



School district and housing price responses to fiscal stress labels: Evidence from Ohio[☆]



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ABSTRACT

This paper examines the effect of the Ohio fiscal stress labeling system on school district outcomes and housing prices. Under this policy, financially troubled districts are labeled and required to implement financial recovery plans. In response to these plans, districts increase local tax revenues and decrease capital and operating expenditures. Although these recovery plans lead to better long-term financial health for school districts, there appear to be some negative impacts on welfare in these districts during the duration of the label. I find that residential home sale prices fall following fiscal stress label receipt, but rise again once the label is removed. These districts also undergo substantial restructuring, including reductions in enrollments, teachers, and schools, which coincide with a transitory reduction in math proficiency rates following label receipt.

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1. Introduction

In the current financial climate, rising budget deficits have burdened many school districts and local governments, leading some to the brink of bankruptcy. To help address these growing deficits, many states have developed financial intervention systems that identify financially troubled school districts or local governments and provide varying levels of state intervention.¹ On one end of the spectrum, some states heavily intervene and overhaul financial practices. One example is the state of Michigan, where an emer-

gency manager took over the financial decision-making for the city of Detroit after the bankruptcy declaration and accumulation of nearly \$20 billion in debt. In contrast, other states monitor financial behavior of districts, but provide little, if any, intervention into financial practices. The California financial monitoring system is an example of this approach, where one-fifth of all school districts in the state were found to have FY2013 deficits, but little state intervention is offered beyond short-term loans.

Despite the growing use of these financial intervention systems, little is known about the effects of these programs. I analyze the Ohio fiscal stress labeling system, which labels school districts that have projected general fund deficits and requires these districts to implement a financial recovery plan. Districts with less severe deficits receive a fiscal oversight label, under which districts are placed in charge of developing and implementing these recovery plans. Districts in more severe financial trouble receive a fiscal emergency label, under which the state takes over the financial decision making of the district. As part of this financial takeover, the state assumes the responsibility of developing and implementing the recovery plan. Given the distinction between whether financial recovery is operated by the district or by the state, the Ohio system allows me to identify separate effects depending on the type of label received.

This paper provides the first estimates of the effect of these fiscal stress labels on school district outcomes and housing prices. I compile a balanced panel of all 613 Ohio school districts from 2000–2012; collecting data on dates of label receipt and removal,

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¹ A 2013 Pew Charitable Trusts report found that 17 states currently have a financial intervention system in place for local governments (e.g., municipalities, townships), with some of these (like Ohio) also having a system in place for school districts. An additional six states (Arizona, Arkansas, California, Iowa, Missouri, and Washington) only have a financial intervention system in place for school districts. Earlier work by Honadle (2003) and Kloha et al. (2005) found that 15 states had some fiscal health evaluation system in place and nearly a third more states were considering using these indicators.

school district expenditures and revenues, school district demographics, projected and current deficits, tax rates, taxable values, and housing transactions. Using difference-in-differences and an event study model, I find that these recovery plans do change financial behavior. Districts decrease capital and operating expenditures following receipt of fiscal oversight, with larger percentage reductions in capital expenditures, and increase local property tax revenue financing operating expenditures during both fiscal oversight and fiscal emergency. Although these recovery plans lead to better long-term financial health for school districts, there appear to be some negative impacts on welfare in these districts following label receipt. Using difference-in-differences and a boundary regression discontinuity analysis, I find that residential home sale prices fall following fiscal stress label receipt, but rise again once the label is removed. Substantial restructuring occurs in these districts as a part of these recovery plans, including reductions in student enrollments, the number of full-time equivalent teachers, and the number of schools in the district – changes that coincide with a transitory reduction in math proficiency rates following label receipt.

For states considering these types of policies, the structure of the K-12 educational financing system is likely to play a role in how districts respond. In Ohio, school districts are able to supplement state aid through local tax revenue funding operating expenditures. This funding structure allows fiscally stressed districts to increase taxes along with decreasing expenditures to offset deficits. Given that fourteen states have a similar funding structures to Ohio and 11 states place no restrictions on local tax revenue (see Wang, 2004), districts in these other states may respond similarly to these types of labels. Districts in states where raising local operating tax revenue is restricted, such as Michigan and California, would likely focus more heavily on reductions in expenditures in response to these labels and recovery plans.

2. Previous literature

In addition to being the first to analyze the effects these labels, this paper also contributes to the literature on responses to budgetary issues. Previous literature on the responses of school districts and local governments to budgetary issues focuses on how districts exhibiting characteristics of fiscal distress behave.² This literature finds that financially troubled jurisdictions reduce administrative expenditures (Forrester and Spindler, 1990; Honadle et al., 2004; Kodrzycki, 1998), seek state and federal aid, increase taxes, increase student and user fees (Pagano, 1993), delay capital expenditures, and eliminate “non-essential” programs (e.g., athletics and fine arts). School districts and local governments that are unable to alleviate financial distress through these approaches are often forced to make reductions in essential public services (Higgins Jr, 1984; Maher and Deller, 2007; Trussel and Patrick, 2012). However, this previous literature has primarily focused on voluntary changes to expenditures and revenues as a result of budget deficits, which are likely to be different in size and scope compared to those made under the scrutiny of the mandated recovery plans examined here.

This study also contributes to the literature on the capitalization of school quality into housing prices.³ Much of the previous literature has focused on the effect of changes in school inputs and outputs on housing prices. Most notably, Black (1999) finds that a

\$500 increase in per-pupil expenditures increases house prices by 2.2 percent. Cellini et al. (2010) examine the effect of bond referendum passage on housing prices. They find that marginal homebuyers are willing to pay \$1.50 for an additional dollar of capital expenditure, largely due to increases in safety and aesthetics of new and renovated buildings. Numerous studies of United States and international school districts (Bayer et al., 2007; Black, 1999; Clapp et al., 2008; Davidoff and Leigh, 2008; Fack and Grenet, 2010; Gibbons and Machin, 2003; 2006; Gibbons et al., 2013) find around a three percent increase in home prices resulting from a one standard deviation increase in test score levels.

Another set of papers examines the capitalization of school report card grades into housing prices. These grades, which are composite ratings of multiple test scores and district characteristics, serve as an overall summary measure of the current academic quality of the district. Figlio and Lucas (2004) examine the capitalization effects of school district report card grades in Florida and find that report card grades do provide valuable information about school quality to homebuyers. Studies examining these ratings in other settings find more mixed results (Kane et al., 2003); Fiva & Kirkeboen, 2011; (Zahirovic-Herbert and Turnbull, 2009). The fiscal stress labels may capture aspects of school quality that these school district academic quality rankings fail to signal and that the housing market may value differently than achievement levels. Thus, this study complements this literature by focusing on residents' valuation of the financial quality of the district and the resulting expectations of future academic quality or tax burden.

3. Fiscal stress labels in Ohio

Ohio school districts with projected general fund deficits receive either a fiscal oversight label or fiscal emergency label depending on the level of the projected deficit.⁴ Labeled districts are required to develop financial recovery plans that outline changes to financial behavior that achieve balanced budgets. These proposed changes can include reductions in expenditures and/or increases in local tax revenues.⁵ Under fiscal oversight, school boards are required to develop and implement the recovery plan, incorporating recommendations made by the Auditor and the Ohio Department of Education. Successful implementation of the recovery plan will result in removal of the label, but failure to adopt or adhere to the plan results in a downgrade to fiscal emergency. Under this most severe label, a state commission assumes financial control of the district, including the development and

⁴ Ohio designates three separate label categories – fiscal caution, fiscal watch and fiscal emergency. Given that the main variation of interest is between district-led recovery and state-led recovery, I choose to combine fiscal caution and fiscal watch into one category called fiscal oversight. Differentiating between fiscal caution and fiscal watch does not change the overall conclusions. The fiscal emergency and fiscal watch labels were introduced in 1996, while the fiscal caution label was not instituted until 2001. For more detailed information regarding the history of these labels, the various criteria used to select these districts, and the requirements associated with these labels, see the Ohio Auditor website (<https://ohioauditor.gov/fiscal/schools.html>) or the Ohio Department of Education website (<http://education.ohio.gov/Topics/Finance-and-Funding/District-Financial-Status>).

⁵ Ohio school districts increase local tax revenue through voter-approved property and income tax referenda. Districts can generate additional revenue for operating expenditures through either current expense or emergency operating property or income taxes. Current expense taxes raise revenue over a period of five or more years, while emergency operating taxes collect a district-specified amount of revenue for a period of, at most, five years. Districts can generate additional revenue for capital expenditures by either issuing debt through bonds to fund new capital projects and improvements/renovations to existing classroom facilities or by using permanent improvement property tax levies to fund short-term, at most five year, capital improvements. Districts can place these taxes on the ballot up to three times per year during either the November general election or during a special election held in February, May, or August. During presidential election years, the February and May election dates are subsumed into the March presidential primary.

² While the pre-2000 literature is largely cross-sectional and descriptive, the more recent literature uses across time variation to estimate how local jurisdictions respond to changes in characteristics of financial distress. For a thorough review of this literature, see Trussel and Patrick (2012).

³ For a more expansive review of this literature, see the Black and Machin (2011) handbook chapter or Nguyen-Hoang and Yinger (2011).

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