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Professional Perspective

Special Districts During Covid-19

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Much has been written about the long-term effects of the Covid-19 pandemic, the shutdowns it has caused, and the effects on state and municipal government budgets and revenues. Special districts are government entities that are uniquely vulnerable but have not received the same level of attention. This article provides an overview of the challenges facing these special districts and the current attempts to provide relief, then offers considerations for the path forward.

There are over 50,000 special districts throughout the country, according to the U.S. census bureau. They are constituted separately from general units of government, such as states, counties, and municipalities. Special districts typically have access to or authority to assess a limited number of defined revenue sources to fund their activities. Many of these are school districts and health districts, but at least 2,000 are responsible for operating, and are reliant on revenues from, transportation and tourism assets that have been severely affected by the pandemic. These include airports, ports, transit systems, highways, parking facilities, and convention centers.

Special districts face unique risks, with near-total temporary losses and no near-term expectation of full recovery. Unless steps are taken to provide relief for these districts, many will face an uncertain future. Even though the federal government has devoted significant resources to state and local governments to help mitigate the financial damage caused by the pandemic and stay-at-home orders, these resources largely have not reached special districts, leaving them and the parties that rely on their services vulnerable.

Dilemmas Facing Special Districts

General government units estimate steep Covid-19-related losses of income, sales, and fee revenues, with some experts estimating the average rate of loss around 20 percent. Any special district that has access to such revenues will need to contend with the fact these decreased resources will be needed to address increased shortfalls for all entities with a claim to those funds.

Special districts reliant on coronavirus-affected revenues could suffer even worse consequences: revenues from travel, tourism, ridership, and similar sources were lost on a magnitude much closer to 100 percent during the peak of the stay-at-home orders and may take much longer to recover. This may create significant challenges not only for the operational budgets of these special districts, but also on the payments on billions of dollars of municipal debt that these districts have issued.

Relief Efforts Fall Short

The federal government's efforts to address the Covid-19 crises facing states and local governments have failed to address adequately the needs of special districts:

Coronavirus Relief Fund

The Coronavirus Aid, Relief, and Economic Security Act, enacted on March 27, 2020, included a $150 billion Coronavirus Relief Fund for states and local governments. However, the only eligible beneficiaries are U.S. territories, tribal governments, states, and "units of local government." A "unit of local government" is defined to include only "a county, municipality, town, township, village, parish, borough, or other unit of general government below the State level with a population that exceeds 500,000." This definition does not include special districts, so they are not able to avail themselves of this funding.

The CARES Act did provide both $10 billion for airports and a $25 billion appropriation to the Federal Transit Administration for additional Transit Infrastructure Grants. However, this assistance falls well short of the amounts necessary to help special districts attain long-term stability. In a statement to Congress, the president and chief executive of the American Association of Airport Executives stated that, despite the CARES Act having provided "much-needed funding," airports still "will need additional federal assistance at least as large as the initial amount provided in the CARES Act."

Municipal Liquidity Facility

The CARES Act also authorized the Federal Reserve to create a Municipal Liquidity Facility to provide liquidity to states and municipalities, the terms and parameters of which have been laid out in a term sheet published by the Federal Reserve. The proceeds of notes issued under this facility can be used to "help manage the cash flow impacts of income tax deferrals… or reductions of tax and other revenues or increases in expenses related to or resulting from the Covid-19 pandemic; and requirements for the payment of principal and interest on obligations."

On June 3, 2020, the Federal Reserve released an updated term sheet that provides greater potential opportunities for special districts to receive aid. In addition to states, certain multi-state entities, certain large cities and counties, or, subject to review and approval by the Federal Reserve, an entity that issues securities on behalf of such government for the purpose of managing its cash flows, the June 3 version includes certain "Governor-Designated Participants."

This category includes certain additional cities and counties to ensure each state has at least two total cities and counties, but it also includes up to two designated "Revenue Bond Issuers" per state and one for the District of Columbia. That term is defined to mean "a State or political subdivision thereof, or a public authority agency, or instrumentality of a State or political subdivision thereof, that issues bonds that are secured by revenue from a specified source that is owned by a governmental entity." Special districts would qualify under this definition. A designated Revenue Bond Issuer may borrow up to a limit of 20 percent of its gross revenue as reported in its audited financial statements for fiscal year 2019.

Special districts that are not designated could still potentially receive aid, at least indirectly, from the Municipal Liquidity Facility. Despite the general rule of one issuer per jurisdiction, The Federal Reserve may approve one or more additional issuers "to facilitate the provision of assistance to political subdivisions and other governmental entities."

Additionally, states, counties, and cities may use the proceeds of their borrowing under the program "to purchase similar notes issued by, or otherwise to assist" such entities in their jurisdictions that are issued for the same purposes, and states may request additional assistance above the general limit of 20 percent of general revenue from its own sources and utility revenues to better facilitate such assistance.

While the expanded definition of eligible issuers and the additional exceptions could be helpful to special districts, there are multiple hurdles to the Municipal Liquidity Facility being an effective source of aid for such districts.

First, the eligible term is not allowed to exceed 36 months, which means the Municipal Liquidity Facility cannot serve as a long-term source of relief from the extended revenue shortfall that many special districts will require.

Second, these exceptions do not provide an affirmative process for the special districts to take advantage of the aid. Instead, it is only a possibility if governors, in their discretion, decide to designate a district as one of the two authorized Revenue Bond Issuers for their states; the Federal Reserve, upon request of a general government, qualifies a special district as an additional eligible issuer; or an eligible issuer agrees to use the proceeds of its lending under the program to purchase notes issued by the special district or otherwise provide assistance with those proceeds.

Finally, and perhaps most importantly, the parameters set by the Federal Reserve have made it unlikely that most otherwise eligible issuers will seek to borrow under the program in the first place. As an additional threshold to qualifying as an eligible issuer, a designated Revenue Bond Issuer must have been rated A-/A3 as of April 8, 2020, by two or more major rating agencies, subject to limited exceptions; this will prevent many special districts who are most in need of aid from qualifying.

While general government issuers with a lower credit rating could provide assistance to a special district, they still must submit a certification that they are unable to secure adequate credit accommodations and must agree to the expensive spreads included in the term sheet. This limiting of potential issuers will significantly narrow the scope of special districts that could request assistance under the program.

Uncertain Path Forward

Congress has considered providing direct aid to special districts in the next phase of coronavirus-related relief and has additionally proposed making modifications to the Municipal Liquidity Facility to make it more effective, including directives to extend the maximum maturity to 10 years and to decrease the interest rate for all borrowers to the federal funds rate. However, the likelihood of another package as broad as the CARES Act is uncertain, at best.

If Congress does not provide assistance for these entities, states will need to find new and creative ways to aid the districts within their borders. This could take a number of forms, including:

- Creating state versions of the federal coronavirus relief programs, with special districts as beneficiaries.
- Expanding, in a manner tailored to the needs of the special district and mindful of responsible limits, debt authorization, and access to alternative revenue streams to secure such debt.
- Contributing administrative or other resources to reduce expenses, or creating sharing programs for such resources across special districts.
- Revising long-term capital plans and restructuring related long-term obligations.
- Consolidating special districts.

In addition to these ideas, and particularly if such actions do not adequately address the impacts on these districts, states may need to consider additional steps. These steps could include authorizing the use of Chapter 9 of the Bankruptcy Code, which Congress has made available to any "political subdivision or public agency or instrumentality of a State."

While some states already provide this authorization, others have limited it to certain types of districts or conditioned its use on added steps or approvals, and nearly half have not authorized it at all. States alternatively could authorize their own restructuring process outside of Chapter 9, which could include the use of a receiver or a financial control board.

Regardless of what form it takes, this state action will be necessary to avoid further negative impacts on special districts' operations and, potentially, the risks of insolvency and default.