

Pequea Valley School District (Pennsylvania) Series of 2021 and 2022 Bonds Investment Discussion

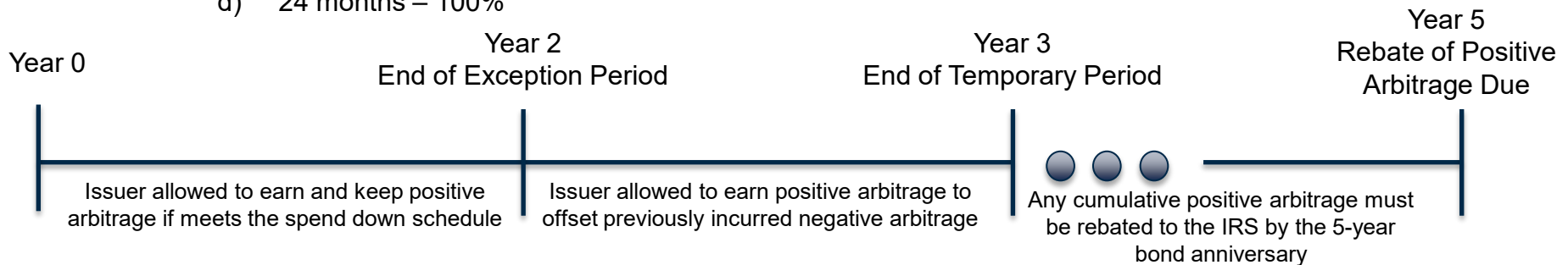
Public Finance Investment Strategies Group

Discussion Materials
Confidential | June 2023



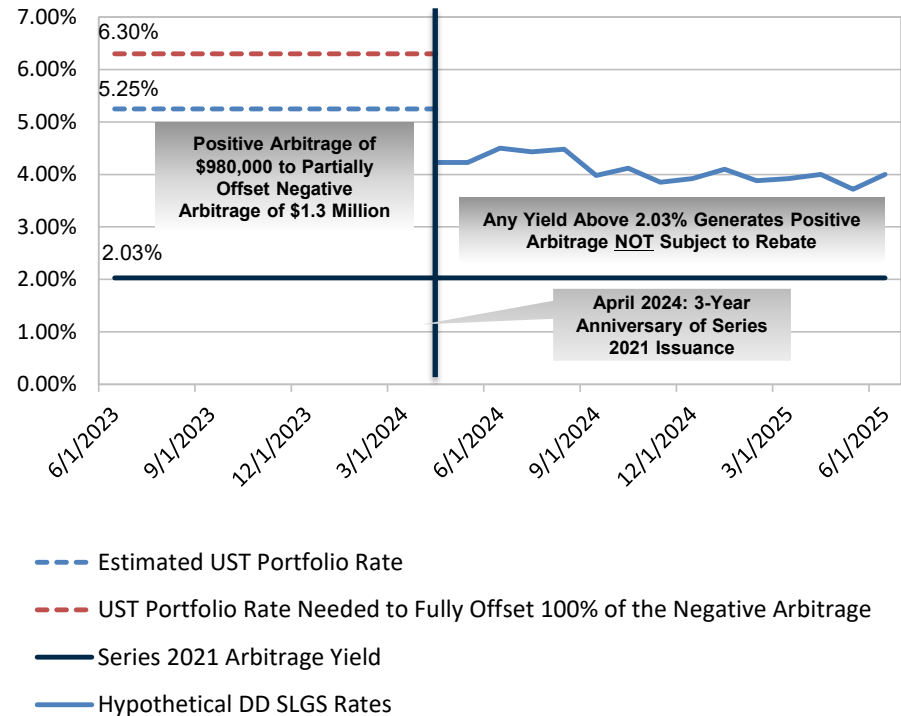
- ▶ Pequea School District (the “District”) issued its General Obligation Bonds, Series of 2021 (the “Series 2021 Bonds”) in April 2021 in the par amount of \$55,400,000 and issued its General Obligation Bonds, Series of 2022 (the “Series 2022 Bonds”) in May 2022 in the par amount of \$29,265,000.
- ▶ Due to the low interest rate environment over the last few years, the District was able to issue the Series 2021 Bonds with a federal arbitrage yield of 2.0265% and the Series 2022 Bonds with an arbitrage yield of 3.8043%.
- ▶ As a result of supply chain issues from COVID, the District has approximately \$47.7 million remaining in its Series 2021 project fund and \$28.9 million in its Series 2022 project fund. As discussed on the next slide, because the District has been unable to achieve the IRS spend-down benchmarks required to retain positive arbitrage, it will be required to rebate any positive arbitrage earned above its respective arbitrage yields of 2.03% and 3.80%.
- ▶ Currently, the District has accrued approximately \$1.4 million in negative arbitrage on its Series 2021 project fund and approximately \$56,000 on its Series 2022 project fund.

- ▶ Temporary Period (Usually 3-year capital projects) — Ability to invest bond proceeds at an unrestricted rate for 3 years after issuance of the bonds.
- ▶ Rebate — Computation should be conducted utilizing the elected schedule pattern from those identified below, and if investment returns result in a higher rate than the arbitrage yield, the issuer will owe the difference back to the U.S. Treasury after five years if unable to meet the selected schedule.
 1. **6-Month exception** requires the issuer to spend 100% of the proceeds within the first six months from the date of issuance.
 2. **18-Month exception** requires the issuer to spend based on the below schedule:
 - a) 6 months – 15%
 - b) 12 months – 60%
 - c) 18 months – 100%
 3. **24-Month exception** requires the issuer to spend based on the below schedule:
 - a) 6 months – 10%
 - b) 12 months – 45%
 - c) 18 months – 75%
 - d) 24 months – 100%



- ▶ The combination of high taxable rates in the current market and the likelihood that funds are anticipated to be remaining unspent as of the 3rd anniversary of the Series 2021 issuance presents the District with a unique investment opportunity
 - ▶ The high taxable rates, which are well in excess now above the 2.03% Series 2021 federal arbitrage yield, present an opportunity to invest the remaining funds in a manner to fund anticipated draws through the 3-year anniversary and limit the maturity on the remaining funds to no later than the 3rd anniversary of the issue
 - ▶ Such a term limitation should enable the District to generate earnings at a rate well above 4.00% which can generate positive arbitrage to help recover some of the approximate \$1.3 million of accumulated negative arbitrage in the Construction Fund
 - ▶ After the 3rd anniversary of issuance, the District can avoid yield restriction on the remaining funds by investing all remaining funds at that time in Demand Deposit SLGS (described more fully herein)

Series 2021 Proceeds Proposed Scenario



- ▶ The net outcome is the District can utilize the high taxable rates to recapture the some of the accumulated negative arbitrage and capitalize on the really low 2.03% arbitrage yield by investing in the tax-exempt demand deposit SLGS to generate earnings above 2.03% which will not be subject to rebate
- ▶ As long as the demand deposit SLGS rate exceeds that of the 2.03% arbitrage yield it will make sense to leave remaining funds invested in those whereas if the demand deposit SLGS rate declines below the 2.03% rate, then the District should shift the investments to taxable instruments to lock in at LEAST the 2.03% rate to avoid subsequently re-incurring more negative arbitrage
- ▶ The entire program should be vetted with bond counsel prior to implementation

Investment Scenario	Estimated Yield	Investment Amount	Estimated Earnings
Series of 2021 Project Fund			
Scenario 1a: Earnings Limited to Arbitrage Yield up to 3-Year Issuance Anniversary (April 2024)	2.03%	\$47,700,000	\$660,540
Scenario 2b: Remaining Draws after 3-Year Issuance Anniversary (April 2024) Invested at Arbitrage Yield	2.03%	\$27,825,000	\$348,400
Scenario 2a: Earnings from Draws Invested in U.S. Treasuries up to 3-Year Issuance Anniversary (April 2024)	5.25%	\$47,700,000	\$1,640,748
Scenario 2b: Remaining Draws after 3-Year Issuance Anniversary (April 2024) Invested in Demand Deposit SLGS	4.23%	\$27,825,000	\$741,557

*Market Rates as of June 6, 2023, and subject to change

**Does not assume compounding

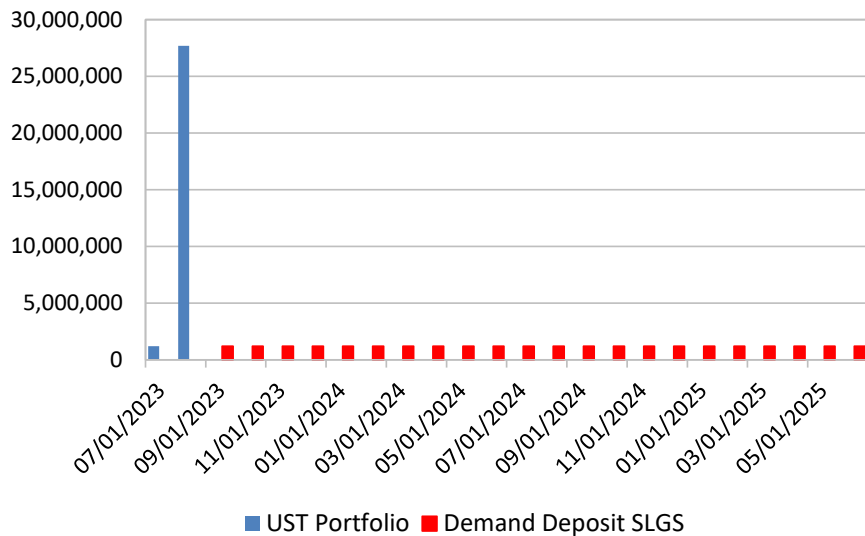
- ▶ The earnings assumptions in the table above assumes the District spends its remaining Series 2021 Project Fund proceeds of \$47.7 million over 24, equal monthly installments through June 2025.*
- ▶ The scenarios presented above are structured as follows:
 - ▶ **Scenario 1a:** Highlights the earnings the District could keep if the investment yield was restricted to the arbitrage yield of 2.03% up to the 3-Year Issuance Anniversary of April 2024.
 - ▶ **Scenario 1b:** Highlights the earnings the District could keep if the investment yield was restricted to the arbitrage yield of 2.03% after the 3-Year Issuance Anniversary of April 2024.
 - ▶ **Scenario 2a:** Illustrates the potential investment earnings assuming the District invests the remaining proceeds in U.S. Treasury securities up to the 3-Year Issuance Anniversary of April 2024 to recapture some or all of the previously accrued negative arbitrage.
 - ▶ **Scenario 2b:** Illustrates the potential investment earnings assuming the remaining draws after the 3-Year Issuance Anniversary of April 2024 are invested in the current demand deposit SLGS rate of 4.23% throughout the remainder of the 24-month draw schedule.

*Source: April 30, 2023 PSDLAF statement

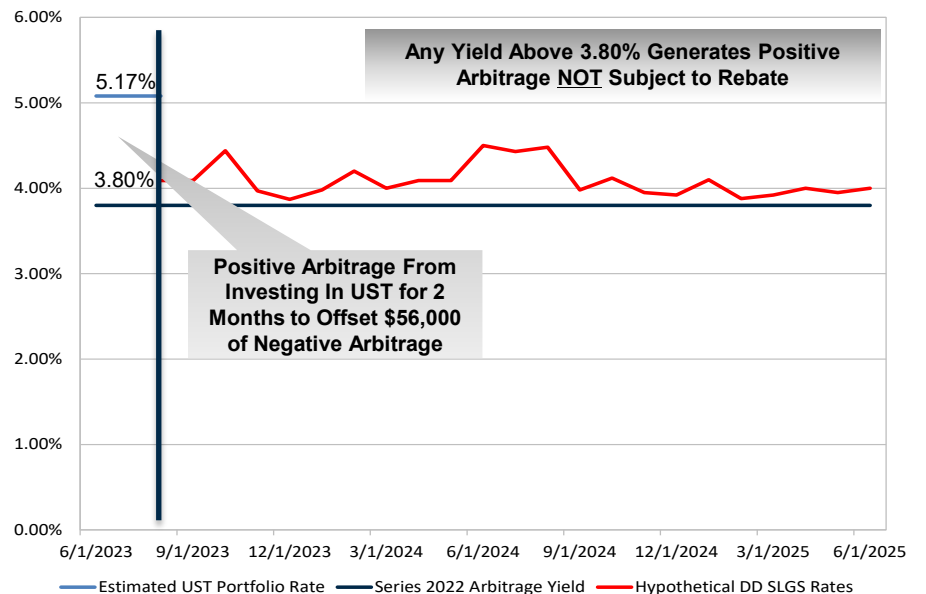
- ▶ The combination of current high taxable and tax-exempt Demand Deposit SLGS rates in the current market present the District with a unique investment opportunity with respect to the Series 2022 Bonds
 - ▶ The high taxable rates, which are well in excess now above the 3.80% Series 2022 federal arbitrage yield, present an opportunity to invest all of the remaining funds for a short period of time at a yield in excess of the 3.80% in order to re-capture all of the approximate \$56,000 of accumulated negative arbitrage in the Construction Fund
 - ▶ The balance of funds for the remaining draws after the first short-term investment can be invested in Demand Deposit SLGS at a rate in excess of the 3.80% federal arbitrage yield, and as long as the variable demand deposit SLGS rate remains above the 3.80% arbitrage yield, the District can keep all of that positive arbitrage as it will be exempt from rebate

- ▶ The entire program should be vetted with bond counsel prior to implementation

Series 2022 Proceeds Proposed Portfolio Draw Schedule



Series 2022 Proceeds Proposed Scenario



Investment Scenario	Estimated Yield	Investment Amount	Estimated Earnings
Series of 2022 Project Fund			
Scenario 1a: Earnings Limited to Arbitrage Yield for Initial 2 Months	3.80%	\$28,900,000	\$182,051
Scenario 2b: Earnings Limited to Arbitrage Yield for Remaining Draws after 2 Months	3.80%	\$26,491,667	\$933,578
Scenario 2a: Earnings from Draws Invested in U.S. Treasuries for 2 Months to Recover Negative Arbitrage	5.17%	\$28,900,000	\$239,862
Scenario 2b: Remaining Draws after 2 Months Invested in Demand Deposit SLGS	4.23%	\$26,491,667	\$1,103,744

*Demand Deposit SLGS and UST Rate as of June 6, 2023, and subject to change

**Does not assume compounding

- ▶ The earnings assumptions in the table above assumes the District spends its remaining Series 2022 Project Fund proceeds of \$28.9 million over 24, equal monthly installments through June 2025.*
- ▶ The scenarios presented above are structured as follows:
 - ▶ **Scenario 1a:** Highlights the earnings the District could keep if the investment yield was restricted to the arbitrage yield of 3.80% if invested for two months.
 - ▶ **Scenario 1b:** Highlights the earnings the District could keep if the investment yield was restricted to the arbitrage yield of 3.80% for the remaining proceed after the initial two-month investment.
 - ▶ **Scenario 2a:** Illustrates the rate needed on a two-month U.S. Treasury investment to recapture all of the previously accrued negative arbitrage of approximately \$56,000.
 - ▶ **Scenario 2b:** Upon maturity of the U.S. Treasury investment and the full recapture of negative arbitrage, this scenario assumes the remaining proceeds are invested at the current Demand Deposit SLGS rate of 4.23% through the end of the draw schedule in June 2025.

*Source: April 30, 2023 PSDLAF statement

▶ What Are Demand Deposit SLGS?

- ▶ Variable rate securities backed by the full faith and credit of the U.S. government.
- ▶ Have a maturity length of one day which are reinvested daily at the next day's rate.
- ▶ Interest is reinvested and paid out upon redemption.

▶ Procurement and Redemption Process

- ▶ Procured in the same manner as Time Deposit SLGS through the SLGSafe platform by the client's custodian.
- ▶ Once purchased, the balance is automatically reinvested the next day until the client asks the custodian to submit a redemption request.
- ▶ If withdrawing less than \$10 million at one time, the Treasury only needs one business day's notice with the redemption request submitted through the SLGSafe platform.

▶ Benefit of Demand Deposit SLGS

- ▶ Provides the client with 24-hour liquidity similar to a money market account.
- ▶ Allows the client to potentially generate legally retainable positive arbitrage above the bond yield.

▶ Considerations

- ▶ Based upon comments from Treasurer Yellen, the federal government may reach the debt ceiling by June 1 or shortly thereafter in the summer 2023, and as a result has temporarily closed the SLGS window. As a result, the District will have to wait until the SLGS window re-opens in order to access this portion of the investment program.

Feature	Demand Deposit SLGS
Issued As	One-day Certificate of Indebtedness
Maturity Length	One-day but they roll over automatically until redemption is requested
Interest Paid	Interest is capitalized every day on principal and prior accrued interest and paid at redemption
Interest Rate	Based on an adjustment of the average yield in the most recent auction of the 13-week Bill
Amount Offered	Minimum: \$1,000 Maximum: None Does not have to be whole dollar amounts

Source: Treasurydirect.gov

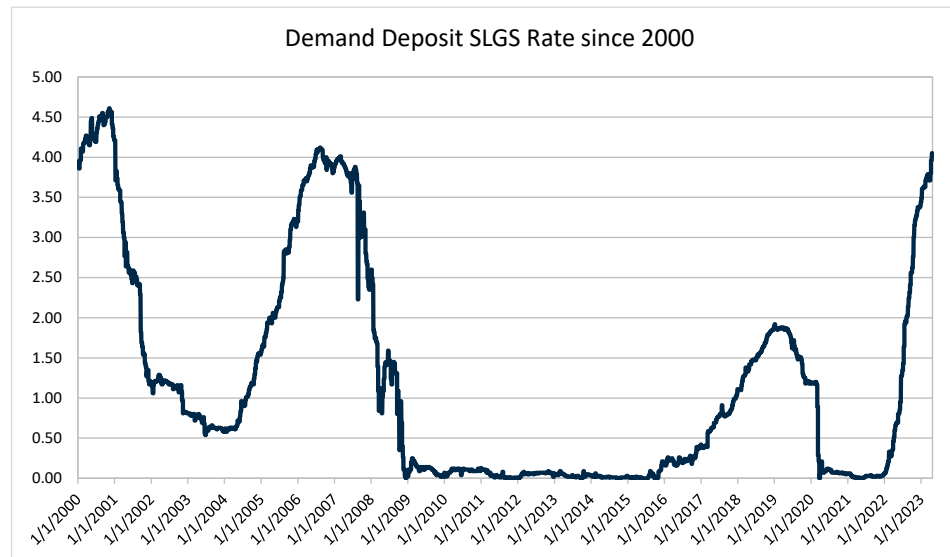
Source: Treasurydirect.gov

▶ **Demand Deposit SLGS Pricing**

- ▶ Priced off of the most recent 13-week T-Bill auction minus some spread.
- ▶ Given these securities are priced at a level below the prevailing short-term taxable rate, these securities are treated like non-AMT tax-exempt municipal securities and are exempt from rebate.*
- ▶ Current rate as of May 10, 2023 is 4.09%.

▶ **What Happens During a SLGS Window Closure?**

- ▶ If the SLGS Window is closed while funds are invested in Demand Deposit SLGS, the Demand Deposit SLGS convert to normal Time Deposit SLGS with a 90-day maturity at the prevailing Demand Deposit SLGS rate at the window closure.
- ▶ Even though the security is converted to a Time Deposit SLG, clients are able to redeem this security early according to the Demand Deposit SLGS redemption rules without a penalty.

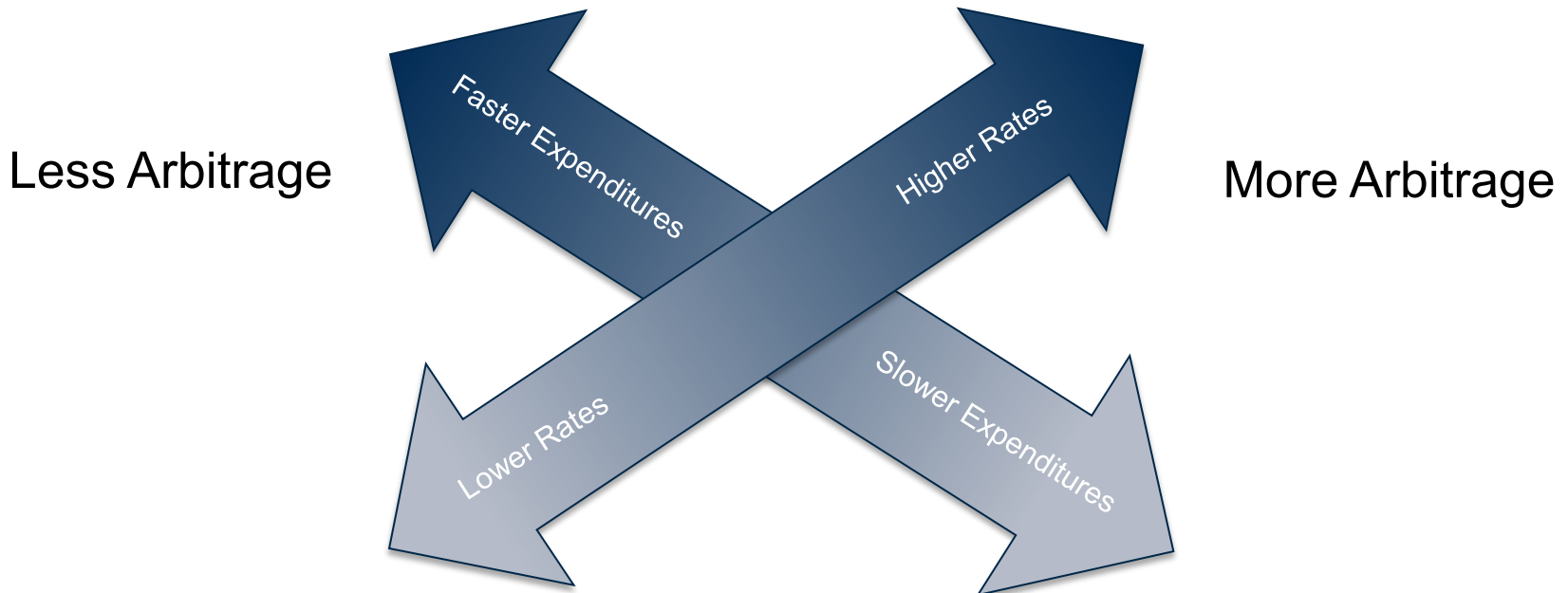


Subject to change on a daily basis

*Always confirm with bond and/or tax counsel

- ▶ With respect to the Series 2021 Proceeds, once the taxable investments mature and Demand Deposit SLGS are procured (or Demand Deposit SLGS may be initially purchased soon after the plan starts to provide liquidity), then:
 - ▶ To the extent short-term rates increase and it takes longer than planned to expend the funds, the District will have a greater chance to earn more earnings exempt from rebate.
 - ▶ To the extent short-term rates decline and/or funds are expended faster than planned, the District will likely earn less earnings exempt from rebate.

- ▶ With respect to the Series 2022 Proceeds, again, to the extent it takes longer to expend the proceeds and Demand Deposit SLGS rates remain higher, the more potential retainable arbitrage there will be



Activities	Series 2021	Series 2022
Open Necessary Accounts (both taxable and tax-exempt)	✓	✓
Confirm Custodial Bank is on SLGSSAFE System	✓	✓
Transfer Funds from PSDLF to Custodial Bank	✓	✓
Execute Competitive U.S. Treasury Bid -Prepare Term Sheet -Execute Bid/Award Call -Coordinate Settlement	✓	✓
Purchase Demand Deposit SLGS*	✓	✓
Monitor SLGS Rates	✓	✓
Prepare Quarterly Reports	✓	✓

*SLGS window is currently closed but as soon as window re-opens, SLGS can be purchased

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