July 27, 2021

The Honorable Ralph S. Northam
Governor of Virginia
PO Box 1475
Richmond, Virginia 23218

The Honorable Janet D. Howell, Chairperson
Senate Finance and Appropriations Committee
900 East Main Street
14th Floor, Pocahontas Building
Richmond, Virginia 23219

The Honorable Luke E. Torian, Chairperson
House Appropriations Committee
900 East Main Street
13th Floor, Pocahontas Building
Richmond, Virginia 23219

Dear Madam and Sirs:

Item 145 C.11.e. of the 2021 Appropriation Act (i.e., Chapter 552) requires the Departments of Education and Treasury to:

- Develop recommendations related to making the Literary Fund loan program more competitive and attractive to school divisions as a funding source for school construction projects and increase the fiscal health of the Literary Fund; and
- Report such recommendations to the Governor and Chairpersons of the House Appropriations and Senate Finance and Appropriations Committees by July 31, 2021.

Staff at the Departments of Education and Treasury collaborated on generating the below recommendations in response to this requirement. We offer various recommendations outlined in this letter towards the goal of improving the availability and usage of Literary Fund loans for school construction and for increasing the fiscal health of the Literary Fund itself.

Background

The Literary Fund is a "permanent and perpetual school fund" established in the Constitution of Virginia (Article VIII, Section 8) "for public school purposes" and administered by the Board of

Education. Additional monies in the fund beyond the $80.0 million minimum principal, which consists of the cash balance but also outstanding loans, may be used "for public school purposes." Chapter 10 of the Code of Virginia and Chapter 100 of the Virginia Administrative Code further govern the Literary Fund. Since its inception, the foundational element of the Literary Fund has been the revolving construction loans it makes to support public schools, prioritizing those localities that cannot easily access debt markets or are unable to do so at interest rates that make their loans affordable. Unfortunately, fewer and fewer loans are being made out of the Literary Fund. For the past several decades, over half of available funds have been used for teacher retirement benefits, with a portion applied toward loans. However, since the financial crisis in 2008, the retirement benefit transfers have significantly increased while loans have virtually ceased. This means that not only are public schools not reaping the intended benefits, but the lack of revolving loans has begun to negatively impact the Literary Fund's long-term health and accessibility.

There are other reasons for the lack of loans made from the Literary Fund. First, the size of the Literary Fund, with the $80.0 million minimum principal, is too small to accomplish more than two or three large projects or just a handful of small projects. Second, the maximum loan amount per construction project is $7.5 million, which severely limits the types of projects that can be funded. Third, the interest rates on these loans range from two to six percent, as specified in *Code of Virginia* §22.1-150 (depending on the school division's local composite index), which can be well above existing market rates and therefore often makes these loans unattractive. Finally, inactive projects not ready to proceed with construction or renovation can remain on the Literary Fund waiting list for extended periods, which can limit or delay timely availability of funds for loans to other recipients with viable projects. Also, based on user feedback, the waiting list can give the appearance that the Literary Fund is already subscribed, creating uncertainty on the availability of funding when planning projects, such that potential users should look elsewhere for funding.

Joint Recommendations of the Departments of Education and Treasury Related to the Literary Fund

1. **Prioritize and Increase Construction Loans** - Prioritize available Literary Fund revenues above the $80.0 million threshold (Constitution of Virginia, Article VIII, Section 8) for school construction loans through budgetary action in the state appropriation act. In many

prior fiscal years, the majority of Literary Fund revenues have been appropriated for non-loan uses.

1. Specifically, decrease the use of annual Literary Fund revenues for Virginia Retirement System (VRS) payments to school divisions for Standards of Quality funded positions. In addition, reduce Literary Fund revenues used for annual debt service on the five-year Notes issued by the Virginia Public School Authority that fund the Educational Technology and School Safety Equipment grants to school divisions, using state general funds for debt service instead.

2. Further, via the state appropriation act, establish a minimum principal or asset base in the Literary Fund of $250.0 million to be used solely for construction loans in circulation versus direct expenditures of the Literary Fund revenues for other public school purposes. Increasing the minimum principal/asset base threshold would mean that incoming revenues would be held unspent and available to be issued as direct loans, which in turn "count" towards the increased asset base threshold requirement. This would ensure more revenue goes towards loans versus one-time expenditures of Literary Fund revenues that immediately reduce the principal balance in the fund.

2. **Increase Maximum Loan Amount** - Increase the maximum Literary Fund loan amount per project from $7.5 million (as specified in the *Code of Virginia,* §22.1-147) to $25.0 million. The current maximum loan amount per project can discourage local school boards and localities from seeking a Literary Fund loan as per project school construction and renovation costs typically greatly exceed this amount and continue to increase. For instance, new public school construction costs in Virginia reported to date for 2020-2021 range from $21.7 million for an elementary school to $77.4 million for a high school. It should be noted that increasing the per project loan limit would impact the number of loans that could be released from the fund unless more Literary Fund revenues are dedicated to loans on a routine, annual basis.

3. **Lower Literary Fund Rate Range, Prioritize Using LCI, and Conduct Annual Application Process** - Current Literary Fund loan rates are tied to school divisions' Local Composite Index ("LCI") and range from two to six percent, in one percent increments. This range could be reduced by half, to one to three percent, with increments of a half of one percent. This change would put two-thirds of localities in the one to one and a half percent range. The ranges and increments could be benchmarked to a market index on an annual

basis, not to exceed two percent for the tier of localities with least ability to pay, or could be retained indefinitely. Such modifications would require legislative action to amend the *Code of Virginia* and regulatory action by the Board of Education since current rates are referenced in both the *Code* (§22.1-150) and Board regulations (8VAC20-100-140).

1. As an alternative to the standing loan waiting list, loan applications could be accepted at a specific time or times each year, and loans awarded based on the localities' LCI, with priority going to those with the lowest LCI and on the localities' agreement to proceed with accepting a loan by a certain date or be removed from that annual application cycle.
   Conducting an open application process at a scheduled time each year would allow all loan applications to be considered at one time based on demand and available funding.

4. **Remove Inactive Projects from the Waiting List** - Provide authority for the Board of Education to remove a project from the Literary Fund First Priority Waiting List (or to move the project to the bottom of the waiting list) when the project has been on the waiting list for a certain period of time (such as five to seven years) and loan funding for the project has been offered but the local school board and/or local government decline the loan. Such action could expedite the availability of loan funding for projects that are ready to proceed with construction in a timely fashion and help limit the waiting list to viable projects ready to proceed with construction/renovation. Additionally, a long waiting list can be a disincentive to localities in applying for a Literary Fund loan.

5. **Provide Higher Loan Amount for School Consolidation** - Provide a premium or add-on to the per project loan amount, such as $5.0 million to $10.0 million, when the funded project will result in school consolidation (i.e., a net reduction of at least one existing school), thereby increasing efficiency and reducing costs by consolidating typically obsolete schools with small student enrollments.

6. **Provide Incentive Grants for Loan Closing Costs** - Provide cash incentive grants, such as up to $25,000, from either the Literary Fund or general fund, to school boards or localities to help underwrite local legal fees or financial advisor costs incurred in closing a Literary Fund loan. Such support has been provided in the Literary Fund subsidy program, and school divisions have inquired about the availability of such direct support when applying for Literary Fund loans.

Thank you for the opportunity to provide these recommendations towards the goal of increasing the viability of the Literary Fund as a financing mechanism for addressing critical school facilities needs in Virginia public schools, particularly in localities with less ability to pay significant school facility capital costs. Some of these recommendations might be implemented initially through the *Code of Virginia* or the state appropriation act as a more expeditious means of implementation versus establishing them as regulations through the Virginia Administrative Process Act. If you have any questions or require additional information regarding these recommendations, please contact us directly or our designated agency staff contacts (kent.dickey@doe.virginia.gov at Education and jay.mahone@trs.virginia.gov at the Treasury).

Sincerely,

James F. Lane, Ed.D.
Superintendent of Public Instruction

Manju Ganeriwala
Treasurer of Virginia

JFL/MG/KCD/JM