Bond Accountability
Commission 2, Inc.

American Recovery and Reinvestment Act

How it could affect Cleveland schools and you

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(**Sources:** National Clearinghouse for Educational Facilities; Congressional Research Service; Congressional Budget Office; U.S. Census; U.S. Department of Education; Cleveland Metropolitan School District; Squire, Sanders & Dempsey LLP; Holland & Knight LLP; Womble Carlyle Sandridge & Rice PLLC; Government Finance Officers Association; Council of Great City Schools; Bond Accountability Commission 2 Inc.)

The economic stimulus package signed into law by President Obama on Feb. 17 reserves no money specifically for school modernization, renovations or repairs, although it allows use of some of the money for such work. Therefore, the legislation may have an impact on the Cleveland Metropolitan School District's Issue 14-funded construction program, which is entering the fifth of 10 planned segments. The extent of any such impact will be determined largely by the state government.

Provisions of the law

States distribute the money: Title XIV of the federal legislation, formally the American Recovery and Reinvestment Act of 2009, provides the states with about $53.6 billion in a State Fiscal Stabilization Fund administered by the U.S. Department of Education. Within certain parameters, each state government will decide how to distribute that money among its school districts, colleges and universities. The states have two years to award or commit the money to specific uses; after two years, any money left over must be returned to the federal government.

Of the total aid, 61 percent is to be distributed among the states according to their share of the national population of ages 5 through 24; the remaining 39 percent is to be distributed according to each state's share of the national population of all ages.

Maintaining status quo: After set-asides, the fiscal-stabilization total includes about $39.5 billion to be distributed among the states "for the support of elementary, secondary, and postsecondary education, and, as applicable, early childhood education programs and services." Among permissible uses is "modernization, renovation, and repairs of public school facilities (including charter schools)." New construction, once a feature of the original Senate proposal, is excluded, and none of the money can be used for ordinary maintenance or work on stadiums, school administrative buildings or school facilities used for religious instruction or worship.

Each state is supposed to use the money to ensure that school districts receive the same level of state aid to elementary and secondary education in fiscal years 2009-11 as they did in the current school year. Colleges and universities also are to get the same amount of state subsidy as they did in the current school year. The states are expected to provide non-stimulus funding for schools at least at the level that they were funded in 2006, although waivers may be granted.

If the aid to the state is insufficient to maintain future funding at the current level, then the money is to be distributed on a pro-rated basis to the districts, colleges and universities.

If the aid is more than sufficient to maintain current state educational funding for all public schools, colleges and universities, the rest may be awarded to school districts based in essence on their relative share of eligibility for federal assistance to students in poverty.

Discretionary funds: The $53.6 billion total also includes about $8.8 billion "for public safety and other government services, which may include assistance for elementary and secondary education, and for modernization, renovation, or repair of public school facilities and institutions of higher education facilities." Although this pot of money will be administered by the Education Department, nothing in the legislation's language limits the spending to education. The National Clearinghouse for Educational Facilities (NCEF) concludes that under this provision, "states appear to have complete discretion in distributing this money, making anything possible in terms of how it is spent."

School construction tax credits: State and local governments will be allocated the authority to issue up to $22 billion in "qualified school construction bonds" ($11 billion in 2009 and $11 billion in 2010), a new type of tax-credit bond. Bond proceeds could be used for new construction as well as renovation and repair, and they could be used to buy property for new school sites.

The construction proceeds of the bonds must be expended within three years of issuance. Any remaining unspent construction proceeds must be used within 90 days to redeem bonds.

Sixty percent of the bonding authority is to be awarded to each state based generally on its relative eligibility for federal education assistance.

Forty percent of the allotment is to be reserved for large school districts with high poverty rates. These districts can reallocate their unused capacity to the State. The Council of Great City Schools has estimated this allocation for the Cleveland District at $108 million.

The law includes a carryover provision that permits use of a state's allotment in later years if not all the allotted amount is issued in 2009 and 2010.

And funding for the existing tax-credit Qualified Zone Academy Bonds program for schools will be increased by $2.8 billion ($1.4 billion in 2009 and 1.4 billion in 2010). A qualified zone academy is a public school that provides education and training below the college level and operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates.

The idea behind these tax measures is to make construction, renovation and repairs more affordable for local taxpayers.

Holders of the tax-credit bonds will receive tax credits from the federal government instead of cash interest payments from the issuing school district, presumably a better deal for some investors. The school district will only have to pay back the principal of the bonds.

Generally, interest on municipal debt such as school bonds is not subject to federal tax for bondholders. However, holders of the qualified school construction bonds must report the tax credit as income, but after calculating their overall tax liability as if they had received that compensation in cash, they can subtract the full amount of the credit from the total tax due. The amount of the credit presumably will be linked to the prevailing interest rate paid on tax-exempt bonds, but no rules have been published yet. The tax credit can be "stripped" from the bonds and sold separately. Unused credits can be carried forward to future tax years.

In the case of the remaining $55 million that the Cleveland District expects to issue in spring 2009 for its construction program, use of tax-credit bonds would reduce the amount charged to each property-tax payer to meet the District's debt-payment obligations. In all, taxpayer-paid interest on the $55 million issue is preliminarily expected to total $28.9 million from 2010 through payoff in 2029.

Additionally, if District voters were willing to approve additional bond issuance needed to execute the final segments of the construction/renovation program, the cost to taxpayers would be significantly reduced during the payoff period to the extent that proceeds of the tax-credit bonds could be spent within the allowable periods.

Buy American: The law includes a provision that bars use of the money provided by or made available through the law for construction, renovations or repairs unless all iron, steel and manufactured goods used in the project are produced in the United States. Exceptions are allowed if federal officials decide that applying the rule would not be in the public interest, such goods are not produced in the United States in sufficient quantity or of satisfactory quality, or use of such goods would increase the overall cost of the project by more than 25 percent.

Statehouse decisions

Biennial budget: Under the Ohio Constitution, the state government must approve a new biennial budget by July 1, 2009. The governor has proposed a budget that includes restructuring of Ohio's basic school funding formula but that is dependent on depleting the state's "rainy day" surplus fund and on a certain level of federal stimulus aid (which, preliminarily, the governor's office thinks Ohio will get). All of the governor's proposals are subject to approval by the General Assembly, which is by no means assured.

Based on U.S. Census data for 2007 and 2008, Ohio's share of the $39.5 portion of the stimulus package appears to be about $1.49 billion, and its share of the $8.8 billion portion would be $331 million (The amounts are subject to revision. The Plain Dealer, quoting the governor's office, reported the latter figure on Feb. 18 as $326 million. The grand totals for Ohio fiscal stabilization would thus range from $1.816 billion to $1.821 billion. However, the U.S. Department of Education lists the total for Ohio as of March 16 as $1.789 billion but warns that the numbers may change).

Modernization not top priority. As long as Ohio maintains basic school funding at the required level, the federal stimulus aid would appear to give the state some temporary flexibility to reform its school funding system while also providing assistance for school modernization.

However, since the basic state funding formula does not ordinarily provide money for school modernization and since the state government is facing a serious financial shortfall, the "status quo" priority for the $39.5 billion may mean that most or all of Ohio's share goes to the state operating subsidy for schools and that little or none goes to modernization. In any case, it appears that school districts will have to wait until July 1 to know how much money, if any, is designated for school renovations and repairs.

The state government's financial difficulty may also mean that its share of the discretionary $8.8 billion portion of the federal stimulus will be allocated to priorities other than school modernization, such as health and human services, public safety, protection of natural resources, and other types of educational assistance.

In addition, the Cleveland District is facing a substantial operating deficit for the 2010-11 school year and a tough economic climate in which to presume voter approval of an operating tax increase, if any is requested. The District may therefore be reluctant to apply much of any discretionary funds to modernization when the money could be used to pay operating bills. The District, which by law cannot have a budget deficit, is currently evaluating cost-cutting options, which could include closing schools.

CMSD planning

Premise for maximum impact: This analysis presumes that in order to maximize the impact of any federal stimulus money available for modernization, the Cleveland District should use as much as possible as its cost share of the construction program co-funded by the Ohio School Facilities Commission (OSFC). The OSFC matches District construction dollars 2 for 1 and attempts to limit work to schools that will be needed in the future.

Another Master Plan revision? The two-year "use it or lose it" limitation of the federal legislation and its restriction to renovations and repairs appear to mean that the District's new Master Plan for school replacement and renovation, approved by the Board of Education in July 2008 after more than a year of planning and community meetings, would have to be revised if the state provided substantial federal aid for modernization. That's because only 16 of the 49 scheduled school projects are renovations (either full or partial); the rest are new construction. And only two of the renovation/repair schools are in Segments 5 (currently in the design stage), 6 and 7 of the Master Plan, the approximate time frame for using the money. (Segment 7 may not qualify, depending on how federal authorities define when the money is committed.)

The District has estimated its cost of the 16 renovation/repair schools, with co-funding from the OSFC where applicable, at $60.71 million (a figure that includes inflation adjustments that would not apply if the projects were done earlier). Until the amount of any modernization aid is known, it is impossible to say how many of the other 14 schools would have to be moved up to qualify for the assistance.

An alternative would be to convert some of the planned new schools in Segments 5, 6 and 7 to full renovations, which would reduce the need to shuffle the Master Plan along with the cost and time involved in doing so. Moving planned renovations to earlier segments could increase District expenses for providing "swing space" in which students could attend classes while their school is being renovated.

Modernization aid could also be spent on repairs to some 40 "maintain-only" schools not included in the OSFC-funded Master Plan. That would reduce the federal aid's leverage of OSFC money for the District and could have consequences regarding OSFC limits on overall construction. Some of these schools may be closed in the relatively near future.

Focus for maximum benefit: Aside from construction jobs, the ultimate benefit of any federal modernization aid will depend on how wisely it is spent. Will it be focused on schools that, using OSFC enrollment projections, the District Administration and community decided should be part of the Master Plan? Or, in the rush to meet deadlines, will much of it be spent on repairs to schools that might be closed in a few years due to operating-budget problems and declining enrollment?

In determining where to spend any federal aid, the District can use assessments of existing schools' condition that have already been done as part of the OSFC-funded program. And the Master Plan already designates the schools that the District wants to renovate or replace.

Despite the taxpayer-friendly goal of leveraging the most dollars from the OSFC, it may be that District must make some sorely needed improvements to schools that are not part of the OSFC-funded Master Plan. Lincoln-West and John F. Kennedy high schools are examples.

Essentially, such spending would redress deficiencies in the execution of the Issue 14-funded Warm, Safe and Dry program, which was done for $25 million (including the OSFC share) under budget, chiefly by not fully repairing schools that were to have been renovated or replaced in early segments. The problem arose when those schools were then moved to later segments or were deleted from the Master Plan and the repairs still were not done.

In repairs are done now, they should be performed almost exclusively on schools that the District is sure will remain open, except to address current threats to health and safety.

Temporary quarters: The legislation's limitation to renovations/repairs and the two-year window – combined with the location of most of the District's currently planned renovations – present a difficult hurdle.

As mentioned above, the District has relatively few schools planned for renovation. Of the eight District elementary schools currently planned for renovation in Segments 5 through 10, six are on Cleveland's West Side. And three of the five elementary schools planned for partial renovations are on the West Side. The problem is that swing space is in short supply on the West Side, where student transfers and relative population stability have kept most schools full. Cramming all the renovations into the two-year window to meet the deadline, instead of spacing them out over time, would make finding adequate swing space all the harder.

Renovating the schools while occupied is possible, though it may not be desirable from a safety/health standpoint, especially when very young children are involved. Renovating the schools in phases over several summers is possible, too, if acceptable under the federal rules, but probably more expensive. At the least it appears that the District would have to spread students from a school over multiple swing sites during renovation.

One size fits all? The OSFC will co-fund only enough school space to accommodate the enrollment that it foresees a district having at the end of the construction program (2015 in the CMSD case). It applies the co-funded enrollment limit districtwide, not by neighborhood. A district theoretically could build all of its school space at one campus, though doing so would seem foolish for a district as large as Cleveland.

And the OSFC has what it calls the two-thirds rule. From the OSFC Web site: "While there are several factors that are considered, it is normally the recommendation of the [OSFC] that an existing structure be replaced when the cost of renovating the school building exceeds two-thirds of the cost of building a new facility of the same size. However, a district can request the approval of renovations that cost in excess of two-thirds of the cost of replacing the building if it is demonstrated that the building can provide an appropriate learning environment for students, or if there is other good cause shown. When a waiver is granted, the Commission will co-fund renovations up to the cost of new construction. Any expenditures exceeding the cost of a new building are the sole responsibility of the district."

On its face, fair enough. The OSFC generally doesn't see the point of spending that much money on a renovation when the same money could produce a new school designed for all the modern amenities, energy savings, technology, etc.

However, the OSFC also applies the converse of the rule: It will not pay for a new building if the cost of renovating an existing one is less than two-thirds the cost of building new.

The problem arises from the OSFC's policy of treating large urban districts the same as small suburban districts. It interprets the two-thirds rule to mean that if a district has any school in a classification (high school, K-8, Vo-Ed) that could be renovated for less than two-thirds the cost of building a new one in that classification, then the renovation must be done instead of the new construction – *no matter where in the district the school is located.*

For example, when the District sought OSFC approval for building a West Side Relief High School in Segment 5, the OSFC, citing its districtwide high school enrollment limit for co-funding and the districtwide two-thirds rule, insisted on first determining whether Martin Luther King Jr. High School and Lincoln-West High School could not be renovated for less than two-thirds the cost of a West Side Relief. Never mind that the West Side high schools were overcrowded and that renovating Lincoln-West would not change that, or that busing West Side residents to MLK would be very expensive and impractical. Later, re-assessments found that the costs of renovating MLK and Lincoln-West would exceed the two-thirds threshold, which allowed West Side Relief to be included in Segment 5.

But District administrators now fear that continued application of the rules districtwide could prevent extensive federally paid repairs to some non-Master Plan schools that need them. That's because the OSFC might then say the repairs had improved these schools to the point that they fell within the two-thirds threshold, meaning that they then would have to be fully renovated in place of those already selected by the District under the Master Plan. That, in turn, could produce a District with a surplus of fully renovated and new schools where the population does not merit them, at the expense of other neighborhoods that do need them.

As an example, John F. Kennedy High School is not part of the OSFC-funded Master Plan but could use repairs. The fear is that doing those repairs with the federal money could prompt the OSFC to say that JFK could then be fully renovated for less than two-thirds the cost of building West Side Relief, so the relief school could no longer be part of the Master Plan.

One obvious solution would be for the OSFC to officially acknowledge that applying the two-thirds rule districtwide is ludicrous for a geographically large school district and to allow exceptions in such cases. To do otherwise, applying the JFK example, could mean depriving a high school of needed repairs or depriving a city sector with adequate high school space.

Looking ahead

The Bond Accountability Commission will continue to follow developments regarding distribution of the stimulus aid by the Ohio government. The NCEF offers advice on how school districts should proceed at http://www.ncef.org/school-modernization/ .

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