LESC HEARING BRIEF: STATE-LEVEL SPECIAL EDUCATON MAINTENANCE OF EFFORT

AGENCY: Public Education Department

DATE: June 17, 2016

PURPOSE OF HEARING: Update on federal special education maintenance of effort issues

WITNESS: Rachel Gudgel, Director, LESC; Hipolito "Paul" Aguilar, Deputy Secretary, Finance and Operations, Public Education Department

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EXPECTED OUTCOME: Understanding of potential shortfalls for previous fiscal years, past appropriations made to meet MOE, actions of the 2016 legislative session, and potential settlement terms.

In 2012, the U.S. Department of Education (USDE) notified the Public Education Department (PED) that the state failed to meet the maintenance of effort (MOE) provision pursuant to Part B of the federal Individuals with Disabilities Education Act (IDEA-B) in FY10 and FY11 and was facing potential reductions to federal IDEA-B funding as a result. The MOE requirement of IDEA-B – 34 CFR §300.163(a) – states "a state must not reduce the amount of state financial support for special education and related services for children with disabilities, or otherwise made available because of the excess costs of educating those children, below the amount of that support for the preceding fiscal year." This provision requires states to maintain state level financial support of special education as a condition of continued receipt of federal IDEA-B funds and intends to ensure that states do not supplant state revenues appropriated for special education students with federal IDEA-B dollars or funding from other than state sources. However, provisions of IDEA-B allow the U.S. Secretary of Education to grant a waiver to a state that does not meet annual MOE requirements based on (1) a showing of precipitous declines in financial resources and exceptional and uncontrollable financial circumstances, or (2) clear and convincing evidence that all children with disabilities have available to them a free appropriate public education (FAPE), notwithstanding the state's failure to maintain fiscal effort.

New Mexico Shortfalls. In 2013, USDE alleged New Mexico shortfalls for FY10 of $48.1 million and FY11 of $34.1 million and estimated an FY12 shortfall of $26.9 million. PED submitted waiver requests for FY10 and FY11 alleging precipitous declines in financial resources during those years; the Legislative Finance Committee sent USDE supporting briefs outlining the revenue outlook during those years and noting that the state protected public education spending and decreases to public education appropriations were less than decreases to other sectors.

Fiscal Year 2010 Waiver Request. USDE granted the state's request for a waiver in FY10 noting it was equitable, due to exceptional or uncontrollable circumstances, to permit New Mexico to reduce the amount of state financial support for special education and related services, or otherwise made available because of the excess cost of educating those children, by $48.1 million. USDE determined that New Mexico experienced a precipitous and unforeseen decline in state financial resources in FY10, as general fund revenues decreased 9.8 percent when compared to FY09. USDE's analysis notes that, although the state ended the fiscal year with 5.2 percent in reserves, only 2.5 percent was projected in January 2010 and declining revenues made it difficult to accurately predict the amount of reserves that would be available at the end of the year. After noting the state did in fact experience an exceptional or uncontrollable circumstance, USDE noted New Mexico treated special education equitably when compared to other state programs. The percentage decrease in state financial support for special education and related services was 10.4 percent compared with an 11.2 percent reduction for other recurring appropriations.

Fiscal Year 2011 Waiver Request. USDE determined that it is not equitable to grant a waiver permitting New Mexico to reduce the amount of state

Consequences for Failing to Meet MOE Requirements

If a state fails to maintain the required level of financial support for special education and related services, under 34 CFR §300.163(b), the Secretary of Education reduces the allocation of federal IDEA-B funds for any fiscal year following the fiscal year in which the state fails to comply with the requirement of 34 CFR §300.163(a) by the same amount by which the state fails to meet the requirement. This provision makes any reduction valid for all future years; however, Congress has included language in continuing budget resolutions that make any reduction valid for only a single fiscal year.

MOE APPROPRIATIONS AND DISTRIBUTIONS
FY13 THROUGH FY15

	FY13[1]	FY14	FY15
Sources[2]			
Operating Reserve	$20.0	$16.0	$0.0
General Fund	$15.4	$10.0	$3.0
Other State Funds	$4.6		$0.0
Total	$40.0	$26.0	$3.0
Uses			
Distributed	$16.9	$0.0	$0.0
Total Remaining	**$23.1**	**$26.0**	**$3.0**

Source: DFA, PED, and LESC Files

[1] In FY13, $4.6 million of other state funds and $12.3 million of the $15.4 million general fund appropriations were distributed to school districts and charter schools.

[2] Appropriations made from the operating reserve were made by Laws 2013, Chapter 191 (House Bill 628); all other appropriations were made in the General Appropriation Acts of 2013 and 2014.

financial support for special education and related services in FY11. USDE determined New Mexico did not experience an exceptional or uncontrollable circumstance, such as a precipitous and unforeseen decline in state resources, in FY11. The analysis noted general fund revenues increased 1.7 percent when compared to FY09 and 12.7 percent when compared with FY10, recurring revenues exceeded recurring appropriations by $195.2 million, and reserves of $500.8 million accumulated in FY11. This, USDE noted, constituted sufficient funds that could have been made available for special education and related services.

Other Fiscal Years. In its 2013 letter, USDE notes the state failed to meet MOE requirements in FY12 by approximately $26.4 million and may have failed to meet MOE requirements in FY13. USDE noted it would be reasonable to provide PED time to review the 2013 letter and determine whether New Mexico intended to seek a waiver for FY12 and take all steps necessary to ensure MOE requirements were met in FY13 and FY14.

Appropriations Made to Meet MOE. Since learning of the MOE shortfall during the 2013 legislative session, the Legislature made multiple unique appropriations to meet MOE requirements in FY13, FY14, and FY15 in Sections 4, 5, and 6 of the General Appropriation Acts of 2013 and 2014 outside of the state equalization guarantee (SEG) distribution appropriation. Additionally, during the 2013 legislative session, $36 million in operating reserve was appropriated to the PED in Laws 2013, Chapter 191 (House Bill 628) to ensure MOE was met in FY13 and FY14, contingent on final negotiation and settlement with USDE.

Of the special appropriations made to PED, only $16.9 million of appropriations made for FY13 were distributed to school districts and charter schools. The remaining balances appropriated in FY13 and FY14 were booked as "contingent liabilities," but were never distributed because of disputes in the calculation methodology PED asserted; PED was concerned that they would distribute more than was needed to meet MOE thereby increasing the MOE requirement for future years. The FY15 appropriation of $3 million was not encumbered or distributed, resulting in a $3 million reversion to the general fund at the end of FY15.

Laws 2016, Chapter 12 (House Bill 311) de-earmarked the $36 million operating reserve appropriations to PED made in Laws 2013, Chapter 191. The funding transferred by House Bill 311 was classified as a restricted amount in the general fund operating reserve; House Bill 311 removed this restriction.

As a result of these actions, $13.1 million of the general fund appropriations made in row 4 of the above chart remains encumbered as a contingent liability but may only be allocated for the purposes for which they were appropriated; without further legislative action, these funds may not be used to meet any settlement PED and USDE reach.

MOE Settlement Negotiations. On February 10, 2016, PED staff notified legislators and legislative staff that the department reached a settlement with USDE on previous years' shortfalls. However, to date, an agreement has not been formally reached and it is unclear if the provisions of the negotiated

A "contingent liability" is a strategy that allowed PED to keep the funds at the end of each fiscal year, rather than them reverting, and continue pursuing its waiver on FY11 prior to distributing any funds to school districts or charter schools. The department was concerned that they had asserted a different calculation methodology than USDE was using and if they made available more funds than were necessary to meet MOE, the MOE target would be increased.

Calculation of expenditures made by the New Mexico School for the Deaf and the New Mexico School for the Blind and Visually Impaired for the purpose of calculating "state financial support" include capital outlay appropriations and grants made by the Public School Capital Outlay Council. These appropriations entirely support students classified as special education. These appropriations are one-time appropriations and, when fully expended, may significantly reduce the amount of "state financial support" calculated for other state agencies, potentially having a negative impact on MOE in future years.

settlement framework proposed by PED remain unchanged. PED has since referred to the settlement as a "settlement in principle."

Calculation of MOE Requirements. According to PED, the department and USDE settled on a methodology to calculate MOE that resulted in $85 million in total shortfalls for FY11 through FY15. The calculation of New Mexico's state financial support has been the subject of much debate since early negotiations with USDE, and in a 2013 letter, USDE notes PED submitted different sets of data and claims in support of, and in some cases, inconsistent with its original waiver requests.

According to PED, USDE agreed to PED's calculation methodology, which includes funding allocated through program units generated by A/B, C, and D level special education students, 3- and 4-year-old developmentally disabled special education students (excluding basic membership units), and ancillary staff. However, PED indicated USDE will not allow the state to take credit for retirement swaps in FY11 and FY12 or take credit for reduced workload (fewer special education units being generated year over year because of things like reduced ancillary FTE and reclassifying special education students at lower levels of special education pursuant to their individualized education programs (IEPs)).

Shortfalls After Adjustments for Workload and Retirement Swap

	FY11	FY12	FY13	FY14
Shortfall[1]	$35.2	$29.4	$8.4	$12.7
Workload	($5.7)	($2.8)	($12.8)	($2.6)
Retirement Swap	($4.2)	($8.7)	($4.2)	$0.0
Adjusted Shortfall	$25.3	$17.8	($8.6)	$10.1

Source: PED and LESC Files

[1]The FY13 shortfall includes $16.9 million in special appropriations distributed to school districts and charter schools.

The calculation methodology only includes amounts of unique appropriations made to meet MOE that were actually distributed to school districts and charter schools between FY11 and FY15. This means $16.9 million of more than $69 million appropriated is included as "made available" during these years. The remaining $52.1 million of revenue that has not been distributed is not being considered as "made available."

The reference to "state financial support" also encompasses the financial support of all state agencies that provide or pay for special education and related services, as those terms are defined under IDEA, to children with disabilities and a state must include in its calculation of financial support under 34 CFR §300.163(a) any financial support for special education and related services provided by any state agency. In addition to state financial support made available through the public education funding formula, expenditures for special education students made by the Children, Youth and Families Department, Corrections Department, Division of Vocational Rehabilitation, New Mexico School for the Deaf, and New Mexico School for the Blind and Visually Impaired are also included in New Mexico's "state financial support" calculation.

Settlement Framework. PED indicated the department agreed to increase the base MOE amount by $3 million a year over the next five years, resulting in an MOE target five years from now that is $15 million higher. Additionally, the department agreed to bind the state to appropriate an additional $9 million a year for five years beginning in FY17 (totaling $45 million) for proven special education programs. PED indicated the annual $9 million appropriation would not be distributed to school districts and charter schools based on their proportion of formula funding, but would rather be distributed in a manner similar to related recurring "below-the-line" initiatives. Lastly, if the base appropriation each year is insufficient to increase the MOE requirement by $3 million, up to $3 million of the $9 million appropriation may be used to ensure the $3 million growth required in base spending. This means that amount used to ensure the base grows would be allocated to school districts and charter schools through the formula. Under this plan, the state will be required to appropriate a total of $75 million over the next five years. In year six and subsequent years, the plan will require expenditure of at least $15 million more than today to ensure the base growth is sustained.

Outstanding Issues. It is unclear what the status of the settlement agreement is to date. PED has not yet provided legislative staff with a draft or signed settlement agreement or any written confirmation of the settlement agreement.

The agreement appears to commit the Legislature to spend a minimum of $75 million over the next five years to ensure $85 million in federal IDEA-B funds are distributed to the state; however, the agreement also appears to commit the state to spend at least $15 million more in year six and subsequent years, raising questions about the merits of the deal.

It is also unclear if the department could make a successful waiver request pursuant to the FAPE provision; to date, PED has been unwilling to advance an argument pursuant to the FAPE provisions, noting USDE has indicated the state would likely be unable to meet the burden of proof. However, in its June 3, 2013 letter to the state, USDE references the FAPE waiver and notes PED did not seek a waiver pursuant to the FAPE provision.

It is also possible funds appropriated through the SEG will be insufficient to meet MOE in FY17, though the Legislature can still address FY17 during the 2017 legislative session. Given PED's estimate that an additional $20 million to $22 million increase in program cost was needed to ensure MOE was met in FY17, recent reduction of ancillary FTE units for FY17, and a conservative estimate by PED of 75 percent credits for FY17 ($51 million versus the Legislature's estimate of $64 million), the Legislature may need to address shortfalls for FY17 during the 2017 legislative session.