



# Arizona State Senate Issue Brief

May 2, 2016

## Note to Reader:

The Senate Research Staff provides nonpartisan, objective legislative research, policy analysis and related assistance to the members of the Arizona State Senate. The *Research Briefs* series is intended to introduce a reader to various legislatively related issues and provide useful resources to assist the reader in learning more on a given topic. Because of frequent legislative and executive activity, topics may undergo frequent changes. Additionally, nothing in the *Brief* should be used to draw conclusions on the legality of an issue.

## Students FIRST

### INTRODUCTION

In 1994, Arizona's system of school capital finance was declared unconstitutional by a court decision in *Roosevelt v. Bishop* because it failed to conform to the state Constitution's "general and uniform" clause. The Arizona Supreme Court opined that the system relied too heavily on secondary property tax revenue, which is driven by property value, and created an unequalized system with funding disparities between school districts.

The state twice attempted to address the Court's ruling, first in 1996 through an amended system based on the original financing system, and again in 1997 with the creation of a new system, the Assistance to Build Classrooms program. In *Hull v. Albrecht*, the Court rejected both proposals and imposed on the state a deadline of June 30, 1998, to develop a constitutional system of school capital finance or risk closure of K-12 public schools. On July 9, 1998, during a special session, legislation was passed reforming the way traditional K-12 public schools (not including charter schools) finance capital investment and construction in Arizona. This legislation was called Students Fair and Immediate Resources for Students Today, commonly known as Students FIRST.

Since 1998, the Students FIRST program has served as Arizona's school capital finance system, funded in part by Proposition 301 revenues dedicated from the state transaction privilege tax, state trust land revenues and annual legislative appropriations to the School Facilities Board (SFB). The Students FIRST program consists of three programs:

- Emergency Deficiencies Corrections – Funding to address emergency capital needs after school districts have exhausted all other available sources.
- Building Renewal – State grants to school districts to maintain existing school facilities.
- New School Construction – Funding to construct new school facilities, while retaining a limited ability to raise local funds through bond issuances and capital overrides to supplement SFB funds.

**SCHOOL FACILITIES BOARD**

The Students FIRST program is administered by SFB, which consists of nine voting members appointed by the Governor. Additionally, the Superintendent of Public Instruction or his/her designee serves as a nonvoting member. Each voting member is appointed based on expertise in one of the following areas: school district governing board member, taxpayer representative, school construction, school facilities management, demographics, teacher, engineering, architecture or private business owner. Each member serves a term of four years. Day-to-day operations are managed by the Executive Director, who is also appointed by the Governor, subject to Senate confirmation.

**MINIMUM BUILDING ADEQUACY STANDARDS**

In September 1999, SFB established the Building Adequacy Guidelines, which serve as the minimum standards for SFB and school districts on how existing and new school facilities must be built and maintained. The standards range from statutorily set square footage requirements to specifications on building systems, classroom and nonclassroom space (cafeteria, libraries, and athletic facilities) and energy efficiency measures. Compliance with these standards is the basis on which deficiencies corrections and new construction projects are approved by SFB.

The square footage requirements are calculated using the most recent 100<sup>th</sup> day student count and the gross square footage of all buildings. However statute excludes certain space from SFB’s calculation, including: 1) district administration space; 2) space used for vehicle storage; 3) nonacademic space; and 4) up to 25% of locally funded space that was approved after the creation of SFB; referred to as “invisible space”.

As a result of these exclusions, school districts are more likely to qualify for new school construction awards (see below).

**DEFICIENCIES CORRECTION**

The Deficiencies Correction Program was created to provide one-time funding to correct square footage or structural quality deficiencies in existing school facilities. The determination of deficiency was based on whether existing buildings were in compliance with minimum building adequacy standards. An initial statewide assessment of school facilities completed in 1999 identified the school district facilities that would require repair, renovation or replacement.

Students FIRST legislation required that all projects be completed by FY 2005. In order to address state budget shortfalls however, the completion date was delayed until the Deficiencies Corrections Program was completed in FY 2006. Over the course of the Deficiencies Corrections Program, the state provided \$1.314 billion for over 9,200 projects, including approximately 36,000 computers and statewide Internet connectivity for all school districts. The \$1.314 billion was funded in the following manner:

- Bonds.....\$ 1.1 billion
- General Fund.....\$176 million
- Fund Transfers. ....\$ 38 million

To ensure that the state’s \$1.3 billion investment is preserved, SFB is required to inspect 20 randomly selected school facilities every five years to ensure that school districts perform adequate preventative maintenance so that the school facilities will not fall below minimum building adequacy standards. Each school district is also required to submit an annual preventative maintenance report to SFB. If the school district is found to be in noncompliance, the school district must use building renewal monies (as discussed below) to return to compliance.

The Legislature established the Emergency Deficiencies Correction Fund in 2001 to address emergency capital needs that “seriously threaten the functioning of a school district, the preservation or property, or public health, welfare, or safety.” A school district that experiences an emergency of this nature may

apply for additional funding after exhausting all other funding sources available, such as insurance proceeds or building renewal monies (see below). If there are insufficient monies in the Fund, school districts are allowed to levy an additional primary property tax levy to fund the repairs, with the approval of the county board of supervisors.

Funding for the Emergency Deficiencies Correction program consists of monies transferred from: 1) the Deficiencies Corrections Fund, which no longer exists; and 2) the New School Facilities Fund, as long as the transfer will not affect or disrupt any approved capital projects. Because the majority of new school construction has been financed with bonds in recent years, there is typically little to no excess funds available for the Emergency Deficiencies Correction program. SFB estimates the Emergency Deficiencies Correction fund will have a \$0 balance at the end of FY 2016.

### ***BUILDING RENEWAL***

The Building Renewal Program provided school districts with funding to maintain the adequacy of existing facilities. The funding was determined by a statutory formula that was allocated on a building-by-building basis and took into account the building's square footage, age, student capacity and prior renovations. Monies generated from the formula could be used for: 1) major renovations and repairs of a building; 2) upgrades to building systems (e.g., heating, cooling, plumbing, etc.) that will maintain or extend the useful life of a building; 3) infrastructure costs; and 4) portable and modular building placement or relocation. A school district was also permitted to allocate up to eight percent of funding for preventative maintenance.

Building Renewal monies were prohibited from being used for: 1) new construction; 2) remodeling interior space for aesthetic purposes; 3) exterior beautification; 4) demolition; 5) soft capital items; or 6) routine maintenance.

During the life of the Building Renewal Program (FY 1999 through FY 2008) the formula generated over \$1 billion cumulatively; however due to budget deficits the state

distributed \$693.1 million from the state General Fund. The reduced funding amounts in FY 2005 through FY 2008 reflected a funding level based on a revised building renewal formula passed by the Legislature, and vetoed by the Governor each time it reached her desk. In her veto messages, the Governor raised concerns relating to the impact of the proposed formula changes on a pending lawsuit against the state (see below).

In 2008, the Legislature created the Building Renewal Grant Fund to replace the Building Renewal Program. The Grant Fund largely retained the same purpose, requirements and restrictions as the Building Renewal Program but replaced the statutory formula with a needs-based grant system. Since FY 2009, the Legislature has appropriated \$92,507,400 to the Building Renewal Grant Fund, or an average of \$10,278,600 annually.

Building renewal projects typically fall under one of eight categories: 1) electrical; 2) general renovation; 3) HVAC; 4) plumbing; 5) roofing; 6) special equipment; 7) special systems; and 8) surfaces. The majority of Building Renewal projects and funds are awarded for upgrades to schools' HVAC systems and roofs.

### ***BUILDING RENEWAL LAWSUITS***

In 1999, eight school districts sued the state (*Roosevelt v. Bishop*) citing the Legislature's failure to fund the Building Renewal Program at the formula amount set by Students FIRST as unconstitutional. In October 2006, the court ruled in favor of the state stating that the plaintiff school districts had not attempted to obtain all available funds from the state prior to making the complaint. However, the court permitted the plaintiffs to provide additional evidence by spring 2008 to demonstrate whether a trial would be warranted. After an evidentiary hearing, the Superior Court dismissed the case in 2011 after finding a justiciable controversy still did not exist

### ***NEW SCHOOL FACILITIES***

The New School Construction Program distributes funding to school districts for the purchase of land and costs of construction for

new schools. School districts qualify for new space based on annual capital plans and enrollment projections. SFB provides funding if enrollment projections indicate that additional space will be needed because school district-wide square footage per pupil falls below the statutory minimum in the current year. Prior to FY 2014, SFB projected enrollment out two years for elementary districts and three years for middle or high school districts and awarded new space based on those projections.

SFB distributes new school facilities monies to school districts based on the following new school construction formula:

$$(No. \text{ of Pupils} \times \text{Square Foot per Pupil}) \times \text{Cost per Square Foot}$$

Statute dictates the required square footage per pupil (see Table 1) and the cost per square foot. SFB is statutorily permitted to increase monies in excess of the formula under four conditions: 1) inflation index as identified by the Joint Legislative Budget Committee (see Table 2); 2) five percent increase for rural areas; 3) geographic conditions; and 4) site conditions.

If a project is completed at a cost below the formula amount, a school district may use the excess funds on the same project within one year.

**Table 1  
Funding Guidelines**

Type of School	Sq. foot Per Pupil	Funding per Sq. foot
K-6	90	\$136.66
7-8	100	\$144.27
9-12 (<1,800 pupils)	134	\$167.05
9-12 (≥1,800 pupils)	125	\$167.05

Note: Cost per square foot is increased by five percent for rural school districts.

Beginning in FY 2003, the state took a variety of cost saving measures to mitigate budget shortfalls.

Previously, the state paid for new construction costs on a cash-basis through legislative appropriations from the state General

Fund. In FY 2003 – FY 2005, FY 2008 and FY 2009 however, the state implemented debt financing through lease-purchase agreements to pay for new construction. For each agreement, SFB issued Certificates of Participation that are typically repaid over a period of 15 years. After SFB refinanced these agreements in 2015, the outstanding amount of General Fund lease-purchase principal to be paid will be over \$700 million by the end of FY 2017.

From FY 2009 through FY 2013, the Legislature placed a moratorium on all new school construction but exempted lease-to-purchase authority and land acquisition. The moratorium was lifted in FY 2014.

Finally, in FY 2011 SFB issued Qualified School Construction Bonds, as authorized by the federal American Reinvestment and Recovery Act of 2009, to finance \$91 million worth of lease-to-own transactions that funded the construction of five new schools and additional space for three schools.

**Recent Action**

The Legislature appropriated \$15 million to the Building Renewal Fund in FY 2016 and FY 2017. In FY 2017, the Legislature also appropriated \$23 million to SFB for new school construction for Chandler Unified School District and Agua Fria Unified School District, with the caveat that almost \$17 million will revert to the General Fund if Agua Fria’s enrollment declines below the qualifying threshold.

**INFLATION**

The Joint Legislative Budget Committee (JLBC) is statutorily obligated to develop or identify an inflation index for the cost per square foot funding component in the New School Construction formula (the index also applies to the Building Renewal formula cost per square foot amount). The following table lists the annual inflation index adopted by the JLBC:

**Table 2**  
**Inflation**

<u>Fiscal</u> <u>Year</u>	<u>Index</u>
2000	3.1%
2001	5.0%
2002	0.6%
2003	0.0%
2004	4.2%
2005	1.4%
2006	12.85%
2007	12.20%
2008	2.2%
* 2009 – 2016	0.0%

\* There has been no increase for inflation due to the construction cost index remaining below November 2008 levels.

### **ADDITIONAL RESOURCES**

- *Roosevelt v. Bishop*, 179 Ariz. 233 877 P.2<sup>nd</sup> 806 (Ariz. 1994)
- *Hull v. Albrecht*, 190 Ariz. 520 950 P.2<sup>nd</sup> 1141 (Ariz. 1997)
- *Hull v. Albrecht*, 192 Ariz. 34 960 P.2<sup>nd</sup> 634 (Ariz. 1998)
- Arizona School Facilities Board  
602-542-6501  
[www.azsfb.gov/sfb](http://www.azsfb.gov/sfb)
- Annual Appropriations Report, Joint Legislative Budget Committee  
[www.azleg.gov/jlbc.htm](http://www.azleg.gov/jlbc.htm)