# F I S C A L   I M P A C T   R E P O R T

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|---|---|---|---|---|---|
| | | **ORIGINAL DATE** | 1/30/2020 | | |
| **SPONSOR** | Soules | **LAST UPDATED** | 2/18/2020 | **HB** | |
| **SHORT TITLE** | Core Admin Functions Expenditures Formula | | | **SB** | 31/aHTRC |
| | | | | **ANALYST** | Liu |

## ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

| | FY21 | FY22 | FY23 | 3 Year Total Cost | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|---|
| **Total** | $18,867.1 | $18,867.1 | $18,867.1 | $56,601.3 | Recurring | General Fund |
| **Total** | $378.0 | | | $378.0 | Recurring | Public School Capital Outlay Fund |

(Parenthesis ( ) Indicate Expenditure Decreases)

Relates to HB4, HB131, HB254, SB135, SB141, SB142, SB159, SB198, SB292, SB317
Conflicts with Appropriation in HAFC Substitute of HB2 and 3 as amended by SFC
Companion to Appropriation in HAFC Substitute of HB2 and 3 as amended by SFC

## SOURCES OF INFORMATION
LFC Files

Responses Received From
Public School Facilities Authority (PSFA)

## SUMMARY

### Synopsis of HTRC Amendment

The House Taxation and Revenue Committee amendment to Senate Bill 31 creates a federally-impacted location support program (FILSP) in the Public School Code to distribute awards to public schools that receive federal Impact Aid payments credited in the public school funding formula. Schools must use the award only for capital expenditures, debt service, community services, or educating at-risk students and cannot spend more than 50 percent of the award for capital expenditures or debt service.

The amendment increases the annual FILSP award to Impact Aid schools over 3 years, equivalent to one-third of the 5-year average of credited Impact Aid payments in FY21, two-thirds in FY22, and the full amount in FY23 and subsequent years. Schools receiving this award must engage in meaningful consultation with Indian nations, tribes, and pueblos located in New Mexico whose students are enrolled in the school and verify the consultation with LESC and LFC each year.

Synopsis of Original Bill

Senate Bill 31 amends the Public School Capital Outlay Act, changing the budget limitation on PSFA core administrative functions from a 3-year average of grant assistance to a 5-year average. This bill is endorsed by the Public School Capital Outlay Oversight Task Force.

**FISCAL IMPLICATIONS**

***PSFA Implications.*** The Public School Capital Outlay Act authorizes annual appropriations from the public school capital outlay fund (PSCOF) for PSFA's core administrative functions but limits the expenditures to 5 percent of the average annual grant assistance authorized by the Public School Capital Outlay Council (PSCOC) during the previous 3 years.

Revenue downturns in FY17 and FY18 reduced PSCOC grant assistance to $81.8 million in FY17 and $87 million in FY18, a significantly lower amount than in previous years (between FY12 and FY16 annual grant assistance averaged $188.1 million). The average of grant assistance in FY17, FY18, and FY19 imposed a $4.7 million budget limitation on PSFA's FY20 operations – the agency's lowest operating budget since FY03. In FY20, PSFA reduced staff and other operational expenditures to accommodate the reduced budget level.

The projected FY21 budget limitation (3-year average) is estimated to be $5.4 million, given a substantial increase in projected grant assistance for FY19 and FY20. However, given PSFA's recently expanded scope of work, the agency anticipates operating budget costs will exceed $5.4 million in FY21. This bill would effectively raise the FY21 budget limitation to $5.8 million (5-year average), increasing PSFA's budget authority and creating a potential additional operating budget impact of $378 thousand in FY21 to PSCOF.

The executive and LFC FY21 budget recommendations for PSFA are $5.5 million and $5.7 million, respectively. Both recommendation assumptions are budgeted above the projected limitation currently allowed, although the LFC recommendation includes language reducing PSFA's FY21 budget to the statutory limitation.

***FILSP Implications.*** This bill does not make an appropriation but requires the Public Education Department (PED) to make an annual award from a nonexistent FILSP fund (See Technical Issues) to school districts and charter schools that receive federal Impact Aid. As such, the bill effectively obligates the state to make FILSP distributions, beginning in FY21, to schools that received federal Impact Aid payments in the preceding 5 fiscal years, not including the immediately preceding fiscal year.

The estimated cost of one-third of the 5 year average of federal Impact Aid payments credited in the public school funding formula is about $18.9 million. This cost would double in FY22 and triple by FY23 and subsequent fiscal years. Currently, only 25 school districts and three state-chartered charter schools have received Impact Aid payments for the last 5 consecutive years. Notably, three school districts (Gallup, Central, and Zuni) would receive over 76 percent of the entire FILSPF distribution (See Attachments) each year, given their share of statewide Impact Aid receipts.

Because Impact Aid payments are based on applications to the federal government, more schools may apply in future fiscal years to receive Impact Aid. If these schools submit new applications and receive federal Impact Aid payments for at least 5 years, they would also be eligible for an FILSPF distribution. While this could potentially create additional operating budget impacts in future years, this analysis does not consider those costs.

**SIGNIFICANT ISSUES**

**PSFA Issues**

PSFA provides technical assistance and support to many school districts managing capital projects and facilities. Changes in this bill would stabilize PSFA's budget limitations and reduce volatility in staffing levels due to extreme fluctuations in annual grant assistance. The agency notes the proposed change is also in alignment with PSFA's 5-year school district facilities master plan cycle.

| Year | Operating Budget (in thousands) | Average FTE | Programs | Projects | Total Grant Assistance (in millions) |
|---|---|---|---|---|---|
| FY11 | $6,031.3 | 45 | 3 | 138 | $273.1 |
| FY12 | $5,656.4 | 46 | 4 | 144 | $91.1 |
| FY13 | $5,523.6 | 44 | 5 | 163 | $156.4 |
| FY14 | $5,594.0 | 44 | 4 | 163 | $226.0 |
| FY15 | $5,913.0 | 46 | 4 | 145 | $108.5 |
| FY16 | $6,132.5 | 51 | 3 | 127 | $171.0 |
| FY17 | $6,039.7 | 53 | 3 | 124 | $81.8 |
| FY18 | $5,647.4 | 47 | 4 | 131 | $87.0 |
| FY19 | $5,171.8 | 47 | 5 | 370 | $106.7 |
| FY20 | $4,688.0 | 43 | 8 | 267 | $128.9 |

Source: PSFA

PSFA notes the FY20 operating budget is limited to a funding level similar to the agency's operating budget level in FY03. In FY03, PSFA had an operating budget of $4.7 million and 42 FTE. However, the agency had substantially fewer funding programs and awards to administer.

**FILSP Issues**

***Impact on Disparity Analysis.*** The federal government authorizes a state to "credit," or supplant, a portion of state aid to local educational agencies (LEA) with federal Impact Aid payments if the state can demonstrate that disparities in per-student spending or per-student revenues between LEAs in the 95th and 5th percentile are less than 25 percent (i.e. there are minimal differences in funding per student between LEAs). States must account for (and also credit) other federal and local revenues in the same manner. If the state's funding methodology passes this disparity test, the U.S. Department of Education classifies the state as having an "equalized" methodology and allows the state to adjust (credit) appropriations to minimize funding disparities between LEAs caused by differences in local or federal revenue sources.

Provisions of this bill would effectively provide additional state aid for LEAs equal to the amount of federal Impact Aid credited in the public school funding formula by FY23. The bill restricts the use of FILSP funding for the following purposes, which are technically excluded from the definition of current expenditures used in calculations of the federal disparity test (from PED's analysis of a similar bill):

- Capital expenditures, debt service, and community services (which are not considered

revenue under the definition of "current expenditures" in the Every Student Succeeds Act (ESSA), Pub. L. No. 115-224, § 7013(4) (see p. 381));
- Expenditures associated with educating students who: (a) receive special education services; (b) have a disability; (c) are economically disadvantaged; (d) are English language learners; or (e) are participants in gifted education programs (which are "special cost differentials" excluded from the disparity calculation under 34 CFR Section 222.162, expanding on language in ESSA, Pub. L. No. 115-224, § 7009(b)(2)(B)(see p. 377)).

However, if the FILSP distribution cannot be excluded from the disparity test calculation, the distribution in this bill would increase Gallup's per-student funding ranking above the 95th percentile in the disparity test, which alone could widen the disparity to 46 percent between LEAs in the 95th percentile (Gallup in this case) and 5th percentile (Clovis in FY20). If New Mexico fails the disparity test, the state would not be able to credit federal revenues in the public school funding formula, which would effectively redistribute $63 million in SEG from non-Impact Aid schools to Impact Aid schools (assuming no appropriation to hold schools harmless from this change).

***Public School Capital Outlay History.*** PSFA notes Impact Aid school districts are already eligible for capital outlay funding awarded by the Public School Capital Outlay Council (PSCOC) and providing a FILSP distribution could potentially impact equalization of operational funding. The bill makes more funding available for capital expenditures but not to all school districts and state-chartered charter schools, which may be viewed as dis-equalizing capital funding statewide.

In 2000, the 11th Judicial District Court ruled in the *Zuni Public District v. State of New Mexico* lawsuit that New Mexico's public school capital outlay system violated constitutional requirements 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 for correcting past inequities. The impact of the *Zuni* lawsuit and subsequent legislation resulted in the development and implementation of adequacy standards for schools, which represent the maximum educational facility space the state will finance with matching local capital outlay funds, and a standards-based process for assessing and prioritizing awards for school renovation and replacement overseen by PSCOC and administered by PSFA.

Since the *Zuni* lawsuit, the state has spent $2.5 billion to build school facilities up to the approved statewide adequacy standards (which evolved from considerations of critical corrective needs to a broader range of space types and site features). Despite significant improvements in statewide facility conditions, the *Zuni* lawsuit was never closed and, in 2015, plaintiff school districts asked the court for a status hearing on new claims of inequity. The major claim of the plaintiffs was their inability to raise sufficient local capital outlay revenue to maintain capital assets and build facilities that were outside of the statewide adequacy standards like other districts with available local resources. 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 in implementing a uniform and sufficient system.

During the 2019 legislative session, several historically-impacted Native American school districts (Gallup, Grants, and Zuni) that were plaintiffs in the *Zuni* lawsuit and Central Consolidated School District (CCSD) sought legislative fixes for their capital outlay concerns that eliminated 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. Provisions of this bill would achieve a similar result, albeit in the form of a direct categorical appropriation to Impact Aid schools rather than a change to the funding formula.

PSFA indicates other capital improvement expenditures allowed under this bill may allow Impact Aid schools to complete planning, design and construction of infrastructure and facilities outside of the state funding process through PSCOC. The bill will impact PSCOC's ranking of school facilities, which is used to prioritize funding to schools with the greatest facility needs.

***Overview of Federal Impact Aid.*** Congress has provided financial assistance to local school districts through the Impact Aid program since 1950. Impact Aid was designed to provide financial support to school districts that lack local revenue through property taxes, due to the presence of tax-exempt federal property (i.e., tribal trust lands and military bases). School districts with increased expenditures due to the enrollment of federally-connected children (i.e. children who reside on Indian lands, military bases, low-rent housing properties, and other federal properties, or have parents in the military or employed on eligible federal properties) are also intended recipients of these funds.

Most Impact Aid funds, except for the additional payments for children with disabilities and construction payments, are considered general aid to the recipient school districts. These funds may be used in whatever manner the school districts choose, so long as it is in accordance with local and state requirements. Most recipients use funding for daily expenditures, but recipients may use the funds for other purposes such as capital expenditures. School districts are required by federal regulations to consult with tribal governments and parents under the Indian Policies and Procedures about how these monies are spent.

School districts use Impact Aid for a wide variety of expenses, including the salaries of teachers and teacher aides; purchasing textbooks, computers, and other equipment; after-school programs and remedial tutoring; advanced placement classes; and special enrichment programs. Payments for children with disabilities must be used solely for the extra costs of educating these children. School districts receive Impact Aid funds directly from the federal government through an application process, so states do not receive nor process these funds.

***Discussion on Equalization.*** Plaintiff districts and tribal nations have argued the state's public school funding formula shares operational wealth generated by federal Impact Aid for use throughout the state, which benefits all districts, including those that have wealthier local property tax bases for capital outlay. However, all local operational property tax is also redistributed in the formula, and Impact Aid schools receive 25 percent of uncredited operational Impact Aid payments and 100 percent of Impact Aid payments for children with disabilities and construction that most districts do not generate. Additionally, since the *Zuni* lawsuit, PSCOC's ranking and prioritization methodologies have allocated a larger share of state capital outlay funding to support districts with lower property wealth to account for differences in local taxable property values and areas. Overall, plaintiff school districts' facility conditions (as measured by PSFA's facilities condition index) are comparable or better than the statewide average.

Provisions of this bill could create inequities in the PSCOC process and potentially exacerbate problems noted in the *Zuni* lawsuit, which is still ongoing. While litigant school districts have argued their Impact Aid is a payment in lieu of taxes and should be treated like property taxes and available for capital outlay, this bill's distribution would not be considered in PSCOC's state and local match calculation, which would introduce inequities into the state and local match calculation. The state and local match formula was put into place to provide equity in state funding of public school buildings and address the *Zuni* lawsuit. For this reason, the Legislature may want to consider including the appropriation in this bill that is used for capital outlay in the state and local match calculation, which would result in reducing the state share of projects at Impact Aid school districts.

Notably, legislation has been enacted to provide additional state funding for school districts with low property tax bases. Laws 2018, Chapter 66 (SB30) changed PSCOC's state and local match calculation to be based on the net taxable value for a school district for the prior five years, the maximum allowable gross square footage per student pursuant to the adequacy planning guide, the cost per square foot of replacement facilities, and each school district's population density.

## PERFORMANCE IMPLICATIONS

***PSFA Implications.*** PSFA conducts assessments of school buildings and assists school districts with facility maintenance management. These assessments help determine the building condition and maintenance practices of school facilities statewide, which inform ranking and funding prioritization. Schools with the greatest facility needs are identified and eligible for funding first. PSFA also assists school districts with the development and implementation of 5-year facilities plans, preventive maintenance plans, procurement, and other training programs. Recently, PSFA established a measurement and verification program to help establish energy savings strategies for all school districts. This bill will provide additional budget authority in FY21, which could help the agency expand oversight and technical assistance.

***FILSP Implications.*** On February 14, 2019, the 1st Judicial District Court issued a final judgment and order on the consolidated *Martinez v. New Mexico* and *Yazzie v. New Mexico* education sufficiency lawsuits, and found that New Mexico's public education system failed to provide a constitutionally sufficient education for at-risk, English language learner, Native American, and special education students. The court's findings suggested overall public school funding levels, financing methods, and Public Education Department (PED) oversight were deficient. As such, the court enjoined the state to provide sufficient resources, including instructional materials, properly trained staff, and curricular offerings, necessary for providing the opportunity for a sufficient education for all at-risk students. Additionally, the court noted the state would need a system of accountability to measure whether the programs and services actually provided the opportunity for a sound basic education and to assure that local districts spent funds provided in a way that efficiently and effectively met the needs of at-risk students.

Provisions of this bill would increase funding for some districts with substantial populations of Native American students, a student subgroup highlighted by the court as being at risk of performing academically worse than other peer subgroups. Providing additional resources for Native American students could lead to improve outcomes if schools use funds strategically on evidence-based practices. However, Impact Aid is only associated with students residing on tribal lands or federally-connected children (i.e. children with parents working or residing on federal property). As such, this distribution would not be targeted to Native American students that do not reside on tribal or federal property.

## ADMINISTRATIVE IMPLICATIONS

Since 2003, PSFA has expanded from a single Deficiencies Correction Program to seven funding programs for all schools throughout the state, including standards-based school replacement and renovation, systems-based replacement, school security infrastructure, master planning initiatives, prekindergarten classroom construction and renovation, broadband deficiencies correction projects, and lease assistance awards. In FY19, two additional programs (teacher housing and outside-of-adequacy awards) were added, for a total of nine funding programs. PSFA notes these programs involve hundreds of grants and include most of the 89 school districts and two state-supported schools in New Mexico. These projects are numerous and can require intensive project management support from PSFA staff.

PSFA notes current statutory limitations (3-year average) will likely require another staffing reduction in FY21, which would lower PSFA's ability to deliver quality and timely services to school districts, given the recent significant increase in the number of PSCOC project awards. Between FY10 and FY18, PSCOC awarded an average of 141 awards per year. In FY19, PSCOC made 370 awards and in FY20 made 267 awards. PSFA notes the increased workload necessitates additional staff in FY21.

## CONFLICT, COMPANIONSHIP, RELATIONSHIP

This bill conflicts with a nonrecurring $18.9 million appropriation in the HAFC Substitute of House Bill 2 and 3, as amended by SFC, to schools that receive federal Impact Aid revenue for students residing on Indian lands. The appropriation is from the public school capital outlay fund (PSCOF) and must be used for repairs, maintenance, and other infrastructure expenditures.

This bill is a companion to the PSFA appropriation in HAFC Substitute of House Bill 2 and 3, as amended by SFC, which increases the agency's budgetary authority to a level based on 5 percent of the 5-year average for PSCOC grant assistance.

This bill relates to House Bill 4, which creates a federally impacted location support program that appropriates an amount to schools equal to Impact Aid payments; House Bill 131, which increases the Public School Capital Improvements Act state program guarantee (also known as SB-9); House Bill 254 and Senate Bill 159, which amends the SB-9 calculation; Senate Bill 135, which allocates $29.8 million to schools that experienced at least $1 million in federal Impact Aid credits; Senate Bill 141, which allocates $86 million to schools for local and federal revenues credited in the funding formula; Senate Bill 142, which eliminates the 75 percent federal credit in the funding formula; Senate Bill 198 and Senate Bill 292, which appropriate an amount equal to the credited Impact Aid revenue to schools that experienced at least $1 million in federal Impact Aid credits; and Senate Bill 317, which creates a federally impacted location support program that provides grants to Impact Aid schools that apply.

## TECHNICAL ISSUES

The HTRC amendment requires PED to make an annual award from the federally impacted location support program fund; however, this fund does not currently exist in statute, nor is it created in the amendment. The sponsor may want to consider amending the bill to include creation of a fund to address this technical error.

## WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

PSFA notes if the operating budget for the agency continues to be set by the prior 3-year methodology rather than the prior 5-year methodology, the agency may reduce staffing levels in FY21 to meet the budget limitation. PSFA provided the following scenarios:

**Staffing Levels**

| **Without Passage of SB 31** | **With Passage of SB 31** |
|---|---|
| PSFA Staff (# of FTE) – 40 | PSFA Staff (# of FTE) – 48 |

**PSFA Workload**

| Number of Awarded Projects | Fiscal Year |
|---|---|
| 141 (average per year) | FY10-FY18 |
| 370 | FY19 |
| 267 | FY20 (to date) |

PED would not be required to make an annual FILSP distribution to schools that receive federal Impact Aid payments.

SL/al/sb