SCHOOL CONSTRUCTION FINANCE

Office of General Treasurer Seth Magaziner

10/24/2017
State of Rhode Island Schoolhouses Report
- TODAY: $2.22 billion of total need; $627 million to make schools warm, safe, and dry
- 5 Year Need: $3.02 billion of total need; $793 million to make schools warm, safe, and dry
- Estimated 10 Year Need: 4.1 billion; $988 million to make schools warm, safe, and dry

Today’s analysis:
- How much of this need will be addressed under the current rate of spending?
- What would be the consequences of a higher level of spending with today’s system?
- How can new system improvements yield better outcomes?
  - Shifting to pay-go funding
  - General Obligation bonding
  - Share ratio incentives

Spoiler alert:
- Current spending not adequate to keep up with deferred maintenance
- Simply spending more under current system could be prohibitively expensive
- Need to spend more, and spend smarter to adequately address the problem
• State Budget Allocation: $80 million annually

• Housing Aid:
  • After approval, municipalities float bonds for the full cost of major projects
  • After project completion, state reimburses a portion of debt service
  • Reimbursement level based on economic condition of population served by District (minimum state share for a district is 35%, maximum is 96%)
  • Average reimbursement rate is 47%
  • State spent $69 mil on housing aid in FY 2017, all for projects that had already been completed

• Capital Fund
  • Intended for fast-track, emergency repairs
  • Annual state spend is whatever is left after housing aid reimbursements, up to $80 mil
  • FY 2017 state capital fund spend was $12 mil
  • Same share ratios as Housing Aid apply
SCENARIO 1: STATUS QUO

- Total 5-Yr Project Spend: $682 million
  - $55 million from capital fund
  - $627 million from housing aid

- Total 5-Yr budget impact (mostly for projects completed prior to Year 1):
  - $400 million state
  - $519 million municipal

$682 insufficient to meet Priority 1 and Priority 2 5-Year Lifecycle Costs ($793 million)

Status Quo Assumptions:
- State continues to budget $80 mil per year indefinitely
- $200 million of new housing aid approvals in FY 2018; $75 million in annual approvals FY 19-22; $100 mil annual approvals thereafter
- Average municipal share ratio of 50%
Total 10-Yr Project Spend: $1.2 billion
- $88 million from capital fund
- $1.1 billion from housing aid

Total 10-Yr budget impact (mostly for projects completed prior to Year 1):
- $800 million state
- $1.09 billion municipal

With $1.2 billion of project spending over 10 years, total need after year 10 increases to $2.7 billion
SCENARIO 2: EXISTING SYSTEM WITH HIGHER SPENDING

- Goal of $1 billion in project spending over 5 years and $2.5 billion over 10 years
- No constraint on state or municipal budget impact
- The following level of Housing Aid approvals would be necessary to achieve these project spending goals:
  - $200 million in FY 18
  - $400 million annually from FY19 – FY 21
  - $200 million annually thereafter

[Note: there has never been a year with more than $265M in requests for approval]
Municipalities would need to issue a total of $1.7 billion in new debt over the next 10 years, compared to $641 million under the status quo scenario:

- Capital Fund runs out faster, furthering reliance on debt financing.
SCENARIO 2: CONSEQUENCES

- **Budget Impact**
  - State would spend $288 million more over 10 years than under the status quo level of approval
  - Municipalities would spend $248 million more
  - Even if state is willing to spend additional resources, no guarantee municipalities will request so many project approvals

![State Budget Allocation](image-url)
NEW CONCEPTS

- Shift state share of Housing Aid to Pay-As-You-Go instead of reimbursement
  - Reduces municipal debt burden
  - Reduces long-term cost for state

- Use State General Obligation Bonding for Capital Fund and Housing Aid PAYGO
  - Has been done before
    - School facilities bond referenda appeared on the ballot 8 times between 1972 and 1984
    - Massachusetts relies on bonding for school construction financing

- Incentivize municipalities to spend sooner, and in the right places
  - Use aggressive, expiring bonuses to the state matching formula to encourage municipalities to submit more applications for approval, and focus on high-need projects
2017 state Debt Affordability Study recommended debt affordability targets for the state, quasi-public agencies, and municipalities.

While the study recommended a slight reduction in state debt levels, that still leaves capacity to issue approximately $1.2 billion of new General Obligation bonds over the next 10 years.

State pays off roughly $150 million of old debt annually, and state debt levels relative to income have gradually fallen over time.
## STATE DEBT CAPACITY

### Additional Debt Capacity Through 2036 @ 5.00% Interest

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Additional Debt Over Next 10 Years</th>
<th>Additional Debt Service</th>
<th>Total Debt Service to Revenues Target (7.5% within next 5 years; 7.0% thereafter)</th>
<th>Total Debt to Personal Income Target (4%)</th>
<th>Tax-Supported DS + Pension ARC to Revenues Target: 16%</th>
<th>Tax-Supported Debt + UAAL to Personal Income Target: 9% by 2021</th>
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<td>164,809,046</td>
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<td>1.63%</td>
<td>67%</td>
<td>8.74%</td>
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For 2020: 113,896,829
For 2021: 143,691,200
For 2022: 174,486,571
For 2023: 205,281,936
For 2024: 236,077,292
For 2025: 266,872,647
For 2026: 297,668,002
For 2027: 328,463,357
For 2028: 359,258,712
For 2029: 390,054,067
For 2030: 420,849,422
For 2031: 451,644,777
For 2032: 482,439,132
For 2033: 513,234,487
For 2034: 544,029,842
For 2035: 574,825,197
For 2036: 605,620,552
New Assumptions:

- Goal of $1 billion in project spending over 5 years and $2.5 billion over 10 years

- State Issues $50 million of GO bonds per year for 10 years
  - First use of proceeds: $10 million toward capital fund
  - Additional proceeds: state Housing Aid share

- State Share Incentives (current municipal share averages 47%)
  - Average municipal share years 1-3: 35%
  - Average municipal share year 4: 40%
  - Average municipal share year 5-10: 50%
Scenario 3 Reduces Total School Facilities Need Significantly Over Time
Debt Kept off of Municipal Balance Sheets:
- $160 mil over 5 years
- $360 mil over 10 years

State Housing Aid Spending Significantly Reduced
- State Housing Aid spending reduced by $71 mil over 10 years with PayGo compared to current system
<table>
<thead>
<tr>
<th></th>
<th>Status Quo</th>
<th>Current System with 1 / 2.5 Target</th>
<th>GO Bonding, Paygo and Incentives with 1 / 2.5 Target</th>
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<tr>
<td>5 Year Construction Spend</td>
<td>$682 M</td>
<td>$996 M</td>
<td>$989 M</td>
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<tr>
<td>10 Year Construction Spend</td>
<td>$1.15 B</td>
<td>$2.5 B</td>
<td>$2.59 B</td>
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<td>New Municipal Bonding</td>
<td>$641 M</td>
<td>$1.71 B</td>
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<td>10 Year State Housing Aid Spend</td>
<td>$755 M</td>
<td>$1.06 B</td>
<td>$993 M</td>
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<td>10 Year Municipal Housing Aid Spend</td>
<td>$1.02 B</td>
<td>$1.27 B</td>
<td>$1.22 B</td>
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<td>10 Year Capital Fund Spend (state &amp; municipal)</td>
<td>$55 M</td>
<td>$27 M</td>
<td>$119 M</td>
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<td>Remaining Need After Year 10</td>
<td>2.72 B</td>
<td>1.07 B</td>
<td>959 M</td>
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SUMMARY & NEXT STEPS

▪ Summary
  ▪ Current level of spending not enough to keep pace with need
  ▪ Spending more under the existing system is inefficient and unaffordable
  ▪ Shifting to paygo, state GO bonding and share ratio incentives can help yield a better outcome
    ▪ Smart financing helps, but there is no escaping the need for the state and municipalities to invest more in school buildings

▪ Next Steps:
  ▪ Refined modeling
  ▪ Ideas to lower the municipal cost of borrowing
  ▪ Ideas to lower project costs and incentivize smarter spending