

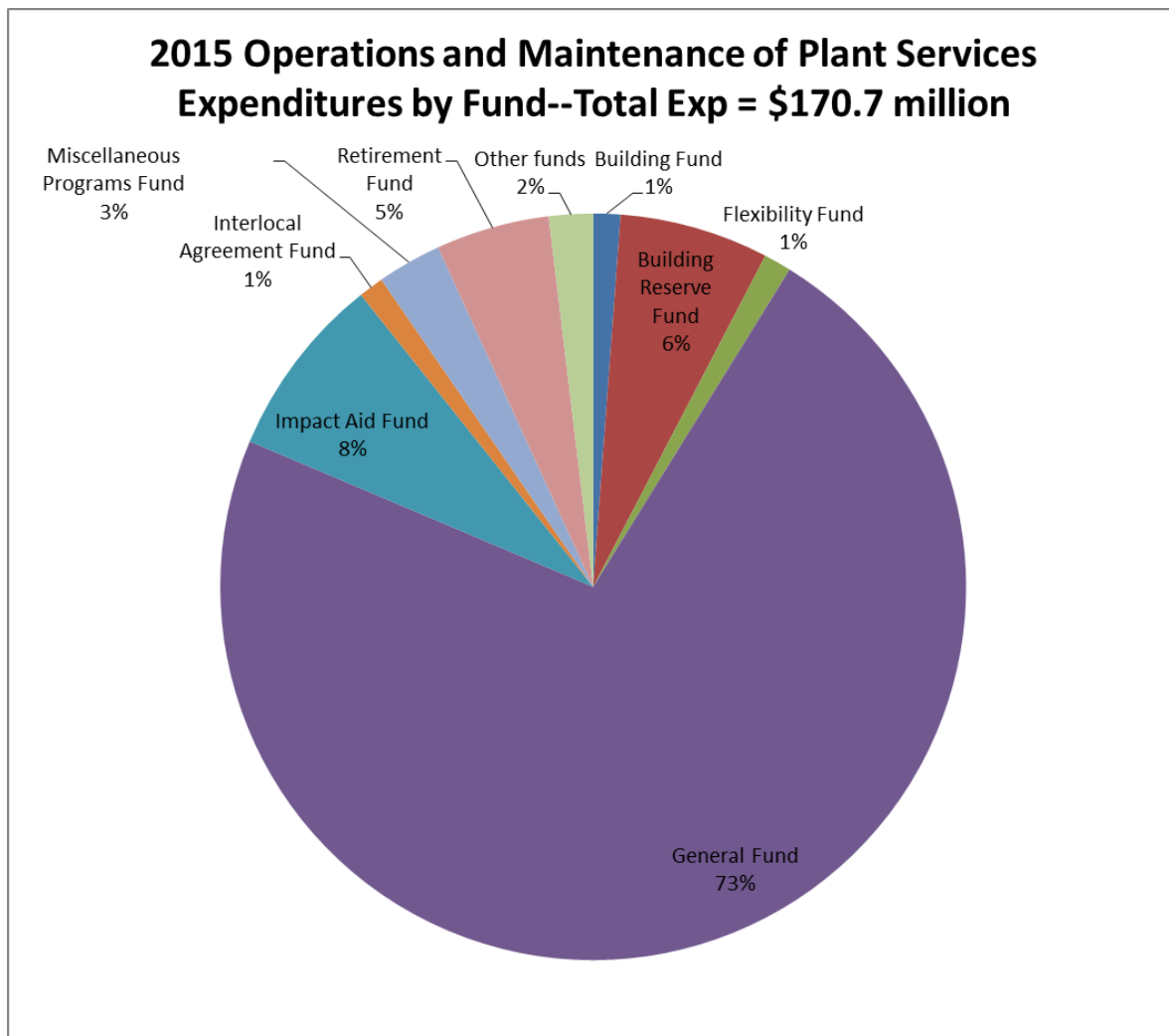
Options for School Facility Funding

prepared for the School Funding Interim Commission
by Pad McCracken, Research Analyst, March 2016

One of the priority issues identified by the commission is funding for school facilities. Chairman Facey directed staff to identify options for the commission to consider at its April meeting. This working paper provides an overview of several possibilities; it should not be viewed as a comprehensive list or examination, but more of a conversation starter.

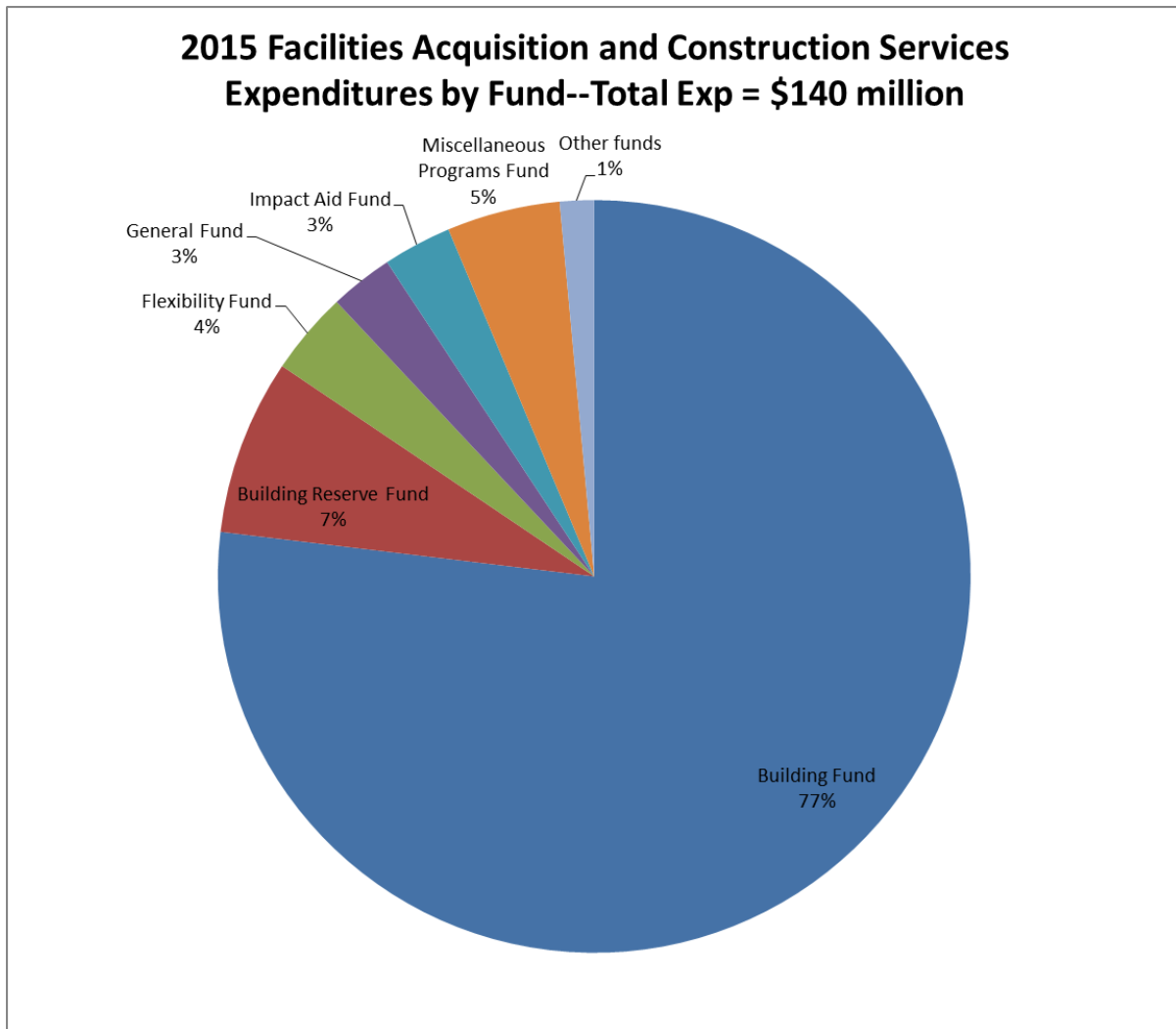
It might be helpful to consider which aspects of school facilities issues the commission intends to address. One question is whether the commission is looking for a mechanism to address ongoing maintenance needs and/or one to address major construction costs, or a mechanism with the flexibility allowing districts to address both. The charts below show the district fund sources for two facilities-related expenditure categories for FY 2015. For context, total district expenditures out of all funds statewide were \$1.9 billion.¹ Options follow the charts. Relevant portions of the Montana Constitution and statute are included at the end of this report for reference.

Figure 1



¹ Data from OPIEXP15.

Figure 2



Maintain Status Quo

Currently Montana has two state programs that provide assistance specifically in support of school facilities. The commission has already received information on these programs, but a quick review may be helpful.

1. School Facility Reimbursements (aka Debt Service GTB) provide state support to qualifying districts for repaying bonds. A complicated formula provides limited, graduated support based on a district's property tax wealth—wealthier districts receive less (or no) support, poorer districts receive more. The 2015 Legislature appropriated \$8.6 million for each year of the 2017 biennium for this program, though not all of that funding may be available (see below).
2. The Quality Schools Facility Grant Program is administered by the Department of Commerce and provides grants to school districts for specific projects. The department solicits grant applications, ranks them according to statutory criteria, and submits this list to the Governor's Office for inclusion in the executive budget. Finally, the Legislature determines which projects to fund and at what level. The 2015 Legislature did not appropriate funding for grants during the 2017 biennium, but the statutory program continues and is soliciting new grant applications.

There are several considerations regarding these two programs. The most fundamental is that they have not provided reliable support to districts. The grant program is competitive and even districts that have their projects included in the executive budget may not receive funding. The reimbursement program is prorated if the appropriation or available revenue is insufficient. Most significantly though, both programs are funded out of the same state special revenue account, the school facility and technology account, and timber and riverbed revenues feeding this account are not sufficient to fund both programs, in fact the revenue available for 2016 and 2017 reimbursements is forecast to be less than the \$8.6 million appropriated for each year and reimbursements will be prorated down. The commission has received testimony questioning whether a competitive grant program is fair to smaller districts as well as concerns that the reimbursement program provides no support for poor districts that cannot pass bonds. The reimbursement program does however provide wealth-equalized support to those districts that do pass bonds.

QSIC proposal

The facility funding issue was certainly part of the Quality Schools Interim Committee’s (QSIC) discussions in 2005. As part of a robust overhaul of Montana’s school funding formula, QSIC proposed adding a new district general fund component related to facilities. The Building Operations and Maintenance Component was intended to support the operational costs of the district’s physical plant. Districts would have received a lump sum and then a per-student amount as described in the table below. The amounts were derived from actual expenditures, square footage per student recommendations, and maintenance cost per square foot estimates.

| District type | Lump | Sq. feet per student | Amount per sq. foot |
|---------------|----------|----------------------|---------------------|
| EL | \$5,800 | 137 | \$4.50 |
| HS | \$51,000 | 178 | \$4.50 |

So an EL district with 100 students would be entitled to $\$5,800 + (100 \times 137 \times \$4.50) = \$67,450$. With roughly 100,000 EL students and 45,000 HS in 400 districts, this component had a total cost of about \$100 million annually.²

Another additional component outside the general fund called the Capital Projects Component was intended to support major capital outlay such as land acquisition and building construction. QSIC recommended that a Facilities Condition Inventory be conducted and that a future legislature determine an amount and distribution formula for this component. For the impending biennium, QSIC’s formula would have distributed \$23 million for weatherization and deferred maintenance, with each district receiving \$1,000 plus \$160 per ANB.

The QSIC proposal also maintained the facility reimbursement program for debt service. While QSIC’s proposed overhaul was not included in QSIC’s final recommendation to the December 2005 Special Session, the school funding bill that emerged from that session (SB 1) did include \$2.5 million for a Facilities Condition Inventory and \$23 million distributed roughly as QSIC recommended.

² It is imperative to reiterate that the QSIC proposal was a major overhaul of Montana school funding. For example the basic entitlement was eliminated and a classroom component was created. BASE budget levels were taken to 100% of entitlement amounts with direct state aid remaining at 44.7% and the GTB area expanding to 55.3%. These and numerous other changes require a large caveat when trying to discuss any component in isolation or make comparisons to our current formula.

Formula distribution

The state could create a formula-driven support payment for districts to use for facilities. In essence, both of QSIC's new components were formula driven, as is the current facility reimbursement, though it does not automatically flow to every district.

Incorporating a formula component into the existing district general fund formula could be done so that a wealth-equalized local match is required, just as it is for the basic and per-ANB entitlements and the special education payment. The state could also direct these formula funds to the district's miscellaneous programs fund and restrict (or prioritize) them for specific maintenance or facilities needs as was done with the distributions in 2007 and 2008.

Alternatively, districts could be given the flexibility to allocate state distributions between several different funds reflecting that district's needs and priorities, for example:

- Allocations to the building reserve fund could be budgeted to be spent on maintenance needs or saved and accumulated (along with locally voted building reserve levy proceeds) over a period of years for larger projects.
- Allocations to the debt service fund could be used to reduce local taxes for bond debt service.
- Allocations to the building fund could be used to supplement bond proceeds for major construction projects.

A formula distribution might attempt to calculate physical plant costs, like QSIC's operations component did, or it might involve the Legislature determining an amount of statewide support adequate for the "state's share" and a means to distribute that share equitably. This brief will not enter into the policy debate over what that state share should be, but for the sake of simplicity and round numbers, the following distribution mechanisms will provide estimates for a \$10 million annual formula distribution:

- By district—each of Montana's 400 districts could receive an equal share of about \$25,000. This example provides the reminder that equal and equitable are different words with different meanings. It would be difficult to argue that this method of distribution is equitable when a district maintaining a one-classroom school building receives the same amount as a district with 15-20 large buildings.
- By student or ANB—districts could receive an equal share based on student population. With roughly 150,000 ANB, this would equate to about \$67 per ANB. Small schools may require less money to operate, but this distribution would not provide much support to Montana's numerous small districts.
- By quality educator—there are about 12,000 FTE quality educators (QE) in the state. Allocating by QE would mean \$833 per QE, not a lot for Montana's smallest districts with one or two QEs, but perhaps more than they would receive under a per-ANB distribution. If each QE FTE requires a classroom, this distribution could be seen as educationally relevant. Current statute already uses the QE distribution for excess interest and income revenue in the guarantee account for prioritized facility spending by districts (see 20-9-622(2), MCA).
- By square footage—maintenance costs are largely a matter of square footage, so allocating state support on this metric might best reflect costs, but it would mean defining

eligible square footage and requiring school districts to report changes annually. The 2008 inventory quantified the square footage directly related to education as 28.9 million of the total 31.4 million assessed. This would equate to districts receiving about \$0.35 per square foot based on a \$10 million total payment.

- By “school unit”—this could mean by school building or perhaps by an ANB-driven metric similar to the basic entitlement increments created in SB 175 (2013). For example, elementary districts could receive an additional “unit” payment for every 250 ANB. If this mechanism were prorated, it would really just be a per-ANB distribution, if not, it would have a “cliff effect” in which the loss or gain of one student could trigger the loss or gain of a “unit” payment.

A formula distribution could also be blended with the current facility reimbursement program to provide equalized support for lower-tax-wealth districts that pass bonds and/or the current quality schools facility grant program to provide support for planning and execution of projects meeting program criteria. It could also be paired with a permissive or required local levy to support facilities as discussed later.

Sinking fund model

A sinking fund is basically an account established to gather revenue over a period of time for funding future capital expenses or for repaying long-term debt. Montana’s current school funding system and district fund structure includes several funds that can be viewed as sinking funds.³

- The **debt service fund** is established when a district takes on debt through the issuance of bonds. Because these bonds need to be paid back over a period of years, the district needs a fund in which to deposit revenue (typically from a voter-approved debt service levy) to make these bond repayments.
- The **bus depreciation reserve fund** is established at the trustees’ discretion as a means of ensuring that the district has enough money to replace, remodel, or rebuild school buses. Districts can permissively levy up to 20% of the cost of the asset per year, not to exceed 150% of the cost over time.
- The **building reserve fund** is established as a repository for revenues from local voted levies (and several other discretionary allocations) and is used to accumulate money for future building costs.

Encouraging the use of sinking funds for facility needs might be accomplished through allowing districts to permissively levy for the building reserve fund, perhaps capped at a percentage of building costs or by a formula based on square footage. A formula-driven state match of these locally raised funds could also be used as an incentive.

One consideration with utilizing sinking funds for large capital projects is the impact on taxpayers over time. For example, if a district passed a bond to build a new \$15 million dollar school building with taxpayers repaying that bond over the next 20 years and at the same time utilized a sinking fund mechanism in their building reserve fund to replace that building by levying enough to replace the building in 20 years’ time, those taxpayers would in essence be

³ For greater detail on the debt service, bus depreciation reserve, and building reserve funds, refer to the School District Budgeted Funds chart prepared by Denise Williams of MASBO and presented to the commission in January 2016 – <http://leg.mt.gov/content/Committees/Interim/2015-2016/School-Funding/Meetings/Jan-2016/OtherBudgetedFundsChart.pdf>

paying for two buildings. In terms of taxpayer equity over time, it seems like districts would need to adopt an enduring philosophy of either “borrowing to build” or “saving to build.”

State/local match mechanism

A resolution that will be considered by the Montana School Boards Association at its annual meeting in June involves replacing the current facility reimbursement and quality schools grant programs with a state/local match program with permissive levying authority at both the county and district level. This would be modeled somewhat on current school transportation funding with state, county, and district contributions.

The conceptual mechanism looks to analysis of maintenance costs done by QSIC and needs identified by the 2008 Facilities Condition Inventory (FCI) and estimates that a \$120 million annual investment would satisfy those findings. This amount is split in thirds between the state, counties, and districts, with a district’s share determined based on the number of quality educators. Counties and districts would permissively levy for the required amounts. District funds would be required to first be spent on facility issues identified in the 2008 FCI and could then go towards facilities expenditures at the discretion of trustees.

One consideration about this mechanism is that as proposed these local and county permissive levies are not equalized for property tax wealth disparities. Lower wealth counties and districts would need to levy considerably more mills than higher wealth districts, and this could lead to greater difficulty for lower wealth districts in passing other voted levies or bonds for bigger facility projects. The table below shows this levy disparity for several K12 districts based on the proposed \$40 million statewide district share allocated by quality educator (QE) FTE.

| District | QE FTE | Levy req’t | Mill value | Mills req’d |
|-----------------|--------|------------|------------|---------------------|
| Heart Butte K12 | 17.85 | \$59,068 | \$66 | 894.97 ⁴ |
| Highwood K12 | 14.15 | \$46,835 | \$1,474 | 31.77 |
| Plevna K12 | 15.51 | \$51,323 | \$15,268 | 3.36 |
| Superior K12 | 28.00 | \$92,677 | \$3,952 | 23.45 |
| Ennis K12 | 30.45 | \$100,776 | \$69,247 | 1.46 |

Possible revenue sources

Most of the options above involve increasing the current state investment in school facilities. Based on current revenue estimates for the school facility and technology account, the state will distribute approximately \$7 million in each year of the 2017 biennium through the facility reimbursement program to about 90 qualifying school districts to support debt service repayment of facility bonds. This will be the smallest amount spent by the state in the past decade (see Figure 3).

Maintaining the status quo means either splitting the limited revenue in the school facility and technology account between the facility reimbursement and quality school grant programs, or

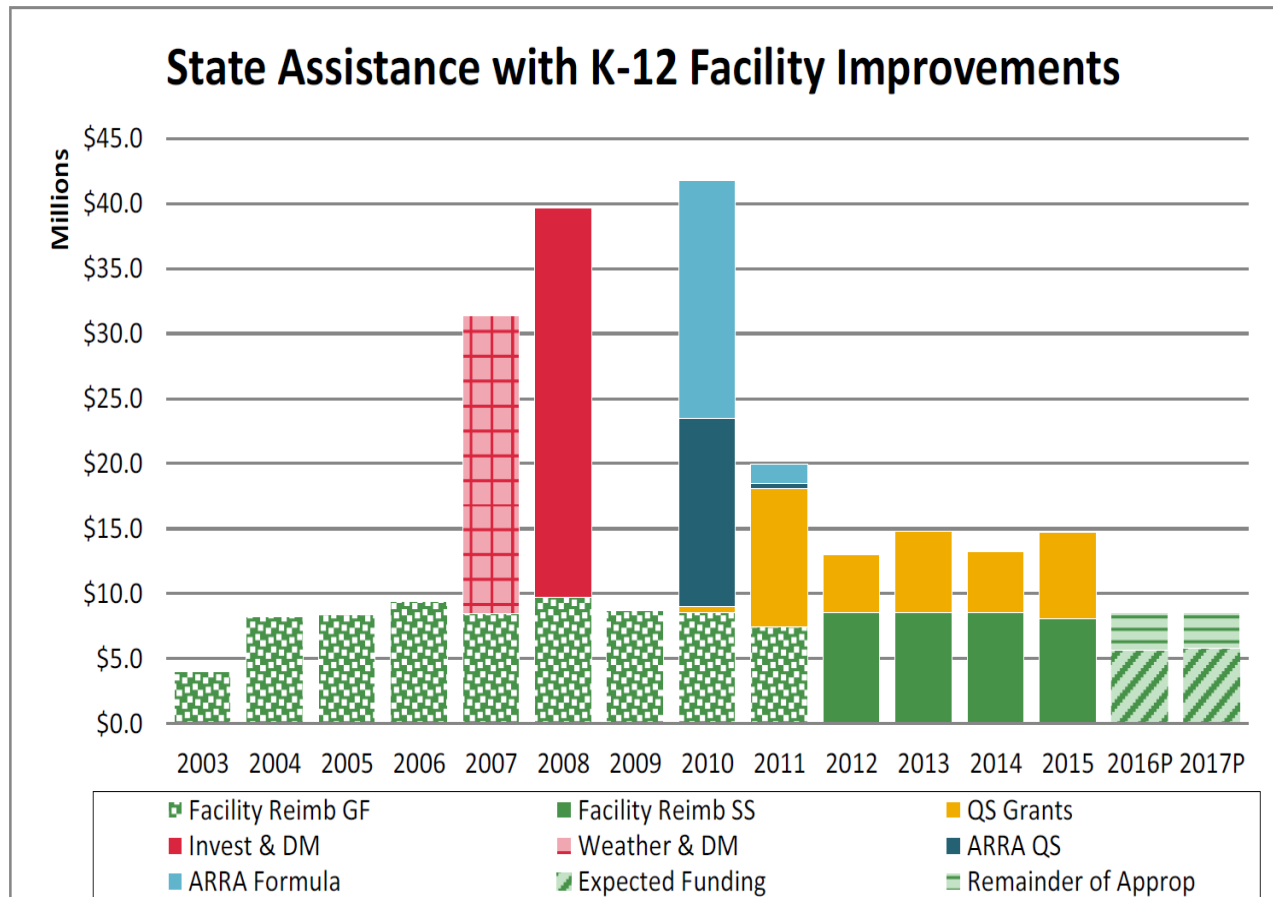
⁴ Heart Butte K12 and other Montana school districts serving “federally connected children” (students whose families reside and/or work on nontaxable federal land—usually tribal, military, or park lands) often have very low taxable values, which translate to astronomical mill levy rates. These districts receive federal Impact Aid as a reimbursement for unavailable local revenue sources, and, as with the transportation fund, could use Impact Aid money to reduce this levy requirement and the required mills.

choosing one or the other. Increasing the revenue to these two programs is another option and this could be accomplished by either channeling more revenue into the school facility and technology account or eliminating the account and making the funding of these programs statutory or HB 2 appropriations from the general fund.

Increasing state funding for school facilities without a new revenue source will mean spending less elsewhere. Several possibilities for additional revenue are often broached when school funding is discussed:

1. Increasing the 40 mill state equalization levy (currently part of the 95 mills). Increasing this statewide levy by 10 mills would raise approximately \$25 million annually. The 95 mills have not been increased since 1989.
2. Instituting a sales tax. Numerous taxation policy questions emerge from this discussion. The Revenue and Transportation Interim Committee (RTIC) heard a presentation from the Department of Revenue (DOR) at its March 10-11 meeting on revenue impacts of statewide and local option sales taxes. A DOR memo to RTIC estimates a 4% statewide sales tax on goods and services similar to those taxed by other states would raise about \$600 million in fiscal year 2018.
3. Promoting more natural resource development and/or collecting more natural resource revenue at the state level.
4. Capping and/or diverting the coal tax trust. This was proposed in SB 354 (2015; Ripley); see separate memo on that bill.
5. Bonding at the state level to raise revenue for school infrastructure investment. The creation of state debt requires a 2/3 vote of each chamber of the Legislature.

Figure 3⁵



For reference (emphasis added):

Constitution of Montana -- Article X -- EDUCATION AND PUBLIC LANDS

Section 1. Educational goals and duties.

(1) It is the goal of the people to establish a system of education which will develop the full educational potential of each person. Equality of educational opportunity is guaranteed to each person of the state.

(2) The state recognizes the distinct and unique cultural heritage of the American Indians and is committed in its educational goals to the preservation of their cultural integrity.

(3) The legislature shall provide a basic system of free quality public elementary and secondary schools. The legislature may provide such other educational institutions, public libraries, and educational programs as it deems desirable. It shall fund and distribute in an equitable manner to the school districts the state's share of the cost of the basic elementary and secondary school system.

Section 8. School district trustees. The supervision and control of schools in each school district shall be vested in a board of trustees to be elected as provided by law.

⁵ This chart was produced by LFD as part of a memo on legislative responses to previous school funding study recommendations. The memo, including a table with more detail on the chart above, is available at: <http://leg.mt.gov/content/Committees/Interim/2015-2016/School-Funding/Meetings/Jan-2016/November%20mailing/Renewal-comm-QSIC-recs.pdf>

20-9-309. Basic system of free quality public elementary and secondary schools defined - identifying educationally relevant factors -- establishment of funding formula and budgetary structure -- legislative review. (1) Pursuant to Article X, section 1, of the Montana constitution, the legislature is required to provide a basic system of free quality public elementary and secondary schools throughout the state of Montana that will guarantee equality of educational opportunity to all.

(2) As used in this section, a "basic system of free quality public elementary and secondary schools" means:

(a) the educational program specified by the accreditation standards provided for in 20-7-111, which represent the minimum standards upon which a basic system of free quality public elementary and secondary schools is built;

(b) educational programs to provide for students with special needs, such as:

(i) a child with a disability, as defined in 20-7-401;

(ii) an at-risk student;

(iii) a student with limited English proficiency;

(iv) a child who is qualified for services under 29 U.S.C. 794; and

(v) gifted and talented children, as defined in 20-7-901;

(c) educational programs to implement the provisions of Article X, section 1(2), of the Montana constitution and Title 20, chapter 1, part 5, through development of curricula designed to integrate the distinct and unique cultural heritage of American Indians into the curricula, with particular emphasis on Montana Indians;

(d) qualified and effective teachers or administrators and qualified staff to implement the programs in subsections (2)(a) through (2)(c);

(e) facilities and distance learning technologies associated with meeting the accreditation standards;

(f) transportation of students pursuant to Title 20, chapter 10;

(g) a procedure to assess and track student achievement in the programs established pursuant to subsections (2)(a) through (2)(c); and

(h) preservation of local control of schools in each district vested in a board of trustees pursuant to Article X, section 8, of the Montana constitution.

(3) In developing a mechanism to fund the basic system of free quality public elementary and secondary schools and in making adjustments to the funding formula, the legislature shall, at a minimum, consider the following educationally relevant factors:

(a) the number of students in a district;

(b) the needs of isolated schools with low population density;

(c) the needs of urban schools with high population density;

(d) the needs of students with special needs, such as a child with a disability, an at-risk student, a student with limited English proficiency, a child who is qualified for services under 29 U.S.C. 794, and gifted and talented children;

(e) the needs of American Indian students; and

(f) the ability of school districts to attract and retain qualified educators and other personnel.

(4) The legislature shall:

(a) determine the costs of providing the basic system of free quality public elementary and secondary schools;

(b) establish a funding formula that:

(i) is based on the definition of a basic system of free quality public elementary and secondary schools and reflects the costs associated with providing that system as determined in subsection (4)(a);

(ii) allows the legislature to adjust the funding formula based on the educationally relevant factors identified in this section;

- (iii) is self-executing and includes a mechanism for annual inflationary adjustments;
 - (iv) is based on state laws;
 - (v) is based on federal education laws consistent with Montana's constitution and laws; and
 - (vi) distributes to school districts in an equitable manner the state's share of the costs of the basic system of free quality public elementary and secondary schools; and
- (c) consolidate the budgetary fund structure to create the number and types of funds necessary to provide school districts with the greatest budgetary flexibility while ensuring accountability and efficiency.
- (5) At least every 10 years, the legislature shall form the school funding interim commission pursuant to 5-20-301 for the purpose of reassessing the state's school funding formula.