ARIZONA HOUSE OF REPRESENTATIVES
Forty-seventh Legislature – First Regular Session

COMMITTEE ON APPROPRIATIONS (B)

Minutes of Meeting
Tuesday, January 18, 2005
House Hearing Room 1 -- 1:30 p.m.

Chairman Boone called the meeting to order at 1:40 p.m. and the secretary called the roll.

Members Present

Mr. Anderson
Ms. Burton Cahill
Mr. Gallardo
Mr. Konopnicki
Mr. Lopez L
Mrs. McLain
Mr. Meza
Mr. Murphy
Mr. Nichols
Mr. Pearce
Mr. Rios P
Mr. Yarbrough
Ms. Burns J, Vice-Chairman
Mr. Boone, Chairman

Members Absent

Mr. Smith

Committee Action

H.B. 2051 – DISCUSSED & HELD

Speakers Present

Jake Corey, Fiscal Analyst, Joint Legislative Budget Committee (JLBC)
Dawn Nazary, Budget Analyst, Governor’s Office of Strategic Planning and Budgeting (OSPB)
Phil Bell, Director, School Facilities Board
Sean Arnold, Deputy Director of Finance, School Facilities Board
Mike Huckins, Majority Research Analyst
Karen Liersch, State Director of Adult Education, Department of Education

Introduction of Members and Staff

Chairman Boone introduced the staff and read short biographies on each.

Adoption of Committee Rules

Chairman Boone stated there is no amendment deadline for the Appropriations Committee. However, he asked that all amendments be submitted by 5:00 p.m. on Monday prior to each meeting.

Vice-Chairman Burns moved the committee rules as printed be adopted (Attachment 1). The motion carried.

Chairman Boone stated in accordance with House Rule 9C, the Committee Rules shall be filed with the Chief Clerk's Office.

Appointment of Committee of Reference

Chairman Boone appointed the following members to the Committee of Reference:
Mr. Meza
Mr. Nichols
Mr. Rios
Mr. Yarborough
Mr. Boone, Chairman

Discussion and Appointment of Sub-Committees

Chairman Boone explained the intent of creating the two sub-committees is to assist with the budget process. The Arizona Health Care Cost Containment System (AHCCCS) sub-committee will examine case load issues. The Childcare sub-committee will examine the childcare subsidy and issues relating to case loads, eligibility and benefits.

Chairman Boone appointed the following members to the AHCCCS sub-committee:
Ms. Burton Cahill
Mr. Yarbrough
Mr. Konopnicki, Chairman

Chairman Boone appointed the following members to the Childcare sub-committee:
Ms. Lopez
Mr. Nichols
Mr. Murphy, Chairman

Agency Budget Presentation – School Facilities Board

Jake Corey, Fiscal Analyst, Joint Legislative Budget Committee (JLBC), addressed the committee. Mr. Corey explained that the School Facilities Board was created in the late 1990's as a result of litigation dealing with facilities and equities within the K-12 district. The board is funded through transaction privilege tax revenues and it has the ability to instruct the treasurer to transfer sales tax money for various funds and purposes without legislative appropriation.

Mr. Corey informed the committee the School Facilities Board is comprised of the following three components:

- The Deficiencies Correction Program corrects existing facility deficiencies and brings all districts in the state up to minimum adequacy standards, including quality deficiencies. It was originally estimated to be completed in fiscal year 2004 but may stretch into fiscal year 2006.

- The Building Renewal Program is designed to provide districts with funding for major repairs and renovations to maintain district facilities at those minimum standards once they have been reached through the deficiencies correction program. Funding is provided on a building by building basis and a statutory formula takes into consideration a building's age, size and any prior renovations.
- The New School Construction Program provides land or facilities to school districts for student enrollment growth. Funding is provided based on the statutory formula that takes into account the needs for lands or facilities by comparing a district's existing space with its enrollment projection.

New School Construction: Fiscal Year 2006 Financing

Mr. Corey discussed proposed funding of new schools in fiscal year 2006. He explained the JLBC budget has $300 million from the General Fund to provide cash funding for new school construction. This would provide funding for an estimated 35 projects, which would house about 24,300 students and would include $5 million to purchase land. The Executive Budget continues to lease-purchase finance new school construction. Under that plan, the board can enter into about $300 million in debt financing agreement. Under the Executive plan the debt service on those agreements would begin in fiscal year 2007 at an estimated cost of $28 million.

New School Construction: Debt Service

Mr. Corey explained that the JLBC budget adds approximately $29.9 million to make the fiscal year 2006 debt service payment on all existing lease-purchase obligations. The total debt payment under the JLBC budget will be about $73 million funded from the General Fund. The Executive Budget adds $7.7 million to make the payment on a restructured debt service schedule. Therefore, they would be about $22 million less than JLBC. The 2006 executive total payment would be just under $51 million from the General Fund. He discussed the Executive Proposal Debt Financing (Attachment 2). He also discussed the long term debt service payment if school construction remains lease-purchased and referred to a chart from his presentation (Attachment 3). He pointed out that if the state continues to lease-purchase new school construction, in 15 to 20 years the state will make $900 million in debt service payments on all existing obligations. He compared that with outstanding debt for new school construction and pointed out that if the state continues to debt finance new school construction, the outstanding debt would be $5.5 billion in 20 years.

Building Renewal

Mr. Corey pointed out that the JLBC budget continues to provide $70 million from the General Fund for building renewal. It also adjusts the formula to do four things:

- Caps the age of a building at 30 years.
- Equalizes funding for portable buildings to allow the same funding available for permanent buildings
- Uses replacement costs per square foot
- Uses square footage per student designated by the minimum adequacy guidelines rather than the new school construction per student.

At the end of fiscal year 2004, local district building renewals balances were at about $100 million. The Executive Budget does not provide funding for the existing building renewal formula. Instead, it establishes a preventative maintenance/building renewal program. He pointed out that there is no funding in the Executive Budget and if revenues exceed the forecast, they would trigger funding of $70.7 million from the General Fund, including $50.7 million for the preventative maintenance as well as an estimated $20 million for the building renewal. He referred to a chart (Attachment 4) to discuss the history of the Building Renewal Fund. He offered to answer any questions from the committee.

Deficiencies Correction

Mr. Corey stated that both the JLBC and Executive Budgets provide $20 million to the General Fund, which is used to fund the School Facilities Board's revised estimates to complete the deficiencies correction program. The board has indicated there are three reasons for the $20 million increase from the prior estimate:

- Inflation and project expansion, which they estimate has caused additional costs of about $4.5 million.
- Construction phase change orders which has increased overall costs by $12 million
- Increased oversight, project development and any other cost increases, which they estimate at $3.5 million.

He added the amount of funding requested is still an estimate and that the legislative mechanism for providing funds if the legislature chooses to do so is unclear. The deficiencies corrections term expires at the end of the current fiscal year. However, the School Facilities Board has instructed the treasurer to transfer $20 million to the deficiency corrections fund in fiscal year 2006.

All Day Kindergarten

Mr. Corey explained that the JLBC budget eliminates $40 million for one-time funding that was provided for capital grants for the districts that had 90 percent or more free or reduced priced students. The Executive continues to provide $4 million from the General Fund in fiscal year 2006, which will be used to expand full day Kindergarten to include schools with at least 80 percent free or reduced priced lunch students. Mr. Corey recapped JLBC changes to the budget (Attachment 5). He discussed the School Facilities Board total funds for fiscal years 2002 and 2003 (Attachment 6). He stated that Chairman Boone had previously requested options when finalizing the 2006 budget. He discussed those options (Attachment 7) and explained the chart that provides further detail regarding the operating budget and appropriated funds (Attachment 8). He offered to answer any questions from the committee.

In response to inquiry from Representative Anderson, Mr. Corey explained that the information given is meant to provide a summary of each individual budget. The School Facilities Board estimates a one-time cost of $50 million to incorporate the half-day kindergartens into full day. That cost is associated with those districts that currently qualify for a new school. He stated that JLBC staff has estimated an annual ongoing cost of about $10 million. He added that the amount would be included in the $477 million.

Presentation by the Governor's Office of Strategic Planning and Budgeting (OSPB)

Dawn Nazary, Budget Analyst, Governor's Office of Strategic Planning and Budgeting (OSPB), addressed the committee. She referred to her handout (Attachment 9) and discussed the following areas:

Lease to Own Payments

Ms. Nazary explained that the OSPB recommendation is $22 million less than the JLBC due to the fact that a debt service schedule that assumes refinancing of the portion of the existing lease to own debt is used. The refinancing would reduce the interest rate creating a savings of $22 million in fiscal year 2006. She pointed out that the net overall cost of the General Fund under the current debt structure has a zero net effect. Additionally, this creates one-time revenues to pay for essentially one-time deficiency correction.

New School Construction Program

JLBC has proposed $300 million in cash financing and the OSPB has recommended the continuation of the lease-to-own program, which has been in existence since 2003. Currently, the School Facilities Board has, under statute, the authority to enter into $200 million worth of lease to own and that authority would have to be increased to allow for the additional lease to own transaction.

Building Renewal Program

Ms. Nazary explained that the Executive has proposed an alternative to the existing building renewal program and is calling it the School Building Maintenance and Renovation Program because it is made up of two main components. First, preventive maintenance is estimated at a $50.7 million cost. Second, the building renewal portion was estimated at $20 million. The state has required for districts to put together preventive maintenance plans in an effort to protect the state's $1.3 billion investment in deficiency correction. The preventive maintenance was the first step to ensure that school buildings are maintained at standard and the goal is to align resources to expectations. She stated it was requested that school districts participate as partners and invest 50 percent of preventive maintenance needs in school districts.

Full Day Kindergarten Capital Grants

Ms. Nazary informed the committee that during the first year of the phase-in, $4 million was identified for first year schools to help with short term capital needs. The Governor has recommended a second year phase-in of 80 and 90 percent schools, and it is estimated that about 100 schools and 10,000 children would be impacted. She offered to answer any questions from the committee.

Representative Yarbrough asked if the holiday payment described in the lease-to-own would be an option that could be exercised notwithstanding whether cash or continued debt financing is used for future expenditures. Ms. Nazary stated it could because the debt exists.

Phil Bell, Director, School Facilities Board, addressed the committee and offered to answer any questions.

Chairman Boone stated there is an estimate of $50 million in terms of the cost for the capital portion of the implementation of full day kindergarten. He asked for a brief overview of how that money will be used. Mr. Bell referred to the budget director for explanation.

Sean Arnold, Deputy Director of Finance, School Facilities Board, addressed the committee. He explained that last fall the study committee requested an estimated amount for implementing full day kindergarten. At that time it was requested that the study committee define the parameters of the program that were going to be implemented in order to make an estimate. It was suggested to calculate the impact the new school facilities formula by switching a kindergarten student from a half student to a full student. He explained the formula used to calculate the number of students that would move from half-day kindergarten to full day kindergarten.

Mr. Bell responded to comments made by Representative Pearce and explained that there are certain districts that will want more space. Mr. Pearce stated his concern regarding incurring new debt to start new programs and further obligate the General Fund.

Discussion

Debt Financing

Chairman Boone asked Mr. Bell to comment on lease-to-own versus debt financing. Mr. Bell indicated his preference to not take a position on the subject, but stated that lease purchase is the mechanism that the Legislature has authorized the School Facilities Board to utilize, and as it changes they will carry out the wishes of the committee.

Mr. Arnold added that statute provides for annual $200 million authorization and it is estimated that $300 million will be needed.

Chairman Boone referred to the chart (Attachment 10) that indicates accumulating debt of new school construction if debt financing is continued and inquired as to how that will impact credit ratings. He pointed out this is an issue that needs to be addressed because ten years from now the debt service from outstanding debt would begin to exceed the amount of new school construction for that year. He reiterated his concern for the long-term picture. He requested a reaction from some of the rating agencies in terms of how they view this because the debt ratings will change as the cost of financing increases.

Mr. Arnold pointed out that recently the state was upgraded in its rating for state repurchase. He explained there are four components that are examined when determining a rating. The performance of the economy, the financial status of the state, the management of the state and also existing debt levels are all taken into consideration. No debt would indicate inadequate investment in the facility and could result in high costs.

Representative Yarbrough inquired as to a reason not to implement the Executive's recommendation to refinance the outstanding debt and secure this one-time savings of $22.2 million regardless of whether cash financing is returned or debt financing is continued.

Mr. Corey referred to the Executive proposal (Attachment 2) and explained that in each out year, there is $1.6 million in additional debt service above and beyond the existing structure. Additionally, if $22 million is saved in fiscal year 2006, that amount has to be recouped in fiscal year 2007.

Mr. Murphy asked if there is any reason why the local school districts cannot pay a portion of the costs for construction as opposed to funding all of it through the state. Mr. Bell explained that at some point, that may happen but the School Facilities Board will continue to carry the instructions of the Legislature.

<u>New School Construction</u>

Chairman Boone stated when the Students First program was implemented, the Class A Bonds were eliminated and a Class B bonding system was created. Restrictions were placed on the funds along with a constitutional rationale for outstanding debt. One of the issues with this was regarding furniture and equipment for new schools. He explained further that currently school districts cannot finance furniture and equipment for new schools. He asked if the School Facilities Board viewed that issue as problematic and whether it could be possible to grant authority to the school districts to use a portion of the Class B bonds for furniture for new schools. Mr. Bell stated he was unprepared to answer that question, but that he would research the issue and get back to the committee.

Chairman Boone inquired about new construction and the issue of utilities. He stated that excess utilities will go away in 2009 according to Proposition 301. He asked how this will be addressed with all the new school buildings in the future. Mr. Bell explained the requirement is to build to a minimum standard, and in many instances school districts find themselves with minimum dollars desiring to install solar or energy efficient type of equipment. The payback is an obstacle that needs to be addressed. However, efforts are being made to implement ways to improve facilities under the current system.

<u>Building Renewal</u>

Chairman Boone stated the Executive’s recommendation is not to fund building renewal at $70 million for 2006 and he inquired as to what kind of exposure that could create. Mr. Bell stated that the building renewal and preventive maintenance should be combined. He pointed out that over one billion dollars has been invested to bring schools to standard and stated that a preventive maintenance program that is funded and requires the school district to participate in maintaining those facilities is a suitable resolution. He added that building renewal is allocated and disbursed but there is limited data on the use of the dollars. By placing the funds on an as needed basis, hard data could be accumulated indicating the precise need regarding building renewal dollars.

Chairman Boone reiterated that the current system for building renewal is based on a formula and the $70 million does not finance the entire formula. He clarified the suggestion that the program should be based on requests from the districts, rather than the building renewal portion being based on a formula. Final approval would follow and then completion of projects.

The second part would be the preventive maintenance, which would consist of a formula that would be distributed, providing a better estimate in terms of the projects that need to be completed under the building renewals, as well as the actual costs of those projects.

Chairman Boone responded to inquiry from Representative Rios as to whether or not a dedicated revenue source will be considered as opposed to the "pay-as-you-go" method. He explained that the dilemma is that when Student's First was implemented, there was no dedicated revenue source. What is available today is the result of that. He added there may be a dedicated revenue source eventually to cover the entire School Facilities Board functions and not just debt financing. In particular, the debt financing needs to be addressed, and he pointed out that there will be legislation in the future that will deal with some sort of dedicated revenue source.

CONSIDERATION OF BILLS

H.B. 2051 – high school equivalency diplomas; fees – DISCUSSION ONLY

Chairman Boone announced that H.B. 2051 would be for discussion only.

Mike Huckins, Majority Research Analyst, explained H.B. 2051 in summary (Attachment 11).

Karen Liersch, State Director of Adult Education, Department of Education, addressed the committee. She responded to inquiry from Representative McLain and explained that the current cost to produce a General Equivalency Diploma (GED) is $50. She explained that August 2004 brought an 80 percent increase in scoring costs resulting in efforts to bring the scoring process in house, which would possibly reduce the cost of the GED diploma to $25. She addressed inquiry from Representative Yarbrough and explained this is not being implemented due to anticipation of a rush resulting from the AIMS testing.

Mr. Liersch responded to inquiry from Representative Pearce and explained the GED test can only be taken by individuals 16 years of age or older and who have been officially removed from high school. She added it was developed after WWII for those veterans who left school to fight in the war. However, currently in Arizona 40 percent of the people who take the GED each year are between 16 and 19 years of age and an additional 26 percent are between 20 and 24 years of age. Currently in Arizona, 65 percent of the people who take the test annually are under 24 years of age and that is typical with the numbers from other states in the country. She added that the $50 cost is for the state administration. Any instructional program that takes place is an additional cost.

She explained further that only ten percent of the people each year who enroll in adult education instructional programs complete and receive their GED and 75 percent of those avoid the instructional program and go directly to testing. They pay $50 at the testing center, which covers the costs of the materials for the test and the seven and one-half hours of the examiner's time at the facility. She added she currently has an outstanding invoice for $600,000 which includes administrative monitoring, opening and closing of the testing centers throughout the state, training up to 100 examiners each year, investigating fraud in transcripts and diplomas, investigating security issues at the testing centers, training all the examiners, and monitoring and maintaining a level of test security. The increase will cover the state administration portion and includes the scoring of the tests and the issuing of diplomas.

In response to inquiry from Representative Murphy, Ms. Liersch, explained that the GED is given to high school seniors each year and up to 40 percent cannot pass it. At one time, there was a waiting list in Arizona to take the GED test but it was removed six years ago, and currently as long as someone is officially removed from high school, he can enter a testing center, pass the test and receive a GED.

Without objection, the meeting adjourned at 3:28 p.m.

Robyne Richards, Committee Secretary
January 31, 2005

(Original minutes, attachments and tape on file in the Office of the Chief Clerk)