

# *Fiscal Navigation Newsletter for NYS School District Leaders*

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By James Mills, Ph.D.

## **Recommendations Related to the 2008 Fiscal Crisis**

**New York State and school districts have been through difficult state budget cycles in the past. This cycle will bring us familiar actions and new challenges. Experience has taught us that there are proactive steps school leaders can take to prepare, mitigate, and manage the impact. School leaders must become both strategic and political.**

### **Set the Stage**

The Board of Education, faculty and staff, and community at large must be primed for future cuts. Good fiscal management demands that you plant the seeds early and repeatedly that the probability of cuts in services and related reductions in state aid are very high given the economic circumstances that the State of New York is in at this time.

*Recommended Action:* Develop an in-district stakeholder committee that becomes knowledgeable about current events and can give guidance to others related to the fiscal crisis impact on the district's finances. Firm up your district's educational philosophy so that it serves as a framework for future discussions. Work with the Board of Education to determine a fiscal philosophy so it becomes a compass for your decisions.

### **Start Now - Reduce the 2008-2009 School Budget**

Because money has been budgeted for 2008-09 does not mean it must be spent.

*Recommended Action:* Reduce costs now in order to build your 2008-09 fund balances, for the next three years. Limit any unnecessary spending. Carefully think through your decisions to implement new programs or hire additional staff. Easing into staffing reductions often helps soften the impact. Therefore phasing should be seriously considered. Increasing your reserve accounts increases the district's position with rating agencies and provides a mechanism to help the district manage fluctuations in state aid. (See remarks below regarding reserve accounts.)

There is talk of a mid-year cut in state aid. The general consensus is that such reduction is not likely. However, your expenditure reductions in the 2008-09 budget should, in many respects, mirror what you believe you would do if the state did cut aid.

### **Watch for NYS Actions on and after November 18<sup>th</sup>**

November 18 is the date the legislature returns to session.(1) The Governor is asking \$2 billion in cuts from the state budget based upon what he predicts will be revenue shortfalls from state taxes. The Governor plans on having next year's state budget ready by December 16<sup>th</sup>.(2) About a third of state revenues flow in during the last state fiscal quarter, which is Jan, Feb, March. This occurs after state business is closed for the 2008 fiscal year. Forty thousand Wall Street jobs are gone. If bonuses are to be paid, they are usually paid in January and February.(3) It's not likely that January 2009 will be full of large bonuses. Governor Paterson is issuing his budget before the State's last quarter revenue is known. Therefore, it is likely to be a budget based upon the worst case scenario.

*Recommended Action:* Pay very close attention to events in Albany after November 18<sup>th</sup>. Watch for signals of what might be coming **and try and be proactive.**

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## **Who Wins Control**

Who wins control of the NYS Senate is important in terms of the strategy for the State economic recovery. The current State Senate, which is controlled by Republicans, has already passed a constitutional amendment bill that would limit yearly spending increases to 4%.<sup>(4)</sup> Knowing past practice makes predicting easier. If Democrats control the Assembly, the Senate, and the Governor's Office different patterns of legislative action can be anticipated.

NYSUT withheld campaign support for the Senate members up for election as a result of the Senate's vote the tax cap. NYSUT has a bankroll of \$7.2 million and is one of the most influential special interest groups in the state.<sup>(5)</sup> However, with just two weeks to go before the election it lifted its freeze. When the President of NYSUT was asked if NYSUT was implicitly backing the Republicans he said "It is not. It's a statement about issues." He said the prospect of a mid-year cut is the "primary issue on the table right now, and we are looking to be supportive of those who understand the devastating effect that a mid-year cuts would have on education."<sup>(6)</sup>

*Recommended Action:* Study political party platforms to understand the promises the political parties are making.

## **Loss of Revenue**

New York State's 2008 Budget is \$120.9 billion.

Early projections were that Wall Street would pay its employees \$48.2 billion in bonuses. That would have generated \$3.3 billion in tax revenue. Now projections are \$27.5 billion which will yield \$1.9 billion in tax revenue.

NYS Comptroller DiNapoli is predicting a potential shortfall of \$6.4 billion in this year's budget and a gap of \$9 billion over the next 18 months.<sup>(7)</sup> Others predict the shortfall may go as high as \$10 billion.

New York State has the highest local property tax in the nation. It is 79% above the national average. Outside New York City, approximately 63% of taxes go to schools.<sup>(8)</sup>

Paterson has ordered all state agencies to reduce their spending first by 3.35% and then another 7%. The result is that the State Education Department (SED) has had to pare \$16.6 million from its budget. SED is prohibited from filling 150 department vacancies in the area of accountability, assessment, curriculum, data systems, school support and improvement, and career and technical education. All State agencies have been directed to develop zero growth budgets for next year.<sup>(9)</sup>

*Recommended Action:* Use these facts and figures and develop appropriate arguments as to why it is necessary to reduce expenses. Share this information with building level administrators and advise them that they might expect fewer services from SED. Most importantly, requests to SED will most likely take even longer to get.

## **Cuts in Foundation Aid**

Spitzer's "Education Investment Plan" called for \$ 7 billion increase over a four year period. That four year period started in 2007-08. 2008-09 is the second year. The funding increase from 2007-08 to 2008-09 was 7.4% or \$1.46 billion. The total education budget is \$ 21.01 billion.<sup>(9)</sup>

The 2008-09 increase was originally expected to be \$1.24 billion, but was increased in order to balance the competing priorities of targeting the support to high need districts, preserving funding stability, and addressing the state's budgetary constraints.

The four year Education Investment Plan is back loaded. This means bigger amounts of funding are due in the last two years. Given the gravity of the current economic situation, conventional wisdom would require that the initiative be reduced to reflect current economic realities. A likely scenario would be to

keep the promise of \$7 billion, but to spread the distribution out over additional years while leaving the basic reform in place.

Building aid is not likely to get touched in any reductions. With the alteration of amortization schedules several years ago, it does not pay for the state to make reductions in any one year. (10)

*Recommended Action:* Study the district's 2008-09 aid print-out and get a complete understanding of the variables that are driving dollars to your school district. Be in a position to explain areas where changes are likely to occur.

Follow-up to make sure your district's SA-100, ST-3, and related supplementary schedules are completed accurately. "Under reporting" your enrollment and special education counts can reduce your district's state aid.

Actively encourage families who are eligible for free and reduced lunch to apply. Higher free and reduced lunch eligibility counts increase total aidable foundation pupil units (TAFPU) and therefore increase foundation aid due to the district.

Take a proactive study approach. You and your business administrator should discuss all scenarios and develop action plans for each scenario.

### **Municipal Credit Market Problems**

Monies will be available to school districts for TANs, RANs, and BANs.(10) However, the rates are likely to be higher. Long term serial bonds are still available. In the municipal bond market interest rates have increased in the early weeks of October from 3% and 4% to upwards of 6%.(11)

The Dormitory Authority (the municipal bond funding agency which raises billions for NYS public projects) currently is not issuing new debt due to the high cost entering the market. However, it estimates that it currently holds enough cash to last two to three years.(11))

*Recommended Action:* Visit your banking partner now to get a local perspective on your situation and the amount of short term financing that would be available should your district need to issue a RAN or BAN. If you currently have BAN's outstanding, you should immediately consult with your fiscal advisors regarding market timing and when the best time is to go out to bond, and whether issuing bonds via the Dormitory Authority will be an option.

There are cases in the past week where municipalities have not had any bidders on their bonds. There are also multiple cases where only one bank offered a bid.(11) Remember, when you have solid reserves, your ratings improve. Consider a hard sell of this to your Board and community

### **Investment Policy**

NYS law requires that the Board of Education have an Investment Policy.(12)

*Recommended Action:* It is imperative that the investment policy be reviewed to assure that it is up to date, that it is being followed, and that the Board of Education knows the content of the policy. Have the policy reviewed by your School Attorney and fiscal consultants, and then advise the Board of Education.

General Municipal Law. Chapter 708 of the Laws of 1992 enacted a new section 10 and amended section 11 of the General Municipal Law to, inter alia, prescribe uniform procedures for securing deposits and investments of public funds by local governments. All deposits in excess of the amount insured under the provisions of the FDIC must be secured in accordance with subdivision 3 of section 10.

Section 3a Cooperative Investments  
Section 10: Deposits of public money  
Section 11: Temporary Investments  
Section 39: Investment Policies (13)

## **Secure Deposits**

State law requires that all deposits and investments with banks or trust companies in excess of FDIC coverage be properly secured. To the extent not properly secured by an eligible letter of credit, letters of credit issued by federal home loan bank or eligible surety bond, these deposits and investments must be collateralized by a pledge of eligible securities. These securities must have an aggregate market value equal to or greater than the aggregate amount of the district's deposits and investments. (Safe at 102%). Districts utilizing investment "pools" must assure that their investments are secured by pledge of a pro rata portion of a collateral "pool" having proper market value.(14)

*Recommended Action:* You should immediately review the individual collateral agreements that the district has with each bank. Become familiar with the details of each agreement. Pay particular attention to liquidity and what is done if bank assets are frozen. If elements of the agreement are not clear consult with your school attorney for an explanation. Check the credit worthiness of the bank where you are depositing funds. Make sure that you document your due diligence in protecting the district's funds. Be able to show proof of your due diligence in checking your arrangements. Involve your Board of Education by sharing information with them. Have this information on the official record.

Check the Office of the State Comptroller (OSC) web site for model security agreements.  
([localgov.osc.state.ny.us](http://localgov.osc.state.ny.us))

## **Asset Valuing**

Banks are required to collateralize deposits with assets. They are required to have 102% of deposits. In the current market the valuing of those assets becomes an issue.

*Recommended action:* Review how often your bank(s) value the assets backing your deposits. Try and secure daily valuing. Also, try and determine if the assets the bank has used to secure the deposit is exclusive to your school district, or if it has been used for multiple school districts.

## **Reserve Account Problems**

The Office of the State Comptroller (OSC) recently did an audit of 19 school districts to determine if their contributions to and use of the Employee Benefit Accrued Liability Reserve (EBALR) fund were appropriate. The results were that districts have reserved far more money than necessary in their EBALR.(15) Specifically OSC says that EBALR may only be used for paying costs associated with compensated leave directly to or on behalf of employees upon separation from employment. It may not be used to pay for health insurance for retirees. These expenses are expected to be recorded as current year expenditure in the general budget. Comptroller DiNapoli has called for legislation to authorize trust funds to enable schools to set aside funds for future retiree health insurance costs and other post employment benefits and to release the reserve funds for immediate use. GASB 45 requires schools to determine the cost of these obligations, but current state law prevents reserves for those obligations.

OSC calculated the amount of over funding by subtracting the reserve amount (A687 on the ST-3) from the liability recorded in the Supplemental Schedule for the Long Term Debt( SS-2 on the ST-3). (16)

*Recommend Action:* Double check how you are using the EBALR, and whether or not the EBALR amount you currently hold represents the true liability associated with compensated leaves due to employees upon separation of employment. Review all other reserve accounts that you are using to make sure you are following all legal requirements. Calculate the estimated current and future liabilities to support your reserves. Document your justification for each reserve. Plan to utilize your reserves to fund current liabilities and budget accordingly to replace them. Check your ST-3 reports for how your reserves were reported to the state. Fund balance projections should be calculated regularly in order to provide for proper management of these accounts. Review the specific requirements found in the Local Government Management Guide "Reserves" April 2003 published by the OSC. (17)

## **Federal Cuts**

Part of your revenue stream comes from the federal government. The outlook at the federal level is as unpredictable as the state. The federal budget for education is \$68.6 billion this year. That amount includes \$ 59.2 billion in discretionary appropriations and \$ 9.4 billion in mandatory appropriations. Since 2005 NCLB funding has continually been reduced.(18) Note that funding for Title 1 is poverty based. Therefore as we see a weaker economy, rising unemployment, etc. there will be an increase in the number of students that qualify for free and reduced price lunch. Even if there is no increase in the allocation per se, an increase in poverty should result in increased funding. The percentage in poverty in New York State currently is at 14%.(19)

The national election in November could make a significant difference in how programs are funded based upon the position of the candidates. Obama is calling for \$18 billion in new dollars for education with \$10 billion of that allocated for early childhood education. McCain is calling for no additional funding. Obama claims that NCLB must be fully funded. McCain believes that NCLB is adequately funded. (20)

*Recommend Action:* Carefully watch the outcome of the election for clues relative to funding for major programs such as IDEA, NCLB, and Title One. Be prepared to absorb losses in funding into the general budget as may be necessary and appropriate.

## **Property Tax Relief**

The state commission on Property Tax Relief is scheduled to issue a final report in December. Governor Patterson supports a tax cap of 4% per year. The republican senate passed legislation for such a cap. The Assembly has not taken up the issue. Proponents of the property tax cap claim the tax cap will force schools to become more efficient. The available evidence does not support such a claim.(21) The alternative to a tax cap is a "circuit breaker." This is fairly straight forward. For a given amount of revenue needed, alter the taxing mechanism so that a larger percentage of the taxes are paid by those believed to be in better financial position to afford them.(22)

In 2007 the state budget provided for a record increase in state aid and thus resulted in a significant decrease in the statewide property tax average. The state average tax levy increase for the 2007-08 school year was 3.8%, where the average for the past 15 years was 6.1%.(22) Adequate state aid is an essential factor in providing the constitutionally mandated sound basic education to all of our children.

NYSCOSS says if the state wishes to responsibly restrain school tax growth, it must get serious about helping school leaders restrain school costs. (21) NYSCOSS recommends: (1) No new unfunded mandates (2) Any new mandates be deferred until the start of the school fiscal year following enactment (3) The 130 plans and reports required by the state should be reduced (4) Competitive bidding thresholds should be raised (5) The Wicks Law should be repealed (6) Reduction of statutory obstacles to the creation of regional health benefit trusts (7) Reduce special education mandates back to what is required only by federal law. (8) Level the playing field in special education hearing processes (9) State government energy related agencies should prioritize services to schools, including the sale of low cost electricity (10) Reduce the operational restrictions on BOCES to provide shared services that save money. (21)

*Recommended action:* Study the tax cap issue and calculate the potential impact on your district if such a cap was mandated.

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