

**MEMO TO: BOARD MEMBERS;
DR. JOHN SIMPSON**

FROM: FINANCE ADVISORY COMMITTEE (FAC)

DATE: DECEMBER 21, 2018

RE: FAC FUNDING RECOMMENDATIONS-SPACE & INFRASTRUCTURE NEEDS

Purpose of Report

The purpose of this report is to provide a recommended funding structure for the facilities space and infrastructure projects identified by the district and separately recommended by the Building Advisory Committee (BAC). While the district has a choice between two options (Option A and Option B) recommended by the BAC and the cost of these two options differs significantly, the FAC's objective was to develop a common funding structure which could ultimately be scaled to the respective amount needed. A further FAC goal was that such funding structure would not require an increase in the district's property tax rate. Finally, it was also important that any funding structure not only be currently affordable, but that it also be sustainable in the longer term in view of future district capital needs. In other words, the district needed to keep some amount of future funding capacity in reserve for anticipated future building repairs and replacements which will inevitably come due in light of the district's aging infrastructure.

While one of the primary roles of the FAC is to monitor district finances, it has been particularly focused for the past few months on identifying potential funding resources for capital projects. The resources considered included current operating budgets, district operating fund balance reserves, available district bonding capacity, lease financing and other potential new revenue sources. This report to the Board of Education and Webster Groves School District community is based on the financial information, funding alternatives and identified capital needs of the district. It is important to note that it is time sensitive in that estimated project costs may be subject to inflationary increases should significant project delays occur. In addition, assumed interest rates applicable to new debt may be subject to future fluctuations in financial markets. Such inflation and market fluctuations could have a significant impact on the cost of both the project itself AND the financial resources with which it is funded. As such, any significant delays in plan implementation may significantly impact the number and scope of district space/infrastructure projects which can be funded.

Purpose of the FAC

The FAC is one of Webster Groves School District's (District) standing Board committees. As such, its meetings are open to the public and are conducted with the same amount of formality (posting of meeting notices and minutes taken) as regular Board of Education meetings. It meets about 8 times yearly and its basic charge is to:

- Monitor district budget, financial position and business operations on an on-going basis;
- Review/assess all significant business/finance-related issues that impact district operations; and
- Make recommendations to the district and Board regarding business, financial and operational issues.

FAC Membership

The FAC consists of 9 community members, a building administrator, the Comptroller, the COO/CFO and a Board liaison. Committee members have a diverse background of education and experience in business/finance and are asked to serve for at least a 3-year term.

Current members of the FAC are:

Allen Todd – Bristol
Larry Fields – Clark
Jayne Drennen – Bristol
Sara Kotthoff – Hudson
Justin Hauke – Clark
Elyse Manterfield – Avery
Kurt Schafers – Hudson
Nikki Lemley – Clark
Rob Stuber – Edgar Road
Aaron Winkler, Assistant Principal, Avery
Joann Kite, Comptroller
Bruce Ellerman, COO/CFO
David Addison, Board Liaison

Background

Three basic funding mechanisms can be used by public school districts for buildings and other capital projects:

- 1 – Operating Funds
- 2 – Long-Term Debt (Bond Issues)
- 3 – Grants/Fundraising

A summary of these alternative financing approaches can be found in Addendum 1 – Capital Projects Financing Options.

Operating Funds Financing Option

One option to pay for capital improvement projects is to use district operating funds. These operating funds may consist of annual operating revenues or they may be taken from district operating reserve balances.

Annual Operating Revenues

The challenge with using annual operating revenue funds is the multiple demands on them make it difficult, if not impossible, to set aside the sizable amounts required for any significant building project. As a service oriented organization, the great majority of public school district operating expenditures (typically 80-85%) go for staff salaries and benefits. Additional expenditures for instructional supplies, food service, transportation, utilities, repairs/maintenance, insurance and other unavoidable outlays consume most or all of the remaining operating budget resources. While a sustainable budget plan does include some level of capital expenditures in order to keep up with major district infrastructure repairs/replacements, it is a relatively small amount which is needed to maintain district buildings and equipment in good, serviceable condition. This leaves little, if any, operating funds available to help fund long-term, large infrastructure additions/renovations.

For the current 2018-19 fiscal year, the district has a balanced operating budget totalling about \$61.7 million. About \$1.8 million of this total is allocated for building improvements. However, about \$400,000 was used to complete 2018 summer projects at the schools. In addition, \$165,000 is already earmarked for the district's contribution to the Webster Groves City tennis court project. Finally, another \$500,000 is reserved for covering other unforeseen Facility Department repair/maintenance costs that invariably arise each year due to the district's aging infrastructure. This potentially leaves about \$700,000 of the 2018-19 operating budget available for capital projects. Future annual budget projections for the next two years include a similar amount each year. However, using these amounts to support significant capital projects at this time would leave no flexibility for the Facilities Department in responding to principal requested building changes (such as adding/removing walls, adding electrical capacity, relocation of instructional equipment fixtures, etc.) in order to meet evolving instructional program needs. The FAC therefore does not recommend utilization of operating budget revenues to support building projects at this time.

Operating Reserve Balances

In contrast to annual operating revenues, operating reserve balances represent an accumulation of past budget surpluses. While such reserves are only available to be used once, this matches up well with the one-time nature of capital expenditures. The major limitation is in the amount of operating reserve funds that may be available compared to the amount needed for any significant capital projects. There are also other critical functions of operating reserve funds such as serving as a cash flow regulator, unforeseen emergency fund and future deficit coverage. Therefore, it is important to leverage any available operating reserve funds which exceed these basic needs as much as possible in order to maximize their impact.

Currently, the district's operating reserve funds total about \$26 million. Of this amount, about \$17 million is needed to cover intra-year cash flow fluctuations. Another \$2-3 million represents accumulated surpluses from specific proprietary funds (such as food service, Preschool, Adventure Club and Student Activities). Finally, district should maintain an emergency fund of about \$3 million for any sudden, unforeseen future needs and for the purpose of temporary coverage of any future budget deficits that may arise. After these set asides, about \$3 million ($\$26 - \$17 - \$3 - \$3 = \3) is therefore available on a one-time basis for dedication toward district capital projects. The best way to leverage this \$3 million for optimal impact is outlined in the "Long-Term Debt (Bond Issues)" section.

Long-Term Debt (Bond Issues)

The most common financing approach used by public school districts for significant capital infrastructure is long-term debt (general obligation bond) issuance. Missouri public school districts are subject to an overall debt limit of 15% of assessed valuation with all bonds required to mature in 20 years or less. For Webster Groves School District with an assessed valuation of almost \$810 million, this technically results in a debt ceiling of about \$120 million. In contrast, the present bonded district indebtedness is about \$50 million (excluding the recent refunding bonds that are serviced by a separate escrow account). While it is not possible for the district to effectively support interest and principal payments at the \$120 million debt limit level, projections indicate the current \$.5699 debt service levy can currently support about \$13 million more than the \$50 million currently outstanding. This projection is based on current market interest rates and a bond maturity schedule that would also allow for additional future bond issues of about \$7 million every 4-5 years. The preservation of future bond issue capability while still maintaining the existing \$.5699 debt service tax rate was an important consideration of the FAC. Combining the \$13 million in new bonds with the \$3 million of available operating fund balance reserves would provide a total of \$16 million for capital improvement projects.

However, it is possible to even further increase the district's bonding capacity under a \$.5699 debt service levy by rethinking how the \$3 million of available operating fund reserves are used. Specifically, instead of using such reserves to directly pay for capital projects, they could be used instead to make a one-time transfer to the debt service fund. This \$3 million one-time funds transfer would increase the district's bond support capacity by \$9 million. Furthermore, the precise timing of such operating reserve transfer could be

flexible based on the requirements of future cash flows in the debt service fund without affecting the supportable bonding capacity. Consequently, this approach would provide \$22 million in immediate bonding capacity while still maintaining an on-going \$.5699 debt service levy. It would also still preserve a cycle of future additional bond capacity of about \$7 million every 4-5 years thereafter. (NOTE/ While the FAC is not recommending a tax increase at this time, it was also noted that the district's bonding capacity could be increased by about \$1.1 million for each \$.01 increase in the debt service levy.)

A district bond amortization schedule indicating interest and principal payments for existing and potential new debt issues is attached as Addendum 2 – Amortization Schedule and Addendum 3 – New Debt Issue Projections. This information is graphically presented in Addendum 4 – Amortization Cash Flows Graph.

New bond issues must be approved by district voters at a duly held public election. Approval requires a 4/7ths majority vote on general election dates and a 2/3rds majority on special election dates. For 2019, April is the only general election date. Because of the significant difference in the majority required, the district should strongly consider targeting a general election date for any future bond issue to be sought.

Grants/Fundraising

Depending on the type of work to be done, capital projects can sometimes be funded by or financed by grants or separate fundraising activities. Grants are usually most feasible for projects which include a specific dedicated purpose consistent with prevailing social or benefactor priorities. Fundraising is usually most applicable in the case of specific extra-curricular or enrichment activities such as athletic facilities, theatres, playgrounds and the like. The FAC was not aware of any significant source of grant funding or fundraising opportunities for the type of basic projects and the implementation timelines currently being considered by the district.

Funding Structure Recommendations

OPTION A

OPTION A consists of new additions at Edgar Road (8 classrooms), Clark (6 classrooms) and addressing space needs at Avery. Relatively minor elementary attendance boundary adjustments would be made to rebalance enrollments. The estimated cost of these additions/space considerations is \$8.5 million. This work would be supplemented by another \$8.1 million in safety, accessibility, abatement and programmatic infrastructure projects across the district. These projects are specifically identified in the BAC report of

recommendations to the Board. Total recommended project work would therefore be about \$16.6 million. In order to provide a contingency reserve for project completion, the FAC suggests rounding this total up to \$17 million. The FAC therefore recommends that if OPTION A is chosen, it be funded by a \$17 million bond issue to be placed before the voters on the April, 2019 ballot or at such other time as the Board of Education deems most beneficial for the district. Contingent on bond issue passage and to support the district's ability to service these new bonds, the FAC further recommends that the Board of Education formally designate an estimated amount (up to a maximum of \$3 million) of operating reserve funds as a restricted reserve for future transfer to the debt service fund as necessary to maintain the current \$.5699 debt service levy and a positive cash flow at all times throughout the year.

OPTION B

OPTION B consists of new building additions at Hixson to include classrooms (16), library expansion, multi-purpose room, cafeteria expansion, nurse's office expansion and other renovations in order to relocate sixth grade from Steger to Hixson. Steger would then be converted to a K-5 neighborhood elementary school. Significant elementary attendance boundary adjustments would be required to create a new attendance area for Steger. The estimated cost of the Hixson addition is \$15 million while the Steger renovations are estimated at \$1 million for a total of \$16 million. This work would be supplemented by another \$6.6 million in safety, accessibility, abatement and programmatic infrastructure projects across the district. These projects are specifically identified in the BAC report of recommendations to the Board. Total recommended project work would therefore be about \$22.6 million. Since the district's maximum bonding capacity without increasing the \$.5699 debt service tax levy is \$22 million, the district operating budget would need to pick up the \$600,000 difference. This should be possible within current/projected operating budget allocations over the expected 2 year construction/renovation period. The FAC therefore recommends that if OPTION B is chosen, it be funded by a \$22 million bond issue to be placed before the voters on the April, 2019 ballot or at such other time as the Board of Education deems most beneficial for the district. Contingent on bond issue passage and to support the district's ability to service these new bonds, the FAC further recommends that the Board of Education formally designate an estimated amount (up to a maximum of \$3 million) of operating reserve funds as a restricted reserve for future transfer to the debt service fund as necessary to maintain the current \$.5699 debt service levy and a positive cash flow at all times throughout the year.

Attachments

- Addendum 1 – Capital Projects Financing Options
- Addendum 2 – Amortization Schedule
- Addendum 3 – New Debt Issue Projections
- Addendum 4 – Amortization Cash Flows Graph