What Does the S&P Downgrade of the U.S. Mean for Community Colleges in Illinois?
“Pre-U.S. Downgrade”...

• The Great Recession did not derail credit quality in the public finance market to the extent some had predicted

• The credit characteristics of each issuer are what matter

• Many state and local governments implemented difficult corrective actions necessary to balance budgets
“Pre-U.S. Downgrade”…

- S&P Credit ratings upgrades still outpaced downgrades
  - Nearly 2:1 in 2011
  - Although S&P rating downgrades in the first half of 2011 exceeded any recent six-month interval

- Moody’s downgrades have outpaced upgrades for 10 consecutive quarters
  - They have had a negative outlook on the municipal bond sector for three years
• The United States’ long-term credit rating was downgraded to “AA+” by S&P on August 5, 2011
  – Political risks and rising debt burden

• Negative outlook affirmed
  – Originally assigned on April 18, 2011
• S&P research report dated August 5th:
  – “We could lower the rating to “AA” within the next two years…”
  – “Our opinion is that elected officials remain wary of tackling the structural issues required to effectively address the rising U.S. public debt burden in a manner consistent with a “AAA” rating…”
  – Estimated that net general government debt would rise from 74% of GDP by the end of 2011 to 79% in 2015 and 85% in 2021
  – “…a higher public debt trajectory than we currently assume could lead us to lower the long-term rating again”

• Per S&P, the earliest a sovereign has ever returned to a “AAA” rating was nine years!
How will the downgrade impact U.S. public finance ratings?

• Debt issues that are directly linked to the sovereign rating are at risk:
  – Municipal housing backed by the federal government
  – Government related entities in housing and public power sectors
  – Federal leases
  – Some defeased bonds (eg: escrows funded with U.S. Treasuries or agencies) that were re-rated by S&P
How will the downgrade impact state government ratings?

• States have significant latitude to raise revenues and alter expenditures
  – No automatic downgrades
• Focus on reductions in federal outlays to states
  – Medicaid
• What is the economic impact of federal spending on a state’s economy?
  – On average, federal spending represents 20% of state gross domestic spending
• Long-term planning is key
How will the downgrade impact local government ratings?

- No immediate or dramatic rating changes expected on local governments
- Specific cuts could have an acute impact on a local entity’s economy or service area
- Areas with large military or other federal presence could also take a hit if those facilities were scaled down or eliminated
- “Localized” recessions would be analyzed on case-by-case basis
How will the downgrade impact higher education ratings?

• Thanks to the Great Recession, higher education has already cut significant expenses

• Significant reduction in sponsored research and student loan programs could further strain these institutions

• Those who receive state operating appropriations could also be under stress if cuts to the states filter down

• The degree to which federal cuts impact ratings will depend on the speed and size of the reductions
Other Thoughts

• S&P has stated that it is very possible for state and local governments to have ratings higher than the U.S., *although it is likely they would be no more than one notch above the U.S.*

• All rating agencies will continue to monitor the federal government’s response to the country’s deficit and debt ceiling
Historical Interest Rate Comparison

MMD "AAA" Bond Index - Day to Day Comparison

*The Municipal Market Data “MMD” is a AAA municipal bond market index produced by TM3. As of September 23, 2011.*
Monthly Bond Sales (Dollar Volume)
January 2009 - August 2011

From The Bond Buyer, September 28, 2011
Rating Agencies’ Hot Topics of Interest for Community Colleges in 2011

– OPEB (Other Post Employment Benefit) Obligations
  • GASB 45 Report
– Timing of late payments from the State
  • Budgeted amounts for such payments in the current fiscal year
– Status of local employers/taxpayers
– Fund Balance Policy
– Debt Management Policy
– Capital Improvement Plans
– Revenue Assumptions
  • EAV Growth
  • Consumer Price Index
Debt Management Strategies in a Continually Low Interest Rate Environment
Traditional Tax-Exempt Refunding Structures

• Current Refunding
  – Only possible within 90 days of next call date
  – Targeted savings are based on market conditions at the time of the call date
  – Allows refunding of all outstanding callable maturities

• Advance Refunding
  – Flexible execution to achieve savings objectives
  – Allowed only once in a bond issue’s lifetime
  – Escrow typically funded with State and Local Government Securities ("SLGS")

• With either type of refunding, the goal is to achieve a minimum present value savings level
• To increase present value savings, Colleges may consider alternate investments for the escrow
  • Need to be considered on a case-by-case basis
    • Potential risks/consequences

• Targeted Repurchase Refunding
  • Provides flexibility of execution timing
  • Refunding issue maintains Advance Refunding option
  • Can be difficult to identify bondholders of the bonds to be refunded
Public Act 96-0912
• Public Act 96-0912 is set to expire on June 9, 2012
  • Allows Illinois community colleges to calculate their working cash limit based upon 150% of Education and O&M taxes (instead of 75%)
• Currently no momentum to extend it
  • Need someone to ask their state representative and senator to sponsor a bill
• Chapman and Cutler is willing to write the bill
• Also, there may be an opportunity to amend the Working Cash Fund section of the statute to mirror the School Code
  • Allow colleges to issue working cash fund bonds and abate the proceeds to the fund most in need
  • Working cash fund bond proceeds could then be issued to finance capital projects
• Chapman and Cutler is also willing to draft this bill
Securities, investment banking and institutional brokerage services are offered through PMA Securities, Inc. PMA Securities, Inc. is a broker-dealer and municipal advisor registered with the SEC and MSRB, and is a member of FINRA and SIPC. Prudent Man Advisors, Inc., an SEC registered investment advisor, provides investment advisory services to local government investment pools. All other products and services are provided by PMA Financial Network, Inc. PMA Financial Network, Inc., PMA Securities, Inc. and Prudent Man Advisors (collectively “PMA”) are under common ownership.

The information contained herein is solely intended to suggest/discuss potentially applicable financing applications and is not intended to be a specific buy/sell recommendation, nor is it an official confirmation of terms. Any terms discussed herein are preliminary until confirmed in a definitive written agreement.

The analysis or information presented herein is based upon hypothetical projections and/or past performance that have certain limitations. No representation is made that it is accurate or complete or that any results indicated will be achieved. In no way is past performance indicative of future results. Changes to any prices, levels, or assumptions contained herein may have a material impact on results. Any estimates or assumptions contained herein represent our best judgment as of the date indicated and are subject to change without notice. Examples are merely representative and are not meant to be all-inclusive.

The information set forth herein was gathered from sources which we believe, but do not guarantee, to be accurate. Neither the information, nor any options expressed, constitute a solicitation by us for purposes of sale or purchase of any securities or commodities. Investment/financing decisions by market participants should not be based on this information.

You should consider certain economic risks (and other legal, tax, and accounting consequences) prior to entering into any type of transaction with PMA Securities, Inc. or PMA Financial Network, Inc. It is imperative that any prospective client perform its own research and due diligence, independent of us or our affiliates, to determine suitability of the proposed transaction with respect to the aforementioned potential economic risks and legal, tax, and accounting consequences. Our analyses are not and do not purport to be appraisals of the assets, or business of the Issuer or any other entity. PMA makes no representations as to the actual value which may be received in connection with a transaction nor the legal, tax, or accounting effects of consummating a transaction. PMA cannot be relied upon to provide legal, tax, or accounting advice. You should seek out independent and qualified legal, tax, and accounting advice from outside sources.

If posted on a webpage, this information has been prepared for informational and educational purposes and does not constitute a solicitation to purchase or sell securities, which may be done only after client suitability is reviewed and determined. Services offered by PMA Securities, Inc. and this registered representative presenter, in particular, are available only in the following states: IL, WI. This information is not an advertisement of services available in any state other than those listed above.