JOINT PUBLIC HEARING ON

BILL 16-250, "SCHOOL MODERNIZATION FINANCING ACT OF 2005"

Before

Committee on Finance and Revenue
The Honorable Jack Evans, Chair

and

Committee on Education, Libraries and Recreation
The Honorable Kathleen Patterson, Chair

Council of the District of Columbia

July 7, 2005, 11:00 a.m.
Council Chambers
John A. Wilson Building

Testimony of
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Good morning, Chairman Evans, Chairman Patterson, and distinguished members of the Committee on Finance and Revenue and the Committee on Education, Libraries and Recreation. I am Natwar Gandhi, Chief Financial Officer of the District of Columbia. I am pleased to present testimony on Bill 16-250, the "School Modernization Act of 2005."

Bill 16-250 would authorize the Mayor, beginning October 1, 2006, to issue up to one billion dollars ($1,000,000,000) in bonds to finance the costs of modernizing, renovating or constructing public school facilities in the District. The bill provides that debt service would be paid with $60 million annually from monies deposited in the Lottery and Charitable Games Fund. The bill would require the District's Board of Education, no later than October 1, 2006, to adopt a Multi-Year Facilities Plan to guide the modernization of District of Columbia Public Schools (DCPS), and to report to the District of Columbia Auditor on October 1, 2007, and each year thereafter, on the use of the capital funds.

Certainly, we are all in agreement about the need to modernize public school facilities. As Superintendent Janey testified before the U.S. Senate Appropriations Subcommittee for D.C. on May 25, 2005, "86 of our 147 schools are more than 50 years old. Another 41 are 75 years or older. And, between 1982 and 2000, only 4 schools were added to or rebuilt. The combined effects of aging structures, deferred maintenance and delayed improvements have created a climate of failing boilers, deteriorating walls, inoperable windows and leaking roofs. Many buildings have not been painted in more than 10 years, and some classroom carpet is more than 20 years old. When pipes freeze, cooling systems breakdown or roofs leak, it affects instructional quality and often instructional time."

To this I would add that maintenance costs are extremely high in the District, growing from neglect caused by our financial structural imbalance. Expenditures per student spent on operation and maintenance in D.C. are $1,489 in FY 2003, 39 percent above the average of $1,070 per student in a group of 18 peer school districts in urban core cities, as designated by the National Center for Educational Statistics (Attachment 1). These expenditures are adjusted for local differences in the cost of living. Only St. Louis has higher costs, at 7 percent above D.C. With a history of inadequate funding for maintenance and replacement, D.C. now has some of the most costly educational infrastructure in the nation.

In current dollars, an estimated $2.8 billion is needed to modernize 130 – nearly 90 percent – of the city's schools. The District's Capital Improvements Plan budget for FY 2006-2011 assumes funding of $640 million, or 22.9 percent of the total needs, at just over $100 million per year. The District cannot fund the entire amount needed quickly enough to ensure that all schools are brought up to acceptable levels on a timely basis.

In addressing this bill today, I would like to focus on the financial implications of the proposal and its impacts on the District's budget. The bill would require that the District issue revenue bonds backed by $60 million annually taken from D.C. lottery proceeds to pay the debt service. We estimate that in order for these bonds to be marketable to bond insurers and investors, they would require a debt service reserve fund, which is common for revenue bond issuances, and that pledged revenue would likely have to cover debt service by at least 2 times. Using these assumptions and the District's practice of issuing debt for a maximum of 30 years with level annual debt service payments, we would be able to issue between $440 million and $500 million in lottery revenue bonds, depending on interest rate levels at the time of issuance. Taking the reserve fund requirements into consideration, this would yield between $410 million and $470 million in bond proceeds for schools modernization. To raise $1 billion in revenue bonds, the annual debt service requirement would be roughly $130 million.

Bonds supported by lottery revenue are relatively unusual in the U.S., with Oregon, Florida, and West Virginia known to have issued them. Several states including Maryland are said to have them under active consideration.

The experiences in Florida and Oregon suggest that coverage requirements can be quite high, interest rates are higher because lottery bonds are rated below General Obligation (GO) issues, and there is the need for bond insurance or recourse to the full faith and credit of the general revenue stream. Bond insurance on lottery bonds would be more expensive than for GO bonds.

GO bonds are a significantly more cost effective way to raise revenue. By earmarking $60 million in lottery proceeds to pay GO debt service, the District could get roughly $875-975 million, or at least twice as much funding from the same $60 million revenue source. With debt service of $65 million annually, the District could raise roughly $1 billion in GO debt at current interest rates.

The credit rating agencies have not fully developed their policies regarding the impact of lottery revenue bonds in assessing a jurisdiction's debt burden. They have indicated varying views on the extent to which this debt would add to the general debt burden of the jurisdiction. However, it would clearly have some impact. As I indicated in my letter to the Chairman of the Council on May 5, 2005, copied to all Council members and the Mayor, the District's ratio of debt service to general fund expenditures stands today at about 9 percent. This meets the industry standard of no more than 10 percent for a financially healthy jurisdiction. With the District's currently planned borrowing, we project that this ratio will rise to 10 percent in FY 2007 and to over 12 percent in FY 2009, raising our debt per capita to about $11,000 (May 5, 2005 letter, Attachment 2).

However the debt service may be raised, $500 million to $1 billion is a substantial amount of new debt for a municipality of the District's size and resources. Such an issuance would substantially impact the District's overall debt profile, and would add approximately $1,800 in overall per capita debt. The District's per capita debt is already the highest in the country, and rating agencies have cited the District's high debt burden as a limiting factor in further upward movement in the District's credit ratings.

The lottery-backed bonds would have a direct impact on the District's budget and financial plan beginning in FY 2007. With required coverage of, for example, 2 times debt service, the financial plan would have to incorporate a $60 million commitment for this purpose in FY 2007. Under existing practice, revenues generated by the D.C. Lottery that are not required to make prize payouts and to fund the authorized administrative budget of the Lottery are transferred to the General Fund and are used to fund the District's general fund budget. Assuming actual debt service of $30 million, the remaining $30 million would be available in FY 2008 and could be combined with another $30 million from the lottery to provide the needed coverage. While the complete budgetary and financial procedures would need to be determined in keeping with GAAP and rules of the financial markets, the net impact is an on-going reduction of funds for the general fund budget of $30 million annually.

Looking forward, if General Fund revenues are decreased by $60 million in FY 2007 and $30 million in later years, there are two choices: either another revenue source must be found to fill this gap, or program spending would need to be curtailed. With the current expenditure budget and revenue forecast, funds are not sufficient in the FY 2007 – FY 2009 to support the legislative proposal (Financial Plan, Attachment 3).

Use of lottery funds to back revenue bonds for DCPS differs somewhat from bonds backed by a dedicated tax increment financing (TIF) revenue stream, the Arena fee bonds, or the Ballpark revenues. Lottery bonds affect the financial plan because this would not be a new revenue stream. Neither TIF, Arena fee, nor potential Ballpark bonds change the financial plan – or the impact is much smaller. This is because the lottery funds represent revenue that is already in use, while TIF, Arena, or ballpark revenue is net new funding and not currently in use. Although these latter bonds influence debt ratios and debt per capita, just like the lottery bonds, they do not pose comparable challenges to balancing the general fund budget.

The lottery is a fairly stable funding source for the General Fund. Since FY 1994, the lottery transfer has averaged $73.5 million a year, with three very good years when the transfer exceeded $80 million and two very off years when the transfer fell below $65 million. Positive variation is often associated with a strong Powerball jackpot that attracts many players, while “off” years result from higher than usual payoffs on other games and from stronger competition from lotteries in surrounding jurisdictions. Given this history, it is unlikely that more than $60 million could be used to back revenue bonds.

In addition to schools, the District has other critical capital needs that must be addressed. The FY 2006 Capital Improvements Plan provides $589 million for capital improvements in areas other than schools. Moreover, the District has $700-800 million in unfunded capital needs citywide each year in the foreseeable future, beyond our borrowing capacity.

What this clearly shows is that the District cannot continue to address the needs for improved school facilities on its tax base alone. I call your attention to the fact that in most states the state government provides funding for school facilities. School districts throughout the country get significant funding for operations from their states – even schools with "financial independence."

In a peer group of 18 school systems located in central urban areas, fully 50 percent of funding comes from the states (Attachment 4). In the District, this 50 percent – or more than $450 million in FY 2005 – comes from local revenues. That, of course, is part of the reason that we continue to have a structural imbalance, a fact now documented by the federal government. In our special circumstance as the capital city to the nation – and therefore as a city intentionally designated to serve without a state – this funding is a federal responsibility. We will continue to work with the Mayor, the Council and the federal government to correct this imbalance. In the meantime, I urge the Council to carefully consider all aspects of this proposal and others to insure that the District continues to make the best and most judicious use of its available resources.

This concludes my testimony. I will be glad to answer any questions you may have.

Per Student Cost-of-Living Adjusted Public School System Expenditures, Expenditure on Operation and Plan Maintenance, FY 2003

DC Peers and expenditures as identified by National Center for Educational Statistics

ATTACHMENT 1: Current Operation Expenditure per Student: Operation and Maintenance of Plant

School System	State	Total Expenditures	Total Salaries and Wages	Total Employee Benefit Payments	All Other Expenditures	Cost-of-Living Adjustment Factor
DC PUBLIC SCHOOLS	DC	$1,489	$569	$109	$810	1.000
Weighted Average for DC Peers		$1,070	$481	$126	$463	
ORLEANS PARISH SCH DIST	LA	$846	$363	$65	$418	1.307
OAKLAND UNIF SCH DIST	CA	$865	$409	$148	$309	0.907
EL PASO IND SCH DIST 902	TX	$889	$427	$94	$367	1.322
YSLETA IND SCH DIST	TX	$906	$430	$115	$361	1.322
MILWAUKEE CITY SCH DIST	WI	$992	$462	$235	$294	1.171
BOSTON CITY SCH	MA	$992	$410	$78	$505	0.923
BALTIMORE CITY SCHOOLS	MD	$1,015	$392	$15	$608	1.289
SAN ANTONIO IND SCH DIST 907	TX	$1,029	$517	$101	$412	1.322
CLEVELAND CITY SCH DIST	OH	$1,040	$540	$199	$301	1.132
FORT WORTH IND SCH DIST 905	TX	$1,056	$553	$88	$415	1.319
CINCINNATI CITY SCH DIST	OH	$1,059	$530	$153	$377	1.265
TULSA SCH DIST 1	OK	$1,084	$430	$97	$557	1.357
COLUMBUS CITY SCH DIST	OH	$1,224	$533	$151	$540	1.243
ATLANTA PUBLIC SCHOOLS	GA	$1,246	$520	$114	$612	1.168
BUFFALO CITY SCH DIST	NY	$1,342	$330	$82	$931	1.208
INDIANAPOLIS PUBLIC SCHOOLS	IN	$1,396	$741	$214	$441	1.257
ST LOUIS CITY BD OF EDUCATION	MO	$1,594	$723	$242	$629	1.284

Attachment 3

FY 2005 - 2009 Revised Budget and Financial Plan – General Fund ($ in 000s)

		FY 2004 Actual	FY 2005 Approved	FY 2005 Revised	FY 2006 Proposed	FY 2007 Projected	FY 2008 Projected	FY 2009 Projected
	Revenues							
1a	General Fund Revenues (February 2005), including Lottery	4,303,441	4,200,901	4,512,217	4,752,706	4,984,835	5,259,413	5,545,714
1b	Other Transfers In	0	6,361	23,261	48,078	24,268	24,476	24,311
1c	Local Fund Balance Use	97,361	49,365	49,365	466,930	0	0	0
1d	Special Purpose Revenue Fund Balance Use	31,767	115,650	115,650	102,091	0	0	0
1e	Transfer to Capital	0	0	0	-30,000	-30,300	-30,603	-30,909
1f	Revenue Proposals/One-time Revenue	0	128,107	27,000	-31,302	-32,802	-34,602	-36,102
1	**Total General Fund Resources**	**4,432,569**	**4,500,384**	**4,727,493**	**5,308,503**	**4,946,001**	**5,218,684**	**5,503,014**
		0	0	0	0	0	0	0
	Program Expenditures							
2	General Program Expenditures	3,988,190	4,448,247	4,441,478	4,866,760	4,874,268	5,064,216	5,245,658
3	Cash Reserve (Budgeted Contingency)	0	50,000	15,000	50,000	50,000	50,000	50,000
4	Paygo Capital	0	0	0	198,900	0	0	0
5	Transfer to Trust Fund for Post-Employment Benefits	0	0	0	138,000	0	81,000	86,200
6	General Fund Contribution to Capital Fund Balance	0	0	0	53,800	0	0	0
7	**Total General Fund Expenditures**	**3,988,190**	**4,498,247**	**4,456,478**	**5,307,460**	**4,924,268**	**5,195,216**	**5,381,858**
8	**Operating Margin, Budget Basis**	**444,379**	**2,137**	**271,015**	**1,043**	**21,733**	**23,467**	**121,155**
9	Beginning General Fund Balance	897,357	1,215,015	1,215,015	1,301,015	713,037	714,770	718,237
10	Operating Margin, Budget Basis	444,379	2,137	271,015	1,043	21,733	23,467	121,155
11	Projected GAAP Adjustments (Net)	2,407	-20,000	-20,000	-20,000	-20,000	-20,000	-20,000
12a	Deposits into Reserve Funds (From Fund Balance)	-31,609	-19,041	36,032	-4,489	-4,570	-37,667	-5,330
12b	Deposits into Reserve Funds (To Cash Reserves)	31,609	19,041	-36,032	4,489	4,570	37,667	5,330
13	Fund Balance Use	-129,128	-165,015	-165,015	-569,021	0	0	0
14	Ending General Fund Balance	1,215,015	1,032,137	1,301,015	713,037	714,770	718,237	819,392
	Composition of Fund Balance							
15	Emergency Cash Reserve Balance (2%, formerly 4%)	163,091	179,930	83,126	84,622	86,145	98,701	100,477
16	Contingency Cash Reserve Balance (4%, formerly 3%)	122,318	124,520	166,251	169,244	172,290	197,401	200,955
17	Fund Balance not in Emergency & Contingency Reserves	929,606	727,687	1,051,638	459,172	456,335	422,135	517,960
18	Ending General Fund Balance (Line 14)	1,215,015	1,032,137	1,301,015	713,037	714,770	718,237	819,392

Attachment 4

DC and "Peer" School Systems: Revenue Sources, FY2003				
DC Peers and sources as identified by National Center for Educational Statistics	Percentage of Total Revenue from:			
	Federal	State	Local	Total
DC PUBLIC SCHOOLS	**14%**	**0%**	**86%**	**100%**
DC Peers: Average (17 districts)	**13%**	**50%**	**37%**	**100%**
Min	9%	26%	18%	
Max	18%	69%	65%	
DC Peers: Dependent School (3 districts)	**12%**	**51%**	**36%**	**100%**
BALTIMORE MD	14%	61%	25%	100%
BOSTON MA	10%	32%	58%	100%
BUFFALO NY	14%	69%	18%	100%
DC Peers: Independent Schools (14 districts)	**13%**	**49%**	**38%**	**100%**
OAKLAND CA	11%	61%	28%	100%
ATLANTA GA	10%	26%	65%	100%
INDIANAPOLIS IN	13%	63%	24%	100%
NEW ORLEANS LA	18%	45%	37%	100%
ST LOUIS MO	13%	49%	38%	100%
CINCINNATI OH	10%	33%	57%	100%
CLEVELAND OH	18%	49%	34%	100%
SAN ANTONIO TX	16%	55%	29%	100%
MILWAUKEE WI	15%	63%	22%	100%