.

With regard to fees, they are traditionally on a flat fee basis. It is two components. They would quote a fixed fee per transaction. They can also bill at an hourly basis. An engagement letter would outline how the fees would be charged.

Mr. Scott Shearer reviewed a packet which was given to the board. He reviewed the districts debt service. The majority of the district's bonds are in a variable rate mode.

Mr. Amato asked Mr. Shearer to explain what is remarketing and FSA insurance.

Mr. Shearer stated that RBC Capital markets are Remarketing Agents for all the bond issues. They are supposed to be remarketing, finding new buyers every week for these issues. The variable bonds are basically seven day bonds. RBC has to find new buyers every week. If they cannot find a buyer per the Standby-Purchasing Agreement, DEXIA steps up to the plate, and they then buy the bonds from RBC. FSA was a very solid insurance firm. Moody's has downgraded them.

If the school district cannot make their payments, FSA will step in and make the payments. These are the three very important parties in all of these transactions that play an on going role.

Mr. Amato asked if in any transaction there would be three parties or can one party handle it.

Mr. Shearer stated that the debt could be structured differently RBC would still be the Remarketing Agent, but instead of having an Insurance Agent of FSA, and a Stand-by Purchase Agreement with DEXIA, you could replace those two parties with one Letter of Credit from one bank; like Wachovia or Wells Fargo. Both structures come and go over the years with regard what gets better pricing, how the bonds are trading. When these issues were done this was probably the better way to go at that time.

Mr. Amato asked when there are multiple agents involved do you get the type of service where they will be watching the district's investments as if it was all in one parties hands.

Mr. Shearer replied yes.

Mr. Damgarrd stated that the Remarketing Agreement states that the agent will make the best efforts. It does not end when they go to bank bonds.

Mrs. Dexter asked Mr. Shearer if he was going to address whether the district should find another Remarketing Agent.

Mr. Shearer replied that he would.

Mrs. Follweiler asked if the main problem right now is that no one wants to buy the district's bonds.

Mr. Shearer stated that the buyers do not want the bonds right now because of what the market is saying about FSA and DEXIA.

Mrs. Follweiler referred to Easton School District. They are selling their bonds.

Mr. Shearer responded that the swaps from other school districts are all totally different. It has to do with the structure of the debt.

Mr. Damgaard stated you have to think about who owns these bonds. He compared it to a money-market fund. They need to know they can liquidate their holdings at any time. It is based upon the strength of the bank. When a bank provides both the credit and liquidity you are getting the credit rating of the bank. What is unique about a Variable Rate Bond Issue is the ability of the bond holder to demand their money back at any time. They can put the bonds back to you on seven days notice. Fixed rate bonds have no such feature.

Mr. Shearer gave an in-depth slide presentation on Swap Fees.

Mrs. Leeson asked why the district got in the double swap. What was the advantage at the time?

Mr. Majewski stated we were trying to structure some of the swaps because we were at markets that could potentially, and were providing us positive cash flow. We were constantly tracking the opportunity to terminate some of the swaps because it was positive for the school district to do so at the time. However, as a result of the volatilities in the market and the slowness of the bureaucracy's approval process, there were lost opportunities. There were attempts to be able to terminate some of the swaps when we thought they were no longer advantageous, but lost the opportunities to do so. The swaps were put in place to provide hedges for the variable rate, as well as provide positive cash flow for the district.

Mr. Damgaard explained if the district just had bond issues and no swaps they would have variable rate exposure. It was viewed that it would not be a good thing to have that. The idea is to hedge against that. You could have a traditional fix or a synthetic fix. The benefit of synthetic fix at the time was the idea that you could access a much bigger taxable loan market. By paying the variable rate on the bonds, because you are getting such an advantageous rate on the swap, the combination of the two is lower than the fixed rate bond. No one ever foresaw what has happened now.

Mr. Shearer reviewed the options available to the board with both the swaps and the bonds. One option would be to do a two-year bank loan with Wachovia Bank. The loan would be used to refund the Shippensburg Borough Authority Bond and get rid of the FSA/DEXIA problem. The new proceeds from the bank loan would go to refund also. Simultaneously, we would also enter into a Forward Purchase Agreement, a future bond contract with an underwriter, Wachovia. This would be like a long term bond issue to match the amortization of the existing Shippensburg Borough Authority Bond. We are not shortening the debt or extending the debt, we would be basically matching it.

We need it to write a facility so we could refund the DEXIA/FSA problems. By doing this we would get out of the FSA/DEXIA problem, and we do not have to terminate the swap. The swap would transfer over to this new arrangement, and this will lower the overall cost of funds.

There are some risks associated. This is not something that is done on a daily basis. It is a new type of structure to get around some of the issues, and correct the problems. One of the risks would be in two years, if the market is still extremely volatile and we cannot access the capital markets at that time to, we would have to do another kind of short term loan. This basically buys us a two year window to refund out of the FSA/DEXIA bonds. This will lower the cost of funds for the overall $40,000,000 package.

Option two relates to the $55,000,000 2007 Bonds. Wachovia would be willing to give us a direct pay Letter of Credit after January 1, 2009, when they have merged with Wells Fargo. Wells Fargo is a triple A rated bank.

The third option deals with another $55,000,000 for the 2005 Bonds. There are several Bond Pools available throughout the Commonwealth. Dauphin County General Authority can make loans sometime in January. Mr. Shearer has asked to have Bethlehem put on the list for consideration. This pool would get us a variable rate. It would be used as Pool money. The money would be used to pay off the FSA/DEXIA bonds.

The key with the three options is, in today’s market, we do not want to terminate the swaps. They are high values right now. What is in the best interest of the district now is to find solutions to the bonds so that we do not have to terminate the swaps at this point. Long term, our goals are to start shedding some of these risks.

Mr. Tenaglia asked how high is high with regard to terminating the swaps?

Mr. Shearer replied that it could cost over $5,000,000 for a single one.

Dr. Lewis stated there would be no need to terminate to move into the pool, but there would be an issuance charge. It could be part of the proceeds. He asked what the issuance fee would cost.

Mr. Shearer replied that typically, for any kind of transaction, the rule of thumb is roughly two percent of the amount being borrowed. On a $40,000,000 transaction, two percent of that would be roughly $800,000. In today's times, those costs are done.

Mr. Tenaglia asked why there were no fixed rate options.

Mr. Shearer replied, right now to access the fixed rate market it is pretty costly as far as the interest rates.

Mrs. Cann asked if with all three options there is no FSA/DEXIA.

Mr. Shearer replied that she was correct.

Mrs. Cann asked if any of these could go into Bank Bonds.

Mr. Shearer replied that there is no guarantee. There could be a situation where that happens. It could occur again if things do not work out the way it is expected.

Mrs. Cann asked what the benefit is.

Mr. Shearer responded that it would get the district's cost of funds down to what was budgeted, and we do not have to terminate the swaps. We do not have to pay substantial termination fees.

Mrs. Cann asked if the same thing could happen again.

Mr. Shearer responded that the only way the district could not get back in the same spot would be if we went out and issued Fixed Rate Debt. The district has a total principal of $220,000,000 in debt right now. The cost to terminate the swaps would be close to $30,000,000.

Mr. Shearer stated that we do not want to put "all our eggs in one basket." We want to create solutions that mix things up a little.

Mrs. Cann questioned options number two and three which is related to bonds that have no acceleration clauses. Are they are real priority?

Mr. Shearer replied that PFM went to a lot of banks. State-wide, regional-wide, and nation-wide to try to find a Letter of Credit. It is very hard to get a Letter of Credit right now for over $50,000,000. The West Cornwall Bond is $72,000,000.

Probably nothing will happen until after January 1, 2009. If, after January 1, 2009, if we are able to get a credit facility for that issue, we will replace the credit facility, do an RFP for a Remarketing Agent to get that on board. PFM is watching this issue very closely, and we are looking at a Fixed Rate Bond Issue; changing the Remarketing Agent; and getting a Letter of Credit for the West Cornwall Issue.

Mrs. Leeson asked what type of rates we could possibly anticipate getting with options one, two and three under today's conditions.

Mr. Shearer replied, with option number one is for a two year facility at Libor plus 131 Basis Points. Libor right now is 140.

Option two, we do not know the rates as we do not have the Letter of Credit, we will have that in January.

Option three, the rate for similar transactions would be SIFMA Index plus 100.

Mrs. Leeson asked if it would be to the district's advantage to begin to spread the risk. At this point, we are still focusing on the Variable Rate. Even though the Fixed Rate is significantly higher, but to spread our risk by getting into some Fixed Rate.

Mr. Shearer responded, yes that is why we are looking at the West Cornwall deal the most closely to convert to Fixed Rate Bonds. Typically in January of each calendar is when we receive the better rates.

A lengthy discussion followed regarding the district's various options.

Mrs. Leeson asked if the bailout would help the district in anyway.

Mr. Shearer stated that at this time, it does not appear to be a benefit to the district. Things could change after January. At the moment we are not hearing much about it.

Mrs. Dexter asked what the cash impact to the district is if we reach acceleration in the West Cornwall Issue. She further asked that if it were assumed that we are in that situation what Mr. Shearer's recommendation would be regarding the settlement.

Mr. Shearer replied if West Cornwall went to early acceleration, in round numbers, it may be an annual payment of $9,000,000 over a seven-year period of time. We do not want the district to have to start making the accelerated payments. That would have a huge budget impact.

Mr. Shearer's recommendation is to deal with option one and two. Come back for the December 8, 2008, meeting with a Resolution for option one, and hopefully a Resolution for option three as well. The option three Resolution would be very close as we are just going to be receiving final approval from Dauphin County General Authority Pool right around that time. Mr. Shearer is asking that the board have a short Special Meeting after December 8, to adopt the Resolution for option three. Option two cannot be done until January.

The date for the Special Board Meeting to adopt the Resolution for option three will be December 17, 2008.

Mr. Shearer explained the differences between the swaps. The district could continue with all three of the Swaps. Based on ratios and rates as of last week, for a full fiscal year, the district would get about $2.4 million. Since we are half-way through the year, the district could collect $1.2 million.

If the district decides to suspend all three of the swaps, the district could receive a payment today, of roughly $2 million. The cash flows with the cost of the Maturity Swap would stop for two years. The board needs to decide if the $2 million today is worth foregoing the deposit cash flows going forward. That is the decision that needs to be made. The option PFM is most comfortable with is a two-year suspension that is what has the most value.

Mr. Shearer recommends that the board adopt a Resolution which would give the finance team the authorization to suspend the swap when it reached a certain amount. The board needs to decide who should be on the finance team.

Mrs. Cann questioned if this is only one part of the swap?

Mr. Shearer replied that this relates to swaps 3, 5 and 7 which are Constant Maturity Swaps.

Mrs. Leeson asked if we could terminate while the swap is in a suspension.

Dr. Lewis stated that the two critical questions are do we wish to suspend, and what the trigger is?

Mrs. Follweiler stated that we entered into the swaps because the district needed the cash flow. If we suspend and take the $2 million now then we do not have a cash flow from the three bonds do we not need to take other measures to cut costs.

Discussion followed regarding suspending the swaps and the effects of the decreased cash flow on the district.

Mrs. Leeson questioned the district's risk and what the Variable Rate risk is.

Mr. Shearer stated that he believes the Variable Rate will stay low. Options one, two and three do not eliminate risk. We are eliminating the FSA/Dexia problem. Ultimately, long term, we are looking to reduce some of the risks.

Mr. Majewski stated that the district is looking to cut some of the costs, provide stability with the debt service, and continue to look for a Fixed Rate vehicle at a rate that makes sense for the district.

Mr. Damgaard asked how long the Letters of Credit would be for.

Mr. Shearer stated they would be three to five years.

Mr. Damgaard stated that after that period we would rely on the banks renewing them. The bottom line is that we still have to deal with them as they have to be renewed.

Mr. Shearer stated that he would really like to see Option four which would be to do a Fixed Rate Bond Issue for West Cornwall in January. That would take $72,000,000 off the table, and take away some of the risk. A Fixed Rate Bond Issue is very high on the list.

Mrs. Leeson asked what the trigger point is for a Fixed Rate.

Mr. Shearer responded closer to 4.5 percent.

Mrs. Dexter asked to have another courtesy of the floor so that the board could hear from the public regarding their questions or comments.

Mr. Antalics stated that he spoke to people in the City of Bethlehem and the Allentown School District and they avoided Bond Issues because they were designed to help the investment industry. He stated if we had followed them we would not be in this situation.

Dr. Lewis stated that all the construction the district did would have resulted in an increase in taxes of 5.2 mills instead of going to swaps. The swaps generated about $14,000,000. There was positive flow since 2003. No one could have anticipated this total reversal of the market. The district's goal now is to try and right the ship so to speak.

Mr. Majewski stated that the swaps are a gamble, but so is Fixed Rate. If you go at the wrong time, you could be paying 25, 50, or 100 Basis Points more than the Variable Rate. You are stuck with that rate for an extended period of time. Either way you look at it there is a gamble regarding the decision that needs to be made. You may not have the same volatility with a Fixed Rate but there is still a gamble.

A lengthy discussion with regard to the board's decision on which option to take and what the ceiling should be was held.

The board agreed to place a Resolution on an Agenda to suspend the West Cornwall Swap.

A recommendation to suspend, for a two-year period, for $2.5 million will be on the December 8, 2008, Regular Board Meeting Agenda.

VOTING REGIONS UPDATE – Dr. Lewis stated that there will be one board member elected from District I and four at large. The petition draft to vote on will be on the Regular Monthly Board Agenda for December 8, 2008, for board approval.

IMPACT OF LEASE CHANGES ON YOUTH ORGANIZATIONS – Dr. Lewis provided a spreadsheet listing all non-mandated items regarding custodial costs. Custodial fees will be charged for weekend events. A site manager can waive his costs if he/she desires. Depending on the lease and what is required of the custodian will determine the cost.

Mr. Majewski stated that the majority of events will be held during the evening during on weekdays.

OPERATIONAL COSTS – Dr. Lewis reviewed additional operational costs cuts with the committee.

Mr. McKeon asked how the proposed relocation of the Career Academy to Liberty will impact ESOL transfer back from Freedom back to Liberty.

Dr. Lewis replied that it would not.

Mrs. Dexter asked how the students are counted if the Career Academy moves back to Liberty.

Dr. Lewis stated that they are counted in the school they come from.

Mrs. Dexter asked about the re-negotiation of health insurance fees. She stated that she believes we should be shopping around.

Mrs. Follweiler commented on the transportation costs and asked if there was any idea about how much could be cut.

Dr. Lewis stated that the administration is meeting with school districts that have gone to private transportation.

Mrs. Dexter questioned what the overall impact fee would be if the district eliminated the Regional Academic Standards Academy, Career Academy, SPARK, and Welcome Classrooms. Those students would still have to be educated in our schools. There would be some increase in teachers.

Dr. Lewis stated that SPARK would be no impact. The Welcome Classrooms would be distributed over multiple grades in schools and as the numbers are low, there would be no impact. Career Academy has the equivalent of one and one half or two sections of students which would equal to one teacher at each high school.

Mrs. Dexter stated that if we eliminated SPARK there would be an impact. If we send children to kindergarten who have had no pre-school experience, they would have to be taught skills.

Dr. Lewis stated we would probably have some retentions.

Mrs. Koch stated that the principals are supporting Welcome Classrooms, and the difference they make.

Dr. Lewis stated he does not believe that it would be the administrations' recommendation to eliminate SPARK, Career Academy, and Welcome Classrooms. The administration is just complying with providing numbers for all non-mandated programs. We do not want to see these go.

We would rather see some consolidation. As for RASA, because they are spread out in predominately fifth grade, although three schools send the majority of the students, there might be a teacher and part of teacher in each of the three schools. We would probably be looking at a couple hundred thousand coming off the current figure. The Career Academy would save somewhere around $100,000 to $150,000.

Mrs. Dexter stated before the vote was taken she would like to see harder numbers.

Dr. Lewis stated we will loose the Alternative Ed. funding. If we do not run an Alternative Program, we cannot take that money even though they are technically at risk children. We have to have a program to get that money. We have to analyze the impact. It is about $1,100 per student. If we close the program, we cannot apply for that money.

Mrs. Follweiler asked if these cuts would impact the current budget or next year's budget. Things that we would have to vote on would most likely not occur until the next budget.

Dr. Lewis stated there are still a lot of things that could be cut to impact this year's budget. Northampton School District is moving out of Stabler Arena to save money. They plan to use our stadium for graduation. A plan is being worked on.

Mrs. Dexter stated the board was told that there would be about a $4,000,000 deficit this year. We are seeing $474,000 in cuts. What is the feeling for the other $3.5 million dollars?

Dr. Lewis responded he feels that there will be other "larger nuts," like LERTA, transportation privatization, and debt realignment. The administration is working on some larger pieces.

Mrs. Dexter stated in November we have a projected deficit of $4,000,000. She feels it behooves the board to cut expenses and programs that we are running this year unless the administration is telling the board that they believe the revenues and expenses will equal out this year.

Much discussion followed regarding the deficit.

OPEN FORUM - Mr. Tenaglia stated it appears that for the 2007 A bond issue, when the money was moved over in July, we are paying a monthly management fee of 6.5 basis points. He is disturbed that we are paying Baird a management fee. He does not believe that any of the board realized that we were still utilizing Baird for management.

Mr. Tenaglia is asking that the board direct the administration to seriously consider re-management of the remaining 2007 Bond Fund in house for management.

Mr. Tenaglia asked about the status of the Dual Language Charter School application.

Dr. Lewis stated that the district is required, under the law, to process any application. We do not prepare it, we do not assist. He stated that he does not oppose charter schools, but he does oppose public funding of charter schools. The district has supported some charter schools, but not all. There is a timeline once a completed application is received. There is a Public Hearing requirement where people can give testimony. Then the board will vote to either grant the charter or deny the charter.

Mrs. Koch added that the board gets to ask extensive questions, and they are required to have a financial plan, a budget. They are required to tell the board who they plan to hire, how many teachers, and have a curriculum planned out.

She stated she is also opposed to the funding of charter schools. This means from the district's budget that they are now struggling for it would take out a couple of million depending on how many students they have.

Mrs. Dexter asked for more information regarding the management fee paid to Baird.

There was a discussion regarding how this fee is paid.

Mr. Majewski explained the mechanics of the payment method of journal entries.

Mrs. Dexter asked that the journal entries be provided to the board. If it is not a great deal of work, it should be done.

Dr. Lewis stated the wire transfers were shown. They were not being hidden. There was no intent to keep information from the board.

There was much discussion regarding wire transfers, journal entries vs. written checks.

Mr. Tenaglia asked for further verification of payments to Baird.

Mr. Majewski will provide the information requested.

The meeting adjourned at 10:40 p.m.

Minutes prepared by_________________________________
Adele Embardino, Confidential Secretary