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ARIZONA TAX RESEARCH ASSOCIATION

School Capital Finance Issues & Reforms

Enacted in 1998, Arizona's school capital finance policy continues to challenge Arizona policymakers. The State Supreme Court's rulings in *Roosevelt v. Bishop* and *Hull v. Albrecht* set two main legal requirements for future policy: 1) the state has an ongoing responsibility for facility construction and maintenance; and 2) the finance system cannot put voters between school capital needs and funding.

Now that Students FIRST is in its eighth year, policymakers have the benefit of considerable experience to review what has worked and what has not. ATRA's recommendations are to keep and fund Students FIRST. The \$250 budgeted for new school construction in FY 2006 represents a mere 3% of the \$8.2 billion general fund. The Legislature's decision to discontinue debt financing and pay cash for ongoing new construction demands should continue to be the state's policy in the future.

While Students FIRST should be continued, there are several significant problems associated with the current policy that should be reformed.

Specific Areas for Reform in State & Local School Capital Funding

One of the biggest mistakes the Legislature made in designing Students FIRST was to relinquish significant appropriation power to the School Facilities Board (SFB), an executive agency with unprecedented spending authority. Last year the Legislature took an important step by eliminating SFB's ability to draw funds directly from the state treasury and circumvent the appropriation's process. However, SFB is still able to approve projects and commit state dollars years into the future without the consent of the Legislature. This loss of spending control and accountability is at the core of several inefficiencies within Students FIRST.

Recommendation:

Eliminate the board; transfer responsibility and accountability to JCCR. SFB, like other agencies, should obtain funding from the Legislature as part of the appropriations process.

This will eliminate the institutional clumsiness that currently exists where the Legislature receives general fund spending requests, often after monies have already been committed by a gubernatorially appointed board that approves spending, often for projects several years out into the future. Placing both the oversight and the spending authority in the same institution may result in increased sensitivity to pricing as the agency will have to live within a budget.

In 1998, the Arizona Supreme Court rejected a version of Students FIRST that allowed districts to opt out of the new state program. Ultimately, however, school districts maintained the ability to access significant amounts of property taxes for bonds and unlimited capital overrides. Thus, school districts obtain all the benefits of Students FIRST, *as well as* the option to use local tax dollars to for school facilities. School district square footage that is built with local option dollars (class B bonds or overrides) is invisible to the state. However, students within the walls of that square footage are *not* invisible for "pupil per sq. foot" calculations. In other words, the current system not only maintains some inequitable features of the system that was found to be unconstitutional, in some instances such disparities in capital funding and taxation may be worse. *Recommendation:*

Count all square footage for new school qualification calculations. Limit overrides to 100% of CORL and/or require districts to spend CORL on capital while an override is in effect.

Property taxes for adjacent ways have increased significantly in recent years, due in part to pressure from municipalities. *Recommendation:*

Narrow authority to levy taxes for adjacent ways and restrict municipal pressure for special projects.

Capital spending occurs through desegregation/OCR and small school district adjustment levies. *Recommendation:*

Eliminate ability to budget for capital outside limits under deseg/OCR and small school district adjustment statutes.

SFB currently provides new school funding for accommodation schools, run by county school superintendents. *Recommendation:*

Give county superintendents authority to sponsor one charter school, or to operate one state-sponsored charter school. Charter schools do not receive SFB funding.

The state provides statutorily-defined rural districts with an additional 5% for new construction or building renewal. Definition of rural is flawed. *Recommendation:*

Eliminate the automatic additional 5%. Deal with exceptional circumstances for new construction as they occur.

Discussions about school capital funding usually discount capital outlay monies (known as CORL), most of which are transferred by districts to maintenance and operations (M&O). In addition, confusion exists about the intended uses of building renewal for major renovations

and that routine and minor maintenance that would normally be funded through CORL or M&O. *Recommendation:*

Disabuse school districts of the confusion that exists about building renewal and routine maintenance and capital dollars available. Clarify that building renewal is for major renovations and other funds exist for minor or routine maintenance.

The Legislature lacks flexibility in building renewal formulas and statutory inflation adjustments to new construction formulas. *Recommendation:*

Make clear that inflation adjustments and building renewal formulas are subject to appropriation.

Geographic exceptions and "emergency" funding requests provide opportunities to lobby for additional funding and set precedents outside the intent of Students FIRST.

Recommendation:

Narrow definitions of geographic exceptions and emergencies. Allow funding for truly exceptional circumstances.

Qualifications for new construction/school size is inequitable and too reliant on school demands. *Recommendation:*

State needs to play a more significant role in decisions involving new construction qualifications.