MEMORANDUM

JOINT BUDGET COMMITTEE

TO	Joint Budget Committee Members
FROM	Craig Harper, JBC Staff (303-866-3481)
DATE	March 6, 2019
SUBJECT	B.E.S.T. Program Mid-year Request for FY 2018-19

During discussion of the Department of Education's FY 2018-19 supplemental requests, the Committee asked JBC Staff to analyze a proposal from the Public School Capital Construction Assistance Board (often referred to as the Building Excellent Schools Today (B.E.S.T.) Board) to spend down the balance of the B.E.S.T. Program's cash fund. This memo provides that analysis.

REQUEST: As described by the Committee, the B.E.S.T. Board is proposing to spend down the balance of the Public School Capital Construction Assistance Fund (Assistance Fund), which supports the B.E.S.T. Program, by approximately $200 million in FY 2018-19. The Board specifically proposed to increase the appropriation for cash grants provided under the B.E.S.T. Program.

- Based on that description, staff's analysis assumes that the proposal would increase the appropriation for cash grants from $85.0 million (the current FY 2018-19 appropriation as well as the official request for FY 2019-20) to $285.0 million. Staff assumes that the General Assembly would provide the increase mid-year in FY 2018-19.
- Staff notes that this request did not go through the standard budget process. Staff's understanding is that neither the Department of Education's budget office nor the Governor's Office of State Planning and Budgeting were aware of the Department's request.

RECOMMENDATION: Staff strongly recommends that the Committee deny the request for a significant mid-year increase in FY 2018-19 *and* any request for large significant increase in cash grants for FY 2019-20. As outlined below (in the Analysis section), the staff recommendation includes the following components and justifications.

- Spending the cash fund balance down over a longer period of time to avoid a "cliff effect" requiring a sudden and dramatic decrease in cash grants supporting emergency construction needs. The B.E.S.T. Board's internal estimates assume that cash grants would have to decrease from the proposed $285 million in either FY 2018-19 or FY 2019-20 to less than $50 million per year based on ongoing revenues.
- If the Committee wishes to provide a one-time infusion of funds for cash grants (as proposed) then staff specifically recommends against doing so in either FY 2018-19 or FY 2019-20. The Department/B.E.S.T. Board have already allocated grant funds for FY 2018-19 and have already received the grant applications for FY 2019-20. Staff strongly recommends providing sufficient notice of any increase in cash grant spending to allow potential applicants (school districts and charter schools) to base application decisions on that information.

ANALYSIS:

Background Information - Building Excellent Schools Today (B.E.S.T.) Program

House Bill 08-1335 created the B.E.S.T. program to increase the amount of state financial assistance provided and allow for quicker completion of projects. Rather than relying on annual General Fund appropriations, the B.E.S.T. program is supported by royalty and rental income earned on state trust

lands, interest earned on the Public School Fund, lottery proceeds, and (beginning in FY 2013-14) recreational marijuana excise tax revenues pursuant to Amendment 64 and Proposition AA. Current law annually credits the following revenues to the Public School Capital Construction Assistance (PSCCA) Fund:

- 50.0 percent of the gross amount of revenues from income and mineral royalties derived from state public school lands, or more if required to make lease payments under the terms of lease-purchase agreements ($64.9 million in FY 2017-18).
- Recreational marijuana excise tax revenues ($40.0 million in FY 2017-18)[1]. Please note that, beginning in FY 2018-19, H.B. 18-1070 (Additional Public School Capital Construction Funding) increases the deposit of excise tax revenues from the first $40.0 million collected in a given year to the greater of $40.0 million or 90.0 percent of total excise tax revenues. Current law credits the remainder of excise tax revenues to the Public School (Permanent) Fund.
- A portion of the interest and income earned on investment of the Public School (Permanent) Fund ($4.3 million in FY 2017-18). Under S.B. 16-035 (The Public School Fund), interest and income earned on the Permanent Fund over and above the $21.0 million already distributed under current law will be deposited into the PSCCA Fund, up to a limit of $10.0 million in FY 2017-18 and $20.0 million in FY 2018-19 and subsequent years.
- Local matching moneys for COP projects ($17.4 million in FY 2017-18).
- Lottery proceeds that would otherwise transfer to the General Fund ($4.1 million in FY 2017-18).
- Interest and investment income earned on the PSCCA Fund ($6.3 million in FY 2017-18).

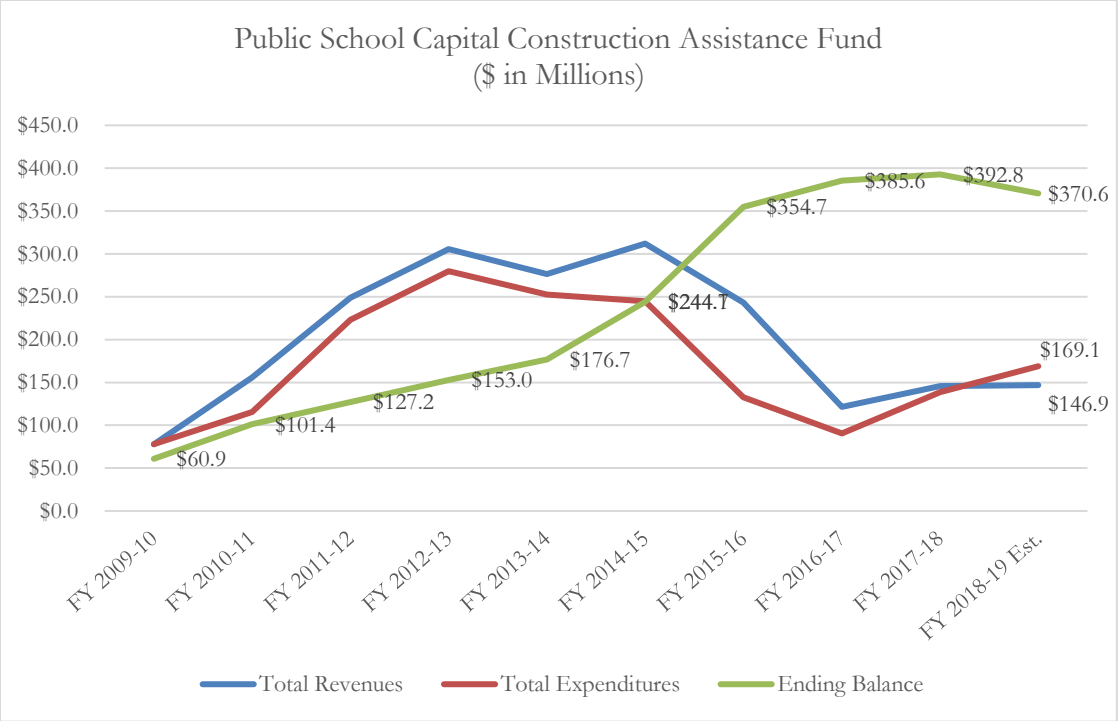
<u>The PSCCA Fund is subject to annual appropriation by the General Assembly.</u> In addition to supporting the PSCCA Division and Board, the fund supports assistance to schools and school districts in two forms:

- Lease payments required for lease-purchase (certificate of participation or COP) agreements. Current law caps lease-purchase payments at a total of $100.0 million with a maximum of $50.0 million in *state* funds for those payments. The FY 2018-19 appropriation includes $100.0 million, although anticipated expenditures are below that amount based on the cap in state expenditures.
- Cash grants to support construction projects, which are generally (though not always) smaller in scale than the COP projects. The FY 2018-19 appropriation includes $85.0 million for cash grants.

Cash Fund Balance

Because annual revenues have generally exceeded expenditures for the program, the PSCCA Fund has accumulated a significant balance. As shown in the following graph, the fund balance has grown over time, ending FY 2017-18 with a balance of $392.8 million. The Department currently estimates that the fund will end FY 2018-19 with a balance of $370.6 million.

[1] In FY 2015-16, the Public School Capital Construction Assistance Fund also received a one-time deposit of $40.0 million in marijuana *sales* tax revenues because of Proposition BB (2015).



Staff notes the following with respect to the fund balance:

- The fund balance is largely the result of several years with exceptionally high revenues. One-time funding from large oil and gas projects on State Land Board lands drove those increases. Based on discussions with the State Land Board, staff does not expect similar spikes in revenues in subsequent years.
- In fact, the State Land Board expects revenues going to B.E.S.T. to decline further (to the statutory floor of $40.0 million). With State Land Board revenues still highly dependent on oil and gas development, staff notes there is a significant amount of ongoing uncertainty regarding both oil and gas prices (and consequent revenues) *and* the level of anticipated development in Colorado.
- Although the General Assembly has added more revenue sources supporting B.E.S.T. (including increasing shares of marijuana excise taxes as well as interest earnings from the Permanent Fund), B.E.S.T. Program expenditures exceed anticipated revenues by $12.2 million in FY 2018-19. Staff and the Department agree that this trend will continue barring additional changes to either increase revenue or decrease expenditures.
- Based on current revenue estimates, simply maintaining current annual appropriations ($50.0 million in state funds for COP payments and $85.0 million in state funds for cash grants) will continue to exceed annual revenues. As a result, maintaining existing appropriations would spend down the fund balance to the $140 million target by approximately FY 2028-29.

B.E.S.T. Board Request for FY 2018-19

Based on the Committee's description of the B.E.S.T. Board's request, this (staff) analysis assumes that the Board is proposing to increase the FY 2018-19 appropriation by $200 million at mid-year, presumably through a Long Bill "add-on." The request would increase the appropriation for cash grants in FY 2018-19 from $85.0 million (the current appropriation) to $285.0 million.

According to B.E.S.T. program staff, the B.E.S.T. Board has approved a resolution targeting an ongoing fund balance of approximately $140 million (sufficient to support a year of program operations, including program staff, COP payments, and cash grants). If the General Assembly agrees with the Board's target balance, then the key question for the General Assembly is how quickly to spend down the fund balance.

Based on discussions with Department and B.E.S.T. staff, it appears that the B.E.S.T. Board has two basic reasons for trying to spend down the fund balance quickly (e.g., $200 million over one or two years).

- First, the Board is concerned about ongoing escalation in construction costs, which will reduce the buying power of any grants that the program does provide. In short, the program argues that the State can buy more with that money now than it would be able to over the next several years.
- Second, the Board appears to have concerns that the General Assembly may "sweep" some of the fund balance into the General Fund if the State experiences another recession. Staff notes that the General Assembly did not sweep this fund balance during the most recent economic downturn.

Staff recognizes the Board's concerns and reasons for the request. **However, staff strongly recommends against a large infusion of funds for additional grants in either FY 2018-19 or FY 2019-20 based on the following reasons:**

- *Equity and Process:* First, and perhaps most importantly, staff argues that adding a large infusion of funding for either FY 2018-19 or FY 2019-20 would not be fair to schools and districts that did not apply for grants because there was no notice that the additional funds would be available. The application process for FY 2018-19 closed in February 2018 and the application process for FY 2019-20 closed on February 25, 2019. If the General Assembly intends to provide a large one-time infusion of funds for cash grants, then staff strongly recommends giving potential applicants sufficient notice to incorporate that information into their decision making process. Staff acknowledges that the current pool of applicants exceeds even the proposed revenues (B.E.S.T. staff has indicated that the current pool includes a total of approximately $450 million in state funds). However, in order to be confident that the program is funding the highest priority projects, staff recommends giving the districts notice that the funding will be available *before the application process,* particularly for a one-time infusion of funds that will require a significant reduction in cash grants in subsequent years (see following point).

- *Implications for Subsequent Grants:* The current FY 2018-19 appropriation includes $85 million for cash grants. Once the balance reaches the $140 million target, B.E.S.T. staff estimates that cash grants will have to decrease to approximately $47 million per year to maintain that fund balance and continue to support the State's ongoing obligations for COP payments. Staff is concerned about the implications of a reduction of that size to the cash grants appropriation, particularly in light of the equity concerns discussed in the first point. Schools and districts that had no notice of the increase in funding in FY 2018-19 (or FY 2019-20) would suddenly see the appropriations for cash grants reduced (in the years for which they can still make decisions) reduced by nearly 50 percent.

- *Implications of a Mid-year Increase for recipient districts:* As described by the Committee, the B.E.S.T. Board is proposing a mid-year increase for FY 2018-19. Staff notes that the Long Bill appropriation allows grant recipients to spend funds over three years. Appropriating the funds in

April 2019 would effectively allow two years to spend the funds because the award would inherently take place late in the fiscal year (at the earliest).

- *Priority Assessment:* Statute requires the program to develop and use a priority assessment to inform grant making decisions. The General Assembly added significant funding and additional staff in FY 2015-16 to update the priority assessment (with complete assessments of every public school facility in the state). However, thus far, the program has only been able to update the assessment for approximately 17 percent of the square footage statewide (though that amount includes roughly 60 percent of the square footage outside of the Front Range). Based on the statutory direction to use the priority assessment, and the State's ongoing investment to update the tool, staff would recommend waiting until the priority assessment could provide more information before spending depleting the fund balance.