



**National School  
Boards Association**

# LEADERSHIP Insider

June 2010

[www.nsba.org/leadershipinsider](http://www.nsba.org/leadershipinsider)

PRACTICAL PERSPECTIVES ON SCHOOL LAW & POLICY

A Membership Benefit of NSBA National Affiliates

## Surviving tough budget times

Public school districts are being asked to do much more with much less. How will your board navigate this new age of ambitious reform agendas and unprecedented budget cuts? This issue of *Leadership Insider* is the first of two issues designed to assist school boards in navigating the perils and potential impacts of the economic recession. Look for the second issue in February 2011.

In the fall of 2008, financial markets in the U.S. experienced failures not seen since the Great Depression. Fueled by hunger for investment opportunities in newly capital-rich countries like China, Wall Street had come up with creative and risky investment options, including many backed by mortgages. Wall Street continued to feed investors' hunger for risky investments (think "credit default swaps"), and mortgage lenders responded to Wall Street's demands by handing out risky mortgages. Mortgage defaults on a grand scale led to the rapid decline in value of assets held by many investors. The free-fall began. Baer Sterns was sold to JPMorgan Chase. Venerable financial giant Lehman Brothers collapsed in September, 2008—the largest corporate bankruptcy in U.S. history. Mortgage giant Washington Mutual was taken over by the FDIC and sold to JPMorgan Chase. The federal government took over Fannie Mae, Freddie Mac, and AIG. The stock market plummeted. Invest-

ment portfolios took huge hits. Credit dried up. Jobs disappeared. Property values tanked.

School districts would feel the sting of the recession not only as direct investors in the tanking market, but also as the recipients of state and local funds dependent on tax revenues. In fact, the failure of Lehman came at great cost to public entities including school districts, according to recent testimony from members of Congress in a probe into Lehman's collapse. Public bodies, like so many other investors, had made "conservative" choices with their invested money, only to find out those investments were quite risky.

### Public school pain

Public schools were poised to feel some acute financial pain in early 2009. With state and local tax revenues decreasing sharply, public school budgets experienced unprecedented decreases. Soon after taking office, the Obama administration pushed through Congress the American Reinvestment and Recovery Act of 2009 (ARRA), designed to infuse the economy with federal funds. The ARRA allocated about \$100 billion in additional funds for education, an unprecedented amount, aimed at preventing state cuts in education funding and district cuts in successful programs. The largest portion of that money, \$48.5 billion, was labeled the State Fiscal Stabi-

lization Fund. Smaller portions were added to Title I and special education (IDEA) monies. And some smaller programs were initiated, including \$5 billion in discretionary grants to be distributed under a new program called "Race To The Top."

At least one study indicates that the federal ARRA money did indeed help districts maintain current funding levels during times of fiscal constraint, even if that money was not used to take action in the reform areas outlined in the Act. If the ARRA averted disaster, however, it did not fix state education budgets. State budgets are now seeing unprecedented cuts in education spending. With stimulus funds set to end in 2010, moreover, school officials are urging Congress to take action so that school districts do not tumble over the expected funding cliff. Education Secretary Arne Duncan asked Congress to pass legislation providing states with an additional \$23 billion. Touted as a jobs bill, the legislation would help districts avoid tumultuous staff layoffs. See the text box on page 7.

### Creative solutions

School districts are coming up with creative and innovative funding sources, revenue generating activities and spending reductions. An Arizona district runs

See Budget on page 7

## IN THIS ISSUE

2 Bargaining in a down economy

4 The perfect storm

8 Bond financing

*Leadership Insider* is published by NSBA's National Education Policy Network and the NSBA Council of School Attorneys in cooperation with the National Affiliate Program.

Opinions expressed in and by *Insider* do not necessarily reflect positions of the National School Boards Association.

Copyright 2010,  
National School Boards Association.

President **Earl C. Rickman III**  
Executive Director **Anne L. Bryant**

---

Editor  
**Sonja Trainor**  
Senior Staff Attorney

---

Director of Publications  
**Glenn Cook**

Managing Editor, National Affiliate Publications  
**Kathleen Vail**

Director, National Affiliate Program  
**Gene Broderson**

Production Manager  
**Carrie E. Carroll**

Production Assistant  
**Donna J. Stubler**

Web Coordinator  
**Andrew Paulson**

---

#### About NSBA

The National School Boards Association is the nationwide advocacy organization for public school governance. NSBA's mission is to foster excellence and equity in public elementary and secondary education in the United States through local school board leadership. Founded in 1940, NSBA is a not-for-profit federation of state associations of school boards and the school boards of the District of Columbia, Hawai'i, and the U.S. Virgin Islands.

For more information, visit [www.nsba.org/na](http://www.nsba.org/na)

#### About the National Affiliate Program

The National Affiliate Program extends NSBA's services directly to local school districts.

School districts are eligible to join provided they are members in good standing of their state school boards associations.

#### About the Council of School Attorneys

The Council of School Attorneys provides information and practical assistance to attorneys who represent public school districts. It offers legal education, specialized publications, and a forum for exchange of information, and it supports the legal advocacy efforts of the National School Boards Association.

## Teacher union bargaining in times of economic distress

By **Barbara A. Ruga**

**D**epending on the bargaining climate in your district, you may find labor negotiations particularly trying in the face of a budget crisis. Recent teacher strikes in California, where roughly 10 percent of school districts face negotiation stalemate, illustrate the challenges. There as everywhere, school districts are facing budget shortfalls they must close, so teachers are being asked to accept salary cuts and furlough days and contribute more to health benefits. A veteran of the bargaining table, Barbara Ruga gives school board members facing such negotiations some valuable advice.

Across the country, public school boards will face contract negotiations with teachers unions, simultaneously pursuing concessionary bargaining on economic issues and hoping to establish stronger accountability using student growth criteria to evaluate and pay teachers. In light of the harsh reality of school budgets in a time of increased academic accountability, and as school boards tackle increasingly unpopular decisions from privatizing support staffs to closing schools, this article offers key strategies to make your contract negotiations more effective.

**1. Assemble the right team.** Boards should assemble experienced negotiators familiar with the complexities of modern school bargaining, pressures for improved academic outcomes, and the need for economic concessions. Whether an outside attorney is part of the district's bargaining team will depend upon the culture and history of teacher bargaining in each district. At minimum, the school attorney should be an integral part of the preparation for bargaining and a regular consultant in the ongoing development of proposals and strategies. Experience counts when school budgets are tight. Union bargainers usually are either experienced or highly trained; a team of veteran school negotiators will reap dividends for the board and provide the best counsel for effective options and strategies.

**2. Prepare.** When funding dries up, school boards need to look beyond setting economic parameters and identifying language proposals. They should also foster internal and external stakeholder support by systematically communicating about

the academic and economic factors that drive the board's positions during bargaining. Boards should insist that administrators develop communications plans—ideally launched well in advance of the contract talks—to explain the central issues in negotiations. Well thought-out messaging helps explain why negotiations may be more difficult and protracted than in prior years and should help maintain support for the board's position if the talks become contentious or work stoppages occur, possibly leading to board recalls.

In order to communicate effectively, boards should consider retaining consultants experienced in strategic planning during difficult bargaining. Many school negotiators (including lawyers) and superintendents are either not skilled in, or lack the time to manage, this important facet of negotiations. In most states, teachers unions are already deftly using social media to reach large numbers of people to garner support. It is naïve to believe that school boards can ignore that reality and maintain sufficient public support to withstand protracted or complex negotiations. To be completely prepared for difficult bargaining, boards must recognize that local politics and parental support play a large role in determining who survives the marathon of tough bargaining.

Board members who are up for election during a time of tough negotiations should be protected from the bargaining rhetoric and active roles. Sometimes the most important key to bargaining success is maintaining the original composition of the board that set the parameters for the district's team.

**3. Know your union.** Understanding the union's role and likely strategies helps the board prepare for what could be a lengthy bargaining process. Many unions do not perceive their role as helping the board survive economic downturns; their job is to advocate for pay and benefit enhancements regardless of the economic environment. Unless a board has concrete reasons to believe that its local leadership will promptly act in a collaborative manner to address the district's fiscal woes, the board must be prepared to respond to anticipated union pressure

tactics.

Experienced negotiators should be consulted to prepare board members for emotionally charged rhetoric, packed board meetings, and possible votes of no confidence in district and board leadership. In some states, boards have access to a teachers union's internal materials explaining how board members are targeted during difficult negotiations, e.g. [www.mealexposed.org](http://www.mealexposed.org). Knowledge is truly power for board members, as reducing the element of surprise will help boards maintain their commitment to the original parameters.

**4. Consider your style of bargaining.** As interest based bargaining (IBB) has grown in popularity, a board can be unfairly viewed as unreasonable when it is unable to reach a quick agreement with its union. Some will assume that since it is obvious money is tight, it is easier to reach a concessionary deal. Experienced negotiators know this is a fallacy, as protracted bargaining may signify that the issues are more complex or difficult, or that resources are insufficient to lead to a quick settlement.

A change in bargaining style is not necessarily important to the success of concessionary bargaining. If a board has a long tradition of successfully using IBB, it may be culturally impossible to revert overnight to a more traditional or positional form of bargaining, even though some suggest that IBB cannot work in difficult economic times.

An IBB approach typically takes longer, because of the amount of time spent in identification of the issues and problem solving. Such time can be very productive and lead to greater buy-in, or it can be perceived, with hindsight, as wasted time. Some negotiators believe that IBB is not as effective during distressed financial times because of the need for prompt solutions and the understandable difficulty unions have in supporting quick concessionary settlements; others believe that IBB is even more important when times are tough.

The reality is that most effective negotiators use a mixed style of positional and interest based bargaining because agreement is rarely achieved without some level of collaboration and consensus. Boards should not be apologetic for taking difficult positions required by their financial circumstances, nor feel compelled to utilize any particular method of bargaining. The board should leave the style and method of bargaining up to the

team, as it is in the best position to assess what is necessary and productive to achieving an agreement.

**5. Develop a timetable based on economic and operational needs.** Whether a district uses an IBB or more traditional approach, the board should identify a realistic timetable for the process as well as strategies for maintaining control of the timeline to the extent possible. When funding for education declines, the unions understandably prefer the status quo—no change may be better than the change the board seeks. Just as boards should not be reactive to the union's communications, they should not allow the union to dictate the pace of bargaining.

**6. Accept "working without a contract."** More districts may start the next school year without a contract in place. This is not a sign of failure; nor is it cause for alarm. Most states require that even when the contract expires, the mandatory terms dealing with wages, benefits, and working conditions cannot be changed unilaterally unless a legal impasse is reached. Thus, districts typically assume the cost of any insurance premium increases and automatic step increases. While there is no overall salary increase, there is no decrease in pay or benefits and the other working conditions continue.

Board members should understand these dynamics and be able to explain them effectively to curious parents and community members. Otherwise, the rhetorical refrain that teachers are "working without a contract" distorts reality and makes it appear that employees are vulnerable to losing their jobs or subject to arbitrary decision making. This is one more example of why a communications plan is needed to explain pivotal time periods in any lengthy bargaining process.

**7. Understand your bargaining leverage.** Boards are encouraged to use all tools available during difficult and/or protracted negotiations, but they cannot do so if they don't know what those tools are and how to use them effectively. As fiduciaries, board members are expected to act in the best interest of the district as a whole in order to preserve a viable academic program. Being aware of the tools state laws provide and exercising them if necessary to maintain economic and educational viability is part of a board's fiduciary responsibility.

For example, many states' public sec-

tor labor laws provide a vehicle for unilateral implementation of a board's "last best offer" at impasse. The board should understand whether and to what extent alternate avenues for achieving needed economic results are available if table bargaining is unsuccessful. Most boards are normally reluctant to utilize the leverage state laws provide because of an understandable desire to reach compromise and avoid conflict. Yet, candid dialogue that some view as conflict may be the best way to produce viable creative options for adjusting to the new economic reality emerging across the nation in our schools.

**8. Demonstrate shared sacrifice.** In concessionary times, boards and administrations cannot send mixed messages about financial distress. The superintendent and administrators must also demonstrate a willingness to sacrifice, often in advance of the teacher bargaining, rather than wait for the results of the teacher negotiations. This can be a delicate balance because it is also necessary to provide competitive compensation packages for superintendents whose jobs are more difficult when resources decline (yet another reason why the communications plan mentioned above is so critical). Pursuing cost reductions with all bargaining units is important and is best done simultaneously, rather than waiting for a particular unit to be first.

Further, teachers unions typically challenge a board's priorities when budgets are tight, perhaps arguing that boards should cut athletics and/or transportation. Boards must use their best efforts to explain to internal and external stakeholders that personnel costs are usually 70 to 80 percent of the budget and that services like busing and athletics are essential to any effective school program. These explanations are best made in an environment of demonstrated shared sacrifices.

**9. Put all your cards on the table.** The district's team cannot know at the beginning of concessionary contract talks what form of sacrifice may be ultimately (though reluctantly) palatable to the union's bargaining team. The board's initial proposals must be sufficiently broad to leave many doors open for ways to reduce costs. The initial proposal should identify all possibilities for meaningful savings. The board should not be fixed on a specific way to cut costs, but should determine if it is willing to accept short term fixes or whether a structural change

is needed. The bargaining team should then be given maximum flexibility to devise the best way to achieve the board's cost reduction targets.

While managing insurance costs usually is a key component of the ultimate package needed for settlement, other important reductions should be on the table, as well, including suspending or reducing tuition reimbursement, sick banks, or pay for unused sick and personal days, reconfiguring salary schedules and the way step or longevity increases are paid, and terminating or phasing out contractual retirement stipends.

**10. Be creative.** In addition to exploring multiple avenues to cost savings, the district's negotiating team is well-served by exploring non-traditional ways of compensating teachers. For example, in many districts across the country, teachers are paid according to a salary grid that provides for automatic salary step increases. Depending on the placement of teachers on that grid, the cost of the automatic step increases may exceed the cost of a salary increase on the grid. Spreading around the dollars required to pay for the step increases, in lieu of providing fixed salary increases to the existing grid, may save money and give increases to more teachers. Also, funding flexible savings accounts in lieu of a salary increase to offset higher copays and deductibles in the insurance plan, or contributing to a

tax sheltered annuity, may create a foundation for compromise in the short term, albeit without structural change.

Race To The Top legislative initiatives in many states encourage, if not require, serious consideration of pay tied to student achievement. While it may seem daunting to consider such options in a time of declining funds, financial incentives may prove attractive if reasonable and fairly structured. Now is the time to expand creativity rather than reduce it, as long as the options discussed are truly meaningful and not mere band-aids when budget surgery is required.

**11. Manage insurance costs.** As service organizations, districts usually spend more than 70 percent of their budgets on employee salaries and benefits, with insurance being one of the fastest growing components of such costs. Sharing annual insurance increases is a central goal of most school negotiations today. Fortunately, there are a number of ways to control costs: hard caps on a board's monthly or annual obligation; cost sharing through percentage copays; benefit design changes such as higher deductibles; three or four tier prescription copays; and coordinating or excluding coverage for working spouses or domestic partners.

Boards should avoid the historic tendency to look only at other public school districts in determining what controls to

seek at the bargaining table; review of insurance benefits provided nationally and statewide in the private sector offer creative ideas for cost-sharing, e.g., the Kaiser Foundation surveys at [www.kff.org](http://www.kff.org).

**12. Haste makes waste.** The temptation when times are tough is to settle for modest or short term concessions, or to accept packages that seem tantalizing on the surface, but upon closer inspection, merely defer costs—or worse, create larger financial obligations in the uncertain future. Experience counts here: Board bargaining teams should consult veteran negotiators who can evaluate the future cost of a novel package to make sure the short term savings will not cost more down the road.

School boards are entering uncharted waters this year and next; persistent low and declining funding is probably a reality for several years. Most of the new money will come from the federal government and will be tied to strong accountability measures that impact collective bargaining agreements. School boards that consider the above tips and strategies will be best positioned to emerge with stronger, financially viable schools and students prepared for the future. ■

*Barbara A. Ruga is a member of Clark Hill PLC, in Grand Rapids, Mich.*

## Fiscal crises and public school collective bargaining agreements: the perfect storm

By Rosemary Healey

**W**hat happens if, due to financial hardship, your school board cannot fulfill its obligations under an existing collective bargaining agreement? Labor expert Rosemary Healey gives you some options to consider.

### The perfect storm

You do not have taxing authority or, if you do, you are limited by law as to how much you can increase taxes. Real estate property values are tanking. Your local, state, and federal revenue have all declined with little hope of improving any time soon. In fact, your revenue sources are informing you that due to unexpectedly horrific tax collections

caused by high unemployment, midyear cuts may be made to school district appropriations. The financial perfect storm is truly stirring.

At the same time, state government employees are taking unpaid days and local government employees are being required to take furlough days. Alternatively, their unions have agreed to pay and/or benefit cuts. The pressure from taxpayers on school boards and district administrations to follow suit is enormous in these challenging economic times. The lack of money truly brings out the worst in people. All of a sudden, the collective bargaining agreements that you believed were economically feasible when you negotiated them a short time ago seem to present insurmountable economic chal-

lenges.

In the face of these financial challenges, all school boards and districts are obliged to provide quality education to their students. Policy- and law-makers are placing greater emphasis on accountability standards designed to prove statistically whether schools are providing high-quality, effective education. Federal law requires that each district achieve continuously improving student proficiency as measured by standardized assessments. The 2013-2014 school year is right around the corner. By that year, the current dictates of No Child Left Behind require that all school districts achieve 100 percent student proficiency. Failure to do so or failure to maintain adequate yearly progress will result in, among other

things, costly remediation efforts. An already precarious budget situation may worsen.

### Labor peace disturbed

School districts cannot achieve academic success as measured by adequate yearly progress without talented and skilled professionals in the classroom supporting students. Obviously, school districts have a better chance of achieving student proficiency if they can successfully recruit the best and brightest teachers and support staff. The level of wages, benefits, and working conditions in a particular district is a key ingredient to a district's success in recruiting the best and brightest. Pay cuts, furlough days, and the existence of labor strife tend to have negative effects on recruitment efforts. Satisfactory wages, benefits, and working conditions in a district's collective bargaining agreement, on the other hand, can serve as promotional literature to potential new employees.

For current employees and district officials, existing collective bargaining agreements, which typically are more than one year in duration, provide economic certainty and labor peace. Economic certainty presumably results in low employee turnover. Low employee turnover provides students with more experienced instruction in the classroom. More experienced teachers in the classroom intuitively improve student performance. While labor strife is a distraction, labor peace provides stability and focus.

Typically, then, a completed collective bargaining agreement of a reasonable duration is something to be valued by everyone in a school district community. With labor and economic issues put aside, all are left to focus on teaching and learning.

What happens, however, when that perfect economic storm hits in the middle of the term of a collective bargaining agreement and a district does not have the funds to honor that to which it previously agreed? Can a district rescind or reduce a pay raise that it promised to make? Can it increase class sizes over the contractually agreed-upon limit? Can it unilaterally mandate that bargaining unit members pay an increased co-share of premium on health insurance to help balance the budget? Can it unilaterally shorten the school year for teachers?

Under typical circumstances, a district can take none of these actions unless the

management rights provision of the collective bargaining agreement or other express language in the contract allows it. To take such actions in violation of the contract would risk a judgment against the district that could cost it more than it saved by the controversial move.

### Legal options

Reducing or cutting previously agreed to wages almost certainly will lead to a back pay award against the district; and furloughs are the equivalent of a pay cut for breach of contract purposes. If state law mandates that students be in class for a minimum number of days per year, state education authorities may simply order a district to keep schools open. In effect, then, closing schools for a period will do nothing more than disrupt and extend the school year.

Alternatively, even if the state education authority waives the minimum number of school days, typical collective bargaining agreements specify a teacher's work year by the number of days a teacher is required to work. If the district does not open schools the requisite minimum number of days, it still owes the teachers for the minimum number of days in the contract even if they did not work those days. The desired cost savings will not be achieved.

While collective bargaining agreements are specialized contracts, they are just as binding as any other contract. A collective bargaining agreement can be breached when one party fails to honor one of its promises. Damages can be awarded to the injured parties. The parties who are harmed by a breach can bring a legal challenge. For most contracts, legal causes of action for breach can be brought in the courts or in arbitration.

In the case of collective bargaining agreements, the legal cause of action is most often brought in arbitration or before the state or local labor board. Arbitrators and labor boards generally have the authority to award, at a minimum, back pay and front pay for breach of a collective bargaining agreement or the commission of an unfair labor practice.

A school district's genuine mistake—its failure accurately to predict a future fiscal crisis—when negotiating its collective bargaining agreement does not serve to relieve it from its contractual obligations. An economic assumption that a

district can afford a contract over the next few years is merely a prediction. It does not constitute the type of mutual mistake of fact that legally could result in portions of the contract being re-written or voided.

For all of these reasons, before ignoring the provisions of existing collective bargaining agreements, districts in financial crises are strongly advised to explore other legal avenues.

### Re-opener

1. Request re-opener. The preferred course of action is to approach union leadership with a request to re-open the contract for purposes of renegotiating sufficient economic proposals to balance the budget. The union has no obligation to agree even to discuss re-opening the contract. Depending on the severity of the fiscal crisis, however, the union is not immune to the political pressures to appear responsive to the concerns of the increasingly tax-weary, and possibly unemployed, taxpayers. The union is not ignorant of the possibility that massive layoffs may occur if cost-saving measures are not achieved. It may, therefore, at least agree to have preliminary conversations.

2. Share accurate budget information. A district should anticipate that the union will ask to scrutinize the district's budget figures. It is important to a district's credibility with the union to share accurate budget information without undue delay. That budget information must be sufficiently detailed so that the extent of the budget deficit is apparent to all who review it. Further, it is absolutely essential that the budget information clearly establish the genuineness of the budget crisis.

3. Share the burden. If a contract re-opener has any chance of success at all, it is also important to demonstrate to the union that other cuts have been taken in non-salary and benefit areas and that other employee groups will be asked equitably to share the economic burdens of the fiscal crisis.

Since wages and benefits often constitute approximately eighty percent of a district's total budget, it should not be difficult to demonstrate that either staffing or wages and benefits will be impacted by a severe budget shortfall. Successfully convincing the union that a reduction in wages and/or benefits is necessary to balance the budget is another matter entirely.

4. Understand the union's potential responses. Some unions may respond to the possibility of large-scale layoffs by making mid-term concessions. In essence, they may be convinced to save the jobs of many by taking an across-the-board reduction in pay and/or benefits. Other unions will remain steadfast in their stated position that re-opening a contract is sufficiently repugnant to collective bargaining that, as a matter of principle, they must enforce the existing contract terms despite the fact that some of their members are being laid off. Pragmatically for these unyielding unions, the

school district can declare "fiscal urgency" in writing to its union and inform the union that modifications to the existing collective bargaining agreement are required to balance the budget.

Once the district declares "fiscal urgency" requiring contract modification, a 14-day negotiating period is triggered. The parties are obliged to meet to discuss possible modification. If no agreement is reached during the negotiating period, either side can declare impasse by written notification to the other party and the labor commission. Upon receipt of the impasse notification,

school district to bargaining to impasse on wage and benefit cuts and, after following the statutory impasse procedure, implement its proposed changes.

This ruling was in contravention of previous case law supporting the theory that Rhode Island's public sector collective bargaining law takes precedence. Under the old legal theory, the parties were obligated to follow the terms and conditions of the old agreement until a successor agreement was negotiated.

3. Actions against the taxing authority. A district facing the perfect financial storm must also consider whether state laws allow it to bring an action against its taxing authority or the state to seek additional education funding. Such challenges can cause a political storm more intense than that caused by eliminating school programs and engaging in massive layoffs. Other branches of government and taxpayers may accuse the district of being selfish and free-spending when others are suffering. On the other hand, such challenges, even if unsuccessful, can serve to prevent labor strife by demonstrating that the district is taking all legal avenues to ensure funding of an existing agreement. To the extent that the legal challenge is successful and results in additional revenue, a district can better fulfill its mandate to ensure a quality education.

“

**Reducing or cutting previously agreed to wages certainly will lead to a back pay award against the district; and furloughs are the equivalent of a pay cut for breach of contract purposes.**

”

laid off employees will be the least senior employees. Union leadership tends to consist of more senior employees whose positions—and wages—will remain intact.

### Lay-offs

Assuming the attempts to re-open the contract fail, all other legal options need to be considered. Massive layoffs certainly provide one possible solution. Given the negative impact on services to students and the ensuing labor unrest, massive layoffs are generally not the optimal choice. They may be the only choice, however. In some districts, even that choice may not be available.

Some unions have negotiated contract provisions limiting a district's ability to engage in massive layoffs. Class size maximums, for example, serve to restrict the number of teacher positions that can be eliminated. Other collective bargaining agreements contain specific limitations on the number of teachers who can be laid off.

### State law remedies

1. "Fiscal urgency" statute. A state's public sector collective bargaining statute may offer a procedure for a fiscally-strapped district to seek relief from the terms of an existing collective bargaining agreement. For example, in Florida, a

the commission appoints a special magistrate. The special magistrate has the authority to conduct hearings and make recommendations as to if and what modifications should be accepted. The parties have the authority to accept or reject the recommendations. If one of the parties rejects the recommendations, the matter then may be taken to the school board for a hearing and a determination.

2. Prohibition on deficit spending. In states where there is no express statutory procedure addressing the "fiscal urgency" contingency, more creative legal remedies will have to be explored. Ultimately, a district may have to concede there are no viable remedies.

In Rhode Island, existing state education law prohibits deficit spending by a school district. That same statute specifically states, however, that its terms cannot be used to abrogate the terms of an existing collective bargaining agreement. Thus far, in Rhode Island, the prohibition against deficit spending has only been used successfully to address budget problems during that period of time after a collective bargaining agreement has expired and before a successor agreement has been negotiated.

In that narrow circumstance, one Rhode Island judge has ruled that the law prohibiting deficit spending allows a

### Looking forward

Once a collective bargaining agreement is signed, it is very difficult in most circumstances to obtain relief from its terms. The best practice is to consider carefully the economic consequences of an agreement in advance of ratification. Sometimes, no matter how careful a district is, it is simply unable to predict a sudden economic decline. When a decline occurs, education is likely to suffer despite best efforts to preserve programs.

The 2014 deadline for 100 percent student proficiency is almost here. Fiscal crises are never welcome, but this crisis could not have come at a worse time. Will the perfect storm subside in time? Will the deadline be extended? Should it be? Can we afford to fund our existing collective bargaining agreements? Can we afford not to? Only time will tell. ■

*Rosemary Healey is director of compliance and human resources for the Warwick Public Schools, in Warwick, R.I.*

## BUDGET

Continued from page 1

a catering service; the Houston Independent School District expects to launch an Internet-based radio station; a Virginia district runs ads on its official website, and Utah considered allowing ads on its school buses.

Despite these creative approaches and economic recovery in the financial sector, however, budget cuts continue to be necessary for states because consumer spending is still low and unemployment is still relatively high. The Rockefeller Institute of Government reports that in the fourth quarter of 2009, state tax revenues dropped by 4.2 percent compared to a year earlier; and the National Conference of State Legislatures predicts that it will be several years before school districts in many states can return to normal budgeting.

School districts are viewing the salary and benefits line item in the budget, by far the largest spending item in a public school district's budget, as the primary target for budget balancing.

## SELECTED REFERENCES

"SEC Chief Pledges Better Oversight of Banks," Associated Press via the *Washington Post*, April 20, 2010, online edition, [www.washingtonpost.com/wp-dyn/content/article/2010/04/20/AR2010042002057.html](http://www.washingtonpost.com/wp-dyn/content/article/2010/04/20/AR2010042002057.html).

"Lehman Meltdown Cost Municipalities Millions, Reps Say," Associated Press via the *Lowell Sun*, April 21, 2010, online edition, [www.lowellsun.com/business/ci\\_14926979](http://www.lowellsun.com/business/ci_14926979).

"Stimulating Equity? A Preliminary Analysis of the Impact of the Federal Stimulus Act on Educational Opportunity," a paper presented by Michael A. Rebell, Jessica R. Wolff, and Daniel A. Yaverbaum at The Campaign for Educational Equity's Fifth Annual Equity Symposium, [www.equitycampaign.org/i/a/document/12857\\_Stimulating\\_Equity\\_Report\\_FINAL.pdf](http://www.equitycampaign.org/i/a/document/12857_Stimulating_Equity_Report_FINAL.pdf).

"Cliff Hanger: How America's Public Schools Continue to Feel the Impact of the Economic Downturn," an American Association of School Administrators survey [www.aasa.org/PressReleases.aspx?id=12986](http://www.aasa.org/PressReleases.aspx?id=12986).

"District Offers Catering to Parents, Workers," *East Valley Tribune*, Novem-

"Eighty percent of what a district spends is on people. Cutting supplies or taking a copy machine out of a school—they are low-hanging fruit but really won't balance the budget. People are the thing you need to remove to balance the budget," says an Illinois school official. So school districts are handing out reduction-in-force notices like never before, cutting as many staff members as they can within the boundaries of applicable state statutes, state and federal labor laws, and collective bargaining agreements, while still maintaining enough staff to run schools so that students learn and improve.

In this issue of *Leadership Insider*, legal experts present insight and information on concerns you may be facing as you negotiate or possibly re-open collective bargaining agreements and consider additional funding options. Barbara Ruga discusses how hard economic times affect your district's position at the bargaining table. Rosemary Healey talks about the legal parameters of honoring, or possibly breaking, negotiated collective bargaining agreements. And Linda Schakel provides

some clarity on the complex area of school district bonds. ■

—Sonja Trainor, editor

## NSBA RESOURCES

Advocacy staff at NSBA have been working hard to urge passage of the



"Keep Our Educators Working Act of 2010," introduced by Senator Tom Harkin (D-IA). If passed, the law would provide \$23 billion to states and school districts to help save education-related jobs.

The bill includes provisions similar to the House-passed Jobs for Main Street Act and the pending Local Jobs for America Act that were both introduced by Representative George Miller (D-CA).

NSBA issued a letter to Senator Harkin on behalf of the 95,000 school board members who govern our nation's 15,000 public school districts urging continued leadership on the passage of this bill, which would extend fiscal stabilization funding to school districts.

The funding, explained NSBA, is urgently needed to help school districts save jobs that directly benefit student achievement and school performance.

Review a state-by-state estimate of projected funding allocations at <http://www.nsba.org/MainMenu/Advocacy/FederalLaws/FederalFunding/Stimulus/SFSF-Resources/ECS-Charts.aspx>.

Read NSBA's letter of support for the bill at <http://www.nsba.org/MainMenu/Advocacy/FederalLaws/FederalFunding/Stimulus/SFSFResources/April-13-2010-Letter.aspx>.

Consider the information provided by NSBA's Office of Advocacy on national public education issues and use the provided tool to communicate with members of Congress at [http://vocusgr.vocus.com/grspace2/WebPublish/controller.aspx?SiteName=NSBA&Definition=Home&SV\\_Section=Home](http://vocusgr.vocus.com/grspace2/WebPublish/controller.aspx?SiteName=NSBA&Definition=Home&SV_Section=Home).

# Bond financing vehicles: 0 to 60 in 13 years

By Linda B. Schakel

**S**chool boards may be able to take advantage of new federal programs that make it easier for public entities to issue bonds for school construction. Bonds expert Linda Schakel provides a summary of the financing vehicles available and factors to consider when you are determining which one is the best option for your project.

Over the past year, the federal government has stepped up its efforts to assist state and local governments in financing the construction and renovation of public schools. With the passage of the Hiring Incentives to Restore Employment (HIRE) on March 18, Congress has added to the number of vehicles made available under the American Recovery and Reinvestment Act (ARRA). The full menu is now as follows:

- Traditional Tax-Exempt Bonds (including "Bank Qualified" Bonds)
- Direct Pay Build America Bonds
- Direct Pay Recovery Zone Economic Development Bonds
- Tax Credit Bonds (including a Direct Pay option)
  - Qualified Zone Academy Bonds
  - Qualified School Construction Bonds
  - Qualified Energy Conservation Bonds
  - Clean Renewable Energy Bonds

## Tax-Exempt Bonds

Historically tax-exempt bonds have been the financing tool by which state and local governments financed both capital, and in some cases, working capital needs. Tax-exempt bonds provide an indirect subsidy from the federal government because the federal government does not tax the bondholder on interest income earned on the bonds. The school district is able to obtain a lower interest rate from the bondholder because the interest income is not taxed. Congress has placed some restrictions on bonds qualifying for the interest exemption, but there is no federal limit on the principal amount of qualifying bonds that state and local governments can issue. Each of the newer financing vehicles follows this basic model of tax-exempt bond financing, but the type of federal tax benefit may differ and additional limitations may apply.

## Bank Qualified Tax-Exempt Bonds.

Tax-Exempt Bonds are typically sold in the public market, but bond issues of smaller issuers have often been purchased directly by local banks. Since the Tax Reform Act of 1986, banks have lost the benefit of interest expense deductions on their federal tax returns relative to the proportion of the banks' holdings of tax-exempt bonds to its total assets. The tax code provides an exception to this 100 percent interest expense disallowance for bonds issued by smaller issuers and designated by the issuer as "bank qualified." Prior to ARRA, an issuer could designate only \$10 million a year in tax-exempt bonds as bank qualified. ARRA increased the \$10 million limit to \$30 million per year for bonds issued in 2009 and 2010, so this vehicle should help smaller school districts finance projects in a more cost effective manner than accessing the public market.

## Direct Pay Build America Bonds ("BABs")

Build America Bonds are municipal bonds that would otherwise qualify as tax-exempt bonds except that the issuer elects to issue the bonds with a taxable interest rate to the bondholders and further elects to receive a "refundable credit" from the federal government equal to 35 percent of the interest payment to the bondholder, so called "Direct Pay BABs".

This idea of a "taxable option bond" has been talked about for several decades, but Congress included it in ARRA in order to open up the market for municipal bonds. Some potential purchasers, such as pension funds and 501(c)(3) foundations, were not interested in purchasing tax-exempt bonds because they were not otherwise subject to federal income tax. The intent was to put the issuer in the same place (and some economists felt a better place) by providing the federal subsidy directly to the issuer rather than indirectly through the bondholder.

Similar to traditional tax-exempt government bonds, there is no federal volume limitation on the amount of BABs that can be issued, provided they are issued in 2009 or 2010. Nor is there a cap on the amount that the federal government will make in direct payment subsidies. The Direct Pay BABs must be used exclusively for capital expenditures, reserve funds (up to 10 percent of the issue), or costs of issuance (up to 2 percent of the issue).

Proceeds cannot be used for refundings or working capital, reflecting Congressional intent to stimulate spending.

ARRA also provides for a form of BABs whereby the bondholder receives taxable interest plus a credit against its federal tax liability equal to 35 percent of the overall return. The issuer does not receive a direct subsidy payment from the federal government with this, so called Tax Credit BABs version. To date, no Tax Credit BABs have been issued.

**Recovery Zone Economic Development Bonds ("RZEDBs").** Recovery Zone Economic Development Bonds are a special form of Direct Pay BABs. The subsidy payment an issuer can elect to receive from the federal government for RZEDBs is 45 percent of the interest payable to bondholders. Congress has capped the issuance of RZEDBs at \$10 billion, with allocations made to states in proportion to job losses. RZEDBs must be issued by December 31, though there is a bill in Congress to add another \$10 billion and extend the issuance through calendar year 2011.

State and local governments are permitted to use proceeds of the RZEDBs for construction of public facilities and infrastructure, which would include public schools, in a "Recovery Zone" designated by the local jurisdiction, but these subsidized bonds may also be used to finance working capital expenses for job training and educational programs. Local jurisdictions are given a great deal of leeway in determining what areas are included in a "Recovery Zone," based on unemployment, poverty, foreclosures and general distress. Projects financed with the proceeds of RZEDBs are subject to the Davis-Bacon prevailing wage rules.

**Direct Pay Mechanism.** The general statutory intent of the Direct Pay BABs is that the school district will submit for the subsidy in time to receive payment contemporaneously with the interest payment due to the bondholder. New IRS Form 8038-CP is provided for issuers of Direct Pay bonds to claim the federal payments. For fixed-rate bonds, Form 8038-CP must be submitted between 90 and 45 days before each interest payment date for the life of the bond issue. School districts should expect to receive payment within 45 days. For variable-rate bonds, the issuer is to file Form 8038-CP within 45 days after the last interest payment date of each calendar quarter to receive a single

payment covering all the interest payments made during the previous quarter. An issuer can direct payments to itself or to an entity designated to receive the payments on its behalf, such as a trustee or paying agent.

Because the direct payment is treated as a “refundable tax credit” to the issuer, the issuer’s right to the payments apparently can be offset against other payments owed to the federal government and other federal tax payments due from the issuer, such as payroll tax obligations.

### Tax Credit Bonds

Tax credit bonds first became available in 1997 in the form of Qualified Zone Academy Bonds, the so-called “QZABs”. This financing vehicle for public schools provided a federal subsidy in the form of a tax credit to the bondholder in lieu of an interest payment from the school district. In order to limit the federal subsidy, the tax code puts in place a mechanism for determining the maximum tax credit rate, maturity of the tax credit bond and principal amount of tax credit bonds that could be issued each year nationwide. The QZAB program began as a \$400 million program and was extended at that level through 2008. ARRA gave the program a big boost by increasing the volume cap to \$1.4 billion for each of calendar years 2009 and 2010.

Although the QZAB program was relatively small and was limited to renovation, equipment, and teacher training at low-income schools, it was popular enough that Congress has added several other categories of tax credit bonds, each with its own limited purpose and its own volume cap. QZABs and the Qualified School Construction Bonds (QSCBs) are specifically limited to public schools, but the other two categories relating to energy improvements can also be used for schools. The credit rate for the two energy bonds, Qualified Energy Conservation Bonds (QECBs) and Clean Renewable Energy Bonds (CREBs), is reduced to 70 percent of the published tax credit rate.

The issuer generally will be required to pay back the principal amount of a tax credit bond only, as the return to the holder is not interest but a credit against federal tax liability. The tax code allows the tax credits to be stripped from the principal component as a way of enhancing the marketability of the tax credit bonds. In March, the IRS published guidance describing the procedures and reporting requirements for stripping the

credits.

Davis-Bacon labor standards, requiring generally that prevailing wages must be paid on public works projects, apply to all tax credit bonds.

**Direct Pay Tax Credit Bonds.** The sluggish economy has left fewer taxpayers with federal tax liabilities and this has made it difficult for issuers to market the tax credit bonds. HIRE now allows issuers

to issue the tax credit bonds as taxable interest bonds and elect to receive a direct subsidy payment from the federal government that is equal to the lesser of the taxable interest rate set by the purchaser of the bonds or the tax credit rate. Thus, if the taxable interest rate is 6 percent and the published tax credit rate is 5.5 percent, the school district would essentially be paying net interest of 0.5 percent to

Type of Tax Credit Bond	Volume Cap	Permitted Expenditures	Issuance Period
Qualified Zone Academy Bond	\$1.4 billion for each of 2009 and 2010  Allocation to states by proportion of population below poverty; State Department of Education makes suballocations	<ul style="list-style-type: none"> <li>• Rehabilitation or repair of public school facility (35% of students on free or reduced lunch)</li> <li>• Curriculum development</li> <li>• Teacher training</li> <li>• Need 10% private business match</li> </ul>	Can carry forward unused allocation for two years
Qualified School Construction Bonds	\$11 billion for each of 2009 and 2010  Allocation of 60% to States by proportion to Title I funding; 40% to 100 largest LEAs plus up to 25 LEAs in need designated by U.S. Department of Education  \$200 million to Bureau of Indian Affairs Schools	<ul style="list-style-type: none"> <li>• Construction or rehabilitation of public school and equipment to be used in the facility</li> </ul>	Can carry forward allocation indefinitely until allocation depleted
Qualified Energy Conservation Bonds	\$3.2 million allocated to states and large local jurisdictions (100,000+) by population	<ul style="list-style-type: none"> <li>• Reduce energy consumption in public buildings by 20%</li> <li>• Renewable energy facility (such as solar, wind)</li> </ul>	Can carry forward allocation indefinitely until allocation depleted
Clean Renewable Energy bonds	\$800 million for governmental entities—by application to IRS	<ul style="list-style-type: none"> <li>• Renewable energy improvements, such as solar panels, wind energy</li> </ul>	Generally three years after receipt of allocation

the bondholder once the direct payment is received from the federal government. The mechanism for receiving the direct subsidy is expected to be the same as described above for BABs.

### **Evaluating options: tax credit vs. direct pay vs. traditional tax-exempt**

A school district looking to finance new capital expenditures may have the ability to finance a specific project with BABs, tax credit bonds, or traditional tax-exempt bonds. To the extent a specific project qualifies for a direct subsidy or a tax credit to the bondholder, the primary criteria for selecting the appropriate vehicle will be financial—the lowest all-in cost and the marketability of the bonds. Direct Pay and tax credit bonds can give the issuer the ability to sell its debt to a broader market, providing state and local governments with access to conventional corporate debt markets. Direct Pay BABs or Direct Pay tax credit bonds should be attractive to investors who may not have been interested in tax-exempt income or a tax credit, given their exemption from federal income taxes, such as pension funds, tax-exempt investors, and foreign investors.

There are some additional more subtle factors that a school district may want to consider in selecting a financing vehicle for a specific project.

### **Accessing the market**

The taxable market has traditionally had a different approach to permitting an issuer to optionally redeem bonds prior to maturity. Issuers are accustomed to being able to refund the debt to obtain a lower interest rate or to eliminate burdensome covenants prior to maturity of the bonds. Within the tax-exempt bond market, fixed rate bonds are sold with a no-call period of 7 to 10 years, and redemption after that is at par or some modest premium. The taxable market typically would require a “make-whole” redemption premium that provides the holder its expected return if the debt went out to maturity. The no-call period and redemption premiums may be available in the taxable market, but at a price.

If the taxable market is unfamiliar with the financials and credit of the school district, the school district and underwriter may need to invest time in making this market aware of the unique attributes of the school district. For example, state intercepts and budget

delays may not be familiar to these purchasers.

A school district may be able to interest local partners, such as pension funds and foundations, in purchasing Direct Pay bonds. These investors often have a personal stake in the school district and now with the Direct Pay bonds, whether BABs or tax credit bonds, they can also receive a taxable interest return that is attractive.

### **Fitting within existing debt issuance structure**

While each of the financing vehicles is essentially no different from the debt instrument issued into the tax-exempt bond market, certain features of the Direct Pay bonds and tax credit bonds may need to be fit within other existing state and local debt rules. For example, with any of the Direct Pay bonds, the school district is obliged to pay bondholders the full taxable interest payment, which will be higher than a corresponding tax-exempt interest payment. While the school district fully expects to receive a direct subsidy payment from the federal government to reduce that debt service payment, a school district will need to determine whether the subsidy is netted against the full debt service for other purposes, such as state or local debt limits, any covenants as to debt service coverage in other bond documents, and for state intercept procedures. This analysis is complicated to some extent by the lack of information about what liabilities might result in an offset of the direct subsidy payment from the federal government, such that the school district would be liable for higher interest payments than it might have expected.

The purchasers of tax credit bonds expect that the full principal amount of these bonds will remain outstanding for the maximum term permitted under the tax code for the bonds. This allows the bondholder to receive a greater credit amount. The tax rules allow an issuer to set up a sinking fund with annual installments of principal that is invested to provide the payment at maturity. This typical financial structure may need to be examined in the case of a school district that is required by state or local statutes to amortize debt prior to maturity. If the sinking fund payment will meet the amortization requirement, the purchaser and the school district will be able to obtain the intended benefit of the zero percent interest for tax credit bonds.

### **Role of the state**

The RZEDBs and tax credit bonds are subject to volume cap limitations, some of which are controlled by the state and others of which are required by the tax code to be allocated to local jurisdictions. A school district that does not receive its own direct allocation of tax credit bonds or RZEDB allocation will have to obtain an allocation from the state. This may require going through an application process. Timing requirements may make a school district’s project less attractive. For example, the tax credit bond proceeds must be spent within three years of issuance and a project may not be far enough along to give assurances that funds will be spent within that time frame.

States have a strong interest in seeing all allocations used, so they may impose deadlines for issuance once the school district receives allocation in order to allow time for reallocation and issuance in a timely manner. A school district can be the beneficiary of the deadlines as the party in waiting or the process may be to its detriment if it cannot meet all conditions in time.

### **Administrative burden**

The Direct Pay bonds will require the school district to file a form prior to each interest payment date. A late filing may result in a late payment of the subsidy. If the school district elects to strip tax credits, the IRS imposes several reporting requirements that will also take time and effort.

### **Qualifying expenditures**

Particularly in the case of the tax credit bonds, the project needs of a school district may not line up with the volume cap allocation available. The tax credit bonds have specific rules on reimbursing costs paid by the school district prior to issuance of the tax credit bonds, and the qualifying expenditures have special definitions that may not seem logical to the school district. For small transactions, the limit on the costs of issuance that may be paid from the bond proceeds may require the school district to come out of pocket for some of the expenses.

### **Relationship to the IRS**

The Direct Pay approach to a federal subsidy is likely to result in a different relationship between the IRS and the issuer. With the exempt bonds, it is the bondholder who receives the tax benefit

and it was always more cumbersome for the IRS to audit or challenge the tax-exempt status of the interest with the issuer. With Direct Pay, the issuer and the IRS should be able to deal directly.

Regardless of whether the school district elects Direct Pay or credit to the holder, the IRS is likely to ask if the school district has written procedures for post-issuance compliance. At this point the IRS is planning to send a compliance checklist to every issuer of a Direct Pay BABs and thus is likely to extend this to the tax credit bonds that are issued as Direct Pay. That compliance questionnaire, a copy of which may be accessed on [www.irs.gov/bonds](http://www.irs.gov/bonds), asks the school district to provide the date it implemented its written procedures relating to issuance of the bonds, use of proceeds, maintenance of records and arbitrage and rebate compliance. There is no statutory or regulatory requirement that a school district have such procedures in place, but given the trend, it would be wise to do so.

Both the more direct relationship with the IRS and the IRS emphasis on post-issuance compliance suggest that a school district should be prepared to pay ongo-

ing costs of compliance for these types of financings. This is probably the trend for all tax-favored financings, but the IRS scrutiny appears to be heightened by the Direct Pay approach. Violation of the tax rules could result in the school district

losing the payment from the federal government, so continuing post-issuance compliance will be crucial. ■

Linda B. Schakel is a partner of Ballard Spahr LLP, in Washington, D.C.

### FOR MORE INFORMATION

Numerous online resources are available to you on the National Affiliate website, [www.nsba.org/na](http://www.nsba.org/na):

- Click on School Grants for access to the Grant Watch Report, providing you the latest information on school funding opportunities and tips on grant-writing.
- Choose Economic Stimulus Package for in-depth information from NSBA's advocacy staff on the various funding programs available under the American Recovery and Reinvestment Act. And look for continuing coverage on this topic in *Leadership Insider*.

NSBA provides an array of useful resources on topics of law and policy affecting schools:

- Go to [www.nsba.org](http://www.nsba.org) and click on

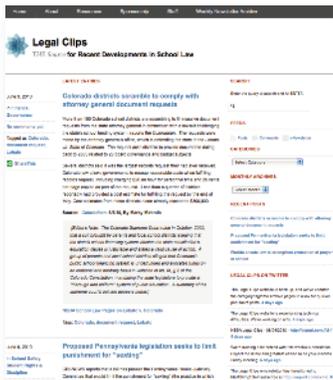
the School Board News tab. There you will find the latest news and information affecting schools, including coverage of economic and labor topics such as state teacher tenure legislation.

- Visit the School Law section of [www.nsba.org](http://www.nsba.org), where you can explore legal topics related to schools. Select School Law from the left column, then click on Issues. For information on budgets and labor negotiations, check out the recent cases and news items under Employment and Labor, as well as Finance.

- You can search the NSBA site for in-depth information on topics of interest to you.

You also can find back issues of *Leadership Insider* and the online resources accompanying those issues.

# Are you taking advantage of Legal Clips?



This free online service from NSBA provides up-to-date information on recent developments in school law, including analysis by NSBA legal staff and links to further materials on the topic. Its new interactive format encourages you to comment, and allows you to receive Legal Clips posts via Twitter or by RSS feed. By subscribing, you receive the stories weekly via email newsletter.

Check it out today, and join the discussion!

# <http://legalclips.nsba.org>