

# Transform Baltimore

## Build Schools. Build Neighborhoods.

### BALTIMORE CITY: PUBLIC SCHOOL CONSTRUCTION PROGRAM BLOCK GRANT FUNDING A Report to Legislative Committees January 8, 2013

## Overview

In the 2012 General Assembly, the budget committee chairmen directed a workgroup, under the auspices of the Interagency Committee on School Construction (IAC), to study nine issues related to the proposed “block grant” bill for city school construction (SB533/HB304). The bill would allow Baltimore City Schools to receive its share of state capital funding as a “block grant” in order to leverage it for greater borrowing (via a third-party entity) to meet its huge school facility needs. The bill called for a block grant amount of the greater of \$32 million (somewhat less than the average level of state capital funding for city school construction) or 15% of the state school construction budget. The state block grant, along with City capital funding for school construction and other local revenue sources, is part of the plan to leverage \$69 million in annual revenue to generate \$1.1 billion up front now for city school construction. The study – BALTIMORE CITY: PUBLIC SCHOOL CONSTRUCTION PROGRAM BLOCK GRANT FUNDING – was released by IAC in January.

The workgroup, led by the Executive Director of the state's Public School Construction Program, Dr. David Lever, worked for six months to develop the detailed analysis. Members included the State Treasurer's office, including the Attorney General advising the Treasurer, the State Department of Budget & Management, Department of Planning, Department of Legislative Services, City Schools, the City of Baltimore, and the ACLU of Maryland's Education Reform Project. The Baltimore Education Coalition sent comments, which are included as an addendum to the report. The IAC reviewed the workgroup's analysis in December, added comments, and forwarded the report to the legislature.

The extensive and detailed report confirms the Transform Baltimore campaign's assertion that the block grant program can work, that it is legal and feasible, and that it can provide a way to build and fully renovate Baltimore's schools, providing benefits to generations of students and communities, if executed well. The report answers the legislature's questions about the proposal's feasibility but notes that decisions about whether to make policy changes rests with the General Assembly.

## Key Findings in the Report

### 1. Baltimore City school buildings are in “very poor” condition; \$2.45 billion needed

“The Jacobs Report concludes that City school buildings are in very poor condition as measured by the average Facilities Condition Index (FCI) of the buildings, and that the total need is for \$2.45 billion to either renovate and/or build new all of the facilities in the City Schools portfolio.”

“The district also receives a failing grade in the capacity of its buildings to support the academic programming in the schools.” Chapter I, I-1

The Jacobs Report shows that “construction of new facilities has virtually ceased over the last 25 years (although a relatively small number of buildings have undergone complete or partial renovation during this period).”  
Chapter I, I-3

“125 of the 182 school campuses – 69%, or more than two-thirds – have an FCI of 50 or higher, meaning their condition is “Very Poor” or worse. 50 of the 182 campuses – 28%, or more than one-quarter – have FCIs of 75 or higher and should be considered as candidates for replacement or surplus.” Chapter I, I-5

“\$2.452 billion has been identified in the Jacobs Report as the cost to bring all facilities to current standards of building performance and educational adequacy within a 10 year timeframe.” Chapter I, I-8

## **2. The current method of school construction funding cannot remedy the scale of need in Baltimore City. The buildings will continue to deteriorate.**

“... the current and anticipated funding levels within the traditional funding structure will address the facility infrastructure problems in 45 years at best if construction cost escalation rates are limited to 1% per year. The more realistic escalation rate of 4% means the facilities... will worsen every year, since the current and anticipated funding levels are outpaced by construction cost escalation.” Chapter III, III-7

“...if the traditional funding methodology is used, the construction program can never be completed as the escalation in construction costs each year...will be greater than the available annual funding. Chapter III, III-4

## **3. Building new and fully-renovated facilities by leveraging current funds via an Authority will reduce the need from \$2.4 b. to \$1.4 billion in four years (completing more than 40% of the full plan).**

“Concentrating the timeframe for construction through a block grant approach would allow the school system to build new schools and fully renovate old schools, in contrast to the current approach of patching leaks and making temporary repairs, such as placing new equipment into old systems.”

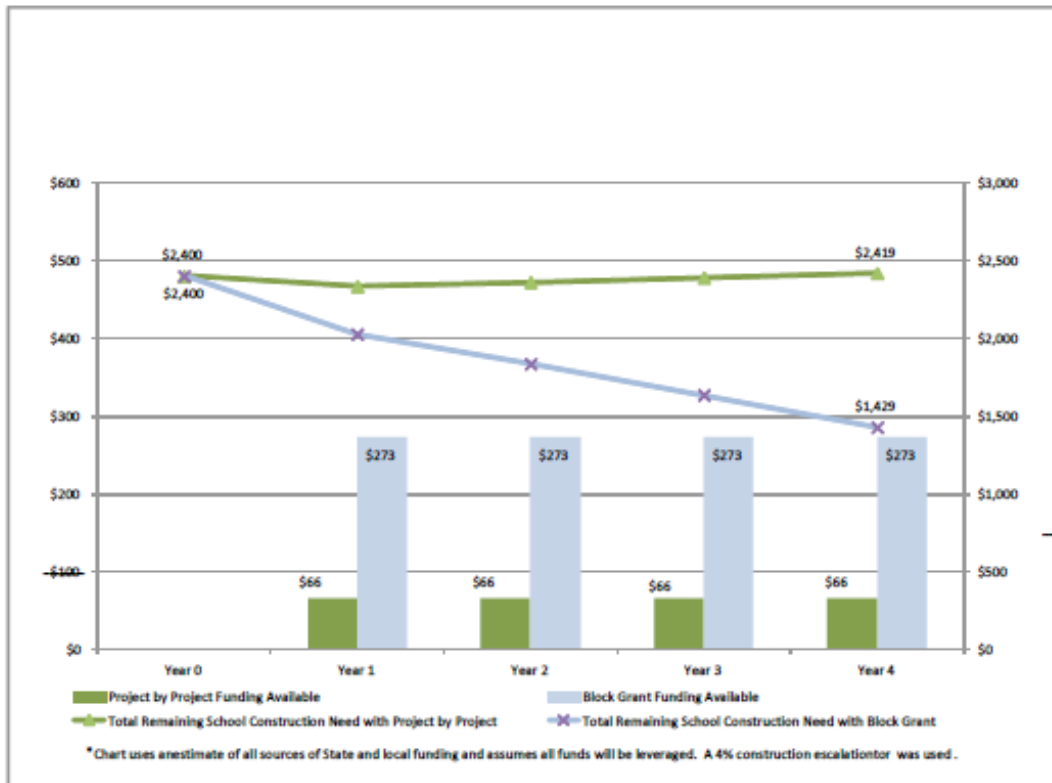
“With adequate upfront funding in combination with a robust management structure (see Chapter IV), City Schools will work on multiple projects simultaneously, thus reducing the full program timetable.”

“While the traditional method of project-specific funding caps the amount of construction activity each year by the amount of annual funding received, the block grant financing method will leverage the annual City and State allocations into approximately 15 times the amount of project spending.” Chapter III, III-2

“Funding for the first four years of the 10-year program, which would address approximately 41% to 45% of the school facilities needs, could be supported with a 30-year pledge of the \$66 million of existing and proposed funding streams via an alternative financing arrangement.”

“The chart below projects that the total school construction need for Baltimore would be significantly reduced from \$2.400 billion to \$1.429 billion over the first four years by leveraging City and State annual funding through alternative financing.” Chapter III, III-3

**Four Year Comparison of the Impact of Block Grant Funding vs Project by Project Funding for Baltimore City Public Schools**



**4. It is both LEGAL and FEASIBLE for the State to provide funding in the form of a block grant in order to leverage funds from a third party issuer (Baltimore School Construction Authority).**

“The Office of the Attorney General has determined that there is no barrier in State law to making capital funds available to local educational authorities (LEAs) in the form of block grants.” *Chapter II, II-6*

“In short, while the complexities of setting up and running this process should never be underestimated, it is the contention of the IAC, based on research conducted by the workgroup, that a method of financing school construction in Baltimore City through a third-party authority can be legally created and can be designed to be managed in an accountable manner if adequate resources are directed to the program.” *Chapter II, II-18*

“In an Advice of Counsel dated March 24, 2011, addressed to counsel for Baltimore City Public Schools and to Baltimore City, the Deputy Counsel to the Maryland State Department of Education “did not find any statute prohibiting block grant distribution of State school construction fund.”

“The work group is aware of the complexity of the process that is under consideration, but believes that the creation of a Baltimore City School Building Authority under State law will allow the establishment of a legal structure that can address the legal, policy, and administrative issues alluded to in the Advice of Counsel.” *Chapter II, II-6*

**5. Structured properly, it will not affect the state's bond rating. It will not affect the state's debt affordability (cost of borrowing).**

“The work group has investigated a method by which State tax-exempt bond proceeds CAN BE provided in a block grant format to repay tax-exempt bonds issued by a third-party issuer, without adversely affecting the State’s

“For example, the Maryland Health and Higher Educational Facilities Authority (MHHEFA) issues conduit financing on behalf of hospitals and universities and its debt is not considered an obligation of the State. This indicates that, if the State structures the arrangement correctly, the debt of the third-party issuers contracted by the [Baltimore City School Construction] Building Authority would not be an obligation of the State and would not count against the State when determining its debt affordability ratios or bond ratings.” Chapter II, page II-2

## **5. The Authority's debt will not count against city or state debt.**

“The arrangement allows the use of State tax-exempt or taxable bond proceeds to fund the grants without impacting State debt capacity or bond ratings, because the new Building Authority would not be a related party to the State under the federal tax laws. The debt of the new Building Authority or of a third-party conduit issuer would not be considered State debt or affect the rating of the State bonds.” Chapter II, page II-3

“If the debt is issued through a third-party issuer such as the Building Authority, and clear language is included in the third-party bond offering documents that the third-party bonds are not debt of the State or the City, this issue is substantially mitigated, since the third-party issuer is distanced from the taxing government body.” Chapter II, II-13

To avoid the Authority’s debt not being the debt of the City or State, “it is essential that the third-party issuer must be viewed as being unrelated to either the State or the City.” Chapter II, II-13

## **6. State tax-exempt or taxable bond proceeds can be used to fund the block grants.**

In referring to the legal issues regarding the use of tax-exempt bonds as a block grant for school construction, the report states, “the use of taxable bond proceeds by the State to fund block grants for public school construction would avoid these legal issues entirely, but it would likely also result in greater interest costs to the State.” Chapter II, II-6

“If the State were to make block grant reimbursements directly to an LEA over a long timeframe, the arrangement could impair the State’s compliance with tax law requirements, potentially jeopardizing the tax-exempt status of the bonds. However, these negative tax consequences are avoided if the bond proceeds are granted to an entity that is not related to the State, such as the Building Authority described above.” Chapter II, II-7

“Through the research carried out by the workgroup, the IAC has found that legal precedent exists for the State to use the proceeds of tax-exempt bonds to support a third-party authority for specific categories of capital projects.” Chapter II, II-18

## **7. There is precedent for this approach from other jurisdictions which used leveraging successfully.**

“Nationwide, school systems and other levels of government are increasingly relying upon third-party entities to develop innovative ways to solve their infrastructure needs when, for a variety of reasons, state and local governments are unable to fully address critical school facility needs.”

“New York State is a prime example of State aid distributed as a block grant which can be used by a local school system for leveraging a large building program.” Chapter VI, VI-5