Reinhart Partners, Inc.

ABHE Annual Meeting

The Two Sided Coin - Debt and Investment Management in a Dynamic Environment

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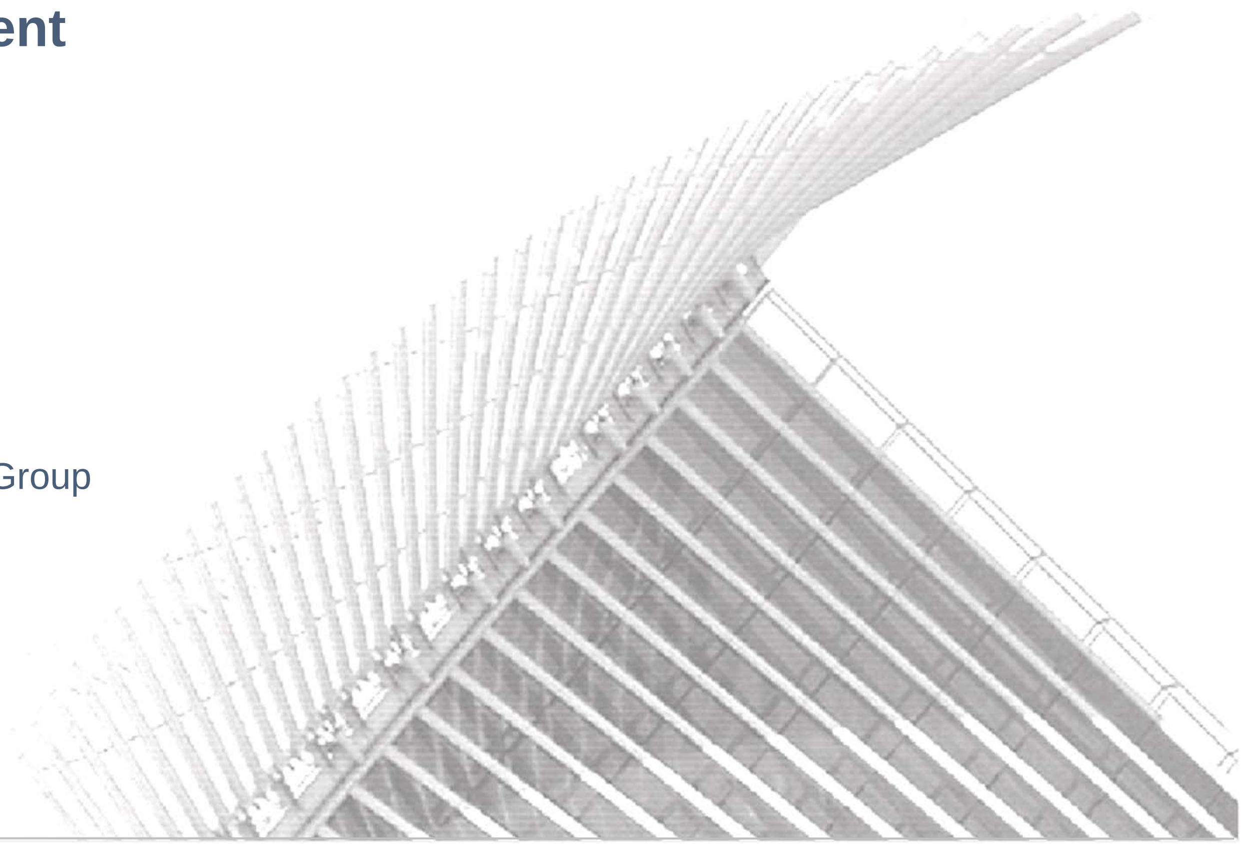


Agenda

BOND BASICS

- The four main risks in a bond
- Yield – how risk drives YTM
- How the business cycle drives total return

MANAGING THE INSTITUTIONAL DEBT STRUCTURE

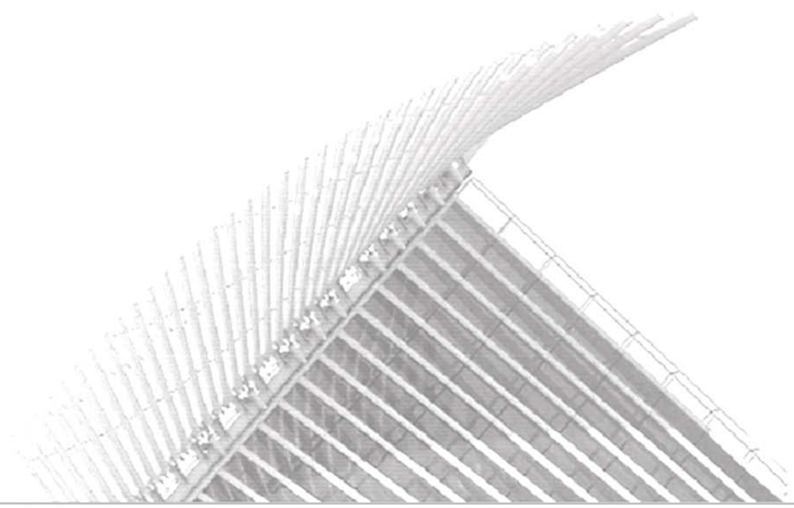
- Who will lend you money
- Typical debt structures
- Interest rate options

ESSENTIALS OF A GOOD INVESTMENT PLAN

- Investment Policy Development
- Common Mistakes

MANAGING THE INVESTMENT PORTFOLIO

- Fixed Income Market Outlook
- Equity Market Outlook



Bond Basics

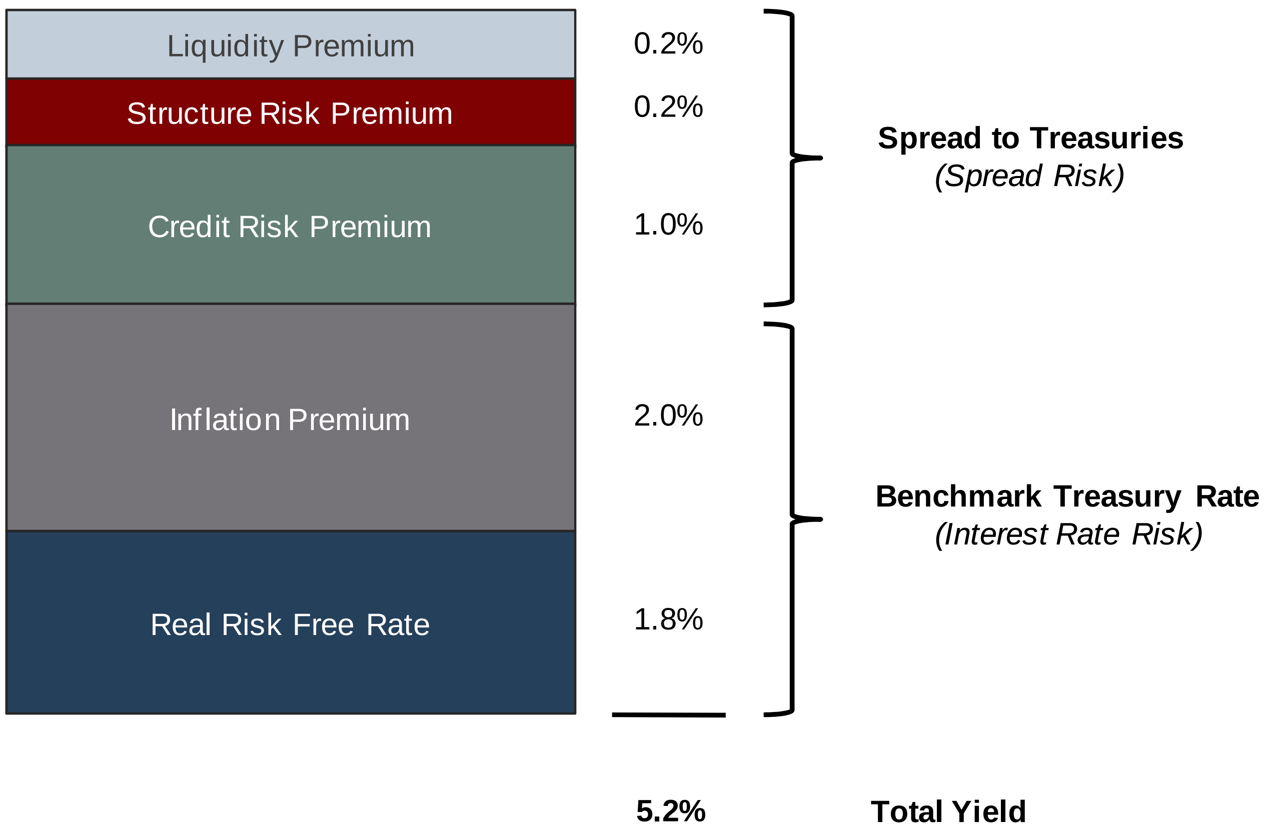
INTEREST RATE RISK

- Sensitivity of price relative to changes in interest rates. Longer maturity bonds are more volatile than shorter maturity bonds.
- Measures – Duration and/or Maturity

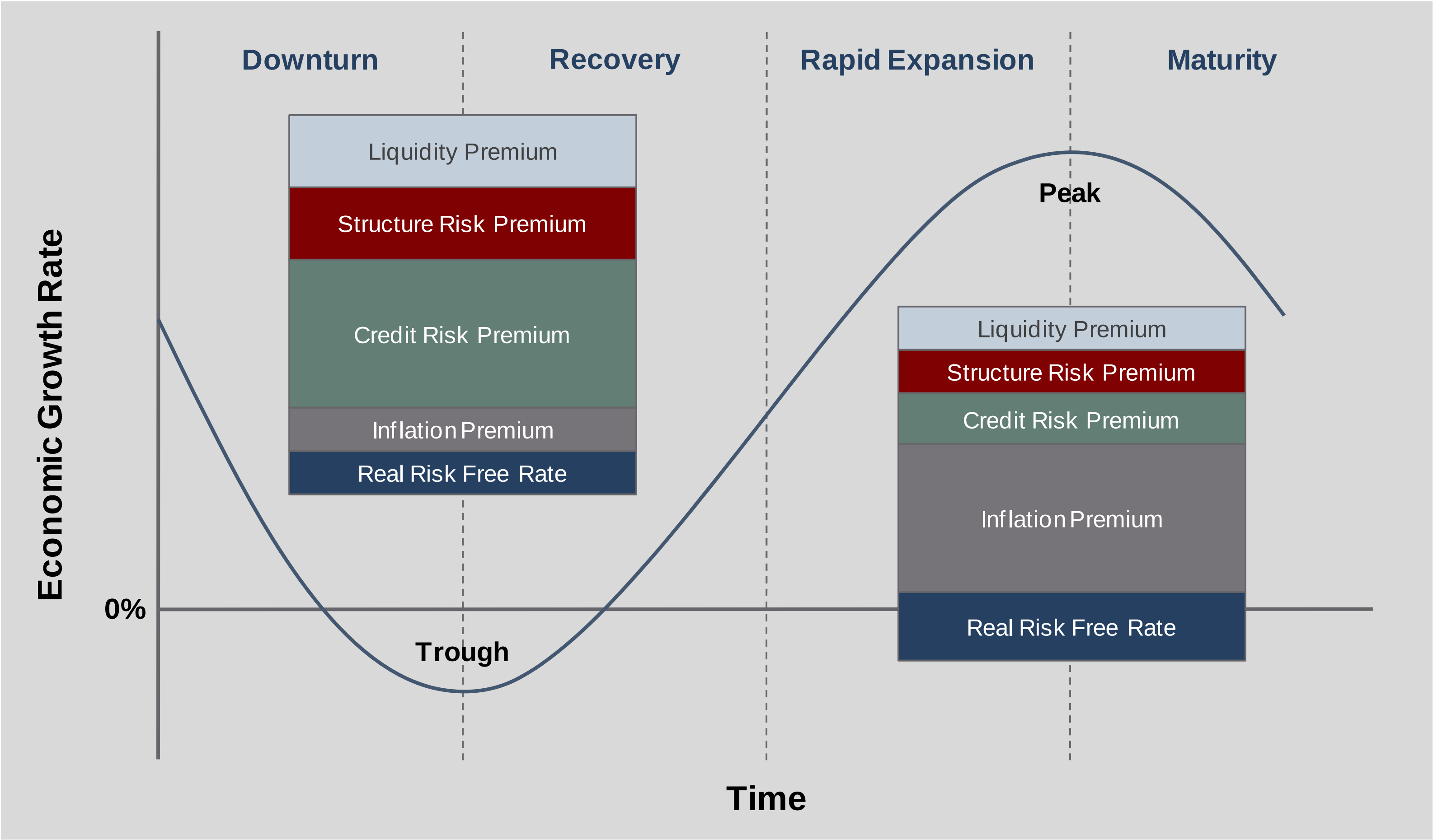
SPREAD RISK

- Credit Risk
  - The likelihood that an issuer will not pay principal and/or interest in a timely manner.
  - Measures – Credit Rating/Score and/or Spread to Treasuries/MMD Scale
- Structure Risk
  - Predictability of security/portfolio cash flows relative to shifts in the interest rates. Usually due to options embedded in a bond (calls/puts/sinks/prepays).
  - Measures – Convexity and/or Option Adjusted Spread
- Liquidity Risk
  - The ability of an investor to convert a security into cash in a timely manner without negatively impacting price.
  - Measure – Bid / Ask Spread

Interest Rate Risk + Spread Risk = Yield to Maturity



The Economic Cycle & Risk Premiums – The Inverse Relationship



Why It's Different This Time

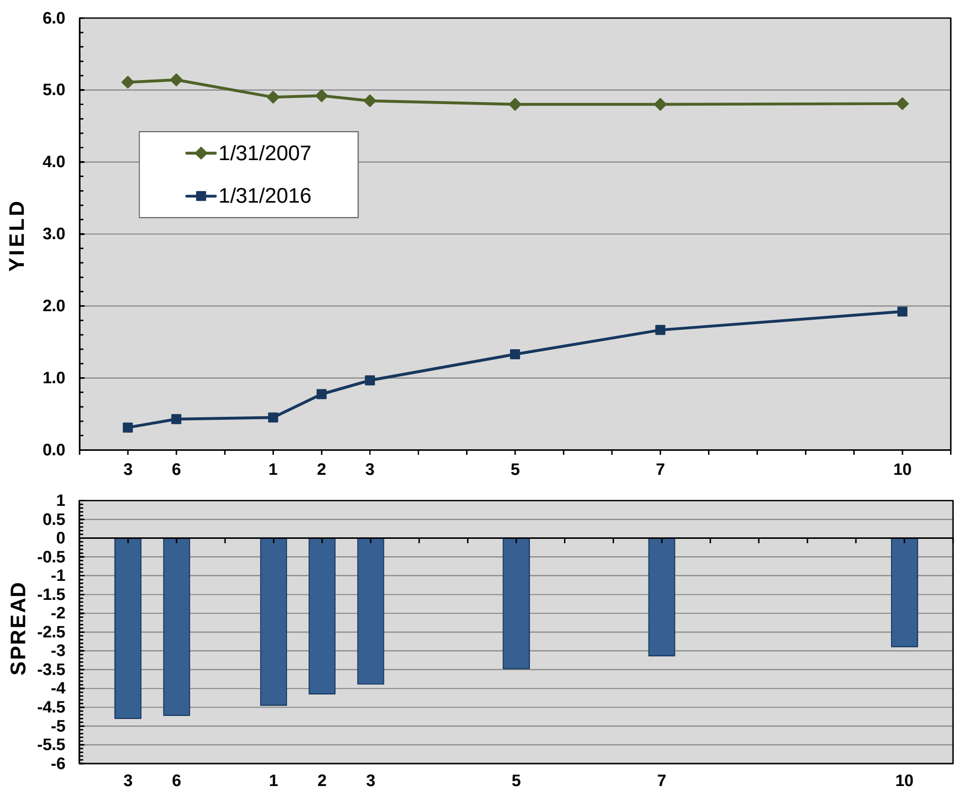
CURRENT MARKET

- Spreads are tight **AND** interest rates are low.
- The Fed has begun its long awaited tightening cycle, but timing and pace of future moves are far from certain.
- Investors are yield starved resulting in a favorable environment for debt issuers.

OUR OUTLOOK

- Interest rates will remain low for the foreseeable future.
- As/when the Fed tightens, we expect a flattening of the yield curve, not substantially higher long term rates.
- Market will remain favorable for debt financing in the bank, private and public debt markets.

Historical Yield Curve
January 31, 2007 vs. January 31, 2016



Source: Bloomberg

Managing Debt Structure – Who will lend you money?

TAXABLE - BANK FINANCING

- Short-term borrowing needs – i.e. operating LOC, bridge financing
- Main Advantage – shortest timeline, least documentation, lowest cost
- Main Disadvantage – short term (usually 5-7 year balloon)

TAX EXEMPT - PRIVATE PLACEMENT

- Sale of bonds directly to investors without a public offering
- Purchases the bonds for its own account (i.e. bank, HNW investors)
- Main Advantage – shorter timeline, less complex and lower costs of issuance
- Main Disadvantage – long term fixed rates (> 10 years typically) is not available and lack of 'committed capital'

TAX EXEMPT - PUBLIC PLACEMENT

- Bonds marketed and sold to the public through an underwriter/investment banker
- Sold to institutional investors (investment managers, mutual funds) or retail investors (individuals)
- Main Advantage – long term fixed rates available and committed capital available for the entire bond issue
- Main Disadvantage – can be a slightly longer timeline, higher costs of issuance and more complex of an issue (i.e. more documentation and disclosure)

Typical Tax-Exempt Financing

CONDUIT ISSUER

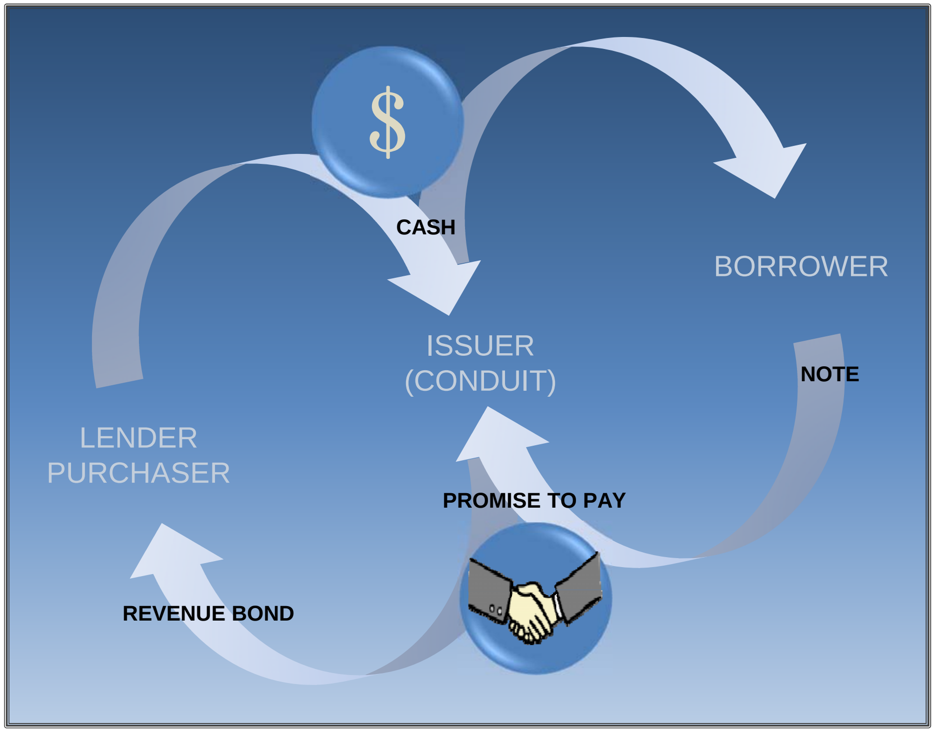
- Must be a governmental or quasi governmental entity; tax exempt obligations may not be issued directly by 501(c)(3) organizations
- Sells the tax-exempt obligations to the Purchaser and loans the proceeds of the sale to the Borrower

WHAT IS A CONDUIT?

- The funds loaned to the Borrower are not funds of the Issuer, rather they are proceeds of debt obligations issued by the Conduit Issuer
- The Conduit Issuer is not required to repay such debt obligations; they are payable solely from the revenues received from the Borrower on its promise to repay the loan of the proceeds of the debt obligations.

CONDUIT ISSUER OPTIONS

- Statewide issuer
- Local Governments (county, city town, village)
- Redevelopment Authorities (created by cities towns and villages)



What Type of Interest Rate

FIXED RATE

- Interest rate fixed for the duration of the loan
- Period of time the loan is not pre-payable/callable – shorter is more expensive

VARIABLE RATE

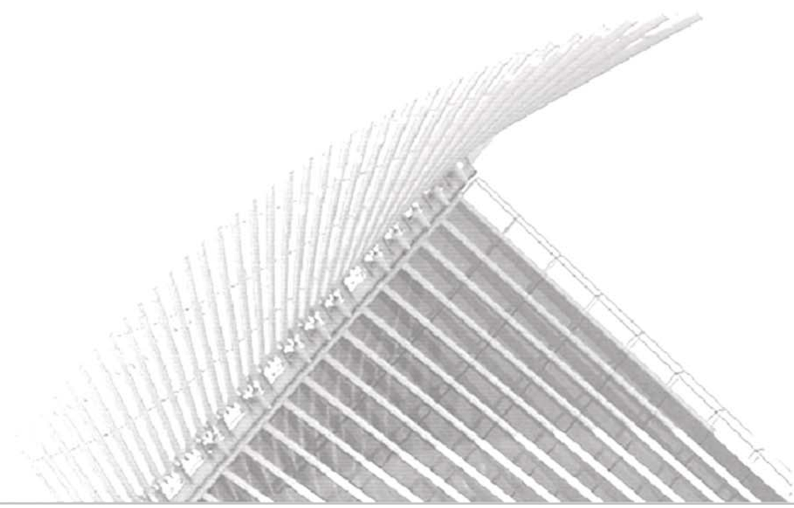
- Interest rates usually will fluctuate (i.e.. daily or weekly)
- Ability to prepay the debt at anytime, usually with 30-days notice
- Historically lower interest rates than fixed
- Typically a letter of credit from a bank is necessary

RESET RATE

- Combination of fixed rate and variable rate

DERIVATIVES

- Swap from variable to fixed rate or vice versa



Standards, Covenants and Security

UNDERWRITING STANDARDS

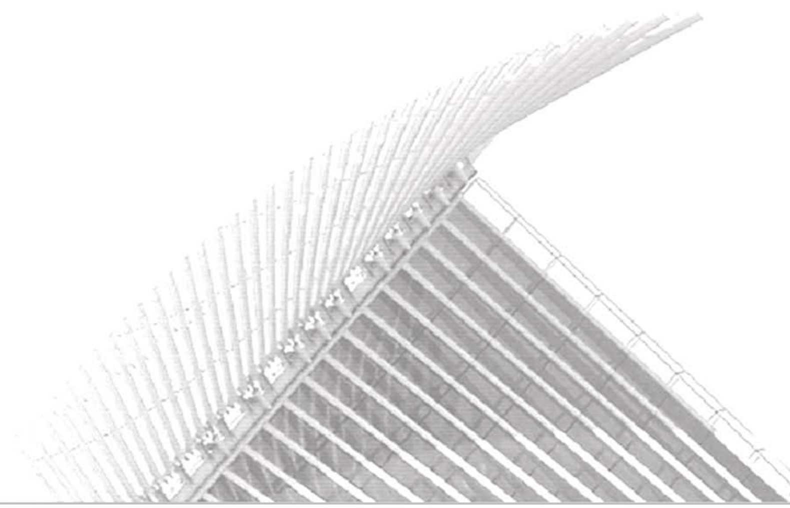
- Enrollment trends
- Ratio analysis – absolute and relative to peers
- Endowment – size and type (restricted vs. unrestricted)

TYPICAL COVENANTS

- Minimum debt service coverage ratio
- Minimum cash on hand test
- Maximum Debt to Capitalization Test
- Debt / Capitalization Test
- Additional debt test
- Feasibility Study or Financial Forecast

TYPICAL SECURITY

- First Mortgage (A rated or better probably not applicable)
- Revenue Pledge
- Guarantee
- Debt Service Reserve Fund (public placements only)
- Master Trust Indenture



Representative Rates

as of January 22, 2016

Current Yield Curve	1 Year	5 Years	10 Years	30 Years
MMD AAA GO	0.45%	1.05%	1.75%	2.76%
US Treasury	0.66%	1.47%	2.05%	2.82%
MMD/UST Ratio	67.8%	71.2%	85.5%	97.9%

Long Term Market (30 Year)	AAA MMD	AA MMD	A MMD	BBB MMD
MMD AAA GO	2.76%	2.97%	3.31%	3.63%

Source: JP Morgan, Bloomberg, Thomson Reuters Municipal Market Data

Essentials of a Good Plan – Investment Policy Development

INVESTMENT POLICY TEMPLATE

PART I:	**PURPOSE**
PART II:	**INVESTMENT MANAGEMENT OBJECTIVES**
PART III:	**ROLES AND RESPONSIBILITIES**
PART IV:	**SELECTION OF INVESTMENTS AND MANAGERS**
PART V:	**INVESTMENT MONITORING, REBALANCING AND REPORTING**
PART VI:	**MANAGER TERMINATION**
PART VII:	**ADDITIONAL PROVISIONS/RESTRICTIONS**

COMMON IPS MISTAKES

- Not having an Investment Policy Statement
- IPS is too vague or too restrictive
- Lack of accountability in the IPS or investment process
- No procedure for reviewing/updating the IPS

Managing the Investments – Interest Rate Risk

CURRENT MARKET

- Anticipating further Fed moves, short rates have moved higher, flattening the yield curve.
- Our outlook:
  - The Fed is expected to tighten this month. This tightening cycle will be modest and slowly implemented.
  - Curve will likely steepen initially, but eventually flatten as short rates move up more than long rates (bear flattener).

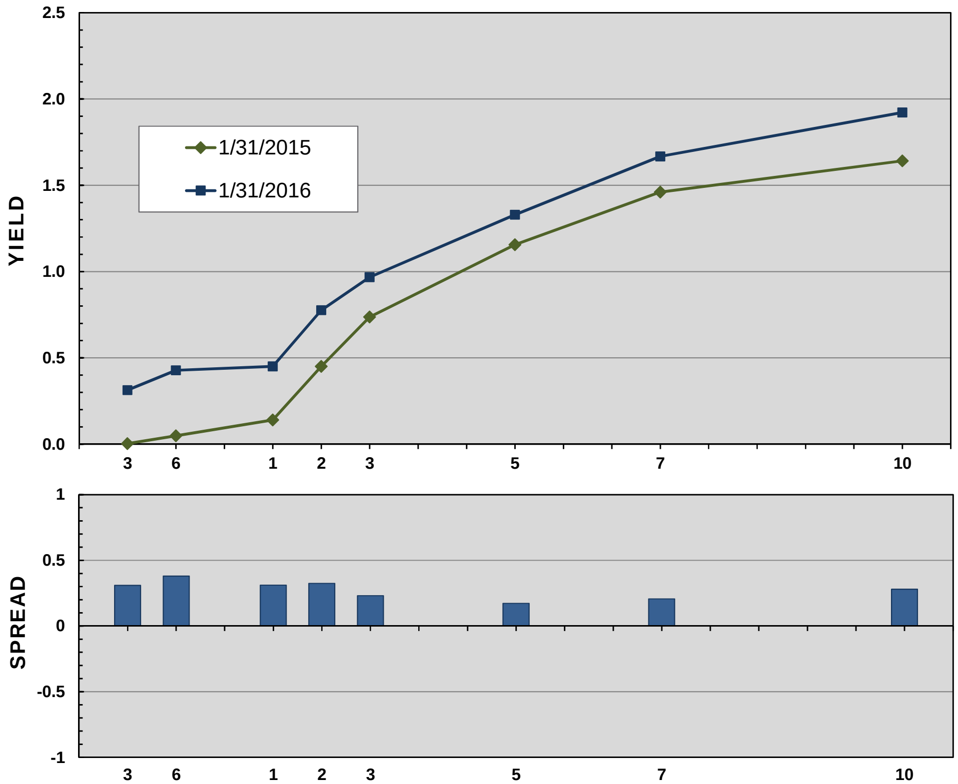
THE MISTAKE

- Investing too long or too short

RECOMMENDATION

- Intermediate maturity – barbelled structure
- Neutral to slightly short benchmark
- Floating rate bonds vs. TIPS

Historical Yield Curve
January 31, 2015 vs. January 31, 2016



Source: Bloomberg

Managing the Investments - Credit Risk

CURRENT MARKET

- Spreads have widened recently, but still tight
- In a world where everything appears rich, corporate bonds still offer relative value in the investment grade sector

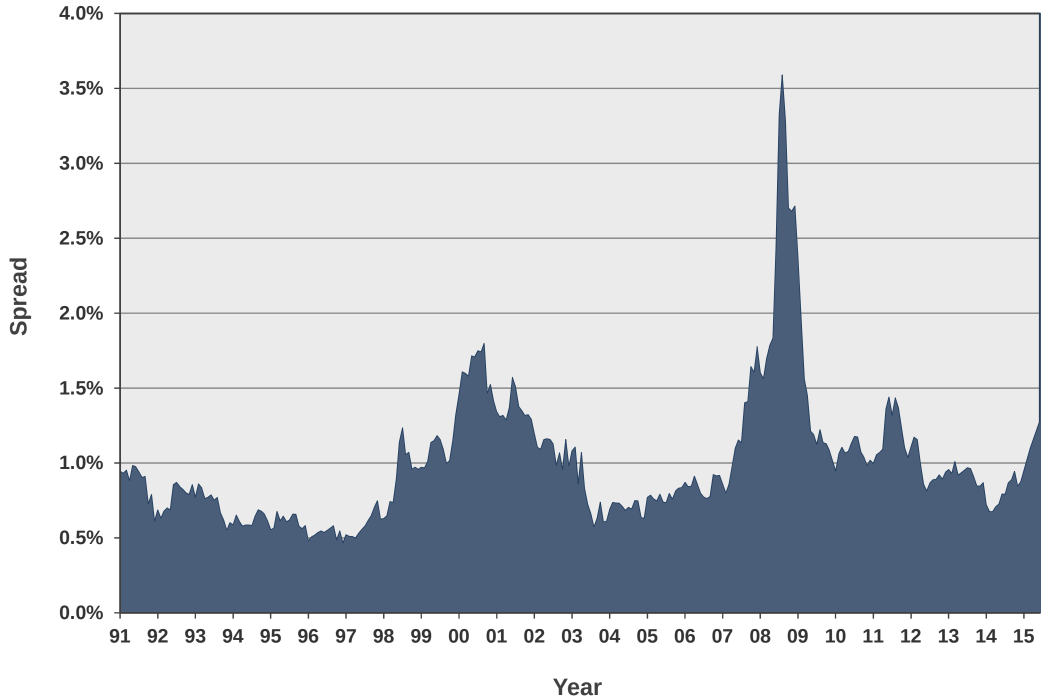
THE MISTAKE

- Moving aggressively down in quality/capital structure with “safe money”
- Investing long in the spread sectors

RECOMMENDATION

- High average quality
- Overweight credit but manage maturity/duration exposure
- If down in quality, keep it liquid

10 Year Treasury vs. "A" Rated Industrial Bonds
1991 - Present



Source: Bloomberg

Managing the Investments - Structure Risk

CURRENT MARKET

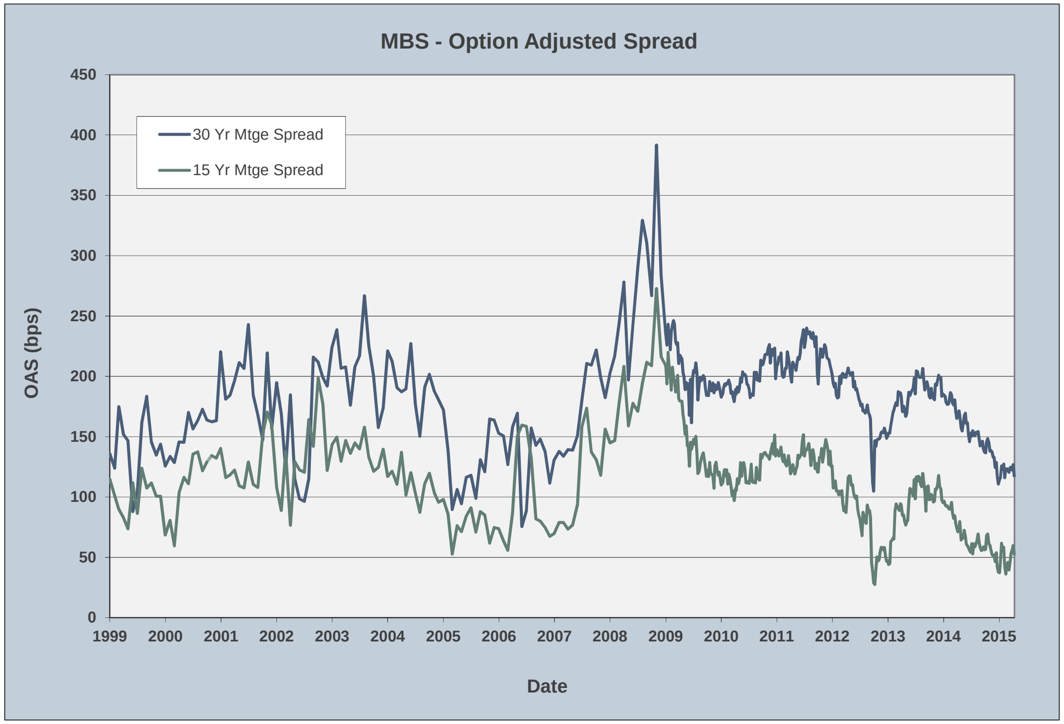
- OAS on Government Backed MBS back at historically tight levels.
- MBS market remains government backed only, private MBS market is non-existent

THE MISTAKE

- Overdoing it
  - Too much exposure
  - Too poorly structured

RECOMMENDATION

- Modest exposure
- Keep it liquid



Source: Bloomberg

Managing the Investments - Liquidity Risk

CURRENT MARKET

- Central banks worldwide continue to flood markets with liquidity
- Significant tail risk related to Europe (economic/geopolitical risk), Asian slowing, turmoil in the Middle East

THE MISTAKE

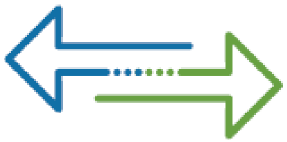
- Investors underestimate liquidity risk
  - There will be another event
  - Illiquid/less structured assets will blow up
  - The "Street" will walk away

RECOMMENDATION

- Always highly liquid with safe money
  - It's always the collateral
  - Rarely paid enough for the risk

	Yield to Maturity				
Price Mark-up	1-Year Bond	3-Year Bond	5-Year Bond	10-Year Bond	30-Year Bond
0 Points (0/32)	6.00%	6.00%	6.00%	6.00%	6.00%
1 Point (32/32)	4.96%	5.63%	5.74%	5.86%	5.92%
2 Points (64/32)	3.94%	5.27%	5.53%	5.73%	5.85%
3 points (96/32)	2.93%	4.91%	5.31%	5.60%	5.79%

Managing the Investments – Equity Outlook



Recession or
Continued Recovery?

TAILWINDS

- Rising consumer confidence
- Increased household spending
- Low energy prices, inflation, and interest rates
- Easy monetary policy

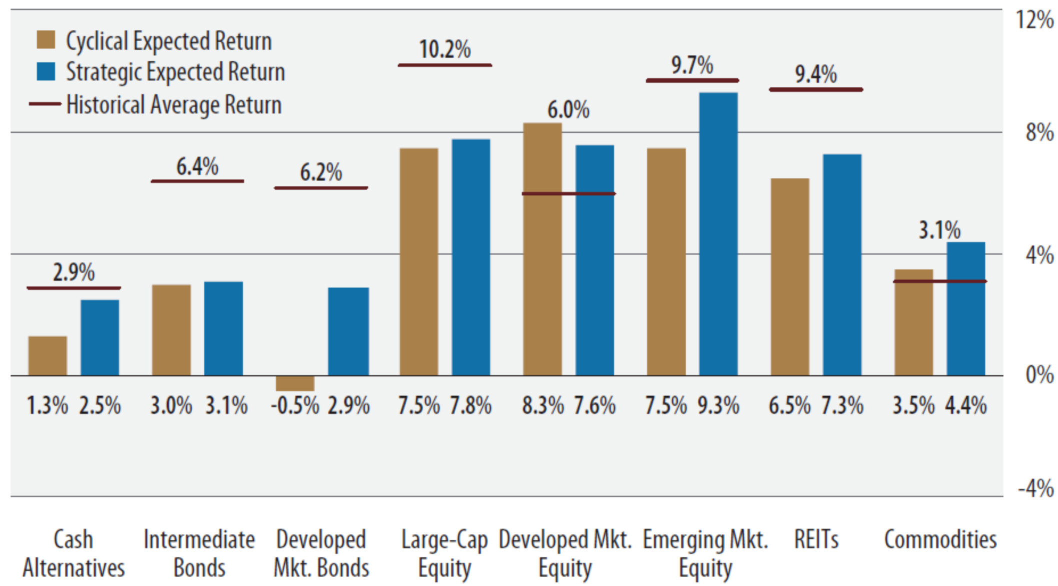
HEADWINDS

- Strong dollar
- Industrial slow-down
- Energy sector collapse
- Political uncertainty

We Forecast Returns to Be Below Historical Averages

Historical Returns Compared to Our Expected Return Assumptions

Cyclical (three-to-five year) and Strategic (10-to-15 year) Expected Returns are forward-looking estimates from Wells Fargo Investment Institute of how asset classes and combinations of classes may respond during various market environments.



Source: Wells Fargo Investment Institute, November 2015

Source: Wells Fargo Investment Institute, November 2015. **Cash alternatives/Treasury bills:** Ibbotson Associates SBBI (Stocks, Bonds, Bills, and Inflation) U.S. 30 Day T-Bill Index. **Intermediate bonds:** Barclays U.S. Aggregate (5-7 year) Index.

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