Budget Impasse Impacts

Pennsylvania has been without a state budget for more than four months. While hints from Harrisburg suggest progress has been made in overcoming the politically induced budget impasse, there is still no money coming into Pennsylvania's public schools. At this point, districts are without 30% of anticipated state subsidies and largely depending on tax revenue, fund balance, and borrowing options to continue day-to-day operations in schools. In order to gauge how deeply the lack of state funding has impacted school districts, PSBA contacted school leaders via survey in October, and again in November for an update.

October responses showed that school leaders in Pennsylvania districts anticipated a potentially protracted stalemate for which they were preparing with paired down spending, use of fund balance in many districts, and a careful look at absolutely necessary expenditures. Overall, responses at that time indicated a sense of prepared anticipation among school leaders in districts not dependent on state aid, and a sense of growing urgency among a smaller number of districts already short on cash flow options. PSBA's November budget impact survey update was distributed statewide, generating responses from school leaders in 225 (45%) of Pennsylvania's public school districts. The survey addressed school services and programming, borrowing, credit ratings, fund balances, vendor services, and monthly payments.

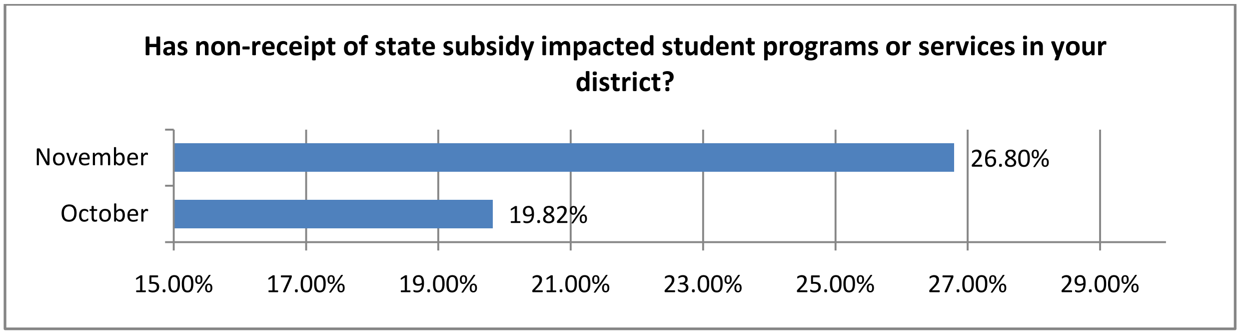
When compared to October attempts to quantify impacts, the survey also shows the beginning of an accelerated transition to fiscal instability particularly among districts in some of the poorest locations of the commonwealth.

The November survey shows as expected that districts most heavily reliant on state aid are quickly approaching a very perilous precipice. In some cases, districts have reached the precipice and have begun to topple over the side. When compared to October attempts to quantify impacts, the survey also shows the beginning of an accelerated transition to fiscal instability particularly among districts in some of the poorest locations of the commonwealth. Survey responses showed more districts at dangerously low and fully depleted fund balance levels; more districts indicating missed payments for charter schools and outside services; an acknowledgement of hits to district credit ratings; and a substantial increase in borrowing.

Some districts report weathering the storm with little ill effect – for now. Even in these fiscally stable districts, school leaders' comments point out that the time for resolution is now. **Another 30-60 days of inaction will lead to a swift financial transition for even some of the most fiscally prepared LEA's in the state.**

This report provides a brief summary of the types of impacts reported by school leaders in PSBA's November budget impact survey.

Student programs and services are suffering.



School services and programs depend heavily on funding from local and state sources. More than a quarter of the school leaders surveyed indicated that non-receipt of state subsidies has had a direct, negative impact on programs and services within the district. Here in Pennsylvania, state funding makes up approximately 37% of the total revenues received by all districts. That number varies in individual districts, essentially depending on local wealth and tax generating capacity. In some districts, state funding makes up as much as 80% of total revenues received for programs and services. One hundred and eighty-four public school districts receive at least 50% of their total funding from the state. Districts with a strong dependence on state funding have been particularly hard hit as a significant portion of anticipated revenues have failed to materialize.

The example below shows a cash forecasting summary for a school district that receives 50% of its total funding from the state. This example shows that when state subsidies are received in a timely manner, districts can use those subsidies to offset total spending. The result is a model that provides revenues sufficient to meet the expenditure needs of the district throughout the year.

Table A	Opening Balance	Real Estate Tax	State Subsidies Received	Total Receipts	Total Disbursements	Ending Balance
July	3,500,000.00	2,500,000.00	1,250,000.00	3,750,000.00	1,500,000.00	5,750,000.00
August	5,750,000.00	15,000,000.00	2,500,000.00	17,500,000.00	1,500,000.00	21,750,000.00
September	21,750,000.00	5,000,000.00	1,250,000.00	6,250,000.00	4,000,000.00	24,000,000.00
October	24,000,000.00	2,500,000.00	2,500,000.00	5,000,000.00	4,000,000.00	25,000,000.00
November	25,000,000.00		1,250,000.00	1,250,000.00	4,000,000.00	22,250,000.00
December	22,250,000.00		2,500,000.00	2,500,000.00	10,500,000.00	14,250,000.00
January	14,250,000.00		1,250,000.00	1,250,000.00	4,000,000.00	11,500,000.00
February	11,500,000.00		2,500,000.00	2,500,000.00	4,000,000.00	10,000,000.00
March	10,000,000.00		1,250,000.00	1,250,000.00	4,000,000.00	7,250,000.00
April	7,250,000.00		2,500,000.00	2,500,000.00	4,000,000.00	5,750,000.00
May	5,750,000.00		2,500,000.00	2,500,000.00	4,000,000.00	4,250,000.00
June	4,250,000.00		3,750,000.00	3,750,000.00	4,500,000.00	3,500,000.00
Totals		25,000,000.00	25,000,000.00	50,000,000.00	50,000,000.00	

The next example shows the same cash forecasting summary for the same district, but without state subsidy payments. This example shows the impact of loss of state revenues for the district. In this example, the district does not generate revenues that are sufficient to the expenditure needs of the district. In only two months, the district has gone from having an opening balance of $3,500,000 to having an opening monthly deficit of $3,500,000. This example shows that without substantial borrowing, the district will find itself crippled with debt in a short time.

Table B	Opening Balance	Real Estate Tax	Anticipated State Subsidies	Actual State Subsidies Received	Anticipated Actual Receipts	Actual Total Receipts	Total Disbursements	Ending Balance
July	3,500,000.00	2,500,000.00	1,250,000.00	0.00	3,750,000.00	2,500,000.00	1,500,000.00	2,000,000.00
August	2,000,000.00	15,000,000.00	2,500,000.00	0.00	17,500,000.00	15,000,000.00	1,500,000.00	500,000.00
September	500,000.00	5,000,000.00	1,250,000.00	0.00	6,250,000.00	5,000,000.00	4,000,000.00	(3,500,000.00)
October	(3,500,000.00)	2,500,000.00	2,500,000.00	0.00	5,000,000.00	2,500,000.00	4,000,000.00	(7,500,000.00)
November	(7,500,000.00)		1,250,000.00	0.00	1,250,000.00	0.00	4,000,000.00	(11,500,000.00)
December	(11,500,000.00)		2,500,000.00	0.00	2,500,000.00	0.00	10,500,000.00	(22,000,000.00)
January	(22,000,000.00)		1,250,000.00	0.00	1,250,000.00	0.00	4,000,000.00	(26,000,000.00)
February	(26,000,000.00)		2,500,000.00	0.00	2,500,000.00	0.00	4,000,000.00	(30,000,000.00)
March	(30,000,000.00)		1,250,000.00	0.00	1,250,000.00	0.00	4,000,000.00	(34,000,000.00)
April	(34,000,000.00)		2,500,000.00	0.00	2,500,000.00	0.00	4,000,000.00	(38,000,000.00)
May	(38,000,000.00)		2,500,000.00	0.00	2,500,000.00	0.00	4,000,000.00	(42,000,000.00)
June	(42,000,000.00)		3,750,000.00	0.00	3,750,000.00	0.00	4,500,000.00	(46,500,000.00)
Totals		25,000,000.00	25,000,000.00	0.00	50,000,000.00	25,000,000.00	50,000,000.00	

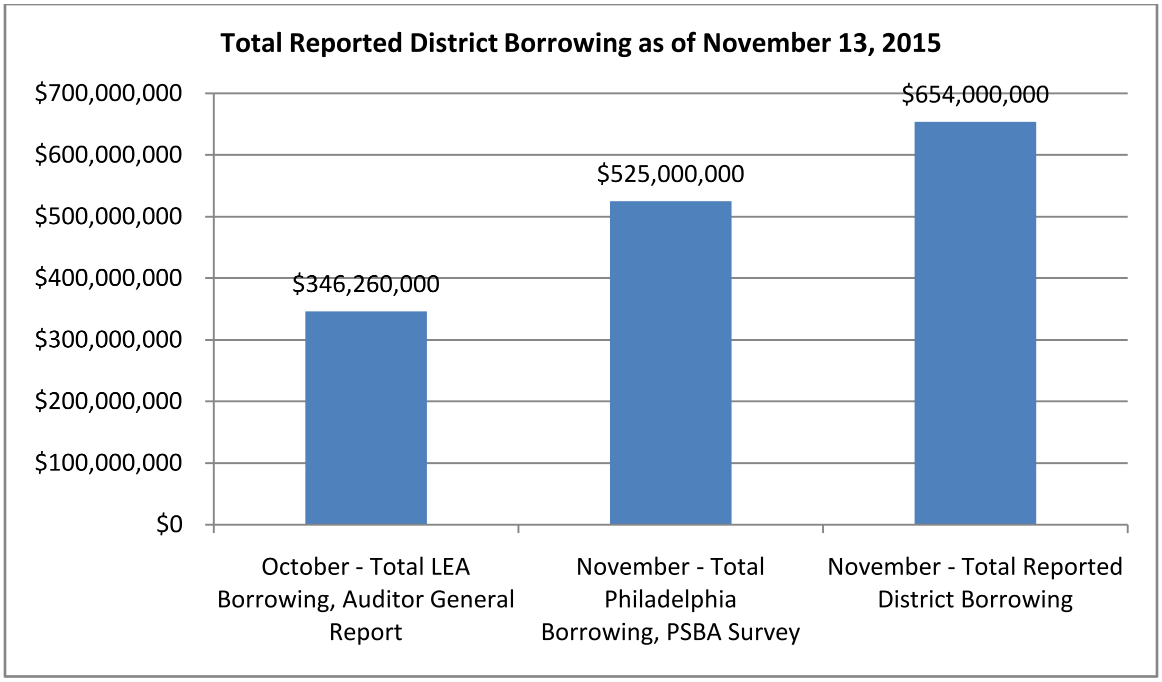
Borrowing with tax dollars?

Many districts receive a significant portion of total revenues from local sources. On average, local revenues make up about 60% of the total amount spent in public schools in any given year. In some more affluent districts, local revenues can represent as much as 87% of total revenues. These districts have largely been able to wait out the budget storm by relying on local revenues intended for later in the year. Other districts with healthy reserves have relied on fund balances to offset non-payment of state subsidies over the past four months. In some districts, however, neither of these options exists.

> District borrowing reported as of November 13, 2015, is equivalent to 3% of total expenditures reported by all districts for the 2013-2014 school year.

Districts without these options have been forced to look at borrowing in order to meet the immediate financial needs of the district. According to Pennsylvania law, public school districts are provided with cash flow borrowing options that include traditional tax and revenue anticipation promissory notes as well as bank lines of credit. Many school leader respondents indicated that borrowing either has been necessary, or that it would become necessary in the immediate future. As of November 13, 2015, ten percent of the school leaders surveyed indicated that they had had to borrow money to meet immediate payroll or other costs directly as a result of non-receipt of state subsidies; and total amount borrowed seems to be growing quickly.

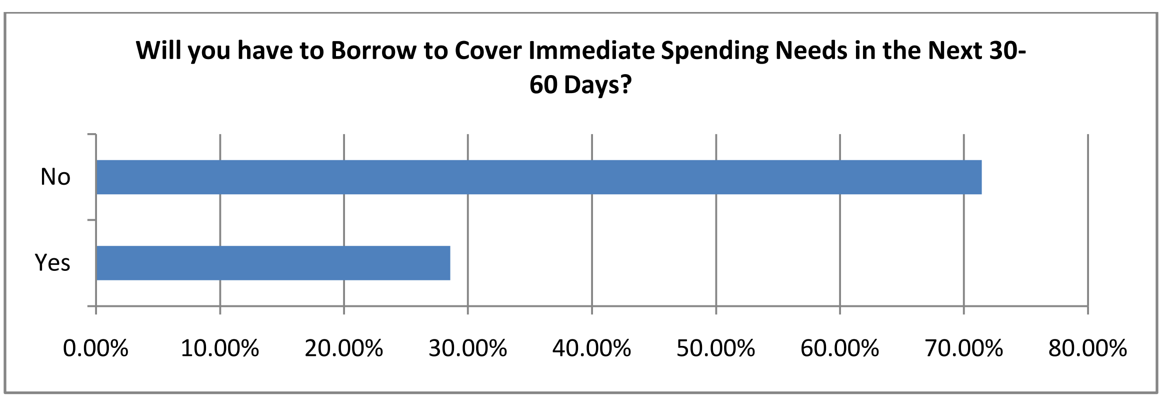
An October Auditor General's assessment of budget impasse impacts reported $346 million in LEA borrowing at that time. Only one month later, PSBA's November survey found that Philadelphia alone has borrowed $525 million with total borrowing among other reporting districts coming in at more than $654 million. That number equates to 3% of the total spending reported by all districts in 2013-2014 Annual Financial Reports submitted to Pennsylvania's Department of Education.



Almost 30% of all districts reported that they would be forced to borrow to cover payroll or other immediate costs in the next 30-60 days if a budget agreement is not reached.

Loans for school districts, like loans for families and individuals, come with fees and interest. The fees and interest payments associated with district borrowing represent expenditures that would not have occurred if not for a late budget. As of November 13, districts unable to meet immediate financial needs have borrowed an average of $7.2 million each, with some districts (excluding Philadelphia) reporting loans as high as $25-$50 million dollars. Districts reported paying an average of $32,000 each in fees and interest for loans.

PSBA also asked school leaders to look at school finances for the next 30-60 days. Almost 30% of all districts reported that they would be forced to borrow to cover payroll or other immediate costs in the next 30-60 days if a budget agreement is not reached.



District credit ratings are dropping.

Credit ratings are used by lenders when assessing the financial stability and credit worthiness of districts. Essentially, a credit rating equates to an opinion about future credit risk. A credit rating evaluates the chances that a borrower will default on existing financial obligations.

There are different types of credit ratings that may be influenced by a number of factors including missed payments, fund balance stability, and overall long term financial planning. Many districts have been forced to spend down fund balances and faced with missed payments as a result of non-receipt of state subsidies. Strong credit ratings are important for districts because they can dictate interest charges and impact the total cost associated with district borrowing for new construction and renovation, needed repairs, or other necessary expenditures.

Enhanced credit ratings under Pennsylvania's State Intercept Program provide a level of credit security that is above the underlying credit worthiness of many Pennsylvania's districts. Because enhanced ratings essentially are dependent on a promise that the state will redirect subsidies to cover financial instability among districts, enhanced ratings are also tied directly to the credit quality of the commonwealth. Citing among other factors Pennsylvania's "chronically late budgets," (2015) Moody's Investors Services recently downgraded the enhanced credit ratings for most school districts in the commonwealth.

In an assessment of the current budget situation and its impacts on school districts, Moody's recently cited a need for a "stronger demonstrated track record of timely budget adoption and school appropriation funding" and "the establishment of a clearer plan for provision of payments in the absence of a state budget" (Moody's, 2015). Downgrades were also accompanied by warnings regarding the possibility of further downgrades in the event of any of the following:

- Failure to make debt service payments or appropriate school aid to allow issuers to make timely payments;
- A further downgrade of the Commonwealth of Pennsylvania's credit rating; or
- Further delays in budget approval which hinder school districts' ability to pay debt service and meet other obligations (Moody's, 2015).

Additionally, PSBA asked school leaders generally if their district's credit rating had been negatively impacted directly as a result of non-receipt of state subsidies. Respondents from fourteen of Pennsylvania's public school districts reported that their credit rating had been negatively impacted as a result of non-payment of state subsidies. One respondent indicated that district's overall credit worthiness was downgraded so severely that the district had been turned down for a loan.

Districts are missing and skipping payments.

School districts are responsible for financial obligations to charter schools, contracted vendors, service providers, lenders, and many other expenditure outlets. School boards are expected to ensure fiscal health by evaluating district finances and making decisions that will allow the district to meet financial obligations throughout the year. As many districts rely on state subsidies for a significant portion of total revenues, budgeting and annual financial planning in many districts is closely tied to state aid.

Because state aid is such an important part of public school funding, PSBA asked school leaders how missing state subsidies were impacting timely payments for contracted services, debt service, charter schools, and other agreements. More than 25% of respondents indicated that their district had been forced to miss payments in one or more of these areas. School leaders in 36 districts reported missing charter school tuition payments. Districts also reported missing PSERS payments, payments for out-of-district placements, payments to outside vendors, and payments to Intermediate Units. The full list of types of missed payments reported by districts includes:

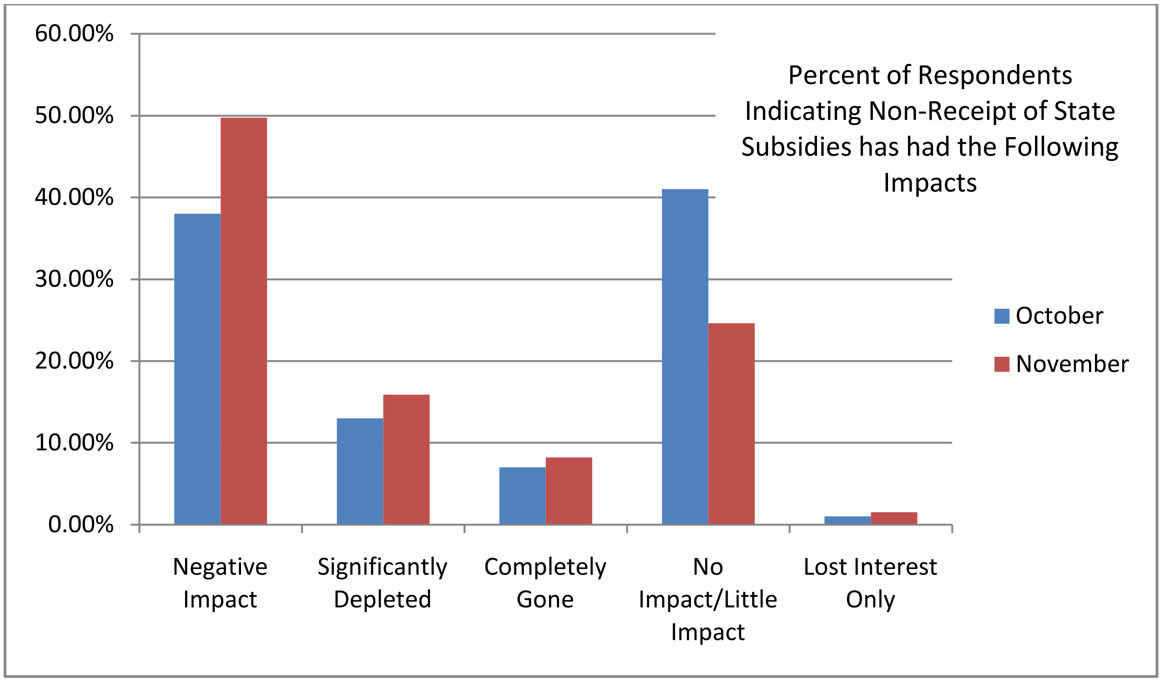
Charter School Payments	General Bills
PSERS Payments	Food Service
Out of District Placements	Local Library Contributions
Payments to Outside Vendors	Debt Service Payments
IU Payments	Tax Collector Payments
Health Insurance Payments	Maintenance Bills
Staff Expenses for Reimbursements	Contracted Facilities Payments

Districts are depleting fund balances.

Fund balances are important to district health the same way a savings account is important to a family. Just as families should maintain a savings account to deal with emergencies or other unforeseen events, districts should also have funds in reserve to pay for emergency repairs, uninsured losses, or unexpected interruptions to revenues. Prior to the budget impasse, a detailed look at Pennsylvania school district fund balances showed sixteen districts with a negative total fund balance and another 24 districts with a total fund balance of less than 5% of total expenditures. The Government Finance Officers Association (GFOA) recommends a minimum unreserved fund balance of no less than two months of regular operating expenditures. This helps to ensure that boards are able to meet financial needs of the district during times of unexpected interrupted revenues.

Some respondents reported that their districts have weathered the state budget impasse without much ill effect. About 25% of respondents said that non-receipt of state subsidies has had little or no impact on district fund balances. A few respondents indicated that negative fund balance impacts were restricted to loss of interest earnings. Most districts, however, reported district fund balances had been negatively impacted by non-receipt of state subsidies.

Districts with low beginning fund balances combined with significant reliance on state aid have been particularly hard. Nearly 25% of respondents indicated their fund balance reserves were either mostly or completely depleted as of November 13, 2015. Fifty percent of survey respondents indicated some level of negative impact on the district's fund balance. Sixteen percent indicated the district's fund balance was either significantly depleted or nearly completely gone, and 8% said that the district has been left completely without fund balance reserves as a result of non-receipt of state subsidies.



Summary.

PSBA's November budget impact survey was distributed to all Pennsylvania school districts, and generated responses from school leaders in 225 districts. Overall impressions gleaned from responses indicate non-receipt of state subsidies have resulted in mixed results for districts. Almost 25% of districts indicated no appreciable fund balance impact as a result of non-receipt of state subsidies, and relatively few reported negative impacts to district credit scores.

However, survey results show that borrowing among districts in need of remedies to immediate cash needs is on the verge of becoming widespread. As of November 13, about ten percent of survey respondents indicated that they had borrowed money, generating a combined total reported debt of approximately $654 million. This number representing approximately 3% of total expenditures for the 2013-2014 school year, establishes a troubling indicator of district debt if the budget impasse is not resolved immediately. Respondents further pointedly drew attention to the fact that if a resolution is not immediately forthcoming, widespread borrowing will become more common among districts.

While about half of surveyed school leaders did not report notably negative impacts related to the budget impasse as of November 13, 2015, impacts among those who did are potentially significant among individual districts. School leaders in 8% of responding districts indicated their fund balances had been completely spent down, and school leaders in an additional 16% reported fund balance reserves were nearly completely gone. School leaders also reported being forced to selectively address imminent payment needs, with some districts experiencing credit rating downgrades.

Overall, responses from the survey highlight the importance of consistency and timeliness with regard to the receipt of state education subsidies.