Pennsylvania Association of School Business Officials

Mailing Address:
P.O. Box 6993
Harrisburg, PA 17112-0993

Office Location:
2608 Market Place
Harrisburg, PA 17110

Telephone 717-540-9551 *www.pasbo.org* FAX 717-540-1796

Testimony of Charles E. Linderman

Director of Business Affairs, Great Valley School District

Senate Local Government Committee

Interest Rate Swaps

September 9, 2013

Good morning. I am Chuck Linderman, Director of Business Affairs for the Great Valley School District in Chester County. I am past president of the Association of School Business Official International (2011) and the 1999 President of the Pennsylvania Association of School Business Officials. I have also served, for the past 12 years, on the Board of Trustees for the Pennsylvania School District Liquid Asset Fund, Acting as Chair of the fund for the past 2 years. I have been with Great Valley School District for the past 32 years, 28 of them serving as the Business Administrator. I want to thank the members and staff of the Senate Local Government Committee for the opportunity to comment on this important issue.

Great Valley School District has entered into three (3) swap transactions over the past eight (8) years starting in February of 2005. Each of these transactions resulted in a positive cash flow for the school district and its taxpayers. Additionally, when we terminated the swaps the termination value on each was positive as reflected in the chart provided with my testimony. The District entered into the swaps for well thought out, practical reasons. Initially, the first swap was utilized to lock in a savings from a future refunding for bonds that could not be advance refunded. Rather than wait and hope that interest rates would still be low enough for a refunding to work, the District chose to take the risk of higher rates off the table and lock in a rate that generated significant savings. The District again acted in the aftermath of the financial crisis when its trusted advisors alerted us to the market opportunity presented by market dislocation in early 2009. This transaction also worked well for the District.

School district business operations are staffed by professionals who do not take the issue of risk lightly. We are responsible for the financial management of multi-million dollar operations, large construction projects, assisting in the negotiation of teacher contracts, and the investment of the funds. Our responsibilities are widely varied, and our track record is very good.

There have been over 600 Swaps entered into in the Commonwealth of Pennsylvania by governmental entities since the law was changed authorizing their use in 2003. Only a handful have encountered difficulties, and the majority of those that did run into problems had issues not with the swap itself but rather because elected boards abandoned construction projects or issuers overleveraged their debt portfolios by entering into swaps in notional amounts far in excess of their actual outstanding debt. The major issue that afflicted Pennsylvania governmental issuers during the financial crisis was the credit downgrades of the major municipal bond insurance companies. School districts and other local issuers who had issued variable rate bonds backed by the insurers found that their debt was no longer marketable. Many of these issues had to be refinanced. This was not a problem caused by interest rate swaps. It seems an overreaction to eliminate all interest rate swaps because of the problems of a tiny percentage of issuers while so many who have utilized them properly have benefited.

At the national level, the Dodd Frank Act of Congress that passed in 2010 became effective for governmental issuers on May 1, 2013. While the provisions of Dodd Frank in many ways mimic many of the safeguards contained in Pennsylvania's Act 23, there have been some additional protections built in for governmental issuers. Dodd Frank specifically requires the engagement of a qualified independent representative (QIR) for any governmental entity utilizing a derivative product. Additionally, and importantly, unlike Pa Act 23, Dodd Frank imposes the requirement of a Fiduciary Standard for all QIRs. This is an important added protection for issuers and requires that qualified advisors go on record at the time the transaction is executed and indicate that not only is the transaction priced fairly, but also that the transaction is in the "best interests" of the issuer. Consequently, some of the risk is put back on the advisors. Is it possible that Act 23 after ten years can be improved? We think the answer is yes, and there are ways to tighten the language of Act 23, that together with the new safeguards of the Dodd Frank Act will help prevent the few problems that have occurred over the last five years but at the same time preserve the flexibility the Act provides for governmental issuers to have access to all the tools the financial market providers to allow for better debt and asset management.

As I stated earlier Great Valley had three (3) successful swaps, and I believe the key to a successful swap is having the right independent team of Advisors, and making sure your elected board understands the potential risks as well as the potential benefits of the swap all within the context of attempting to better manage the debt and assets of an issuer. We always had a Financial Advisor, and independent Swap Advisor, and a Bond Counsel who was well versed in the intricacies of interest rate swaps. We always proceeded slowly and tried to be certain that our board members were well aware of the risks and rationale for our swap transactions. It is also important that the governmental entity and their advisors monitor the swap on a regular basis after it is put in place to stay on top of how it is performing and how general market conditions are affecting its performance. Doing so will make sure the issuer is aware of the impact of changing market conditions and provide the opportunity to make changes to the swap portfolio. In the years between 2005 and 2011 when we terminated the final Swap, Great Valley School District earned $1.97 million dollars, which we were able to use in the education of our students and the maintenance of our facilities.

We haven't entered into a Swap since 2009 as the market conditions have not been favorable, but would like to at least have the ability for the possibility of using these instruments again if the conditions turn around in our favor. Ironically, at the very time the legislature is looking to potentially eliminate the use of these products, current market conditions are providing the best opportunities for issuers to utilize them since the financial crisis. At a time when our Districts are struggling to balance our budgets, these financial tools are potentially valuable solutions when used appropriately.

We thank you for the opportunity to present our views. We would be glad to respond to any questions you may have.

Great Valley School District
Summary of Swap Transactions

Date	Description	Benefit to GVSD
February 2005	Swaption for Current Refunding of 1996, 1998, & 2001 Bonds	
February 2006	Issue Fixed Rate Bonds to Currently Refund Above Bonds	$222,000
February 2006	Basis Swap/2006 Bonds	
February 2009	Basis Swap/Portions of 2003, 2004, 2005, & 2006 Bonds	
February 2006 through February 2011	Net Positive Cash Flow – 2006 Swap	$543,000
February 2009 through February 2011	Net Positive Cash Flow – 2009 Swap	$380,000
June 2011	Termination Payment to Great Valley for 2006 & 2009 Basis Swap's	$825,000
	Total Net Benefit to Great Valley School District (net of all costs)	$1,970,000