LFC Hearing Brief

NEW MEXICO LEGISLATIVE FINANCE COMMITTEE

BACKGROUND INFORMATION

AGENCIES: Public School Facilities Authority (PSFA)

DATE: July 11, 2019

PURPOSE OF HEARING: Capital Outlay Financing for Public Education

WITNESSES: Jonathan Chamblin, Director, PSFA; Mike Hyatt, Superintendent, Gallup-McKinley County Schools; Dr. Arsenio Romero, Superintendent, Deming Public Schools

PREPARED BY: Sunny Liu, Senior Fiscal Analyst II, LFC; Ellen Rabin, Fiscal Analyst, LFC; Noel Martinez, Fiscal Analyst, LFC; Steve Olson, Intern, LFC

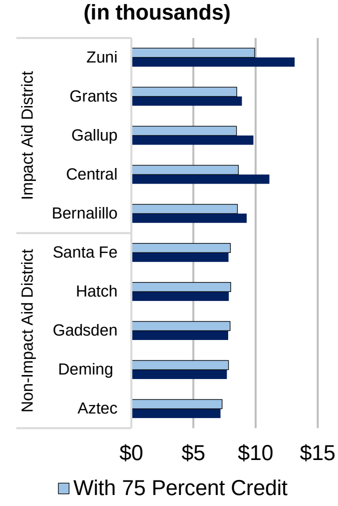
EXPECTED OUTCOME: Informational

The current public school capital outlay process is the result of the 11th Judicial District Court's 1999 ruling in *Zuni Public District v. State of New Mexico* lawsuit, which found the state's public school capital outlay system violated New Mexico Constitution's requirement to provide "a uniform system of free public schools, sufficient for the education of and open to, all the children of school age" and ordered the state to establish and implement a uniform funding system for capital improvements and to correct past inequities. As a result of the *Zuni* lawsuit, the Legislature developed statewide educational adequacy standards for schools, which represent the maximum educational facility space the state will allocate matching funds toward through a standards-based capital outlay process that assesses and prioritizes awards for school renovation and replacement. This process is overseen by the Public School Capital Outlay Council (PSCOC) and administered by the Public School Facilities Authority (PSFA).

Since the *Zuni* lawsuit, the state has spent $2.4 billion to raise school facility conditions to the approved adequacy standards which evolved from a focus on critical corrective needs to encompass a broader range of space types and site features. Despite significant improvements in statewide facility conditions, the *Zuni* lawsuit was never closed. In 2015, plaintiff school districts asked the court for a status hearing on new claims of inequity, primarily that these districts are unable to raise sufficient local capital outlay revenue to maintain capital assets and build facilities outside adequacy standards, while districts with available local revenues are able to do so. In May 2019, the court received testimony on the case and established a deadline in August 2019 for parties to submit evidence on the state's progress toward implementing a uniform and sufficient system.

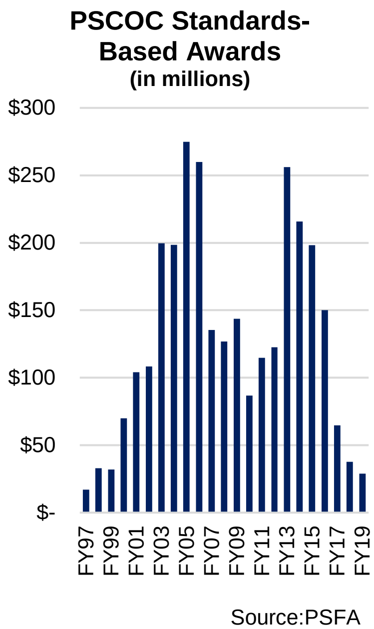
Impact Aid School Districts. During the 2019 legislative session, several historically-impacted Native American school districts (Gallup-McKinley County Schools, Grants-Cibola County Schools, and the Zuni Public School District) that were plaintiffs in the *Zuni* capital outlay lawsuit, along with the Central Consolidated School District (CCSD), supported legislation to eliminate the 75 percent credit for federal Impact Aid payments in the public school funding formula (also known as the state equalization guarantee), which would have increased operational revenues for these districts. The districts contended Impact Aid payments are provided by the federal government in lieu of property taxes, which would have otherwise been used to generate funds for capital outlay projects, and reported difficulties addressing capital outlay needs without these additional funds.

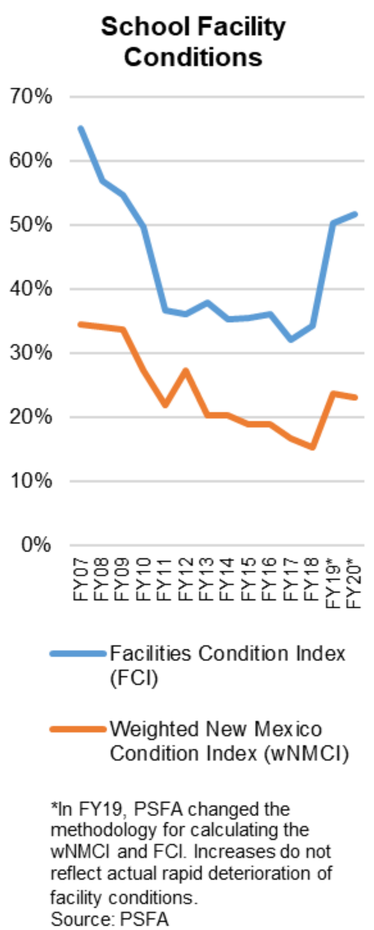
Operational Funding Per Pupil (in thousands)



Source: LFC Files

While legislation eliminating the 75 percent Impact Aid credit was not passed during the session, the proposed policies would have created significant differences in operational funding levels between school districts. Additionally, the Public Education Department (PED) noted that eliminating the Impact Aid credit would likely result in future adjustments to the state equalization guarantee (SEG) to eliminate other credits for local revenue. Eliminating all credits and





allowing school districts to generate operational revenue from local sources in addition to the SEG would represent a departure from an equalized public school funding system and would not directly address the capital outlay issues raised by the plaintiff school districts.

Because the *Zuni* plaintiff school districts and CCSD are requesting the Legislature make more revenue available for capital outlay projects, the state should consider ways to directly address these additional capital funding needs while avoiding policies that would dis-equalize operational funding to address alleged inequities in the capital outlay funding system. This brief outlines how current capital outlay funding options for schools developed and potential solutions to improve equity in public school capital outlay financing.

Public School Capital Outlay

Local and State Match

Prior to the 1975 enactment of the Public School Capital Outlay Act, capital improvements were primarily funded by the local school district through the passage of a general obligation bond (GOB) and repaid by a levy on local properties. However, following the ruling in the *Zuni* lawsuit, the state began the process of establishing a uniform system to correct past inequities, and, in 2001, created the Deficiencies Correction Program (DCP) to identify and fund school projects with serious life, health, and safety deficiencies.

Concerns about inadequate DCP funding and increasing disparities in the ability between property-rich and property-poor districts to build superior facilities surfaced in 2003, resulting in the creation of a public school capital outlay funding formula to determine the proportion of cost sharing between state and local sources for capital improvement projects. This formula considers the need for a project and school districts' ability to raise revenues through bonds or direct mill levies.

The first standards-based funding awards were made in 2004 and prioritized the schools with the greatest need through the weighted New Mexico condition index (wNMCI), a formula that considers the costs to correct facility deficiencies to adequacy, correct educational deficiencies to adequacy, ensure adequate space, and replace the school if beyond repair. The statewide wNMCI decreased from 40.5 percent in FY06 to 23.8 percent in FY19, indicating these investments improved the statewide condition of school facilities over that period.

Policy Considerations. The Public School Capital Outlay Oversight Task Force contracted the Bureau of Business and Economic Research (BBER), at the University of New Mexico, to conduct a detailed assessment of the public school capital outlay funding formula in 2015. While BBER noted the formula was being applied correctly, the assessment indicated the formula did not efficiently leverage state resources and included volatile factors that limited predictability necessary for long-term planning. In 2018, the state enacted Chapter 66 (Senate Bill 30), which adjusted the state and local match rates to more accurately reflect each district's ability to pay for capital outlay projects. The new formula was designed to be fully phased-in by FY24 and considers factors such as gross square footage per student, replacement cost per square foot, and school district population density.

Senate Bill 30 was also intended to address the plaintiffs' concerns that a number of school districts had sufficient capacity to build facilities that were not included in the adequacy standards. By changing the local and state matches, the state's share of PSCOC-funded projects for many large, urban school district will be significantly reduced, decreasing their ability to build facilities outside of the adequacy standards. Reducing the state match for these districts will also increase available funding and potentially allow the state to fund more projects.

Laws 2018, Chp. 66 (SB 30) Local and State Match Changes

	Phase 1 FY19		Phase 2 FY24	
District	Local	State	Local	State
Alamogordo	38%	62%	53%	47%
Albuquerque	45%	55%	91%	9%
Bernalillo	59%	41%	97%	3%
Central	38%	62%	46%	54%
Deming	31%	69%	41%	59%
Gadsden	16%	84%	30%	70%
Gallup	20%	80%	20%	80%
Grants	23%	77%	30%	70%
Hobbs	42%	58%	82%	18%
Las Cruces	36%	64%	71%	29%
Lordsburg	78%	22%	71%	29%
Los Alamos	53%	47%	88%	12%
Raton	54%	46%	39%	61%
Rio Rancho	33%	67%	73%	27%
Roy	54%	46%	39%	61%
Santa Fe	90%	10%	100%	0%
Taos	90%	10%	100%	0%
Zuni	0%	100%	0%	100%

Source: PSFA

Funding Adequacy Standards

The state funds public school capital projects approved by PSCOC through supplemental severance tax bonds (SSTBs). The modern severance tax bond (STB) program dates to 1973, when the Legislature created the Severance Tax Permanent Fund. In 1999, as a result of the *Zuni* suit, the Legislature expanded the STB program so additional revenue could be used to pay debt service on SSTBs. As a result, New Mexico can issue both supplement severance long-term bonds, typically 10-year, and short-term notes, usually one- to three-days. Long-term bonds are sold competitively, but are rarely issued to avoid long-term obligations. Short-term notes, referred to as "sponge" bonds, allow the state to take advantage of remaining capacity in the bonding fund, effectively "sponging" up funds not committed to the debt service on long-term bonds. SSTBs are issued at the end of June and December to fully utilize the percentage of revenues available for authorized projects. For many decades, total debt was statutorily limited to 50 percent of the lesser of current-year or prior-year bonding revenue. The limit was later increased to 95 percent, but 2015 legislation is decreasing the total debt limit from 92.8 percent (FY16) to 86.2 percent (FY22), with a supplemental sponge capacity of $181.5 million in FY19.

Public School Capital Improvement Act (SB-9)

The 1975 Public School Capital Improvement Act (referred to as SB-9) allows school districts to raise local revenues for capital improvements through a 2-mill levy on taxable property over a six-year period. Prior to the Z*uni* lawsuit, the state usually matched local bond initiatives with money from the general fund. This provision was removed and replaced with a funding formula based on adequacy standards that set the state and local match. In addition to funds raised by the 2-mill levy, SB-9 currently guarantees a minimum funding level from the state based on program units (a weighted student count in the SEG formula) and an inflation-adjusted per-unit rate. State funding for the SB-9 minimum guarantee ranged from $22.81 per-member—the average of a district's prior year 80th and 120th day student counts—in Hobbs to $403.49 per-member in Grady.

With the exception of Los Alamos, all school districts exercise SB-9 levies, which can be used to fund facility construction, grounds improvements, building maintenance, activity vehicles, and educational technology. In FY19, PSCOC allocated over $18 million from the public school capital outlay fund to fund the state's minimum guarantee.

Since the *Zuni* lawsuit decision, the state has invested $2.4 billion in matching awards to build school facilities to adequacy. Awards to plaintiff districts include:

- **Gallup:** $275.1 million for 24 schools. Only 5 schools remain ranked in the top 100.
- **Grants:** $55.6 million for 7 schools. Only 1 school remains ranked in the top 100.
- **Zuni:** $37.4 million for 5 schools. Zuni does not have any schools ranked in the top 100.

Over time, PSCOC programs have expanded to include other capital projects aside from standards-based construction such as:

Facilities Master Plans (2003)
Standards-Based Projects (2004)
Lease Assistance (2005)
Broadband Deficiencies (2014)
Systems-Based Projects (2017)
Prekindergarten Classrooms (2018)
School Security (2018)
Teacher Housing and Outside-of-Adequacy (2019)

Facility spaces defined under Adequacy Standards

General use classrooms
Science classrooms
Special education classrooms (d-level)
Art classrooms
Computer classrooms
Physical education (gym locker rooms, office, storage)
Library spaces (book stacks, office, storage)
Food services places (serving, dining kitchen)
Administration spaces
Student health spaces
Teacher workroom
Parent room

Facility spaces not defined but eligible for funding

Special education classrooms (gifted, B, and C-level)
Special education pull out spaces
Occupational and physical therapy spaces
Cultural and language classrooms
ROTC spaces, special program music classrooms
Office spaces for additional support staff
Security spaces, technical infrastructure spaces
Teacher and team collaboration spaces,
Family and community sciences classrooms
Specialized laboratories for robotics or maker spaces
Mock courtrooms
Daycare
Alternative PE spaces
Maintenance shop
Teacher housing (teacherages)

Policy Considerations. While the state-funded SB-9 guarantee is designed to supplement gaps in revenue raised by districts based on property wealth, SB-9 also provides this minimum payment to districts that exceed the guarantee level, which may exacerbate inequities in revenue generation capacity. The Legislature may want to consider repealing this provision and adjusting the SB-9 formula to more effectively close the gaps between property-rich and property-poor districts.

Public School Buildings Act (HB-33)

Similar to SB-9, the Public School Buildings Act (referred to as HB-33) authorized local school districts to levy 10 mills over six years for capital improvements. Additionally, HB-33 funds can be used for administration and oversight of projects related to the Public School Buildings Act.

Policy Considerations. PED reported eight school districts successfully passed an HB-33 levy ranging from 2.25 to 5.00 mills in FY18. Districts that passed the HB-33 levy tend to be located in large, urban areas or regions with higher property valuations. Although HB-33 provides schools with a greater opportunity to generate local funding for capital projects, the inability or reluctance of most districts to exercise this levy may be inadvertently widening funding gaps between property-rich and property-poor districts.

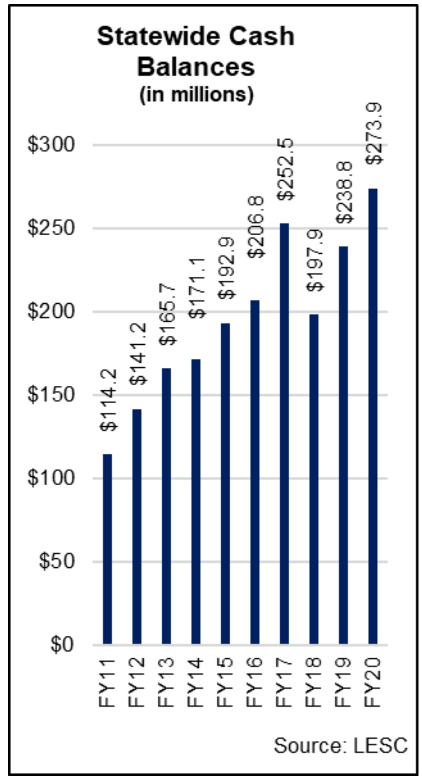
Legislative Appropriations and Offsets

In addition to SB-9 and HB-33, local school districts may fund district capital improvement projects through direct legislative appropriations and local GOBs. Direct appropriations are made by legislators for a specific project in a school district. However, these funds may be less desirable to districts, given statutory provisions that require PSCOC reduce or "offset" state award allocations based on legislative appropriations accepted by school districts. Local GOBs are used for capital improvements, to raise funds for the local district match, and are repaid through revenue generated from local property taxes.

Evolution of Adequacy Standards

Statewide educational adequacy standards, which establish a minimum acceptable level of condition and enrollment capacity of school buildings, were developed as a result of the *Zuni* lawsuit. Adequacy standards are based on PED's standards for excellence, which define the core educational curriculum for all public school students under 11 programs: general provisions; arts education; career and technical education; English language arts; English language development; health education; mathematics; modern, classical, and native languages; physical education; science; and social studies. Since they were initially adopted in 2002, adequacy standards have been updated five times to add site features and adopt technical changes.

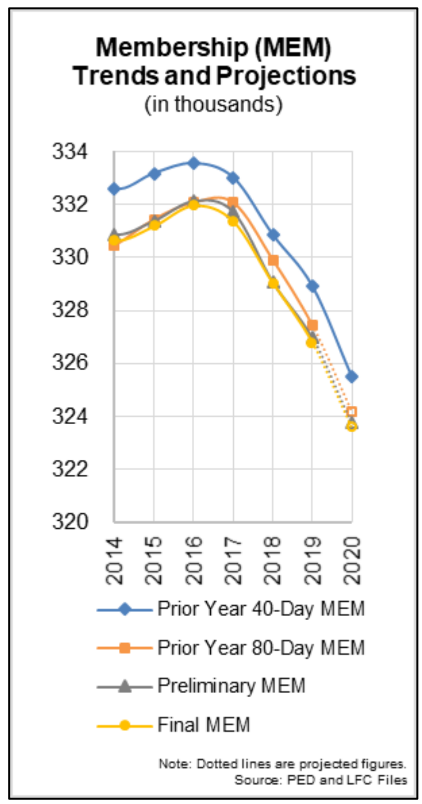
In the early years of *Zuni* compliance, PSCOC prioritized awards for classrooms and other critical capital needs related to core educational needs. Over time, PSCOC began awarding funds for other projects in addition to classroom spaces, such as athletic facilities and libraries. In 2019, PSCOC directed PSFA to identify the types of facility spaces eligible for funding under the adequacy standards. PSFA found a wide range of facility spaces eligible for funding under the adequacy standards (see sidebar) but lacking a defined methodology or criteria for funding through council awards. Thus, building "above adequacy" is perhaps a misnomer and the underlying issue is attributable to how districts leverage their funding sources for capital outlay. PSCOC also directed PSFA to review awards over the past 20 years, develop a program, and determine the feasibility of retroactively awarding funds for spaces not defined under the adequacy standards or spaces that currently lack a mechanism for PSCOC funding, such as teacher housing, athletic fields, auditoriums, school-based health centers. PSFA is currently developing standards and criteria for funding teacher housing with a target date of completion in September 2019. As the local and state match formula changes and the council develops new award mechanisms for facilities, property-poor districts will see greater resource availability over time.



Legislative Actions

During the 2019 legislative session, the Legislature passed and the governor signed legislation to provide additional funding sources for public school capital outlay. Chapter 277 (Senate Bill 280), Chapter 127 (House Bill 241), and Chapter 280 (House Bill 568) provided funding for school districts in the form of direct appropriations, loans from the public project revolving fund, and reauthorized school projects.

Significant revenues in 2019 allowed the Legislature to earmark $34 million for projects in Impact Aid school districts, including $10 million for teacher housing and $24 million for projects not defined by the adequacy standards. In June 2019, PSCOC awarded the teacher housing appropriation to the Gallup, Central, and Zuni districts to pay down existing debt for previously-constructed projects. The remaining $24 million will be used as a supplemental fund for Impact Aid districts retro-actively building facilities to meet current adequacy standards. In July, PSFA reported results from a survey of the 20 Impact Aid districts identifying their top priorities for this funding. The total requested amount was $67.5 million (a state share of $33.6 million) for these districts' top three priorities.



Policy Considerations. While the $34 million earmarked for Impact Aid school districts will help address the particular concerns of Gallup, Central, and Zuni for teacher housing and construction not defined in the adequacy standards, this potential solution is temporary and will not change these districts' ability to generate more capital outlay funding in the long-run.

The state could consider a wide range of potential solutions to level the playing field for all school districts, such as establishing a fully-centralized state process for funding, overseeing, and prioritizing all facility construction and renovation. While this proposal would be the most equitable approach, it would also reduce emphasis on local needs and require significant state capacity to operate.

Alternatively, the state could create an adequacy "ceiling" to prevent schools with greater local capital outlay revenues from building outside the current adequacy standards. While this would equalize facilities statewide, the proposal is likely to reduce local participation in financing construction projects.

Conversely, the state could define new funding mechanisms for projects (like teacher housing) under the adequacy standards to effectively increase state support for facility construction and renovation. The state may also want to consider creating standards with specific conditions or contingencies, such as including teacher housing as part of educational adequacy if PSFA certifies existing housing options within a reasonable radius of a school are unavailable or unaffordable.

The state could also directly designate some operational Impact Aid payments for capital outlay uses and reduce the SEG Impact Aid credit. This would require the state to change the local and state match calculation for Impact Aid districts and supplement the credit adjustment with general fund appropriations. However, it is unclear if federal law will allow the state to restrict federal Impact Aid payments for capital outlay purposes. In addition, a reduction in the credit will likely lead to future reductions of other local revenue credits or imposition of credits for other revenue sources, such as federal funds allocated to Los Alamos Public Schools or revenue generated from wind farms.

Reducing the proportion of Impact Aid credited in the SEG may shift funds to provide for capital outlay in certain districts. This change would not address the needs of other property-poor districts that do not receive Impact Aid payments.

Another option to address the concerns of Impact Aid districts is for the state to indirectly account for the operational Impact Aid credit in the SEG by increasing the state's share of the local and state match calculation (e.g. a bonus state match above 100 percent for Zuni) or a by raising the SB-9 minimum guarantee for these districts. This would effectively achieve the same aforementioned goal of equity without changing the SEG formula; however, the fiscal impact would shift from the general fund to the public school capital outlay fund. While this proposal could shift more local capital outlay revenue to Impact Aid districts, local and state match calculations would need to be reassessed, and the change would not address the needs of other property-poor districts that do not receive Impact Aid payments.

Discussion

Through statutory changes and legislative appropriations, the state of New Mexico is working with stakeholders toward an equitable public capital outlay system. While the *Zuni* capital outlay lawsuit created the impetus for developing adequacy standards and a standards-based process for prioritizing and financing school facility projects statewide, plaintiff districts continue to claim inequities in the state's funding mechanisms to address capital needs. While the proposals detailed above provide potential ways to improve the equity of the public school capital outlay system, it is unlikely that any single approach will completely address all issues. As such, the state may want to consider a suite of short- and long-term options to right-size district financing of capital outlay.

The state should also consider the impact on funding equity due to the transitional changes in the local and state match formula established through 2018 Senate Bill 30 and determine if expanding adequacy standards or allowing construction to exceed these standards will ultimately benefit student outcomes and be fiscally responsible. Additionally, declining student membership statewide may shift focus from expanding construction to right-sizing facilities for smaller populations.