

# MEMORANDUM

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**TO:** Joint Budget Committee Members

**FROM:** Craig Harper (303-866-3481)

**SUBJECT:** BEST Issue Brief and Update

**DATE:** January 9, 2014

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During the FY 2014-15 JBC Staff Briefing on the Department of Education, the Committee asked to revisit the issue paper on the Building Excellent Schools Today (BEST) Program. The issue paper (excerpted from the staff briefing) is attached.

## **Priority Assessment Update**

The Committee also discussed BEST at the Department's hearing on December 19, 2013. At the hearing, the Committee and the Department discussed the recent State Auditor's Office recommendations to update and maintain the program's "Priority Assessment" (assessment). The audit recommends revising the assessment to identify critical projects and create a prioritized list of projects for use in allocating funds. Department staff are investigating options to revise and update the assessment. Based on discussions with the Department, the process would involve two phases.

- Revising the existing assessment to create a prioritized list (using the data from the original assessment) would require approximately \$2.7 million in FY 2014-15.
- The Department is considering a range of options to update the assessment with *new* data and ensure that data in the assessment remains current going forward. The issue is on the BEST Board agenda for January 22, 2014, and the Department expects to have additional feedback after that meeting.

**Staff recommends that the Committee consider appropriating additional funding to revise the priority assessment as part of the FY 2014-15 budget process.** Updating the assessment with *new* data and maintaining the assessment going forward may warrant legislation to provide additional guidance to the Department. Given that the Legislative Audit Committee is considering sponsoring legislation based on the audit recommendations, **staff recommends that the Committee discuss updating and maintaining the assessment with members of the Legislative Audit Committee (LAC) for potential inclusion in the LAC bill(s).**

## **Issue: Building Excellent Schools Today Funding and Status**

The Building Excellent Schools Today (BEST) program is the State's primary public school capital construction assistance program. The program is facing changes from three sources: (1) the program is approaching the statutory cap on lease purchase payments; (2) the passage of Proposition AA in November 2013 will provide additional revenue to the program from recreational marijuana beginning in FY 2013-14; and (3) a recent report from the State Auditor's Office expressed concerns about the operations of the program and recommended a variety of changes.

### **SUMMARY:**

- The BEST program, created in H.B. 08-1335, is the State's primary public school capital construction assistance program. Structured as a competitive grant program, the program provides assistance through both certificates of participation (COPs) and cash grants. State trust lands have provided the vast majority of state funding for the program.
- Including the projects approved in FY 2013-14, the program has provided or approved a total of \$1.1 billion (including \$759 million in state funds and \$330.5 million in local matching funds) in public school capital construction projects from FY 2008-09 through FY 2013-14. This amount represents approximately 8 percent of the 13.9 billion in need identified in a priority assessment completed for the program in 2010.
- The program is approaching the statutory cap on the state share of annual COP payments. After reaching the limit, the program will be unable to issue additional COPS until the current leases begin to expire in 2029. Staff does not recommend raising the statutory cap based on currently available revenues.
- The passage of Proposition AA in November 2013 will direct excise tax revenues from the sale of recreational marijuana (up to a maximum of \$40.0 million per year) to the BEST program, although uncertainty remains regarding the amount of revenue available. Any excise tax revenues would likely have to support cash grants.
- The State Auditor's Office released a statutorily required performance audit of the BEST program in October 2013. The report expressed concerns about the program's: prioritization of projects and grant decision making; calculations of local matching fund requirements; controls on grant contracts; and conflict of interest policies. The Department agreed with and is implementing the audit's recommendations.

### **RECOMMENDATION:**

Staff recommends that the Committee discuss the status and future of the BEST program with the Department at the upcoming hearing. Staff recommends that the discussions include: (1) the program's prioritization of projects in light of the State Auditor's Office report; (2) the operation

of the program after reaching the statutory cap on the state share of lease purchase payments; (3) the Department's plans to utilize recreational marijuana excise tax revenues for the program; and (4) the program's response to the recent report from the State Auditor's Office.

Staff further recommends that the General Assembly enact legislative changes to the program during the 2014 Session. First, in light of the additional excise tax revenues anticipated to support the program in FY 2013-14 and beyond and concerns raised in the State Auditor's Office report, staff recommends that the General Assembly increase oversight of the cash grants program and make the annual cash grants subject to annual appropriation. Second, as recommended in the State Auditor's Office report, staff recommends that the General Assembly work with the Department to adjust the local matching fund calculations to better reflect districts' ability to pay. Staff recommends that the Committee discuss the program with members of the Legislative Audit Committee, as that committee may be considering bills related to BEST.

## **DISCUSSION:**

### **Background**

House Bill 08-1335 replaced the capital construction financial assistance programs that were established in response to the *Giardino* lawsuit with the BEST program. The BEST program was designed to increase the amount of state financial assistance and accelerate project completion.

#### *Historic Fund Sources*

Rather than relying on annual General Fund appropriations, the BEST program is supported primarily by royalty and rental income earned on state trust lands, with some additional revenues from lottery proceeds and interest earned on the Public School Capital Construction Assistance (PSCCA) Fund. Current law annually credits the following state moneys to the PSCCA Fund:

- 50.0 percent of gross revenues from state school trust lands;
- all net proceeds from the sale of certificates of participation (COPs) payable to the State under the terms of such agreements;
- lottery proceeds that would otherwise be transferred to the General Fund; and
- interest and investment income earned on the PSCCA Fund.

Local matching funds for certificate of participation (COP) payments are also credited to the fund because the program makes the *total* COP payment (including state and local funds) from the PSCCA fund.

Although the program receives funds from a variety of sources, state trust land revenues have been the dominant source, accounting for 85.6 percent of the programs actual revenues in FY 2012-13. Table 1 displays actual BEST program revenues from state sources from the program's inception in FY 2008-09 through FY 2012-13.

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**Staff Working Document – Does Not Represent Committee Decision**

<b>State Revenues for the BEST Program</b>					
<b>Revenue Source</b>	<b>FY 2008-09</b>	<b>FY 2009-10</b>	<b>FY 2010-11</b>	<b>FY 2011-12</b>	<b>FY 2012-13</b>
State Land Board Revenues	\$35,195,168	\$33,196,010	\$60,261,217	\$72,357,278	\$61,662,736
Lottery Spillover	<u>5,534,736</u>	<u>88,550</u>	<u>662,230</u>	<u>4,559,159</u>	<u>8,644,124</u>
<b>Total State Revenues</b>	<b>\$40,729,904</b>	<b>\$33,284,560</b>	<b>\$60,923,447</b>	<b>\$76,916,437</b>	<b>\$70,306,860</b>
Interest Revenues	<u>\$1,327,275</u>	<u>\$1,471,506</u>	<u>\$1,772,166</u>	<u>\$1,670,489</u>	<u>\$1,661,848</u>
<b>Total Revenues</b>	<b>\$42,057,179</b>	<b>\$34,756,066</b>	<b>\$62,695,613</b>	<b>\$78,586,926</b>	<b>\$71,968,708</b>

*Types of Assistance*

Designed as a competitive grant program with an annual application and award cycle, the program offers two forms of financial assistance for capital construction projects: (1) COPs and (2) cash grants.

- Certificates of Participation: The program generally uses COPs to support larger projects, such as the construction of new or replacement schools or major renovation projects. The average cost of COP projects approved in FY 2013-14 is \$15.8 million (consisting of \$10.7 million state funds and \$4.1 million local funds). Annual lease payments for COPs are subject to legislative appropriation and appear in the Long Bill each year. Statute (see Section 22-43.7-110 (2) (b) (I), C.R.S.) limits the state share of annual COP payments to no more than \$40.0 million but the annual *appropriation* for BEST COP payments includes state funds, local matching funds, and estimated federal subsidies. Thus, the FY 2013-14 appropriation of \$57.0 million includes an estimated \$34.3 million in state funds and \$13.2 million in local matching funds, along with approximately \$9.5 million in federal subsidies.
- Cash Grants: Generally speaking, the program has used cash grants to support smaller projects such as equipment replacements, roof repairs and replacements, and relatively minor renovations. The average cost of each cash grant approved in FY 2013-14 is \$654,003 (including \$377,645 in state funds and \$276,358 in local matching funds). Unlike annual COP payments, statute continuously appropriates funds to BEST for cash grants, and annual cash grants are entirely at the discretion of the Public School Capital Construction Assistance Board and the State Board of Education.

As the program approaches the \$40.0 million cap on the state share of COP payments, BEST has changed some of the use of cash grants in order to continue to be able to fund large projects.

*Total Assistance Provided*

Including the projects approved in FY 2013-14, the program has supported a total of \$1.1 billion million in school construction projects from FY 2008-09 through FY 2013-14, including \$759.1 million in state funds \$330.5 million in local matching funds. Of that total, \$895.1 million (81.0 percent) has been in the form of COP projects.

As required by H.B. 08-1335, the program completed a Statewide Financial Assistance Priority Assessment. Published in 2010, the assessment found a need for \$13.9 billion in public school

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capital construction statewide for the period from 2010 through 2013 and an additional \$3.9 billion for the period from 2014 through 2018. Thus, to put the program’s level of assistance in perspective, the total project funding of \$1.1 billion represents approximately 8 percent of the \$13.9 billion in estimated statewide need from 2010 through 2013.

***FY 2014-15 Request***

The Department’s FY 2014-15 budget request includes an additional \$8.0 million cash funds to support the legislatively appropriated BEST COP payments. As discussed above, the Long Bill appropriation includes state funds, local funds, and (starting in FY 2013-14) estimated federal subsidies to the program, although all are shown as cash funds in the Long Bill. Based on the COP projects approved this year (with payments beginning in FY 2014-15), the Department now expects the state share of COP payments to be \$38.6 million in FY 2014-15 (see table below). According to the Department, the state share is slightly lower than anticipated in the decision item submitted with the budget request because of changes in the financing assumptions and in the estimated federal subsidy.

<b>FY 2013-14 and FY 2014-15 Gross Base Rent Payments for BEST COPs</b>				
	<b>FY 2013-14 Estimates and Appropriation</b>	<b>FY 2014-15 Decision Item R 10</b>	<b>Change from FY 2013-14</b>	<b>FY 2014-15 Updated Estimate</b>
State Share COP Payment	\$34,305,990	\$39,099,667	\$4,793,677	\$38,636,821
LEA Matching Money Lease Payment	13,160,351	16,516,791	3,356,440	16,165,597
Federal Subsidy	<u>9,477,645</u>	<u>8,616,613</u>	<u>(861,032)</u>	<u>8,758,178</u>
Gross Base Rent Payments for BEST COPs	\$56,943,986	\$64,233,071	\$7,289,085	\$63,560,596
Total Lease Payments Appropriation/Request	\$57,000,000	\$65,000,000	\$8,000,000	\$64,000,000

Please note that the program has already committed the state to the additional COP payments in FY 2014-15 and beyond. Thus, the program’s design leaves the General Assembly little choice but to fund the request.

**Current Challenges**

The BEST program is facing significant change and potential challenges going into FY 2014-15, including: (1) approaching the statutory cap on COP payments; (2) an influx of an uncertain amount of revenue from recreational marijuana excise taxes following the passage of Proposition AA in November 2013; and (3) concerns raised in the State Auditor’s Office recent performance audit of the program.

***COP Payment Cap***

As discussed previously, statute limits the state share of BEST COP payments to no more than \$40 million annually. With an estimated state share of \$38.6 million in FY 2014-15, the program is approaching the statutory limit. After reaching the cap, the program will be unable to issue new COPs until the existing agreements begin to expire in 2029. The General assembly could increase the legislative cap but staff does not recommend doing so, in large part because of the volatility of BEST revenues (discussed in previous staff briefings). Without the ability to

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issue new COPs, staff anticipates that the program will increase the issuance of cash grants as revenues allow.

*Proposition AA – Recreational Marijuana Excise Tax*

The passage of Proposition AA in November 2013 will provide an additional revenue source for the BEST program. As passed by the voters, Proposition AA will direct the first \$40.0 million per year in state excise taxes on recreational marijuana into the Public School Capital Construction Assistance Fund. Staff and the Department assume that those funds will provide additional revenues to the BEST program, although the amount of revenue available remains uncertain. The Legislative Council Staff Fiscal Impact Statement for Proposition AA anticipates \$13.8 million in excise tax revenues in FY 2013-14 and \$27.5 million in FY 2014-15. For scale, those amounts would have represented 19.3 percent and 38.2 percent of actual FY 2012-13 revenues, respectively.

The potential influx of revenues presents opportunities and questions for the program. Clearly, additional revenues would enable additional grants and support new projects. However, staff expects that the program will have to use the new revenues for cash grants because: (1) as discussed above, the program is reaching the cap on COP payments; and (2) regardless of the cap, bonding against revenues from an excise tax on recreational marijuana does not appear likely, given concerns about the status of such a revenue stream under federal law. Thus, the program may receive up to \$40.0 million per year in additional funding for cash grants as a result of Proposition AA.

*State Auditor's Office Performance Audit*

The State Auditor's Office released a statutorily-required performance audit of the BEST program in October 2013. The audit raised several concerns about the program, including: (1) the prioritization of projects; (2) grant decision making; (3) the determination of districts' financial capacity for matching funds; (4) conflict of interest procedures; and (5) grant administration.

*Prioritization:* The audit raises concerns about the program's Priority Assessment (completed through a contract with Parsons in 2010) and the program's overall prioritization of projects.

- The audit found that although the State invested more than \$12 million in the Priority Assessment (required by the BEST legislation), the assessment did not provide a prioritized list of projects and did not clearly identify health and safety projects. The audit also found that the program has not ensured that the assessment was maintained and current.
- In addition, the audit found that the program has not consistently used the priority assessment to prioritize projects and has funded lower priority projects while rejecting higher priority projects (based on common measures of facility condition). The audit staff and JBC staff agree that the BEST program statutes indicate that the General Assembly expected the program to use the assessment to prioritize projects. However, as

shown in the following excerpt from the audit report, the BEST Board has interpreted the statute differently.<sup>16</sup>

“The plain definition of “priority” along with the statutory language that the Assistance Board should be prioritizing public school capital construction needs indicate that the requirement to conduct a priority assessment means that the assessment should identify the school capital construction needs that should have a preferential ranking over others, in other words, which needs should be prioritized over others. Our analysis during the audit is based on this interpretation. However, the Assistance Board has indicated that it does not interpret the word “priority” in the statute to mean that the assessment should establish a prioritized list of public school capital construction needs, but rather that the assessment should be done before other things, as a priority, such as awarding grants.”

- The audit also recommends proactively targeting outreach and technical assistance to specific districts with high priority projects (and limited financial capacity) that *have not applied for assistance*. The Department and the BEST Board conduct general outreach to school districts statewide but have not historically targeted specific districts based on need. Rather, the program has conducted general outreach and then selected from the submitted applications. In response to concerns about high needs districts not applying for the program, BEST staff have historically responded that they select from districts that actually apply. The audit recommends shifting the program’s procedures to specifically work with districts that have the highest need.

Relative to prioritization, the audit recommends: (a) determining whether the priority assessment can be adjusted to prioritize projects and add health and safety data; (b) working with school districts to update the priority assessment; and (c) targeting outreach to school districts with critical needs that have not applied for funding. The BEST Board and the Department expressed concerns about infringing on local control by proactively prioritizing projects and seeking out specific applicants but agreed with all recommendations.

*Grant Decision Making:* Based in part on concerns about project selection discussed above (e.g., the selection of lower priority projects while rejecting what appear to be higher priority projects), the audit raises concerns about the program’s transparency and documentation of the selection process.

- The audit found that the BEST Board has not developed and used a formal tool to document the evaluation of grant applications. Based on the audit, it appears that different Board members use selection criteria differently, and there is no written tool to encourage consistency. The lack of written documentation from the selection process makes it impossible to evaluate how specific projects were selected.

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<sup>16</sup> See pages 22 and 23 of the State Auditor’s Report.



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***Staff Working Document – Does Not Represent Committee Decision***

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- The audit notes that Department staff recommended that the BEST Board adopt a scoring rubric at the March 2013 board meeting but that the Board members rejected the recommendation because each member uses his or her own expertise for evaluation.

The audit recommends that the program standardize the grant process by: (1) developing a standardized evaluation tool based on criteria from the Priority Assessment, statutory requirements, and district financial capacity; (2) communicate evaluation criteria to potential applicants; (3) retain documentation of the selection process; and (4) provide documentation of the evaluation process to the State Board of Education. The BEST Board agreed with all of the recommendations.

*Determining Financial Capacity:* The BEST Program leverages state resources with local matching funds. Statute (Section 22-43.7-109 (11), C.R.S.) requires the BEST Board to consider applicants' financial capacity when selecting projects and setting matching fund requirements. Section 22-43.7-109 (9), C.R.S., provides specific factors for the calculation of applicants' financial capacity and allows the Board to reduce or waive the matching fund requirement.

- The audit found that the BEST Board's calculation of matching fund requirements complies with statute (and considers all of the factors required by statute) but that the calculation does not appear to produce results that are consistent with districts' actual financial capacity. The Department and BEST Board agree that the formula does not appear to measure capacity and agree to consider pursuing statutory changes to improve the formula.
- The audit also found inconsistencies in the evaluation and approval of matching fund waivers. Similar to concerns about overall project selection, the program has not established a formal and consistent tool for the evaluation and approval of waiver requests. The program also has not required significant documentation in support of waiver requests. Without a consistent tool and documentation, the audit could not evaluate the reasons for apparent inconsistencies in the approval process.

The audit recommends that the BEST Board: (1) evaluate whether a statutory change is necessary to improve the calculation of matching requirements; (2) develop a method to calculate matching requirements that correlates to districts' financial capacity; (3) obtain documentation to support matching fund waiver requests; and (4) develop a tool to evaluate matching fund waiver requests and document reasons for approval or denial of each request. The BEST Board agreed with all recommendations.

*Conflicts of Interest:* The audit raises concerns about the BEST Board's conflict of interest policies. Because the BEST Board consists of individuals with related expertise (by statute), and those members are often still active their professional field, there is an opportunity for conflicts of interest.



**JBC Staff Budget Briefing: FY 2014-15**  
**Staff Working Document – Does Not Represent Committee Decision**

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- The audit found prior instances (in 2009 and 2010) of board members voting on projects with a clear conflict of interest, in violation of rules and statute. The BEST Board believes that it has addressed conflict of interest concerns since those events took place.
- The audit argues that the program's rules do not adequately protect against conflicts of interest and do not align with the Colorado Code of Ethics. In addition, similar to concerns discussed above, the BEST Board does not formally document and retain conflict of interest disclosures.

The audit recommends: (1) implementing rules that align with the Colorado Code of Ethics to ensure that members do not evaluate or vote on projects in which they may have a financial interest; (2) establishing rules for handling conflicts of interest, including enforcement in cases of noncompliance; and (3) documenting and maintaining conflict of interest disclosures. The BEST Board agreed with all recommendations.

*Grant Administration:* The audit investigated the program's management of grants once they are awarded and identified three areas of concern: (1) monitoring project budgets; (2) monitoring project performance; and (3) cash grant contracts.

- The audit found limited monitoring of project budgets once grants are awarded. For example, program staff often do not receive detailed final budgets for each project and have not monitored expenditures relative to detailed (line item) budgets. In a limited sample of projects, the auditors identified expenditures that did not appear to be appropriate but the program has not tracked expenditures in that level of detail.
- With respect to performance monitoring, the audit found that the program needs to both strengthen contract requirements and reporting to allow for increased state oversight of performance and give the program's consultants specific guidance with respect to performance monitoring (including site visits, etc.).
- The audit found that the program's cash grant contracts have not included key language to control the use of grant funds. The deletion of the language from the program's standard contract appears to have been an oversight by all parties involved (including the Department and the Attorney General's Office).

The audit includes a series of recommendations related to grant administration designed to: (1) improve the program's monitoring of project budgets; (2) implement a more robust system to monitor project performance; and (3) correct the standard cash grants contract. The Department agreed with all recommendations.

**Potential Statutory Changes**

Staff recommends that the Committee discuss the BEST Program with members of the Legislative Audit Committee. The Audit Committee may be considering legislation in response to the audit and would be best positioned to respond to the specific issues raised in the audit.

**JBC Staff Budget Briefing: FY 2014-15**  
**Staff Working Document – Does Not Represent Committee Decision**

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In addition to concerns raised in the audit, staff recommends that the General Assembly enact legislation making the BEST cash grants subject to annual legislative appropriation and that the Joint Budget Committee consider sponsoring the legislation. Statute makes the program's annual COP payments subject to legislative appropriation (although the legislature has no control over the issuance of COPs that would require a future increase in appropriations up to the statutory cap) but continuously appropriates funds for cash grants. Considering the concerns raised in the audit and the fact that staff anticipates significant increases in the use and size of cash grants, staff recommends increasing legislative oversight of the cash grant program by making it subject to appropriation. Staff does not recommend that the Committee approve or deny specific projects but does recommend that the General Assembly set the total appropriation for cash grants on an annual basis through the budget process.

**RELEVANCE OF BRIEFING ISSUE TO THE DEPARTMENT'S PERFORMANCE PLAN:**

The Department's strategic plan does not include goals or objectives *directly* linked to facilities or capital construction.