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FISCAL IMPACT REPORT

ORIGINAL DATE 02/16/09
LAST UPDATED 03/07/09 **HB** 331/aHEC/aHAFC

SPONSOR Stewart _____

SHORT TITLE Public School Funding Formula _____ **SB** _____

ANALYST Aguilar _____

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY09	FY10		
	NONE INDICATED Will be Substantial in FY12	Recurring	General Fund

(Parenthesis () Indicate Expenditure Decreases)

Companion to HB-346
 Relates to HB-321, HB-392, HB-474
 Conflicts with HB-189, HB-199, HB-435, HB-442, HB-691, SB-134
 Relates to Appropriations in the General Appropriation Act

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY1	FY12	FY13	3 Year Total Cost	Recurring or Non- Rec	Fund Affected
Total	\$3,000.0	\$3,000.0	\$3,000.0	\$9,000.0*	Recurring	General Fund

(Parenthesis () Indicate Expenditure Decreases)

* The HAFC amendment provides for a 10 year hold harmless for those districts that had received more money than the new funding formula provides. The estimated cost is approximately \$3 million annually.

SOURCES OF INFORMATION

LFC Files

Responses Received From

Public Education Department (PED)
 Office of Education Administration (OEA)
 Attorney General's Office (AGO)

SUMMARY

Synopsis of the HAFC Amendment

HB331/aHAFC makes a technical correction to language to keep appropriations for education contained in HB-2 for FY10 from being deposited into a separate account of the public school fund.

The HAFC amendment provides for a 10 year hold harmless for those districts that had received more money than the new funding formula provides.

The amendment also inserts contingency language that the bill will not go into effect unless one of the companion revenue bill raising at least \$350,000.0 is passed and increased revenue is realized.

Synopsis of HEC Amendment

The House Education Committee amendment to House Bill 331 provides for an initial implementation date for the use of the Educational Plan for Student Success (EPSS) to verify, implement and monitor programs as part of the budget approval process.

The amendment clean-up language to align it with federal language.

The amendment inserts a new Subsection B, which requires the PED to use the schedule of sufficient base per-student costs developed by the funding formula contractor to calculate the sufficient per-student cost and establishes the respective base per-student cost for school districts and the base per-student cost for charter schools for school years 2008-2009 and 2009-2010. also establishes the base per-student cost to be used by PED during the testing period and on into implementation.

School District (2008-2009)	\$5,202.82
Charter School (2008-2009)	\$7,038.11
School District (2009-2010)	\$5,218.14
Charter School (2009-2010)	\$7,058.83

SIGNIFICANT ISSUES

The HEC amendments strike Sections 25, 26 and 27 of the original bill relating to special education, which were intended to resolve issues relating to placements in private residential treatment centers. Those issues are currently being addressed by HB 199.

Synopsis of Original Bill

House Bill 331 provides for a new public school funding formula based on student need, grade composition and scale of operations for school districts and charter schools and also provides the maintenance and periodic recalibration of the formula. The bill provides for a longer school year for students, a longer work year for teachers, and codifies the Educational Plan for Student Success (EPSS) as the accountability instrument to be used to verify appropriate programs of instruction are provided. HB 331 also provides for a census-based special education identification rate, clarifies financial responsibility for special education, changes reporting times

to specific dates, creates the Special Education Catastrophic Aid Fund, and makes technical changes to statute.

FISCAL IMPLICATIONS

According to the December 2008 revenue estimate, FY10 recurring revenue will only support a base expenditure level that is \$293 million, or 2.6 percent, less than the FY09 appropriation. All appropriations outside of the general appropriation act will be viewed in this declining revenue context.

Section 17, subsection O (page 42) requires the legislature to use the funding formula provided in Section 17 to **determine the appropriation** for FY11 and further provides that districts and charter schools previously receiving more funding than the new formula provides “**shall be held harmless for no more than three years.**” These provisions if implemented compel future legislatures to make specific appropriations, thereby weakening the Legislature’s power of appropriation. The funding formula has been touted as a better way of distributing the annual SEG appropriation and should not be used to determine appropriations.

Current projections by the LESC indicate the costs of implementing HB 331 to be approximately \$350.0 million. Although LFC remains concerned regarding the validity of the dollar amount tied to sufficiency, using the LESC amount, reductions should be made to account for appropriations of \$22 million made by the Legislature in FY09 for one additional; instructional day and the expansion of elementary physical education and a recommendation of \$5 million for elementary PE in the FY10 LFC recommendation. The resulting amount appears to be closer to \$320 million.

A companion bill, HB 346 *Education Gross Receipts Surtax* has been introduced as a way to provide for increased funding of public schools. HB 346 imposes an education surtax of 0.5 percent on gross receipts and compensating tax, and revises the personal income tax rates to increase the top rate from 4.9 percent to 6.0 percent. These changes would increase revenues by \$360.2 million, \$472.0 million, \$493.0 million, and \$515.5 million in FY10, FY11, FY12, and FY13, respectively, well above the \$320 million needed to implement the formula.

PED has identified a need of more than \$500 thousand in nonrecurring funds to update STARS, OBMS and assist districts with implementation issues. Another \$83 thousand in recurring funding is identified for staff during the pilot phase with more support expected as the formula is implemented in FY12.

During the testing period required by this bill, PED will consult with the USDOE to ensure that the proposed funding formula meets federal Impact Aid requirements. (Section 31, Subsection B). Upon adoption of the bill, PED will request USDOE to review the cost factors in the formula to determine if the factors meet the criteria of special cost differentials. If USDOE determines that New Mexico “has substantially revised its State aid program,” for the first two years during which the new formula is implemented, the state will be required to apply for certification as an equalized state on the basis of projected revenue data. **If the actual revenue data from the first two years does not result in the state’s certification, the state will be required to repay to individual districts amounts equal to the amount of Impact Aid revenues considered in determining each district’s state equalization guarantee distribution.** During the third and

subsequent years of implementation, the state would apply for certification on the basis of second preceding fiscal year data.

This bill creates a new fund and provides for continuing appropriations. The LFC has concerns with including continuing appropriation language in the statutory provisions for newly created funds, as earmarking reduces the ability of the legislature to establish spending priorities.

SIGNIFICANT ISSUES

The proposed funding formula was developed using a “costing-out” study focusing on the cost differences between current expenditures and a “model school” determined by a Professional Judgment Panel (PJP). American Institutes for Research (AIR), the funding formula contractor, relied on the work of PJPs to determine what resources are needed to meet educational sufficiency. Although each PJP received instructions to keep costs in mind when making recommendations, it appears some of the recommendations amounted to wish lists given unlimited resources. Using this information, AIR estimated a sufficiency cost of \$850 million. Recognizing this number was too large, the professional advisory panel (PAP) convened to review the data and make changes as needed to bring resource allocation to a more reasonable level. These changes focused on resources for both the base program and the four focus areas. The result of this work was the final recommendation of approximately \$340 million. Depending on the scope of changes or the views of different panels, this amount could be much higher or much lower. As a result, there is skepticism as to whether the current estimate of \$322 million is accurate or simply an acceptable amount.

Eric Hanushek, senior fellow at the Hoover Institution of Stanford University in *Science Violated: Spending Projections and the “Costing Out” of an Adequate Education*, (2006), notes that “costing out studies” should be interpreted as political documents, not as scientific studies, and are generally used by parties interested in increasing spending for education. He further notes these studies provide spending projections that incorporate, and in general lock in, current inefficient uses of school funds. A number of school district inefficiencies identified in recent LFC performance evaluations and concerns with operational decisions made by some school districts lead to concerns whether additional funding will lead to improved outcomes

According to LFC projections, new recurring funding is projected to decline significantly beginning in FY10, considerably affecting the Legislature’s ability to sustain previous levels of funding for government, including public education. The baseline expenditure forecast is based on the LFC recommendation for FY10 for a 2.4 percent reduction in general fund appropriations. Over the last decade the growth rate of expenditures has been 6.7 percent but since FY02 the annual growth rate has been 7.9 percent and the cumulative growth rate is 54.7 percent. For all categories, other than Medicaid, the expenditure forecast is linked to the Global Insight forecast of the consumer price index (CPI) and New Mexico population. As of the latest forecast, the CPI is expected to be low in FY09 and FY10 while population is expected to grow approximately 1.2 percent per year. Under the baseline expenditure forecast, expenditures outpace revenues.

General Fund Expenditures Baselines:	Actual	Op.Bud.	LFC Rec.	Baseline Forecast		
	FY08	FY09	FY10	FY11	FY12	FY13
Legislative	18.8	20.1	19.7	20.4	20.9	21.4
Judicial	205.8	217.9	215.2	224.4	232.8	240.9
General Control	197.7	205.3	204.7	211.1	216.6	221.6
Commerce and Industry	58.4	61.7	60.2	62.1	63.7	65.1
Agriculture, Energy and Natural Resources	86.6	90.5	84.2	86.9	89.1	91.2
Health and Human Services	1,393.4	1,526.7	1,470.3	1,561.1	1,654.3	1,751.5
Medicaid	707.0	798.4	753.5	813.8	878.9	949.2
Other Health and Human Services	686.4	728.3	716.8	747.3	775.4	802.3
Public Safety	383.3	411.6	394.9	442.9	464.9	477.1
Corrections	277.4	297.1	304.9	321.8	339.3	347.2
Other Public Safety	105.9	114.5	116.1	121.0	125.6	129.9
Higher Education	846.3	884.9	864.7	901.6	935.5	967.8
Public Education	2,484.7	2,608.1	2,567.0	2,657.6	2,740.0	2,816.7
Total Recurring Expenditures	5,675.0	6,028.0	5,881.0	6,167.9	6,417.8	6,653.2
Spending Increase (year over year)	559.2	353.7	221.6	247.7	257.0	242.4
Spending Growth Rate	10.9%	6.2%	-2.4%	4.9%	4.1%	3.7%
Recurring Revenue less recurring expenditures	320.2	-323.5	-147.7	-214.0	-241.1	-315.6
Notes						
1) Medicaid spending grows according to CBO projections of federal Medicaid spending.						
2) Corrections spending grows at inflation plus overall growth rate.						
3) Public Schools grow at projected rate of enrollment growth plus inflation. Additional amounts included for retirement, three-tier licensure and Pre-Kindergarten.						
4) All other agencies grow at the expected rate of inflation.						
5) Sources for economic growth, inflation and demographics include Global Insight, UNM & U.S. Census.						

The Attorney General’s Office notes that it is unclear as to the effect the new public school formula established in this bill would have on New Mexico’s designation by the United States Secretary of Education as an “equalized” state, thereby allowing the New Mexico Public Education Department to “take credit” or reduce operational state funding to an impacted district by the amount of the Federal Impact Aid subsidy. That designation has been the subject of litigation against the United States Secretary of Education, which was ultimately decided by the United States Supreme Court on April 17, 2007 in favor of the Secretary, resulting in the continuation of New Mexico’s status as an “equalized” state. *Zuni Public School District No. 89 v. Department of Education*, 550 U.S. 81 (2007), Case No. 05-1508. Although the bill does require consultation with the United States Department of Education to ensure that the funding formula meets impact aid requirements, the bill does not appear to provide a contingency plan in the event that the Secretary of the United States Department of Education determines that the funding formula does not comply with impact aid requirements, and/or that the new formula could jeopardize New Mexico’s status as an “equalized” state.

The bill removes the option of totaling equivalent instructional hours, ending the practice of districts adding minutes to the instructional day. This language provides clear direction as to the number of instructional days and the instructional time required for students.

Provisions are included in the bill for the department to verify, monitor and evaluate educational plans during the budget approval process and throughout the year. It appears this is the method by which PED will insure districts spend increasing dollars in an effective way to meet the needs identified by the districts to improve student success and achievement. The EPSS must implement the PED’s standards for excellence. Educational programming for the EPSS must include bilingual and multicultural education, physical education, career technical education, visual and performing arts, gifted education, advanced placement and honors programs. Special

education and distance education programs must also be included. Provisions in the bill give authority to the secretary of public education to disapprove educational plans if they do not meet the requirements set forth in the bill. Using the EPSS as the primary and perhaps singular tool to determine if districts are spending additional funds prudently continues to be an area of concern because it is not tied in any way to improvements in student achievement, graduation rates or lowered remediation rates in college. Resistance also continues with regard to identifying teacher performance through any student achievement mechanism.

The bill lays out the foundation for a new formula projecting the sufficient per-student cost calculation for school districts and charter schools. It contains definitions and cost factors consisting of: poverty, English language learners, special education, mobility, percent of district enrollment by set grades and the weighted index of staff qualifications. It identifies the sufficient per-student cost multiplier and guidance about how to complete the sufficient per-student cost calculation. Methodologies are identified for factoring in growth; new school demographics; special education; implementation of intervention strategies related to lowering special education identification rates; annual updates of cost factors; and annual adjustment of the base per-student cost based on appropriations. By using a simplified method, the formula is intended to minimize “formula chasing” by some districts.

Beginning with projections for the 2010-2011 school year, school districts and charter schools must submit annually to the PED, on or before October 15, their enrollment and other cost projections, including the cost factor demographic data by grade level, for the succeeding fiscal year. The bill changes the submission date for the department’s PSS request from November 30th to November 20th. This change provides a little more time for LESC and LFC to develop recommendations.

Provisions contained in the amendment set up a separate account within the Public School Fund to hold revenues received for the purpose of implementing the funding formula until such time as sufficient funding to implement the funding formula is accrued. The amendment further provides that these funds shall not be counted as part of the state reserve for bonding or any other purposes other than to implement the funding formula.

A significant consideration in the bill is the use of a census based special education percentage to determine special education funding. Currently the statewide average Special education population is approximately 14 percent. Some districts are at 9 percent while others are as high as 34 percent. The bill provides for a census average of 16 percent for all districts. Those districts above 16 percent will be required to reassess their special education students to determine whether the high identification rate is due to ethnic or racial background and whether these students are receiving the most appropriate education and related services.

Provisions that a sufficient per-student cost is based on a comprehensive instructional program that includes the cost of core academic programs, career-technical education, gifted programs, bilingual programs, arts and music, health and physical education and special education and appropriate staff. Within this description, local boards are expected to determine priorities that best serve the needs of the community.

To account increased costs related to higher levels of experience and training of instructional staff, the formula implements an Index of Staff Qualifications (ISQ) aligned to the three-tier licensure structure for teachers. Two matrices are provided, one for teachers and a second for

instructional support providers who are not on a tiered licensure structure. As with the current T& E index districts are held harmless to an ISQ of 1.0 if they fall short. In addition to the ISQ, provisions are included to continue the national board certification stipend at current levels and adjusting it every year by the same percentage as salary increases.

Cash balance limits are removed for districts and cash can be used for programs aligned with the EPSS or can be used for meeting the districts share of standards based capital outlay projects. Districts are precluded from budgeting current year cash balances without prior approval of the secretary.

The bill creates the Special Education Catastrophic Aid fund to assist districts with costs associated with ultra-high needs students. In general these students may require a respirator, a full time assistant, a nurse, or other item of this nature. A fund currently is available at PED funded with federal funds but is relatively small and would not go very far. Again the LFC has concerns with including continuing appropriation language in the statutory provisions for newly created funds, as earmarking reduces the ability of the legislature to establish spending priorities.

In response to advocate concerns, requirements are included that provide for PED educational standards to include standards for the identification, evaluation, and education of gifted students. The bill establishes guidelines for these programs.

The bill includes numerous changes and additions aimed at clarifying and aligning special education with current federal law and identifying the responsibility for special education students enrolled in state institutions, private training centers or residential treatment centers (RTCs).

The bill includes three temporary provisions. The first temporary provision defines the references in the Public School Code to the 40th, 80th, and 120th day membership reports as references to the second Wednesday in October, the second Wednesday in December, and the second Wednesday in February, respectively. The second temporary provision changes the reporting dates to those second Wednesdays in October, December, and February, respectively. The third temporary provision focuses on data verification and beta testing of the funding formula for the 2008-2009 school years.

TECHNICAL ISSUES

Current statute does not place an upper age limit on the definition of “school aged person.” As a result, a charter school opened on FY08 that provides education services for adult inmates at the Bernalillo County Metropolitan Detention Center and education services for former inmates and others at the old Bernalillo County Detention Center in downtown Albuquerque. This charter school generates basic student units, related services units and small school units. While having merit, it is probably more appropriate to have these students funded through adult basic education rather than moving funding away from school districts and charter schools serving traditional school aged students. The Legislature may wish to consider on page 7, line 11 striking the remainder of the line after “person” and all of lines 12 and 13.

The General Appropriation Act of 2008 (FY09) includes funding for an extra school day. The Legislature may wish to consider on page 9, line 25 adding “-one after “eighty” and on page 10, line 10 striking “six” and inserting thereof “five”.

At present, many districts include the time used for students to pass from one class to another “passing period” as instructional time in calculating a full instructional day. The Legislature may wish to consider on Page 10 Line 18 adding after the comma “and passing periods”.

A number of district data staff have requested consideration of extending the time required to submit data after the end of a reporting period. Discussions with PED indicate this would not cause difficulties. The Legislature may wish to consider on page 33, line 19 strike “five” and insert thereof “ten”.

PED notes that Page 64, line 13 deletes “all children” and replaces it with “public school students”. The language may conflict with 34 CFR § 300.129 since there are responsibilities owed to children in private schools under IDEA. If the bill is left as is, it will exclude students with disabilities in private schools. In addition, under the IDEA, school districts are required to provide services to students with disabilities in correctional facilities, state institutions and the juvenile justice system.

The bill provides that revenue dedicated to funding the marginal or incremental cost of the new funding formula shall be credited to a separate account in the Public School Fund. This fund receives revenues from a number of sources. An alternative to avoid a general fund income loss would be to deposit these funds in the separate account of the appropriation contingency fund dedicated for the purpose of implementing and maintaining educational reforms created in Section 12 of Chapter 114 of Laws 2004 (the lockbox). By definition, this fund is part of the general fund which would receive interest income from account proceeds.

Page 35, Section D provides that all revenue dedicated to public school purposes by a law or constitutional amendment that is approved after January 1, 2009 shall be credited to the account. It appears this could include the current and future House Bill 2 appropriations which currently contain \$2.6 billion for public school purposes. The Legislature may wish to add “other than a general appropriations act” after the word “law” on line 17.

Page 35, line 13 provides for the public school fund to become a non-reverting fund. This results in an earmarked fund to receive funds from a number of revenue bills as well as transfers from the common school fund and from the federal Minerals Land Leasing Act which account annually for amounts well over the \$320 million threshold for implementing the formula.

OTHER SUBSTANTIVE ISSUES

PED notes that with respect to fiscal impact upon the PED, the PED will assume additional duties to support implementation of HB 331. Technical assistance will be necessary to provide support to school districts and charter schools in the development of compliant EPSS, including assistance a district may request if its EPSS is not approved by the PED (Section 4, Subsection N). The bill references 20 types of expenditures that support educational plans, with the expectation that the district or charter shall tie those expenditures to outcomes with performance measures. In order to accomplish this, the districts will continue to need technical assistance to embed those measures into the EPSS and into the strategies for improving student achievement. Until the 2008-2009 Pilot Project is complete, valid projections of staff needs are not possible. However, it is reasonable to assume that additional staff will be required and a study will need to be completed to determine what skills/training are necessary to ensure full implementation of HB 331.