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The School Construction Budget: Seeming Decline in State Funding a Matter of Fiscal Reporting, Not Support

The Ten-Year Capital Strategy for Fiscal Years 2016-2025 shows a dramatic shift in the city and state shares of capital funding for school construction, from roughly 50-50 in prior years to roughly 88-12 for the next 10 years. Despite the shift, IBO expects it will have very little impact on the city's budget. The change results from the fact that an arrangement to increase capital financing support for city schools that was part of the resolution of the Campaign for Fiscal Equity (CFE) case was not open-ended and—despite a widespread belief to the contrary—did not fundamentally alter the level of state aid for the education capital budget. The city has now nearly exhausted the additional borrowing capacity that was provided by the state.

But this does not mean the state is necessarily providing less support for school construction or that the city's costs of financing the education capital budget will necessarily go up. Indeed, as long as the city's traditional debt capacity remains sufficient and the state does not make major changes to its formula for awarding school building aid, the fiscal impact for the city—if any—is likely to be modest.

The state contributes to the Department of Education (DOE) capital plan, which is managed by the School Construction Authority (SCA), in two ways.

First, the state reimburses the city for capital-eligible projects in the form of building aid. The building aid portion of the state's contribution has existed since 1962, when the building aid formula was enacted and there has been no significant change in the formula in recent years.¹ The amount of building aid to the city fluctuates each year depending on the district's building aid ratio, the dollar value of building aid-eligible projects the city has completed, and annual appropriations by the state Legislature. Since 2000, New York City's building aid

ratio has been roughly 50 percent and the 2016 capital commitment plan anticipates no significant changes in the state's appropriations for building aid. Prior to 2007, all of—and subsequently, a portion of—this traditional building aid has been received by the Department of Education (DOE) as part of its overall state aid allocation, with the funds treated as part of the city's revenue budget rather than its capital budget. The assumption is that the state building aid frees up resources elsewhere in the city budget that can be dedicated to education debt service.

Second, in order to meet the capital funding required under the resolution of the CFE court case the state authorized the New York City Transitional Finance Authority (TFA) to issue Building Aid Revenue Bonds (BARBs) to finance school construction projects and to direct state building aid payments to the annual debt service payments for these bonds.² The amount of financing that can be done through TFA is subject to a cap on the total amount of BARBs debt outstanding.

By the end of this year, TFA is expected to hit the cap of \$9.4 billion outstanding in BARBs, so the city will have to finance most future education construction investment using either general obligation (GO) or TFA bonds not backed by building aid. The 2016 capital commitment plan does not anticipate an increase in the BARB cap and assumes that the city will rely on city-backed bonds to finance most education capital spending in the future.

Background on the CFE Court Case and BARB Authorization

The increase in state education funding to the city since 2007—for both the operating and capital budgets—is the result of a string of court decisions in the long-running



Campaign for Fiscal Equity v. State of New York court case. The CFE, comprised of a coalition of parents, advocates, and community school boards, argued that the state was denying New York City public school students their constitutional right to a sound basic education because the city's schools were significantly underfunded.

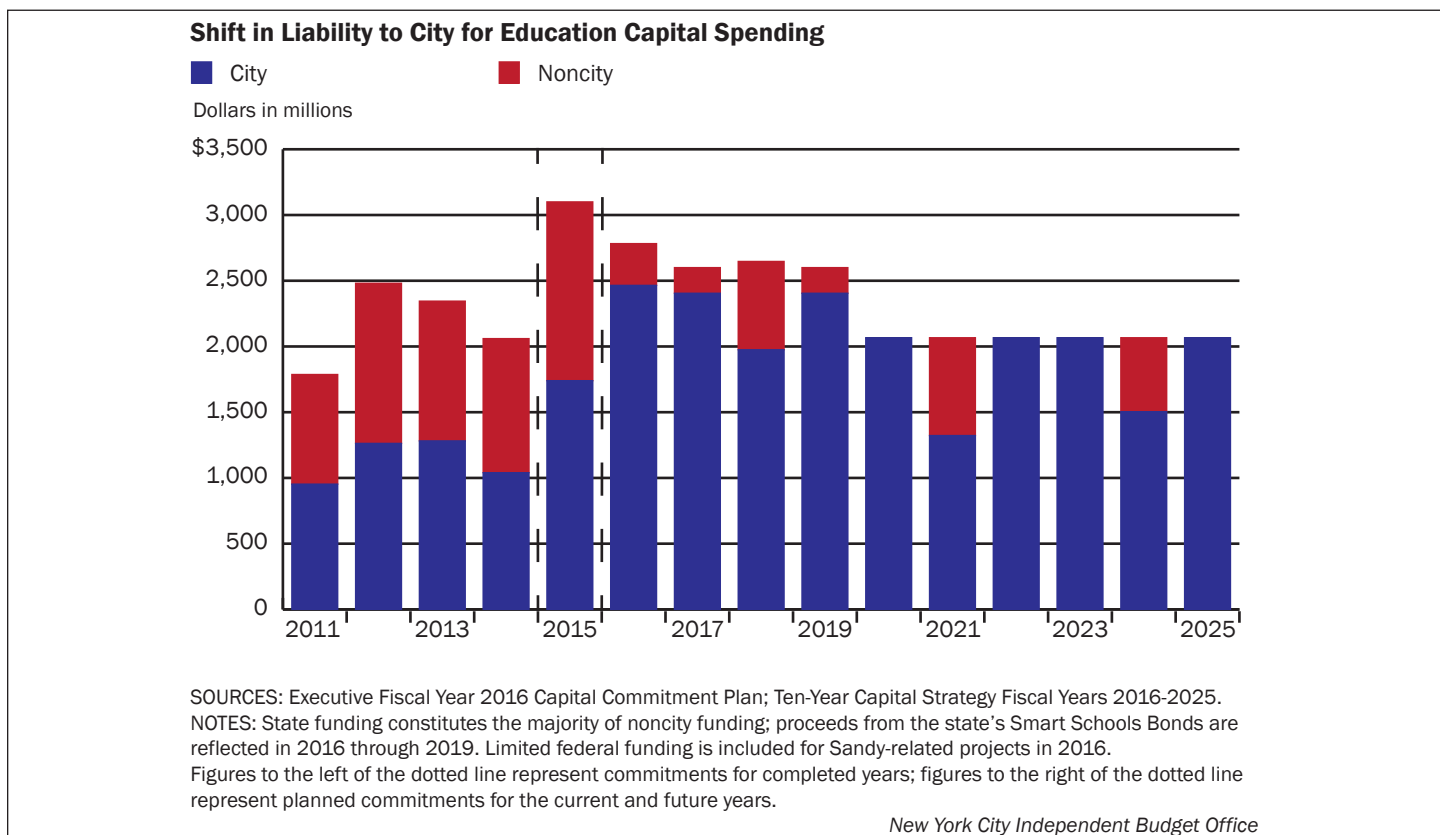
The CFE filed their initial court case against the state in 1993; in 2001 the State Supreme Court ruled in favor of the CFE and ordered the state to rectify the inequity in funding to the city. After several appeals by the state, in 2003 the Court of Appeals again ruled in favor of the CFE and required the state to comply by July 30, 2004. After the state missed the deadline, a panel of three referees was convened to decide how much additional funding and resources were needed to provide a sound basic education for city students. The panel determined that an additional \$4.7 billion to \$5.3 billion in operating support and \$9.2 billion in capital investment were needed.³

After the state lost another appeal in the Appellate Division in March 2006, the state Legislature moved to deal with the capital assistance part of decision (legislative action on the operating support side came later). Legislation was enacted granting the TFA authority to receive the city's building aid from the state as a trustee. The legislation also allowed TFA to use those funds to secure up to \$9.4 billion

in bonds over and above TFA's existing authority to issue debt on the city's behalf.

By the end of 2015, the city expects that TFA will hit the cap of \$9.4 billion outstanding in BARBs. In addition to the \$6.8 billion in BARBs currently outstanding, including \$750 million that were issued in January 2015, significantly more are expected to be issued this year. As previously issued BARB debt matures, new BARB debt can be issued on an occasional basis as long as the total outstanding remains below the \$9.4 billion cap. The Mayor's budget office expects to be able to issue new BARBs in 2018 (\$477 million), 2021 (\$744 million) and 2024 (\$562 million).

Because BARBs are serviced through a dedicated revenue stream directly from state education aid, those bonds are not considered city-funded debt when measuring the city's debt limit or its debt capacity. Beginning in 2016, the city is expecting to shift away from issuing BARB debt and towards issuing GO or other TFA debt, both of which are considered to be city debt. The city will continue to garner state building aid because the amount of aid is tied only to what projects the city uses its capital dollars for, rather than how those projects are financed. Over time, as BARB issuance shrinks and less building aid is needed to service the BARBs, the amount of building aid flowing directly to the DOE for operating purposes will grow. With additional



resources available to the DOE, this will in turn allow the city to dedicate more of its own revenue to finance the education capital plan. But as this switch occurs, the reported funding source for the capital budget shifts from the state to the city, even though little has changed in terms of overall state building aid support.

Past and Future: Composition of Education Capital Commitments

The state's support for the education capital plan increased significantly once TFA began to issue BARBs in 2007. SCA's Final Report for the 2005-2009 Five-Year Capital Plan reported that state funding, largely through BARBs, accounted for two-thirds of the capital plan in fiscal years 2007 through 2009. In 2010, the first year of the next five-year capital plan, SCA reported that the state provided about half the funding necessary.

The city's latest capital commitment plan shows that from 2011 through 2014, education funding was split roughly in half between the city and state. In those four years, the city contribution ranged between 50.5 percent and 54.7 percent. So far in 2015, city funding is expected to account for 56.1 percent of planned commitments.

Beginning in 2016, city funding would increase substantially to offset the decline in BARB issuance. The portion identified as city funded would jump to 88.6 percent of planned commitments next year and is expected to remain at or above 64.0 percent through the 10-year capital

strategy period covering fiscal years 2016-2025. Over the next 10 years, the city commitment to the education capital plan is expected to be 88.3 percent of the total plan. In four of the last six years of that period, the capital plan would be funded only with city funds largely because with the amount of BARBs outstanding at or near the cap there would be no room for TFA to issue new BARBs.

Despite this shift in liability away from the state towards the city in terms of debt issuance, the state's contribution to the city's capital plan through building aid is expected to continue. Thus, provided the city continues to have sufficient room under its debt limit, and the state continues to maintain the building aid formula in its current form, the cost to the city if the BARB cap is not raised is likely to be small. The exact cost, if any, will depend on the difference in interest rates between BARBs and other city debt.

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Endnotes

¹See "School District Organization and State Aid" on the New York State Education Department website: <http://www.regents.nysed.gov/about/history-districts.html>, accessed 5/19/2015; and "School Facilities: Conditions, Problems and Solutions," October 1997, New York State Office of the State Comptroller, <http://www.osc.state.ny.us/reports/schools/1997/10-97.htm>, accessed 5/19/2015.

²In 2006, section 2799-tt of the Public Authorities Law was enacted to amend the law that originally created the TFA in 1997 to allow the authority to receive the city's portion of state building aid as a trustee and issue bonds securitized by the building aid revenue.

³See amicus brief provided by the Brennan Center filed for the November 20, 2006 case before the Court of Appeals. <https://www.brennancenter.org/sites/default/files/legacy/Democracy/2006-11-20%20CFE%20v%20NYS%20Appeals%20Court%20Opinion.pdf>

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