PROSKAUER ROSE LLP

Client Alert

Economic Crisis Response Group

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Education Incentives under the American Recovery and Reinvestment Act of 2009

On February 17, 2009, President Obama signed the American Recovery and Reinvestment Act of 2009, which creates a $787 billion stimulus package comprised of tax cuts and expenditure programs (the "Act"). Although the Act implements spending programs in many different sectors, one of the major allocations is for education initiatives. The education expenditure initiatives are allocated to a number of different categories, including measures addressing college affordability, school modernization funds, and direct funding for education in the form of State Stabilization Funds to help avert education cuts, incentive grants to be distributed to states that aggressively pursue higher standards, and funding for the Individuals with Disabilities Education Act ("IDEA"), Title I of No Child Left Behind ("NCLB") and Head Start Initiatives.

College Affordability Initiatives

The Act implements approximately $30.8 billion of initiatives to help make college more affordable. These initiatives include approximately $17 billion to close the current shortfall in the Pell Grant program and boost maximum grant amounts to approximately $5,350 in 2009-2010 (a $500 increase) and approximately $5,550 in 2010-2011, which grants are estimated to serve 7 million low and moderate-income students. In addition, the Act allocates approximately $13.8 billion to boost the tuition tax credit from $1800 to $2500 for families or joint tax filers earning up to $180,000 per year. Finally, computer technology qualifies as a qualified education expense under Section 529 Education Savings Plans for 2009 and 2010.

Direct Funding for Education

The Act includes a number of provisions which would provide direct funding to states for education programs. Some of the specific grants are $13 billion under NCLB to the neediest school districts, for school improvement programs, $12 billion for IDEA (special education) programs, and $2 billion for other education investments, including pay for performance, data systems, technology grants, vocational rehabilitation and work study. Approximately $10 billion of the $13 billion granted under NCLB will be distributed to the states via NCLB formula grants. The Act also provides for States and school systems to issue $24.8 billion in bonds for renovation, repairs and school construction. Finally, the Act calls for more than $16 billion in funds to be allocated to investing in scientific research, including improving scientific research facilities, some of which are at colleges and universities.

State Fiscal Stabilization Funds

One of the largest education expenditure programs under the Act is in the form of State Stabilization Funds to help avert education cuts. Under this program, the Secretary of Education will allocate among state governors a total of approximately $40 billion in exchange for a commitment to begin advancing education reforms in elementary, secondary and public higher education schools. In addition, $8.8 billion of the State Fiscal Stabilization Funds are available for other state services, including education; states may elect to use some portion of these funds for school modernization efforts. At least 81.8 percent of a state's grant under the State Fiscal Stabilization Funds must be used to support elementary, secondary, and post-secondary education, while 18.2 percent is "flexible" and can be used for public safety and other government services, including elementary and secondary education and public institutions of higher education, and for modernization of public school facilities. The State Fiscal Stabilization Funds will be available immediately, and must be spent within two years of receipt of the grant; if the funds received under this program have not been reallocated by a state's governor in that time period, the governor is obligated to return them. States must use the funds to restore the level of state support provided to primary, secondary and public higher education institutions in 2009, 2010, and 2011 to the greater of the level of State support provided during fiscal year 2008 or 2009. The State Fiscal Stabilization Funds also include $5 billion in incentive grants, which will be distributed on a competitive basis to states that demonstrate aggressive actions to improve standards, data systems and teacher quality initiatives; half of these funds must be passed through to local governments. No funds granted under this program may be used to provide financial assistance to students to attend private elementary or secondary schools.

The governors of states wishing to receive an allocation must submit an application to the Secretary of Education that includes assurances that the state will: (1) maintain state support for elementary and secondary education and for public institutions of higher education at least at the level of support given in 2006; (2) take actions to improve teacher effectiveness in order to address inequities in the distribution of highly qualified teachers between high- and low-poverty schools; (3) improve the collection and use of data; (4) enhance the quality of the academic assessments it administers, comply with requirements related to the inclusion of children with disabilities and limited English proficiency in assessments, and take steps to improve the academic content standards and student achievement standards; and (5) provide additional support to struggling schools.

Allocation and Administration of the Act

The grants that will be given under the Act will be allocated among the states based on several formulas, including those formulas in place for the allocation of funds under the Elementary and Secondary Education Act of 1965 and formulas established under the Act. For example, under the Act the funds for State Fiscal Stabilization are allocated among the states through two population measures: 61 percent is allocated according to each state's population aged 5 to 24, and the remaining 39 percent of funds is allocated based on total state population. On February 19, 2009, the Department of Education (the "Department") announced its preliminary state allocations for the State Fiscal Stabilization Funds. According to the Department's preliminary calculations, the State of New York would be entitled to receive an estimated $3,017,796,810 total education and flexible grants under this program.

The Act imposes some limitations on how local educational agencies and institutions of higher learning may use State Fiscal Stabilization Funds. Local educational agencies may not use these funds to pay maintenance costs, for athletic stadiums for which admission is charged to the general public, to purchase or upgrade vehicles, or to improve stand-alone facilities whose purpose is not children's education, including central offices. Institutions of higher education may not use such funds to increase their endowment, for maintenance costs, for athletic stadiums for which admission is charged to the general public, or to repair or modernize facilities primarily used for religious worship or sectarian education. In addition, money received through the other programs under the Act, such as programs for disabled students, must be used only for the purposes specified by the Act.

Like other stimulus and economic rescue programs, the education provisions of the Act also impose various types of oversight over state and local agencies receiving funds. In some cases, local agencies and/or state governments must submit periodic reports to the Secretary of Education about their use of funds and the improvements they have implemented. For example, the Act requires states receiving State Fiscal Stabilization Funds to submit a yearly report describing the use and distribution of funds and the number of jobs saved or created, as well as any tuition and fee increases for in-state students imposed by public institutions of higher education during the period and a description of actions taken to limit those increases. The Secretary of Education will report directly to Congress about the results of these yearly reports.

The education provisions of the Act offer many different ways for educational agencies and institutions to receive additional funding in order to avoid cuts that may occur. At this time, it is not clear to what specific uses states and other agencies will put such funds.

Proskauer's Economic Crisis Response Group includes lawyers with extensive experience representing private and public companies, institutional investors, financial services companies, private equity and hedge funds, lenders, commercial banks and individuals in the complex and interrelated areas impacted by the current financial situation. Our multidisciplinary group brings together the talents of our business and transactional lawyers with our litigation capabilities, particularly as they pertain to acquiring, managing or disposing of distressed assets, issues concerning investments in financial services companies, complex financial instruments and transactions, including structured finance products, as well as a broad range of other areas such as corporate governance and defense, insurance coverage, reductions in force and other employment and benefit-related issues, securities regulation, and bankruptcy and restructuring matters.

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