

## Districts' Borrowing May Face Hit From Continued Financial Crisis

By Michele McNeil

Even as federal officials and members of Congress struggled this week over a rescue plan for troubled portions of the nation's financial sector, states and school districts braced for ripple effects that could further threaten their stressed budgets.

The situation could have its biggest long-term impact on districts' capital projects, as the upheaval in the credit and stock markets threatens to drive up the cost of borrowing money.

And that would be bad news for districts nationwide already feeling the effects of a decline in state tax revenues of various kinds because of the sagging economy. (["State Fiscal Woes Start to Put Squeeze on K-12 Budgets,"](#) May 7, 2008.)

With investment firms such as Lehman Brothers Holdings Inc. going out of business, and others consolidating, there are fewer buyers for the bonds issued by districts to pay for such projects as new schools and major repairs, according to Susan Gaffney, the director of the federal-liaison center for the Government Finance Officers Association, in Washington.

"The market dynamic is that there are fewer players, and that could drive up the cost of borrowing in the long run," she said.

In 2007, about \$107 billion in education-related bonds was issued.

The financial crisis hit home this week for Laurens County School District 56 in Clinton, S.C., which postponed selling \$28 million in bonds on the advice of the district's financial adviser, said the superintendent, Wayne Brazell. The district planned to try again Oct. 1.

"We have been advised that there will be buyers on that day," Mr. Brazell said in an e-mail. "We are building a new high school, and we need [the money] to finish the project."

Another illustration of market volatility: this week a crisis involving money-market funds, which invest heavily in government bonds, temporarily drove up variable interest rates to near double digits, a "very high" level, Ms. Gaffney said. The federal government's decision to insure those money-market funds gave municipal governments a reprieve, she added.

The credit markets, in general, would likely improve even more for school districts and other borrowers if and when the federal government works out a plan to deal with the troubled mortgagebacked securities at the heart of the current crisis, she said.

### **Another Fiscal Shock**

Meanwhile, the underlying problem— home foreclosures stemming from troubled subprime mortgages— is likely to deliver another fiscal shock to state and local governments early next year, budget experts said.

"We're just starting to realize what's going on with the home foreclosures," said John Musso, the executive director of the Association of School Business Officials International, based in Reston, Va.

Collectively, states have amassed more than \$40 billion in budget deficits, in large part because of a drop in tax revenues from the slumping real estate market. At least a dozen states already have been forced to impose targeted cuts on K-12 education programs. ("[Hard Times Hit Schools](#)," Aug. 27, 2008.)

The impact has been somewhat delayed, however, because many homeowners with mortgages prepay their property taxes over time through escrow. As a result, even if a homeowner is foreclosed upon, money may still be in escrow to pay property taxes for a time.

But as those accounts are depleted and property-tax revenue starts dipping even further, agencies that rate the creditworthiness of school districts will take notice,

and may downgrade districts' bond ratings, Mr. Musso added. And that, in turn, may mean districts would have to pay higher interest rates to finance their building projects.



Erica Everett, 18, a senior at Elk Grove High School, checks the news on the stock market during her morning economics class in Elk Grove, Calif., on Sept. 18.

—Steve Yeater/AP

"This could really affect schools' abilities to pay for their projects," Mr. Musso said.

Still, some aspects of school finance remain somewhat sheltered from the Wall Street upheaval.

They include employee pension funds, which may see the value of their investments decline but which usually are administered and backed by state governments. In addition, school district operating budgets are funded mostly by state and local tax dollars, rather than federal money. That means they would be relatively insulated from new spending pressures on the federal budget from the financial crisis. (See **"Education Budget Roiled by Financial Crisis,"** this issue.)