



## National School Boards Association

# NSBA's Recommendations for Immediate Fiscal Assistance to School Districts

November 2008

As the nation experiences tremendous pressures to overcome the current economic crisis, virtually all sectors, including education, are facing hardships. From the housing crisis to the municipal bond market, each challenge has affected local and state governments, thus affecting the nation's 15,000 school districts.

Pursuant to the enactment of *The Emergency Economic Stabilization Act of 2008*, the U.S. Department of the Treasury has implemented many opportunities for U.S. financial institutions to build capital.

However, the public sector's access to capital for both short- and long-term borrowing needs, including school districts and other local governments and states, is becoming increasingly difficult. Currently the market for tax-exempt bonds has been very slow to thaw, as recently reported by Standard and Poor's. This translates into either no ability to access the market or significantly increased costs to do so, and the problems are especially acute to those school districts and other units of government who need to issue short-term debt in order to maintain payroll and operations, attend to infrastructure repairs, and bulk purchases for textbooks, technology, and other instructional supplies.

Our nation's 15,000 school districts – an integral component to economic revitalization and global competitiveness, a stakeholder in the municipal bond market, a key employer for states and local economies, and a large source of contracting and commerce – have been and continue to be greatly affected by the lack of market liquidity, caused by the financial sector meltdown. This in turn is affecting the performance of our schools, the gross domestic product, and ultimately American competitiveness.

As the Treasury Department continues its efforts to stabilize and reform the financial services industry, the National School Boards Association (NSBA) urges your consideration of the following recommendations that would help spur both local and national economies, reduce the potential for defaults on outstanding debt and address immediate education needs.

- Direct Funding for School Infrastructure
- Reserve to Guarantee Outstanding Bonds
- Fund for Pending Bond Issuances
- Allow for an Additional Advance Refunding

### **Provide Immediate Funding for School Infrastructure**

NSBA urges the enactment of a federal economic stimulus package that will provide grants to school districts for infrastructure repairs and modernization. This source of targeted funding would help advance student achievement, provide contracting opportunities for businesses, and create thousands of jobs throughout the country.

The urgent need for greater investment in school infrastructure is evident by numerous statewide assessments of school facilities, capital improvement projects underway for repairs, modernization and new construction, and the significant number of projects pending because of the local and state budget hardships, as well as difficulties within the municipal bond market.

Moreover, federal grants for school infrastructure provided through an economic stimulus could be used immediately because many projects have already been approved in a number of states and await the necessary funding.

#### *Rationale*

- A recent analysis from New Jersey states that 9,000 new jobs are created for every \$1 billion invested in school repair and construction.
- The National Association of Federally Impacted Schools (NAFIS) recently conducted a survey of school districts that receive federal impact aid funding. The survey focused on school infrastructure projects (whether new construction or modernization and repair) that can commence within a 30- to 60-day time period. Highlights of the compilation are that the total cost of school infrastructure projects studied is about \$630 million, which includes \$150 million slated for school modernization, renovation, repair, or energy improvement projects.
- The Los Angeles school system, which is midway through a \$27 billion school construction program, has opened 70 new schools in recent years and is renovating hundreds. The new schools have attracted a better trained, more diverse teaching staff. Initial evidence suggests that students in smaller, more personal high schools are outperforming their counterparts who still attend dilapidated, overcrowded schools.
- Demands of today's educational programs and services have overwhelmed the structural capacity of many school facilities across the nation. Approximately three million students attend public schools that require major renovation or replacement.
- Modern "green" schools will help increase efficiency by reducing energy dependence and ultimately reducing operating costs. If all new school construction and school renovations went green, energy savings alone would total \$20 billion over the next ten years, according to the U.S. Green Building Council.
- Nationwide, the costs for repairs, maintenance and modernization exceed an estimated \$300 billion. The General Accountability Office has studied this crisis along with a number of education authorities. In addition, statewide assessments indicate a growing demand for new construction to accommodate increasing student enrollment, 21<sup>st</sup> Century skills and learning environments, and health and environmental safety.

- Local school districts are delaying priority school infrastructure projects as they struggle to secure local and state financing amid budget shortfalls and increased expenditures for transportation, utilities, school meals and homeless assistance to students affected by the national housing crisis, for example.
- Providing schools with \$50 billion in funding to address deferred maintenance projects, insulate buildings, upgrade classrooms, install double-pane windows, and build more high schools to focus on smaller teacher-student ratios, for example, would be a catalyst for an economic stimulus to provide thousands of jobs and address school infrastructure needs, according to a November 8 *New York Times* editorial.

### **Establish a Reserve to Guarantee Outstanding Education Bonds**

In the past, many school districts have acquired a financial guarantor (e.g., insurance) when issuing bonds. This elevates the school district's bond rating and makes the issuance more attractive to investors. Since a majority of the bond insurance companies have been downgraded this year, finding affordable access to a financial guarantee (a AAA rating) has been difficult – especially for smaller school districts. Therefore we suggest having the Treasury establish a reserve of at least \$25 billion to guarantee bonds for elementary and secondary education. While municipal bond defaults are extremely rare – less than one tenth of one percent – having a financial guarantee, allows for better bond pricing, which saves taxpayers money. Although the level of assistance from this reserve may have to be determined on a case-by-case basis, such a mechanism would help remove barriers to debt service for the U.S. education system.

#### *Rationale*

- Due to the lack of purchasers, and the downgrading of many bond insurers and liquidity providers, some short-term bonds whose rates are reset on a short-term basis, are finding no buyers. This means that the bank takes back the bonds – and charges the issuer (school district) the bank lending rate, which is much higher than the anticipated debt costs, and accelerates the repayment plans from 30 years to three years, for example. This has caused states and local governments, as well as institutions of higher education, severe financial hardship. These types of bonds may have been securitized into other debt instruments that declined, thereby prompting earlier maturity dates for payment.
- The ability of school districts and governments to meet either the established payment plans or the accelerated payments is crippled by a decline in revenue at all levels. Property tax revenues are lower because of the housing market implosion. With housing assessments falling by more than 20 percent in many communities, property tax revenues that are used to finance as much as 40 percent to 50 percent of education costs are now in a sharp decline.

In addition to the lack of financial guarantee providers going forward, finding ways of restructuring outstanding bond issues that were guaranteed by institutions that now lack a AAA rating, for example AIG, remains difficult.

- Sales tax receipts are much lower because of unemployment and decreased consumer purchasing power. Business activity tax revenues are lower because of the barriers to capital and credit for corporations and small businesses. In fact, recent mid-year projections of state budgets indicate a combined shortfall of more than \$100 billion. The bottom line is that education funding and funding for essential local and state government operations is in serious jeopardy. Hence, bond payments are affected.

- Short-term borrowing for school districts that is generally secured by tax anticipation notes has become a significant challenge. The unfortunate result for many schools has been layoffs, deferrals of purchases for textbooks, technology and supplies, increases in class sizes, transitions to four-day school weeks, and cancellation of electives, extracurricular programs and field trips.

For example, officials in the Miami-Dade school system recently announced a \$122 million cut to its already strained budget this year.

- If districts can actually secure short-term loans, the interest rates are now significantly higher than were budgeted for.

Officials from the Cold Spring Harbor School District in New York stated that the district borrows money through short-term loans while awaiting annual property tax receipts. The district recently closed a sale on \$7 million worth of tax anticipation notes with an interest rate of 3.23 percent, which was an increase of one percentage point, or an extra \$49,000 over the life of the loan. William Bernhard, the district's interim assistant superintendent for business, stated that the extra cost is the equivalent of hiring a teacher or making an educational upgrade.

- For authorities with lower bond ratings, the cost for debt service is significantly higher, thereby placing a higher burden on local and state budgets.

A recent Moody's Investors Service report concluded that the continuous lower revenues, along with the current credit market conditions, could put downward pressure on issuers' long-term credit ratings. The report also stated that issuers lacking strong liquidity and a reliance on short-term note borrowing will face the most pressure if markets do not reopen quickly.

"Ratings on these issuers' short-term borrowings may suffer and there may be downward pressure on long-term ratings if the short-term liquidity crunch manifests as longer-term credit risk," according to Moody's Investor Service.

- When bond ratings are impacted, a region's ability to attract and retain industry and other sources of commerce is damaged. If there is no reasonable commerce and tax base, the school systems are impacted. As you are aware, the financial services industry impacts education and all related components for sustainability and growth.

### **Fund for Pending Bonds**

Establishing a fund of at least \$50 billion for the government to purchase bonds for pending projects, including those for school infrastructure, that have not been able to be issued due to the liquidity crisis.

#### *Rationale*

- Providing capital to meet immediate needs for short-term borrowing that a number of school systems utilize, based on scheduled receipts from tax revenues, is essential. Without the ability to address short-term borrowing needs, the nation's school systems cannot operate at their full capacities. If this is not addressed, a number of contracts and agreements are at risk, thereby increasing the liability of school systems with limited capital.

- From employment and collective bargaining agreements, to utilities and special education programs, a designated source of funding for school systems is needed until the market can sufficiently accommodate the education sector.
- The *Atlanta Business Chronicle* recently reported that state, local and school district planners are putting more than \$1 billion in building and highway projects on hold, waiting for stability to return to markets racked with uncertainty.
- Challenges facing long-term borrowing are also evident for school systems such as Cumberland County, North Carolina, where officials froze plans to build a \$20 million elementary school in the 53,000-student district after a neighboring county failed to find buyers for \$454 million of its own construction bonds.

*Education Week* reported that the state of Maine has delayed 12 major school construction projects totaling \$348 million in 11 school districts. In other states, even districts able to borrow money are paying higher interest rates while bracing for yet another drop in property-tax revenue. And in San Mateo County, California, officials in some two dozen districts are unable to access of millions of dollars invested with Lehman Brothers.

### **Advance Refunding**

The ability of bond authorities to refinance outstanding debt at lower interest rates needs greater flexibility. The *1986 Tax Reform Act* restricted a government's or district's ability to refinance their debt and save taxpayers money. Under current law, entities have only one opportunity to advance refund their debt over the lifetime of the bond (usually 30 years). We recommend allowing an additional advance refunding opportunity so that governments have the flexibility to take advantage of lower interest rates in future years or restructure their debt service payment options.

### *Rationale*

- Allowing additional advance refundings of bonds in this current economic climate would be a great help to school districts and other issuers as governments explore all options to reduce expenditures, preserve credit ratings, and maintain fiscal solvency. If this cannot be achieved broadly, the option for refinancing outstanding bonds should be made available to authorities whose payment schedules need to be modified because of falling receipts, as well as those authorities that project declines in future revenue.
- Easing debt service on school construction bonds could ensure that a bigger share of bond revenues goes toward employment creation.
- Just as Congress approved additional advance refundings for certain bond authorities as a form of fiscal assistance when the economy declined after the September 11 terrorist attacks and after Hurricane Katrina, NSBA urges the implementation of a similar measure that will help provide flexibility for local and state governments.
- Allowing additional advance refunding is a sound financial management tool that will provide immediate assistance to help alleviate state and local budget shortfalls.

While these recommendations are not inclusive of all measures that can be implemented to help stabilize local and state economies, NSBA appreciates your consideration and implementation of these recommendations as you work to target federal investments and achieve the goals of *The Emergency Economic Stabilization Act of 2008*. Immediate funding for school infrastructure, the creation of a reserve fund to guarantee outstanding education bonds, a fund to accommodate pending bond issues for urgent education needs and school construction, allowing for an additional advance refunding, and exemption from recent 403(b) regulations will provide immediate assistance to local and state governments and will help strengthen the financial market.

Without such assistance, projections of greater losses in revenue and economic dislocation in 2010 threaten local and state budgets and the bond market even more. Credit trends for K-12 and higher education were strong at the beginning of the recession. Our goal is to sustain the fiscal integrity and stability of the nation's education system.

NSBA would very much appreciate the opportunity to discuss our recommendations. Questions concerning our positions may be directed to Michael A. Resnick, Associate Executive Director, at 703-838-6720, or by e-mail at [mresnick@nsba.org](mailto:mresnick@nsba.org).