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

		ORIGINAL DATE	01/26/21		
SPONSOR	Stewart	**LAST UPDATED**	03/01/21	**HB**	
SHORT TITLE	School Funding Changes			**SB**	41/aSEC/aSFC
				ANALYST	Liu

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY21	FY22	FY23	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		$0.0 - $51,667.5	$0.0 - $51,667.5	$0.0 - $103,335.0	Recurring	General Fund
Total		($0.0 - $26,818.5)	($0.0 - $39,378.9)	($0.0 - $66,197.4)	Nonrecurring	Public School Capital Outlay Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

Relates to HB6, HB52, HB84, HB86, HB87, HB135, SB131
Relates to Appropriation in the General Appropriation Act of 2021

SOURCES OF INFORMATION
LFC Files
Legislative Education Study Committee (LESC) Files

Responses Received From
New Mexico Attorney General (NMAG)
Indian Affairs Department (IAD)
Public School Facilities Authority (PSFA)

No Response Received
Public Education Department (PED)

SUMMARY

Synopsis of SFC Amendment

The Senate Finance Committee amendment to Senate Bill 41 makes technical corrections and removes enrollment growth program units from the calculation of save harmless units in the funding formula (See Administrative Implications).

Synopsis of SEC Amendment

The Senate Education Committee amendment to Senate Bill 41 makes the effective date of this bill July 1, 2021, and strikes provisions that make the effective date contingent on dismissal of the *Zuni* capital outlay adequacy lawsuit and withdrawal of all Impact Aid school districts from the *Martinez-Yazzie* education sufficiency lawsuit.

Synopsis of Original Bill

Senate Bill 41 amends the Public School Code to:

- remove the 75 percent credit for federal Impact Aid, local half-mill levy, and federal forest reserve fund revenues from the public school funding formula;
- include unrestricted revenue (such as the aforementioned local and federal revenues) used for capital outlay expenditures into the calculation of the local-state match formula for public school capital outlay awards;
- require each school district or charter school to report how the aforementioned local and federal revenues are used to improve student outcomes and consult with tribal entities on Impact Aid expenditures; and
- require PED to submit a list of school districts proposing to enter into approved guaranteed utility savings contracts to LESC.

The effective date of this bill is contingent on dismissal of the *Zuni* capital outlay adequacy lawsuit and withdrawal of all Impact Aid school districts from the *Martinez-Yazzie* education sufficiency lawsuit or the date of July 1, 2021, whichever occurs later.

FISCAL IMPLICATIONS

The fiscal impacts of this bill are dependent on dismissal of the *Zuni* lawsuit and withdrawal of Impact Aid district plaintiffs from the *Martinez-Yazzie* education sufficiency lawsuit. The SEC amendment removes this provision. For simplicity, the fiscal impacts of this bill are assumed to potentially begin in FY22.

The bill eliminates $83 million in recurring credits from the public school funding formula. Absent any appropriations to offset the loss of these credits, the formula would redistribute state equalization guarantee (SEG) distributions from local education agencies (LEAs) with fewer credits to LEAs with significantly more credits.

However, the FY21 operating budget included a partial offset of $31 million for Impact Aid credits (see Other Substantive Issues), and the FY22 LFC budget recommendation for public school support includes $52 million to eliminate local and federal credits, which is the estimated additional operating budget impact reflected in this analysis. Together the two appropriations (totaling $83 million) could offset the full fiscal impact of redistributing the SEG in FY22 and subsequent years. Because $67 million, or 80 percent, of all credits within the formula are attributable to federal Impact Aid payments, Impact Aid LEAs would receive a larger share of redistributed SEG allocations.

The SFC amendment removes enrollment growth units from the calculation of save harmless program units in the funding formula. Because PED promulgated new rules to include enrollment growth units in the calculation of save harmless units in FY21, this amendment would presumably revert the department's new save harmless calculation to the original calculation and result in no fiscal impacts for FY22 and subsequent years.

The bill further amends the Public School Capital Outlay Act formula that determines the local and state share of funding for public school capital outlay awards. The bill adds unrestricted revenues used for capital outlay expenditures into the local-state match calculation, effectively reducing the proportion of state aid for capital projects at LEAs that use unrestricted revenue for capital outlay. The bill would count unrestricted revenue (e.g. SEG, Impact Aid, half mill, federal forest reserve, etc.) as part of a school district's total capacity to finance projects, increasing the local district's proportion of funding for the costs of construction.

Increasing the local share within the formula would reduce state participation for each project, potentially allowing the Public School Capital Outlay Council (PSCOC) to increase the number of capital outlay awards made to other schools. While it is highly unlikely all LEAs would use all of the additional unrestricted revenue from eliminated credits for capital outlay expenditures, this analysis includes the full range of potential cost savings to the public school capital outlay fund if all unrestricted revenue from eliminated credits was used for capital outlay expenditures.

SIGNIFICANT ISSUES

Provisions of this bill would provide additional unrestricted operational revenue for LEAs equal to the amount of credits in the public school funding formula. This analysis assumes $83 million is appropriated within the General Appropriation Act to completely offset distributional impacts and all LEAs receive additional SEG distributions for the aforementioned purposes. Notably, nearly 60 percent of the potential appropriation would be allocated to the Gallup, Central, and Zuni school districts due to the significant amount of Impact Aid payments budgeted by these districts.

Elimination of credits in the funding formula would substantially increase operational revenue for LEAs with significant local and federal revenue sources (see Attachment 1). Gallup-McKinley School District, the LEA with the most formula credits, would receive an additional $22 million from eliminated credits, a 26 percent increase in SEG payments. In contrast, the LEA with the fewest formula credits, Pecos Independent Schools, would receive an additional $12.8 thousand, a 0.2 percent increase in SEG payments.

According to PSFA, the bill has the potential to destabilize the SEG distribution of funds to school districts and charter schools. Based on the formula, every school district and state-chartered charter school is guaranteed to receive the program cost calculated by the funding formula, regardless of how much the school district or state-chartered charter school is able to raise in local taxes or other funding sources, including Impact aid. Consequently, the state only reduces a school district's and state-chartered charter school's SEG distribution by 75 percent of federal Impact Aid, forest reserve, and local half mill levy receipts. As a result, these school districts and state-chartered charter schools actually receive more than their guaranteed program cost in the form of the additional 25 percent of federal Impact aid, forest reserve, and local half mill levy receipts.

PSFA notes the bill changes the public school capital outlay phase two formula. Currently, the phase two formula value for each school district begins with three calculations:

1. The sum of the final prior five years net taxable value for a school district multiplied by nine ten-thousandths;
2. The maximum allowable gross square foot per student multiplied by the replacement cost per square foot, divided by 45; and
3. The result of calculation 1 divided by the result of calculation 2.

The proposed change involves including an additional revenue value in the phase two formula. The value of calculation 1 (above) would be added to a value equal to any unrestricted revenue used to make capital outlay expenditures and the amount of any interfund transfers from an unrestricted fund into a fund restricted to capital outlay expenditures as certified by PED, averaged over the 10 prior years. The value from these unrestricted revenues will be added to the taxable land value for each district, generating a sum total local revenue capacity for capital projects.

The combined sum of values from unrestricted revenues and taxable land valuations represents a school district's total capacity for funding their own capital expenditures and capital projects. If a district has more taxable land valuation and/or access to unrestricted revenues that are used for capital projects, the district is potentially more able to expend local funds on capital projects, so these districts will receive less state funding, as calculated by the phase two state and local match funding formula. Including unrestricted revenues in the calculation to determine a district's state match percentage may encourage districts to use these unrestricted revenues for operational purposes, to improve educational outcomes, before expending these unrestricted revenues on capital projects. If a district regularly uses large amounts of unrestricted revenues for capital projects over a 10 year period, the district will have a lower state match percentage for capital projects. If a district uses small amounts of unrestricted revenues for capital projects less frequently (for example, once within a 10 year period) the reduction in the district's state match percentage will be less, as illustrated in the following tables:

District	Revenue	Additional Unrestricted Funds to Capital Outlay	Total Funds Available for Capital	Annualized Amortization	Percent of Amort. Covered by Revenue (District Share)	Increase to Revenue	New District Share After Including Unrestricted Funds	Change in District Share	Percentage Increase in District Share
Gallup	$ 3,780,023	$ 151,200	$ 3,931,224	$ 11,116,701	34.00%	4.0%	35.36%	1.360%	4.0%
Grady	$ 43,935	$ 1,757	$ 45,692	$ 242,027	18.15%	4.0%	18.88%	0.726%	4.0%
Los Alamos	$ 3,279,059	$ 131,162	$ 3,410,221	$ 3,498,462	93.73%	4.0%	97.48%	3.749%	4.0%
Moriarty	$ 2,508,087	$ 100,323	$ 2,608,411	$ 3,515,209	71.35%	4.0%	74.20%	2.854%	4.0%
Pecos	$ 609,053	$ 24,362	$ 633,415	$ 676,796	89.99%	4.0%	93.59%	3.600%	4.0%
Rio Rancho	$ 10,092,430	$ 403,697	$ 10,496,127	$ 12,291,974	82.11%	4.0%	85.39%	3.284%	4.0%

District	Revenue	Additional Unrestricted Funds to Capital Outlay	Total funds Available for Capital	Annualized Amortization	Percent of Amort. Covered by Revenue (District Share)	Increase to Revenue	New District share after including Unrestricted Funds	Change in District Share	Percentage Increase in District Share
Gallup	$ 3,780,023	$ 945,005	$ 4,725,029	$ 11,116,701	34.00%	25.0%	42.50%	8.501%	25.0%
Grady	$ 43,935	$ 10,983	$ 54,919	$ 242,027	18.15%	25.0%	22.69%	4.538%	25.0%
Los Alamos	$ 3,279,059	$ 819,764	$ 4,098,824	$ 3,498,462	93.73%	25.0%	117.16%	23.432%	25.0%
Moriarty	$ 2,508,087	$ 627,021	$ 3,135,109	$ 3,515,209	71.35%	25.0%	89.19%	17.837%	25.0%

Pecos	$ 609,053	$ 152,263	$ 761,316	$ 676,796	89.99%	25.0%	112.49%	22.498%	25.0%
Rio Rancho	$ 10,092,430	$ 2,523,107	$ 12,615,538	$ 12,291,974	82.11%	25.0%	102.63%	20.526%	25.0%

Source: PSFA

PERFORMANCE IMPLICATIONS

Provisions of this bill would increase funding for school districts with significant numbers 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) or high taxable property values. Given the 1st Judicial District Court's findings in the *Martinez* and *Yazzie* education sufficiency lawsuit, which found significant achievement gaps for Native American students, this bill would indirectly provide more SEG funding to districts educating this specific student demographic.

A 2021 LFC evaluation on implementation of the Indian Education Act found Native American students continue to perform below their peers on state and national measures of achievement, despite recent improvements in their high school graduation rates, college attendance, and native language fluency. The evaluation noted a history of understaffing in PED's Indian Education Division, difficulties with utilizing Indian education funds, challenges with local collaboration at the district level, and problems with ensuring funds were aligned to specific, targeted outcomes. Provisions of this bill increase revenue for LEAs, rather than the state, to implement programs for Native American students. Substantial local funds could improve implementation of the Indian Education Act, given the state's limited capacity to drive improvements through smaller, statewide grants.

ADMINISTRATIVE IMPLICATIONS

Provisions of this bill would require LEAs to report how local and federal revenue is used to improve outcomes for students through their annual educational plan to PED. LEAs must include a comprehensive evaluation of how programs and services improved outcomes and demonstrate evidence of consultation with tribal entities if the LEA received federal Impact Aid revenue by October 1 of each year. Impact Aid LEAs must submit this report on spending and outcomes to the appropriate tribal authorities. Additionally, PED must compile this federal and local revenue outcomes report to the LESC and LFC by November 15 of each year.

The SFC amendment to Senate Bill 41 removes enrollment growth units from the first reporting date calculation for purposes of computing save harmless units, which are units generated to protect very small districts from a precipitous decline in revenue. In FY21, PED promulgated new rules changing the save harmless calculation to include membership, small school, and enrollment growth program units. These changes increased the number of save harmless program units generated by the formula for school districts and charter schools with less than 200 students, diluting the FY21 unit value.

RELATIONSHIP

This bill relates to House Bill 6, which eliminates the Impact Aid credit in the funding formula; House Bill 52, which establishes a bilingual multicultural education advisory council; House Bill 84, which creates a native language education program factor in the funding formula; House Bill 86, which appropriates funding to tribal libraries and broadband projects; House Bill 87, which

which appropriates funding to Native American programs at higher education institutions; House Bill 135, which includes a Native American demographic factor in the at-risk index of the funding formula; and Senate Bill 131, which changes the capital improvements (SB-9) state funding calculation using discretionary program units.

This bill relates to the state equalization guarantee distribution appropriation in the General Appropriation Act of 2021. However, the FY22 LFC budget recommendation for public school support holds $83 million contingent on enactment of a bill in the first session of the fifty-fifth legislature amending the Public School Finance Act to remove local and federal revenue credits from the public school funding formula and allocate an amount equal to the removed revenue credits for public school capital outlay, capital improvements, information technology and programs necessary to meet requirements of the Indian Education Act and Community Schools Act. Although the LFC appropriation recommendation covers the fiscal impact of this bill, the contingency language conflicts with provisions of this bill.

OTHER SUBSTANTIVE ISSUES

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. LEAs receive Impact Aid funds directly from the federal government through an application process, so states do not receive nor process these funds.

The federal government authorizes a state to "credit," or supplant, a portion of state aid to LEAs that receive 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 (USDE) 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.

Public School Capital Outlay. 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, and ordered the state to establish and implement a uniform funding system for capital improvements and for correcting past inequities. Since the *Zuni* lawsuit, the state has spent $2.7 billion to build school facilities up to the approved statewide adequacy standards. Despite significant improvements in statewide facility conditions, the *Zuni* lawsuit was never closed and, in December 2020, the court ruled in favor of plaintiff school districts 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.

PSFA notes the court order granted injunctive relief to the plaintiffs and enjoined the defendants "to create and implement a statutory scheme funding capital outlay for public schools with the mandates of Article XII, Section 1 of the New Mexico Constitution in such a way that does not create substantial disparities in capital funding among the school districts in New Mexico." However, the bill does not necessarily make more funding available to litigant districts in the *Zuni* lawsuit because Impact Aid includes expenditures for operational purposes and the "local" revenues that will go directly to the school districts are not earmarked for any specific purpose in this bill.

School districts that receive federal Impact Aid funds have argued these funds are essentially payments to replace lost property tax revenue because of federal activity. However, 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. Overall, plaintiff school districts' facility conditions (as measured by PSFA's facilities condition index) are comparable or better than the statewide average.

The state modified its method of funding public school capital outlay projects in FY19, earmarked $34 million for Impact Aid districts to build teacher housing and facilities outside of the adequacy standards in FY20, and appropriated $18.9 million to Impact Aid districts for maintenance and infrastructure in FY21. Between FY19 and FY21, PSCOC awarded over half of all standards-based construction awards, or $262.4 million, to Impact Aid districts.

USDE Determination. In FY20, the Gallup, Central, and Zuni school districts requested a USDE predetermination hearing to evaluate PED's request to credit federal Impact Aid payments in the FY20 funding formula. The plaintiff districts argued that specific revenue sources, like SB-9 capital improvement funds and transportation distributions, should be considered operational revenue within New Mexico's disparity test calculations. USDE sided with the plaintiff districts' methodology, which caused New Mexico to fail the FY20 disparity test. As a result, USDE determined the state could not credit Impact Aid payments in FY20.

PED appealed and then withdrew its appeal of USDE's FY20 determination. However, the department submitted a revised disparity test calculation for FY21, which incorporated the new revenue sources requested by plaintiff districts and a new methodology for crediting Impact Aid payments by LEA. The Gallup, Grants, and Zuni school districts filed an injunction to prohibit PED from providing inaccurate information to USDE for the FY21 determination; however, this motion was overturned by the 1st Judicial District Court.

During the 2020 first special legislative session, the Legislature appropriated $31 million to partially offset the potential loss of the $67 million Impact Aid credit within the FY21 funding formula. The recurring appropriation anticipated USDE's ruling would prohibit the state from crediting Impact Aid in future years. PED has continued to credit Impact Aid payments in accordance with state law pending a final determination on the state's ability to do so for FY20 and FY21.

Martinez-Yazzie Lawsuit. 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 learner, Native American, and special education students. The court's findings suggested overall public school funding levels, financing methods, and 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.

In FY21, the New Mexico Center on Law and Poverty, representing the *Yazzie* plaintiffs in the *Martinez-Yazzie* lawsuit, filed a new motion requesting further relief in the lawsuit for essential technology to at-risk students. The motion noted the state failed to provide students (particularly Native American students and students in rural districts) with reliable access to digital devices, high-speed Internet, and funding for district technical support and requested the court order the state to provide immediate funding for these purposes. In response, PED noted the state spent nearly $46 million from federal CARES Act funds to close the digital divide, and the department is working with providers of satellite Internet to support connectivity in rural areas.

ALTERNATIVES

During the 2019 interim, LFC and LESC staff held regional stakeholder engagement sessions to discuss ways to address concerns brought by Impact Aid districts. Some suggestions included:

- Amending the Public School Capital Improvements Act (commonly known as SB-9) to shift more state funding to low property wealth districts,
- Increasing the SB-9 state program guarantee, allowing PED to advance SEG payments to cover delayed federal Impact Aid payments,
- Creating a new PSCOC program to retroactively update schools that received an early standards-based award (given the evolution of adequacy standards since 2003),
- Reprioritizing existing PSCOC programs to support facilities needed by Impact Aid schools,
- Increasing emergency support for schools with declining enrollment or property valuation (Central Consolidated Schools anticipates significant revenue loss from the closure of the San Juan Generating Station),
- Centralizing all capital outlay project funding and oversight through the state,
- Restricting expenditures to specified revenue sources, and
- Changing the public school funding formula, including increased funding for at-risk students and reducing SEG credits.

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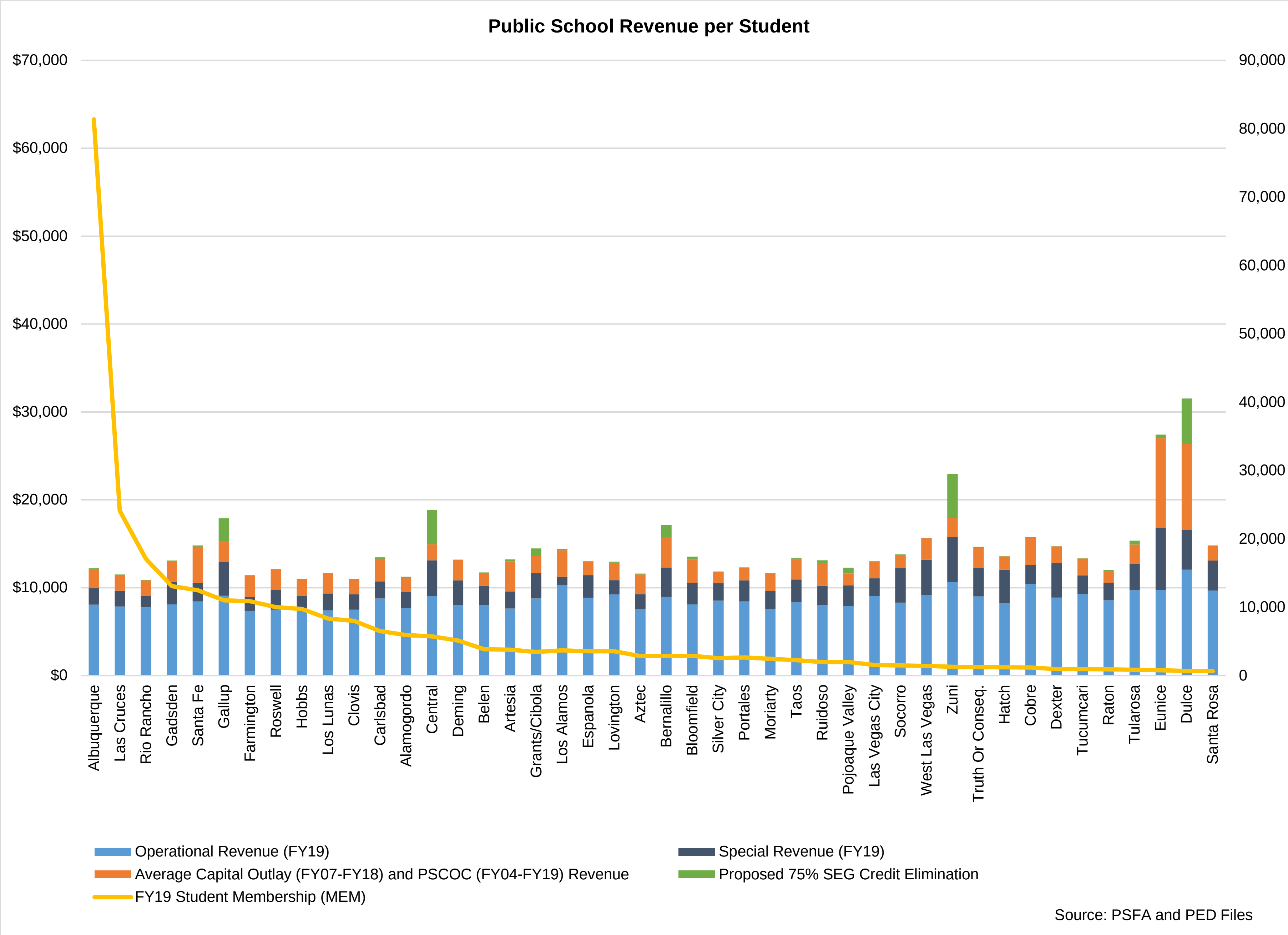
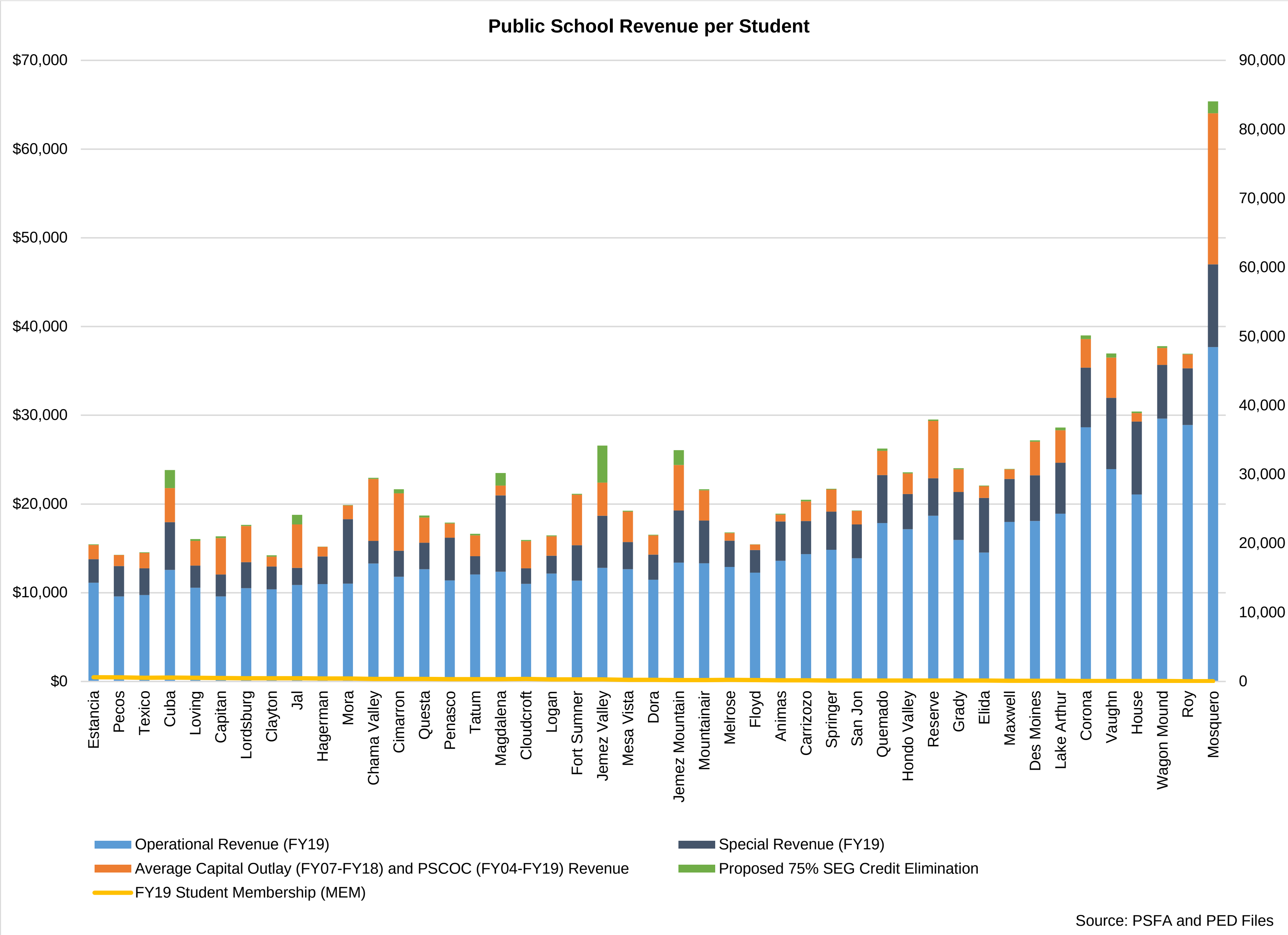


Public School Revenue per Student
$70,000
$60,000
$50,000
$40,000
$30,000
$20,000
$10,000
$0
90,000
80,000
70,000
60,000
50,000
40,000
30,000
20,000
10,000
0
Albuquerque
Las Cruces
Rio Rancho
Gadsden
Santa Fe
Gallup
Farmington
Roswell
Hobbs
Los Lunas
Clovis
Carlsbad
Alamogordo
Central
Deming
Belen
Artesia
Grants/Cibola
Los Alamos
Espanola
Lovington
Aztec
Bernalillo
Bloomfield
Silver City
Portales
Moriarty
Taos
Ruidoso
Pojoaque Valley
Las Vegas City
Socorro
West Las Vegas
Zuni
Truth Or Conseq.
Hatch
Cobre
Dexter
Tucumcari
Raton
Tularosa
Eunice
Dulce
Santa Rosa
Operational Revenue (FY19)
Special Revenue (FY19)
Average Capital Outlay (FY07-FY18) and PSCOC (FY04-FY19) Revenue
Proposed 75% SEG Credit Elimination
FY19 Student Membership (MEM)
Source: PSFA and PED Files


Public School Revenue per Student
$70,000
$60,000
$50,000
$40,000
$30,000
$20,000
$10,000
$0
90,000
80,000
70,000
60,000
50,000
40,000
30,000
20,000
10,000
0
Estancia
Pecos
Texico
Cuba
Loving
Capitan
Lordsburg
Clayton
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Hagerman
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Chama Valley
Cimarron
Questa
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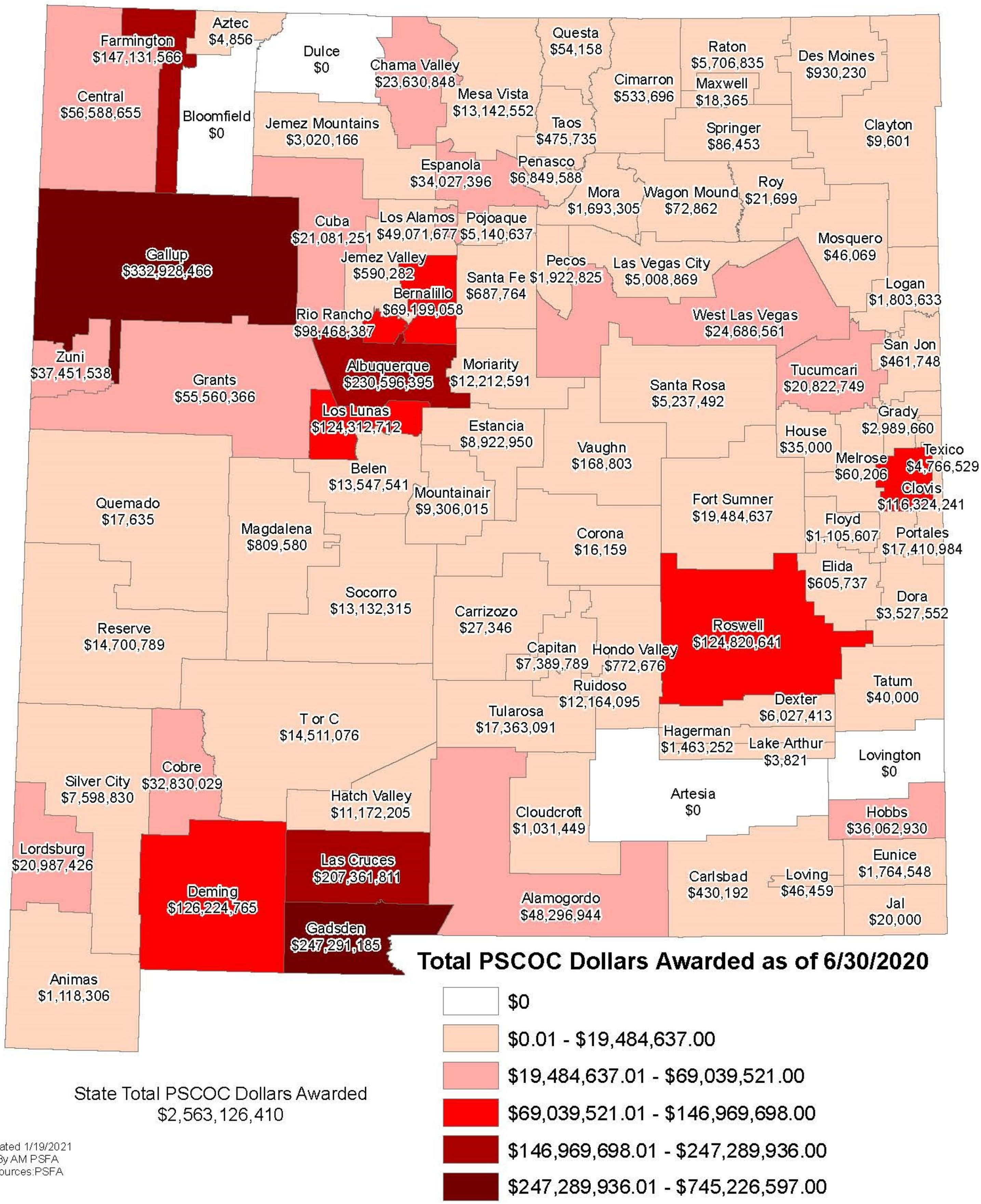
Tatum
Magdalena
Cloudcroft
Logan
Fort Sumner
Jemez Valley
Mesa Vista
Dora
Jemez Mountain
Mountainair
Melrose
Floyd
Animas
Carrizozo
Springer
San Jon
Quemado
Hondo Valley
Reserve
Grady
Elida
Maxwell
Des Moines
Lake Arthur
Corona
Vaughn
House
Wagon Mound
Roy
Mosquero
Operational Revenue (FY19)
Special Revenue (FY19)
Average Capital Outlay (FY07-FY18) and PSCOC (FY04-FY19) Revenue
Proposed 75% SEG Credit Elimination
FY19 Student Membership (MEM)
Source: PSFA and PED Files

Total PSCOC Dollars Awarded



State Total PSCOC Dollars Awarded
$2,563,126,410

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By AM PSFA
Sources:PSFA