DEPARTMENT OF FINANCE BILL ANALYSIS

AMENDMENT DATE: 06/23/2014
POSITION: Oppose
BILL NUMBER: AB 2235
AUTHOR: Buchanan, Joan

BILL SUMMARY: Kindergarten-University Public Education Facilities Bond Act of 2014

This bill, an urgency measure, places on the November 2014 ballot the Kindergarten-University Public Education Facilities Bond Act of 2014 (bond measure). If approved by voters, the bond measure authorizes the state to issue an unspecified amount of general obligation bonds to provide funds to school districts, county superintendents of schools, county boards of education, community college districts, the University of California (UC), the California State University (CSU), and the Hastings College of Law for public education facilities.

FISCAL SUMMARY

If the bond measure is approved by voters, the state would be authorized to issue an unspecified amount of bonds. Assuming 30-year repayment periods for these bonds and interest rates of 5 percent, which is the average interest rate of the state general obligation bonds sold in 2013 and 2014, a $1 billion bond would require $65 million in annual debt service and cost a total of $2 billion; a $5 billion bond would require $325 million in annual debt service and cost a total of $10 billion; and a $10 billion bond would require $650 million in annual debt service and cost a total of $20 billion.

SUMMARY OF CHANGES

Amendments to the bill since our analysis of the original version are minor and do not alter our position.

COMMENTS

Finance opposes this bill for the following reasons:

- It creates new General Fund costs when the Administration is focused on paying down existing obligations and saving for a rainy day. Finance estimates that, in 2014-15, the state will pay $3 billion in debt service for general obligation bonds issued for K-12 and higher education projects. A new bond would add to those costs, crowding out other state priorities.
- It continues to finance K-12 and community college facilities using mechanisms that do not respond to the Administration's concerns about the appropriate role for the state in supporting education programs and problems with existing facilities programs. The Governor's Budget articulates several reasons the K-12 School Facilities Program (Program) is ineffective, particularly in the context of the Local Control Funding Formula, which shifts responsibility to the local level and provides school districts with discretion to use resources to meet the needs of their students. The Administration intends to continue a dialogue about how the state should support school infrastructure.
- It is inconsistent with the Administration's expectation that the universities consider infrastructure needs within the context of their other costs and priorities. For both the UC and the CSU, the annual budget act includes appropriations for use for both operations and infrastructure and authorizes the universities to pledge General Fund appropriations to issue university bonds for capital projects.

Analyst/Principal	Date	Program Budget Manager	Date
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Department Deputy Director			Date

Governor's Office:	By:	Date:	Position Approved_______
			Position Disapproved

ANALYSIS

1. Programmatic Analysis

K-14 Infrastructure

Generally, changes in enrollment patterns within K-12 and community college districts create needs for increased facility construction funding. Although many schools are experiencing declining enrollment, others may lack the school capacity necessary to accommodate increased enrollment.

The existing K-12 Program, administered by the State Allocation Board (Board), apportions state bond funding primarily in the form of per-pupil grants to eligible school districts that can be used to acquire school sites, construct new school facilities, or modernize existing school facilities. Program participants apply for either new construction or modernization grants and are generally served on a first-come-first-served basis until the funds are exhausted.

The current new construction grant program generally provides funding for half of project costs, requiring that school districts provide the other half, and the modernization grant program generally provides 60 percent of project costs, requiring that school districts provide 40 percent. School buildings are eligible for modernization project grants every 20 years for portable classrooms or every 25 years for permanent structures. The modernization project grant can generally be used to fund major repairs, purchasing of new equipment, or replacement of existing facilities.

School districts that are unable to provide the local share of project costs may be eligible for state financial hardship funding, which will cover up to 100 percent of project costs. To receive financial hardship assistance, a district must have made all reasonable efforts to meet several criteria, including the requirements to attain a 60-percent level of local bonded indebtedness and an attempt to pass a local bond in the past two years.

No bond authority remains in the core school facilities new construction and modernization programs. The 2013-14 and 2014-15 Governor's Budgets have proposed a dialogue on the future of school facilities funding, including consideration of what role, if any, the state should play in the future of school facilities funding. While this bill makes changes to the existing facilities program, the following concerns remain:

- Complexity—While the bill intends to simplify the program by only providing funding for the core new construction, modernization, and charter school programs, districts will still have to seek approval from up to ten different state agencies with fragmented oversight responsibilities, continuing the cumbersome and costly existing process.
- Imbalanced Financial Incentives—While the bill authorizes the Board to require districts to reestablish program eligibility, it is likely that districts will still have incentive to build new schools to accommodate what may be absorbable enrollment growth.
- First-Come, First Served—Under this bill, larger districts with dedicated personnel to manage facilities will continue to have substantial competitive advantage for obtaining state bond funds.
- Local Control—While the bill requires regulations to be recommended that provide design flexibility, it is unclear whether or not program eligibility will continue to be based on standardized facility definitions and classroom loading standards that do not encourage utilizing modern educational delivery methods.

ANALYSIS (continued)

Community college districts seek state and local financing for their facilities through state general obligation bonds and, less frequently, lease-revenue bonds. The Board of Governors of the California Community Colleges distributes bond funds to the 72 locally governed community college districts. State bond grants are made pursuant to the annual State Capital Outlay Grant Application Process, similar to the K-12 Program, and approved based on the Board of Governors' funding priorities. The State Public Works Board's lease revenue bond program finances acquisition and construction projects for community colleges also, as projects are included in the annual Budget Act.

The Smaller Classes, Safer Schools, and Financial Accountability Act (Proposition 39 in 2002) lowered the vote threshold to 55 percent for school facility bonds. Since then, voters have approved 652 local bond measures for K-12 schools authorizing more than $71 billion for K-12 school construction and modernization since 2002. Over the same time period, the state has issued $28.7 billion in general obligation bonds for K-12 schools. Additionally, voters have approved 94 of 110 local bond measures for community colleges, authorizing more than $26 billion for construction and modernization in 66 community college districts.

UC, CSU, and Hastings Infrastructure

In prior years, the state has addressed infrastructure needs at the UC, the CSU, and Hastings by appropriating state general obligation bond funds and State Public Works Board lease revenue bond funds specifically for capital outlay and by authorizing these entities to use support appropriations for both capital outlay, subject to limitations, and maintenance.

This bill allocates unspecified amounts of the bonds sold pursuant to the bond measure to the UC, the CSU, and Hastings, subject to appropriation by the Legislature. However, recent changes in law related to the UC and the CSU obviate the need for additional bond funds for these entities.

Chapter 367, Statutes of 2013, includes a set of goals intended to guide the Governor's and the Legislature's decisions about higher education. These are to improve student access and success, to align degrees and credentials with the state's economic, workforce, and civic needs, and to ensure effective and efficient use of resources to improve outcomes and maintain affordability. The enacted budget gives discretion to both the UC and the CSU to allocate available resources to support all of their costs, including capital outlay costs, and address these expectations.

The annual budget act includes General Fund appropriations for the UC and the CSU that fund both operations and infrastructure. These segments pay the costs of state debt, including any state general obligation bond debt service and State Public Works Board lease revenue bond rent, from these appropriations. The Budget Act of 2014 provides an additional $142 million each to the UC and the CSU in 2014-15, and the Administration's multi-year plan will provide additional increases of $120 million in 2015-16 and $124 million in 2016-17. These segments are expected use these funds to balance obligations and funding priorities.

Existing law authorizes the segments to (1) pledge General Fund appropriations when issuing university bonds used to fund capital outlay and (2) use General Fund appropriations to fund capital outlay projects on a "pay-as-you-go" basis. The segments are required to receive approval from Finance, with notification to the Legislature, before using funds for these purposes. The UC may not use more than 15 percent of its General Fund appropriation for capital outlay projects in any given year, and the CSU may not use more than 12 percent of its General Fund appropriation for these projects in any year.

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ANALYSIS (continued)

2. Fiscal Analysis

If the bond measure is approved by voters, the state would be authorized to issue an unspecified amount of bonds. Assuming 30-year repayment periods for these bonds and interest rates of 5 percent, which is the average interest rate of the state general obligation bonds sold in 2013 and 2014, a $1 billion bond would require $65 million in annual debt service and cost a total of $2 billion; a $5 billion bond would require $325 million in annual debt service and cost a total of $10 billion; and a $10 billion bond would require $650 million in annual debt service and cost a total of $20 billion.

The debt service for these bonds would be continuously appropriated from the General Fund. However, the annual budget bill specifies that an amount equal to the UC's state debt payments be transferred from the UC's General Fund appropriation and that an amount equal to the CSU's state debt payments be transferred from the CSU's General Fund appropriation, thereby offsetting new General Fund costs.

In 2014-15, Finance estimates that the state will pay $3 billion for K-12 and higher education general obligation debt service, including $2.4 billion for K-12 schools, $260 million for the community colleges, $189 million for CSU, $193 million for UC, and $1 million for Hastings.

The Leroy F. Greene School Facilities Act of 1998 authorizes the allocation of voter approved general obligation bonds for the construction and modernization of K-12 school facilities. Subsequent to passage of this act, voters have approved approximately $45 billion in general obligation bonds for K-12 and higher education facilities. Specifically, Proposition 1A of 1998 allowed $9.2 billion for K-12 ($6.7 billion) and higher education ($2.5 billion); Proposition 47 of 2002 allowed $13.1 billion for K-12 ($11.4 billion) and higher education ($1.7 billion); Proposition 55 of 2004 allowed $12.3 billion for K-12 ($10 billion) and higher education ($2.3 billion); and Proposition 1D of 2006 allowed $10.4 billion for K-12 ($7.3 billion) and higher education ($3.1 billion).

Code/Department Agency or Revenue Type	SO LA CO RV	PROP 98	FC	2014-2015	FC	2015-2016	FC	2016-2017	Fund Code
				(Fiscal Impact by Fiscal Year) (Dollars in Thousands)					
6350/Facil Aid	LA	No		----- See Fiscal Analysis -----					0795
6440/UC	SO	No		----- See Fiscal Analysis -----					0001
6610/CSU	SO	No		----- See Fiscal Analysis -----					0001
6870/Comm College	LA	No		----- See Fiscal Analysis -----					0795

<u>Fund Code</u>	<u>Title</u>
0001	General Fund
0795	Pending New Select Bond Fund