



## Overview of Select State Public School Bond Enhancement Programs

In order to assist public school districts in accessing the capital markets, several states have created school bond enhancement programs. The programs vary across states, but the goals are to enhance marketability of the local school bonds and lower borrowing costs by providing additional security through a state-created enhancement mechanism. Rating agencies typically assign an enhanced rating (such as they do for bond insurance), along with an underlying issuer credit rating.

Generally, the programs fall into one of four structures: explicit state guaranty, state aid intercept, direct state payment, or a fund program. Program details vary state by state, but share some common characteristics summarized below. Note the programs described below are not an exhaustive list of all state enhancement programs, nor are they absolute guarantees that debt service payments cannot be interrupted. Investors should rely on official statements of individual bonds for more details on the mechanics of each state enhancement program, and on the underlying credits themselves.

**State Guaranty Programs:** Under these types of programs, the states pledge their full faith and credit to qualified bonds. States will use general fund reserves or pledge to issue GO bonds, if necessary, to make up debt service deficiencies of qualified bonds. Each program is structured to ensure timely and full debt service payment on bonds of districts in the programs. Ratings on these programs match the corresponding state's general credit rating.

State of Michigan: Aa2/AA-/AA-

- Michigan School Loan Revolving Fund (SLRF): Aa2/AA-/AA-
  - Mechanics: School district administrators transfer funds to bond trustees at least 5 days prior to debt service payment (principle and interest) due dates. If the transferred funds are short of what's due on the bonds, the trustees notify the state treasurer within 3 days of the debt service payment date. The state treasurer then makes a loan from the fund to ensure timely debt service payment. The treasurer pays the required debt service, and payment to bondholders is uninterrupted.
  - If the balance in the state's loan fund is insufficient to cover obligations, the state is required to make loans from its general fund. The fund is an obligation of the state, thus the guaranty program is rated on par with the state's own GO debt.

State of Oregon: Aa1/AA+/AA+

- Oregon School Bond Guaranty Program: Aa1/AA+/AA+
  - Mechanics: School district administrators transfer funds to bond trustees at least 15 days prior to debt service payments. If the transferred funds are short of what's due on the bonds, the trustees notify the state treasurer within 10 days of the debt service payment date. The state treasurer then transfers funds to the districts' trustees to cover debt service in full and on time.
  - To reimburse the state's general fund in the event a payment is made, the state will intercept state aid payments due to the district, plus interest and penalty fees. If interceptable funds are short, the state can issue GO bonds to reimburse its treasury.

State of Utah: Aaa/AAA/AAA

- Utah School Bond Guaranty Program: Aaa/AAA/AAA
  - Mechanics: School district administrators transfer funds to bond trustees at least 15 days prior to debt service payments. If the transferred funds are short of what's due on the bonds, the trustees notify the state treasurer within 10 days of the debt service payment date. The state treasurer then transfers funds from its general fund to the districts' trustees to cover debt service in full and on time.



State of Washington: Aa1/AA+/AA+

- Washington School Bond Guaranty Program: Aa1/AA+/AA+
  - Mechanics: County treasurers transfer money to bond trustees for each scheduled debt service payment. If full payment is not made, county treasurers are required to immediately notify the state treasurer and bond trustees of the shortfall; the state treasurer would then transfer sufficient money to pay full debt service payment on program bonds. Although reporting dates are not specified, the state treasurer's office is required to immediately forward funds for debt service payments.
  - The state's full faith, credit, and taxing power are pledged to guarantee full and timely payment of principal and interest on program bonds.

**State Aid Intercept/Withholding Programs:** These programs vary across states, but, generally, they operate by diverting to bond trustees state aid payments due to participating districts in the event that districts are unable to make timely and full debt service payment due on their bonds. Ratings on these programs are sometimes on par with the states' appropriation ratings, reflecting the appropriation nature of the intercept/withholding mechanism.

State of Colorado: Aa1/AA/

- Colorado School Credit Enhancement Program: Aa2/AA-/AA
  - Mechanics: Bond trustees notify the state at least 1 business day prior to a debt service payment date of any deficiency in the debt service fund. The state then advances the shortfall directly to the bond trustee and withholds up to 12 months of the district's state aid payments until it is repaid.
  - Policy stipulates the payment will be made by 1 p.m. on the debt service payment due date to allow for full and timely payment to bondholders.
  - This program is stronger than most state intercept programs as the source of enhancement comes from the state's general financial resources, not just interceptable state school aid.

State of Georgia: Aaa/AAA/AAA

- Georgia State Aid Intercept Program: Aa3/AA+/AA+
  - Mechanics: Bond trustees notify the State Board of Education (BOE) at least 15 days prior to a debt service payment date of any deficiency in the debt service fund. The BOE then diverts available funds to the trustee no less than 2 days prior to the debt service payment date.
  - The funds available for intercept are the current fiscal year's undistributed state aid to a school district.

State of Massachusetts: Aa1/AA/AA

- Massachusetts Qualified Bond Act: Aa2/AA-/
  - Mechanics: The act allows communities and school districts in Massachusetts to authorize the commonwealth to pay debt service on their bonds. The commonwealth's treasurer pays debt service directly to the trustees of qualified bonds, and withholds the amount of payment from the district's annual state aid appropriation. Only the current year's state aid is available.
  - Trustees of qualified bonds must send to the commonwealth's treasurer the maturity schedule and debt service payment dates within 10 days of issuance. The commonwealth's treasurer then assumes the responsibility to make debt service payments by the due dates directly to bond trustees, without the trigger of a notice of potential default (i.e. payments are automatically made by each debt service due date). After payment is made, the treasurer withholds an amount equal to the debt service payment from the amount of state aid to be distributed to the district.
  - Under the program school districts are required to annually appropriate and include in their tax levies amounts necessary to pay debt service on the qualified bonds. After debt service is paid by



the commonwealth, the districts can reallocate the taxes levied for qualified bonds to any other purpose.

State of New Mexico: Aaa/AA+/

- New Mexico School District Enhancement Program: Aa1//
  - Mechanics: Bond trustees notify the New Mexico Department of Finance and Administration (DFA) at least one business day prior to debt service payment dates if funds are insufficient to make debt service payments on participating school district bonds. The DFA then forwards available funds to the trustee.
  - The funds available for intercept are the current fiscal year's undistributed state aid to a school district.

State of New York: Aa2/AA/AA

- New York State Aid Intercept Program: A2/A/
  - Mechanics: School districts notify the state comptroller of any debt service shortfall. The comptroller then transfers funds to bond trustees to cover the shortfall.
  - The funds available for intercept are the current fiscal year's undistributed state aid to a school district. If the current year's aid payments are insufficient to cover the shortfall, the balance would be deducted from the succeeding year's allotment.
  - There are no specific timing provisions for the intercept mechanism, thus notification may occur after a missed payment.

State of Ohio: Aa1/AA+/AAA

- Ohio State Aid Intercept Program: Aa2/AA/AA+
  - Mechanics: Bond trustees notify the state at least 10 business days prior to debt service payment date if funds are insufficient to make principal and interest payments on participating school district bonds. The Department of Education then transfers funds to the trustee sufficient to cover the shortfall.
  - The funds available for intercept include the remaining aid appropriated to the district for the remainder of the state's fiscal year. Aid in future years may continue to be intercepted, if necessary, until the debt service shortfall is fully paid.

State of Pennsylvania: Aa1/AA/AA+

- Pennsylvania State Aid Intercept Program: Aa2/A+/AA
  - Mechanics: Bond trustees notify the secretary of education 15 days prior to debt service payment dates if funds are insufficient to make debt service payments on participating school district bonds. Available funds are then forwarded to the trustee.
  - The funds available for intercept are the current fiscal year's undistributed state aid to a school district.

Other states with credit enhancement programs for school districts with an intercept/withholding mechanism include Indiana, Kentucky, Mississippi, Missouri, South Dakota, and Virginia.

**State Appropriation Programs:** These programs call for state funds to make up any debt service deficiencies on participating school district bonds. Some programs have standing appropriations, while others require annual appropriation.

State of Minnesota: Aa1/AAA/AAA

- Minnesota School District Credit Enhancement Program (standing appropriation): Aa2/AAA/AA+
  - Mechanics: If a district cannot meet its debt service requirements, the state has pledged unlimited appropriation from its General Fund. District repayment is secured by either withholding state aid or by levying a mandatory special school district tax. Districts foreseeing their inability to



make timely debt service payment in full must notify the State of Minnesota Department of Education at least 15 working days prior to the due date.

- If a district fails to notify the state of its inability to meet its debt service requirements, the bond trustee undertakes notification at least 3 days before payment is due.
- The State of Minnesota annually appropriates funds to the Department of Education from the state's general fund.

State of South Carolina: Aaa/AA+/AAA

- South Carolina Education Finance Program (annual appropriation): Aa1/AA/AA+
  - Mechanics: If a district cannot meet its debt service requirements, the district's county treasurer is required to notify the state treasurer 15 days prior to the debt service payment date. The state treasurer then transfers to the bond trustee from the state's general fund the debt service shortfall.
  - The maximum amount of general fund money available to be applied to potential defaults is based on the total annual funds appropriated by the state for basic education under the Education Finance Act for that year. Upon advancement of funds, the state treasurer will withhold future state aid due to the district to reimburse the state's general fund.

Other states with credit enhancement programs for school districts with an intercept/withholding mechanism include West Virginia.

**State Fund Programs:** These programs generally operate by diverting to bond trustees money from state constitutionally-created funds in the event that participating districts are unable to make timely and full debt service payment on their bonds. Ratings on these programs generally don't have a direct link to the corresponding state's rating, but rather are based on the features of the funds themselves.

State of Nevada: Aa1/AA/AA+

- Nevada School District Bond Guarantee Program: Aaa/AAA/AAA
  - Mechanics: If a district cannot meet its debt service requirements, it is required to notify the state 60 days ahead of the debt service payment date. Districts are also required to transfer money for debt service payments to trustees 5 business days ahead of the payment dates. In the event of a debt service shortfall, the state treasurer transfers money from the fund to the trustee to cover the shortfall. If a school district doesn't repay the fund for the transfer, the state treasurer can intercept funds payable to the district by the state.
  - The Nevada Permanent School Fund is constitutionally earmarked for educational purposes. The fund is required to maintain liquidity to support 10% of guaranteed bonded indebtedness, and is permitted to invest in U.S. Treasuries and agencies.
  - Total guarantees outstanding are capped at 250% of the fund balance, and the fund can guarantee no more than \$25 million of outstanding bonds from any individual school district.

State of New Jersey: Aa2/AA-/AA

- New Jersey Fund for the Support of the Free Public Schools Program: Aa2/AA-/AA
  - Mechanics: Bond trustees notify the state treasurer of a debt service payment shortfall at least 10 days before a payment date. The fund trustee then immediately makes payment to the bond trustee from the fund. In the event the fund is tapped to make a debt service payment on school district bonds, the state can redirect aid payable to the district to pay back the fund.
  - The Fund for the Support of the Free Public Schools is maintained at 1.5% of outstanding school debt issued before July 1, 2003 and 1% of outstanding school debt issued after that date. If the fund falls below the required levels, the state treasurer is required to appropriate and deposit the shortfall into the funds in an amount necessary to meet fund level requirements.
  - The fund's assets are invested in U.S. Treasuries, with a mandate that one-third of the portfolio mature within a 12-month period.



State of Texas: Aaa/AA+/AAA

- Texas Permanent School Fund Program: Aaa/AAA/AAA
  - Mechanics: If a district cannot meet its debt service requirements, it is required to notify the state Commissioner of Education at least 5 business days ahead of the payment date. If funds are insufficient, the state treasurer transfers money from the fund to the trustee to cover the shortfall. If a school district doesn't repay the fund for the transfer, state aid funds are withheld to repay the fund.
  - The Texas Permanent School Fund is constitutionally earmarked for educational purposes. The fund has minimum and maximum ranges for each of the fund's general asset classes (equities, fixed income, and alternative asset investments).
  - Total guarantees outstanding are capped at 300% of the fund balance.

Other states with credit enhancement programs for school districts with a fund program include Wyoming and Oklahoma.

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