



Pennsylvania Association of School Business Officials

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**Testimony of Wayne McCullough, PRSBA
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Good morning. I am Wayne McCullough, President-Elect of the Pennsylvania Association of School Business Officials. PASBO is an association of 2,000 members, two-thirds of which are K-12 non-instructional administrators who provide finance, accounting, operations, facilities, transportation, food service, technology, communication, human resources, purchasing and safety services to support classroom learning in schools in Pennsylvania. Thank you for the opportunity to speak regarding the use of swaps by school districts in Pennsylvania and, in particular, my experience at the Southern York County School District.

Before I discuss the two primary reasons school districts have entered into swap agreements, let me first share with the House Finance Committee PASBO's position on swaps. First, it concurs with many of the Auditor General's concerns regarding the potential risks associated with these very complex financial transactions. Also, we concur with the report's warnings of the consequences of inadequate discussion and disclosure of risk and excessive reliance on advisors compensated by these products. PASBO also agrees with the need for more thorough and understandable disclosure of the associated fees. However, the experience of one entity cannot reasonably be the basis for the repeal of a seven-year-old law and the termination of hundreds of financial transactions.

Swaps are used as an interest rate "hedge" in the case of variable rate indebtedness and its associated risks. The associated risks, such as lack of bank liquidity required to support variable rate bonds, and the risk of credit ratings downgrades, were for many years minimal. Only after the recent global financial meltdown have these same risks become heightened. In many cases, extraordinary financial circumstances caused by the financial meltdown have forced the termination of otherwise normally functioning swap transactions. In the current low interest rate environment, these terminations have proven very costly. In many cases and in "normal" financial environments, however, these termination costs have been successfully avoided.

In most cases, when there was a problem it was not a result of the swap performance, it was a result of the variable rate interest crisis. I think most of us would agree that we should not prohibit school districts from variable rate debt or even from variable rate interest rate investments.

Swaps associated with fixed rate debt have been used quite successfully as a method of hedging against falling investment earnings. At Southern York County School District, for example, the swap has mitigated plummeting school general fund interest revenues. From June 2006 through November 2009, Southern York County School District realized a total net benefit of \$919,889.55. This included a net cash flow of \$168,899.55, a suspension payment of \$531,000.00 and a termination payment of \$250,000.00 minus fees paid.

The Auditor General's report seems to focus on two primary concerns that can and should be addressed:

First, there are school districts that lack the internal expertise to understand swaps. I think it is appropriate to require certified professionals for school districts to enter into swap agreements and require appropriate reporting and monitoring controls through the process.

Second, there is the view that school districts paid too much in fees without full knowledge of the fees. Again, I think it is appropriate to address the manner in which these fees are disclosed to school districts.

In the case of Southern York County, both the financial staff and school board were well informed of potential gain and risk of the swaps transaction. In fact, during this 3 ½ year process, our professionals made no less than 6 presentations to our board of education and provided monthly advisement to the district's financial staff.

The point I would like to make is that although swaps are not appropriate for all school districts and financings, I believe the recommendations found in the Auditor General's report are overly severe and should be reconsidered.

Swaps do provide local school districts an option for reducing taxpayer burden and having a balanced debt portfolio. School districts, like the private sector, should have the opportunity to look at all debt management tools, including swaps.

Finally, the Auditor General's report calls for terminating all existing swaps. Terminating an existing swap in an unfavorable interest rate environment could be a costly mistake. Early terminations could result in penalties and losses for many school districts throughout the Commonwealth.

I ask you to view the swaps as a credit card. For most, the credit card is a useful and beneficial tool. For a few, it is abused and causes financial problems. Eliminating use of credit cards or requiring everyone to terminate their credit cards is not the solution.

PASBO is prepared to work with the Representative Scavello and the House Finance Committee to adopt amendments, regulations or policies to improve the law and enhance the existing safeguards. We believe addressing direct issues such as disclosure of fees and insuring proper financial advisement seems much more appropriate instead of not allowing swaps and forcing all school districts to terminate existing swaps.

Again, thank you for your time and interest. I am glad to answer any questions or address any comments the committee may have.

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