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Evaluation Report Summary / March 2019

Debt Service Equalization for School Facilities

State aid from the Debt Service Equalization program represents a small amount of funding, and few school districts receive it.

Key Facts and Findings:

- The Debt Service Equalization program, first operated in 1993, offers state aid to certain school districts to help them repay debt used to construct or renovate school buildings and other facilities. Program aid is intended to help offset or "equalize" variation in school district property taxes due to districts' varying levels of property wealth.
- To be eligible for aid, school districts must have low tax-base wealth per student and relatively high debt for capital projects.
- To finance facilities, school districts issue bonds that allow districts to borrow money for capital projects. District voters must first approve the bonds. Districts repay the principal and interest, known as "debt service," typically over a 20-year period.
- For Fiscal Year (FY) 2019, 34 of 329 school districts (10 percent) received Debt Service Equalization aid. All but six of them were outside the metropolitan area. Aid amounts ranged from $500 to $6 million.
- The Debt Service Equalization program has had limited impact in recent years. The number of school districts receiving aid declined from 131 in FY 1997 to 34 in 2019. The program's aid (inflation adjusted) declined 64 percent from FY 1997 through 2018. The aid paid for 11 percent of all eligible debt service statewide in FY 1997 but just 3 percent by 2019, meaning that districts have increasingly paid their eligible debt service mostly with their local property tax revenue.
- Minnesota has several programs to help school districts pay for school facilities. The ones we examined are not substitutes for the Debt Service Equalization program.
- To be eligible for the Debt Service Equalization program, projects of at least $2 million must receive a positive "review and comment" from the Minnesota Department of Education (MDE), which administers the program.
- MDE completed its review and comment within the required 60-day limit for 91 percent of a sample of 98 school district proposals. It may have exceeded the limit for the remaining 9 percent, but these cases involved circumstances that current statutes do not address.
- School district officials we interviewed said the program is inconsistent and complex, which some believe contributes to unsuccessful bond referenda.

Key Recommendations:

- The Legislature should consider changing the Debt Service Equalization program to help pay for school facilities in more of the districts that have low amounts of tax base per student and high capital debt.
- The Legislature should clarify in law the start and end points for the 60-day limit on MDE's review and comment of districts' facility proposals.
- MDE should provide additional information regarding the required content of districts' facility proposals.

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Report Summary

The Debt Service Equalization program provides state aid to certain school districts to help pay for bonds that school districts use to borrow money for financing the construction or renovation of school facilities. School districts may not issue bonds for certain facility projects until they obtain voter approval through a bond referendum.

School districts pay back the borrowed money—both principal and interest, known as "debt service"—over a number of years, most commonly a 20-year period. They typically raise the money by levying annual property taxes on property owners in the district.

Some school districts have large tax bases (the value of taxable property within a school district on which property taxes are levied), but others do not. For example, in 2016, the tax base per student ranged from about $3,700 per student at the 5th percentile of districts to more than $24,000 per student at the 95th percentile. The Debt Service Equalization program offers state aid to help offset such variation in school district property taxes due to varying levels of property wealth.

Between Fiscal Year 1997 and 2019, the percentage of school districts receiving Debt Service Equalization aid declined by 71 percent.

Not all debt service is eligible for the Debt Service Equalization program. Eligible debt service must meet certain statutory requirements, such as its use for facilities with a primary purpose of serving students in kindergarten through 12th grade. To be eligible for the aid, school districts must have low tax-base wealth per student and relatively high debt service for capital projects.

In Fiscal Year 2019, 34 of 329 school districts (10 percent) received Debt Service Equalization aid. All but six were located outside the seven-county metropolitan area. On average, school districts receiving aid had smaller tax bases, served more students, and had higher debt service than other districts. The largest amount of aid for Fiscal Year 2019 ($6 million) went to St. Michael-Albertville Schools, and the smallest ($500) to Rush City Schools.

The Debt Service Equalization program has had limited impact in recent years.

Compared with earlier years, Debt Service Equalization aid represents a small amount of funding and helps a relatively small number of school districts. Aid peaked in Fiscal Year 1997 at $61.3 million (adjusted for inflation). Although aid amounts had periods of growth and decline, over time, aid dropped to $22.3 million in Fiscal Year 2018, a 64 percent decline from its 1997 peak.

Debt Service Equalization aid pays for a smaller proportion than it once did of eligible debt service for school districts statewide. The aid paid for 11 percent of all school districts' eligible debt service in Fiscal Year 1997, but this decreased to 3 percent in Fiscal Year 2019. This decline means that school districts use a greater proportion of their local property-tax revenue to pay debt service than they did in the past.

Looking at individual school districts that receive Debt Service Equalization aid, fewer districts over time have received the aid. In Fiscal Year 1997, 51 percent of school districts with eligible debt service (131 districts) received aid. By contrast, 15 percent (34 districts) received aid in Fiscal Year 2019, a 71 percent decrease.

For those school districts that have received Debt Service Equalization aid, the aid has covered a decreasing percentage of a district's eligible debt service on average. In Fiscal Year 1997, aid paid an average 26 percent of a school district's eligible debt service, but this decreased to an average 13 percent in Fiscal Year 2019.

Certain other programs for school district facilities have limitations and are not a substitute for the Debt Service Equalization program.

Minnesota has several programs to help school districts pay for school facilities. As one example, the Operating Capital Revenue program offers state aid for certain expenditures, such as school building repairs and Fire Code compliance. The program is part of the general education revenue program; as such,

Without legislative changes, the Debt Service Equalization program will likely continue to help a relatively small number of school districts.

almost all school districts receive aid through it. Operating Capital Revenue provides greater equalization than the Debt Service Equalization program, and it has provided greater amounts of state aid since Fiscal Year 2005.

However, the Operating Capital Revenue program does not generate enough revenue to pay for large projects, such as adding classrooms or building a new gymnasium. Some school district officials we interviewed said they use their Operating Capital Revenue for smaller projects, such as safety equipment and technology needs; they do not have enough of this revenue left over for larger expenses.

The Legislature should consider changing the Debt Service Equalization program to help pay for facilities in more of the school districts that have low tax base per student and relatively high capital debt. Keeping the program as it is means it will likely remain focused on a relatively small number of districts, leaving without aid other districts that also have relatively low tax base per student and high capital debt.

Depending on what legislators hope to achieve, they can consider options to expand the number of school districts that would receive aid. For instance, the Legislature could change elements in the current formula to potentially increase the aid or number of recipients.

A second option is that the Legislature could redefine which school districts are eligible for Debt Service Equalization aid. One way to redefine eligibility is to consider the age of districts' facilities and focus eligibility on districts that have older buildings as well as high capital debt and low tax base per student. Another is to consider not only districts' tax base per student but also homeowner income. The Legislature could focus Debt Service Equalization aid on districts where tax base per student is low *and* a significant proportion of taxpayer incomes is also relatively low.

The Legislature could also consider modifying the Debt Service Equalization program by stabilizing the year-to-year differences in aid for a given school district. The Minnesota Department of Education (MDE) calculates annually the program's revenue, levy, and aid, taking into account changes in each district's tax base, enrollment levels, and amount of debt service, among other factors. Amounts of aid can change from one year to the next, and reductions in aid mean a school district likely has to increase property taxes to have sufficient local revenue to pay the debt service.

Guaranteeing a stable amount of aid for some number of years will help maintain the local tax impact at an even level. Some school district superintendents we interviewed said if they could assure residents that the tax impact would not increase, voters might be more likely to approve bond referenda.

It is unclear whether the Minnesota Department of Education fully met a requirement to review school district facility proposals and issue a comment within 60 days.

State law requires MDE to review and comment on certain facility proposals.[1] This includes proposals that involve referenda for bonding and projects with at least $2 million in expenditures per school site. The requirement applies to virtually all proposals for which school districts might plan to receive Debt Service Equalization aid.

By law, MDE is to review facility proposals to assess each project's "educational and economic advisability."[2] Statutes also specify the information, such as a list of existing facilities by age and use, that school districts are to include in their proposals.[3] Beyond that, statutes require a school district to provide any other information the department determines is necessary.[4]

[1] *Minnesota Statutes* 2018, 123B.71, subd. 8.

[2] *Minnesota Statutes* 2018, 123B.71, subd. 11.

[3] *Minnesota Statutes* 2018, 123B.71, subd. 9.

[4] *Minnesota Statutes* 2018, 123B.71, subd. 11.

State law requires MDE to review school districts' proposed facility projects; all but one project in a sample of recent projects received a positive review.

To qualify for Debt Service Equalization aid, a school district's project must receive a "positive" rating from MDE's review.[5] Projects that receive "unfavorable" or "negative" ratings are ineligible for the program aid. All but 1 project in a sample of 98 projects we reviewed from Fiscal Year 2016 through 2018 received a positive rating.

State law requires MDE to provide its review and comment to school districts within 60 days of receiving the proposal to issue bonds.[6] MDE completed its review and comment within the 60-day limit for 89 of the 98 projects (91 percent) in our sample.

At the same time, MDE may have exceeded the 60-day limit in up to nine of the remaining cases, but the statute does not address these cases' circumstances. That is, MDE had deemed six of the cases as incomplete, stating that the districts had failed to provide statutorily required information. Five of these six cases were school districts that had no recent experience with the review and comment process. The remaining three cases involved two department letters: an original that arrived within the 60-day limit and a second, corrected letter that MDE sent after the deadline.

The Legislature should clarify in law the start and end points for the 60-day limit on MDE's review and comment process. Timeliness of the department's comment is important to school districts as they follow the many steps required in preparation for their bond referenda. One possible change is to "stop the clock" during the time between when MDE requests additional information and when MDE actually receives it from the school district.

MDE should also provide additional information on the content required in school districts' facility proposals. The department already has a "review and comment checklist" with general descriptions of the required information and a guide for planning school construction projects.

However, to help school districts unfamiliar with the particulars of information required for the review and comment process, MDE could add more specific information, such as a template. Districts lacking recent experience in collecting the needed data could follow the template to ensure they provide sufficient information. This may help reduce the frequency of MDE requests for additional information from school districts. It could also potentially aid the timeliness of department reviews.

[5] *Minnesota Statutes* 2018, 123B.53, subd. 2(a)(3).

[6] *Minnesota Statutes* 2018, 123B.71, subd. 11.

Summary of Agency Response

In a letter dated February 25, 2019, Minnesota Department of Education Commissioner Mary Cathryn Ricker wrote that the Debt Service Equalization program's effectiveness has "eroded significantly" since 1997. She said the department agrees with the recommendation to change the program to help pay for school facilities in more school districts. In addition, the department generally agrees with the recommendation that the Legislature change statutes regarding the start and end points for the 60-day limit on the review and comment process. However, Ricker said that receiving general direction to correct comment letters in a timely manner is preferable to requiring that corrections be made in a fixed number of days. Ricker stated that the department generally agrees with the recommendation that it provide additional information on the required content of school district facility proposals. She said staff will review recent cases where the department required additional information from districts and then determine whether a template or other changes would help minimize such cases in the future.

The full evaluation report, *Debt Service Equalization for School Facilities*, is available at 651-296-4708 or: **www.auditor.leg.state.mn.us/ped/2019/debtserviceequalization.htm**