

SENATE FINANCE COMMITTEE
March 26, 2019
9:00 a.m.

[9:00:37 AM](#)

CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 9:00 a.m.

MEMBERS PRESENT

Senator Natasha von Imhof, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Click Bishop
Senator Lyman Hoffman
Senator Peter Micciche
Senator Donny Olson
Senator Mike Shower
Senator Bill Wielechowski
Senator David Wilson

MEMBERS ABSENT

None

ALSO PRESENT

David Teal, Director, Legislative Finance Division; Michael Partlow, Fiscal Analyst for Education, Legislative Finance Division; Senator Cathy Giessel; Senator Mia Costello; Senator Chris Birch; Senator Gary Stevens; Senator Shelley Hughes.

SUMMARY

^K-12 EDUCATION FUNDING CONSIDERATIONS

[9:01:29 AM](#)

Co-Chair Stedman relayed that the committee would be discussing the governor's proposed education budget and its effects on school districts. The committee would discuss the local contribution, the cap issue, and the federal funding issues. He commented that the education budget was complicated. He thought it would be beneficial to go into

more detail to understand the federal disparity test, spending caps, and local contribution issues.

Co-Chair Stedman continued his introductory remarks. Co-Chair von Imhof had been working on different proposals and options available to consider as a committee. Senator Hoffman had been in charge of the Senate Finance Subcommittee. The committee had asked the legislative budget director to present the governor's proposed budget.

9:04:07 AM

DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION, stated that the slides were mostly prepared by the Department of Education and Early Development (DEED). He thought the issue being considered was how did the governor's plan to prorate the K-12 formula impact voluntary local contributions. He reminded that in addition to state aid, school districts received local government funds and federal funds.

Mr. Teal explained that there were two types of local contributions: required (based on property tax values) and not required. His presentation would disregard required local contributions, which would remain the same under any interpretation of the law. He discussed voluntary local contributions, which normally were limited to 23 percent of "basic need." He clarified that "basic need" was the formula for the count of students affected by a number of multipliers including school size and geographic differentials, among other things. The adjusted student count was multiplied by the Base Student Allocation (BSA). He informed that that in order to keep basic need within the federal disparity test, voluntary local contributions were limited to 23 percent of basic need.

Mr. Teal noted that DEED made it clear that it believed voluntary local contributions must be prorated if the formula itself was prorated. He thought the idea made sense, but it was unfortunate that the law wasn't clear on the issue. Basic need was prorated, and voluntary local effort was less clear. The Anchorage School District had a legal opinion that said voluntary local contributions would not be prorated if the formula was prorated. He had asked for a legal opinion and referenced a memorandum from Legislative Legal Services (copy on file). He summarized

that legal services was leaning towards opining that voluntary legal contributions were not prorated.

[9:08:13 AM](#)

Mr. Teal detailed noted that federal funds came in the form of impact aid. The impact aid and voluntary local contributions were tied together by a disparity test, which he would discuss further in the presentation.

Mr. Teal spoke to the document "Document 1: Governor's FY20 K-12 Funding Proposal" (copy on file). He pointed out that the formula would have provided \$1.8 billion in formula funding. Then next column over showed the governor's plan, which would use prorating and reduce spending by \$269 million. He noted that there was another \$30 million that was available as additional formula-type aid on top of the formula. If the \$30 million was also repealed as the governor had requested, education funding would be down by roughly \$300 million.

[9:09:43 AM](#)

Co-Chair Stedman asked for greater detail with regard to the status of the proposed FY 20 budget.

Mr. Teal thought it was well worth explaining that normally, FY 20 funding would be in front of the legislature while going through the FY 20 budget process. He recounted that the previous year, the legislature had funded FY 20 education and added \$30 million, which many people referred to as "forward-funding." It was not technically forward-funding, which would imply that funds from FY 19 were set aside for spending in FY 20. Rather, the \$30 million was funding with a delayed effective date. The legislature passed the law, and used FY 20 money for education, not FY 19 money.

Mr. Teal continued his remarks. He recounted that the governor had not vetoed the funding, and the time for vetoes was long past. Unless the legislature revised the previous year's law, the funding for FY 20 would stand at the full formula funding plus \$30 million. The governor requested that the full funding and the \$30 million in forward funding be repealed and replaced by roughly 75 percent of the formula with zero additional funding.

Mr. Teal considered how it would affect voluntary local contributions if the legislature accepted the governor's proposal, repealed the previous year's appropriation, opened education back up, and prorated. He made the point that school districts may get a double whammy when state funding was cut, which could also reduce local contributions. At a time when local communities would step up to replace lost state funds, the communities would be limited in the ability to do so.

[9:13:09 AM](#)

Senator Olson referenced Mr. Teal's comments about the limitation of local government to increase contributions. He asked if local governments would be limited or barred.

Mr. Teal did not know if local contributions would be prorated. If the contributions were prorated, DEED indicated \$51.5 million could be lost district by district. He referenced the document "Document 2: Projected FY2020 Local Effort" (copy on file). He noted that the amount was the maximum that all communities could lose. It was unlikely that voluntary local contributions would be at the maximum.

Mr. Teal used the example of Anchorage, which had an allowable voluntary contribution of \$102 million. If the formula and the voluntary contributions were prorated, Anchorage would only be allowed to contribute \$82 million. He explained that Anchorage was funding to the cap; if voluntary contributions were prorated, the school districts would not receive the same amount of funds.

Co-Chair Stedman asked if there were school districts that were so far under the cap as to not be affected.

Mr. Teal affirmed that there were a number of districts that were way under the cap. He noted that the Regional Educational Attendance Areas (REAA's) did not contribute at all locally and would be unaffected.

Co-Chair Stedman asked about the meaning of REAA.

Mr. Teal explained that an REAA was a Regional Education Attendance Area, which was essentially a school district in an unorganized borough that was also not in an organized community.

Co-Chair Stedman thought there was a significant difference between organized regions that payed property tax and areas that did not.

[9:17:08 AM](#)

Senator Hoffman commented on the three appropriations, which if kept in the budget, were not subject to veto by the governor. He asked about the \$30 million in one-time funding, and asked Mr. Teal's opinion on if the legislature decided to reduce the amount to \$20 million. He wondered if a changed appropriation would be subject to the governor's veto and asked about options for the legislature.

Mr. Teal thought a legal opinion might be needed. He thought if the previous year's statute was repealed, then any changes would be subject to veto. He pondered that a new appropriation for a different amount would be subject to veto. He thought that if the legislature changed the previous year's statute, then the governor could not veto the entire line, as it would return the line to \$30 million. He suggested the legislature get a legal opinion if it wanted to do something other than the governor had done.

Mr. Teal discussed the document "Document 6: LFD Projected Local Effort" (copy on file). He referenced Co-Chair Stedman's question about some districts exceeding the cap and pointed out the column "DISTRICTS EXCEEDING Cap."

[9:20:47 AM](#)

AT EASE

[9:21:12 AM](#)

RECONVENED

Mr. Teal continued to discuss Document 6. He pointed out that the previous slide had shown that the maximum voluntary local contribution (if prorated) would be about \$51 million. The second column of the document showed the amount that would be affected by the cap. The bold numbers showed which cities were at or near the cap. He discussed the amounts districts could have to reduce local contributions. He reminded that the numbers were approximations. If state funding were to be reduced and

local entities had to increase funding, local contributions would bump up against a newly decreased cap.

Co-Chair Stedman considered Sitka and thought the numeric did not change. He thought Mr. Teal was saying that Sitka couldn't make up the funding difference, since it was already funding to the cap.

Mr. Teal stated that Sitka would be unable to contribute its current contribution if the formula was prorated. Ketchikan had some headroom and would not be affected unless it wanted to make up for lost state money and contribute more than \$1.6 million. He reiterated that the numbers were approximations since the documents used FY 19 numbers and it was unknown what districts would do in FY 20.

[9:25:19 AM](#)

Co-Chair von Imhof thought that Document 6 was important. She looked at the second column of numbers and thought there was about \$56.4 million of available headroom. She thought that theoretically there was headroom to accommodate some type of reduction. She estimated that \$100 for the BSA equated to about \$30 million in funding. She asked about how to translate the \$56 million into the BSA.

Mr. Teal stated that Co-Chair von Imhof had estimated correctly. He stated it was not the BSA that was at issue. If the BSA increased, local contributions went up; and the inverse was also true. He thought the problem came in as several districts were at the cap. He noted that the \$56 million total in the second column was the sum of negative and positive numbers and included about \$21 million of funds that were projected to be capped. He observed that Fairbanks was highly unlikely to be affected by prorating and could be contributing substantially more to the school district, as could anyone in the column with a positive number. He expressed that the headroom calculation on the document was not as clear as one might wish.

[9:28:53 AM](#)

Co-Chair von Imhof asked if the cap could potentially remain unaffected if the BSA remained intact in statute but education was simply underfunded. She thought the administration had suggested underfunding.

Mr. Teal stated that Co-Chair von Imhof's scenario would make a big difference. If the BSA was reduced there was no question that voluntary local contributions would also be reduced. There would be no risk of breaking the disparity test. He thought that DEED was assuming that reducing state contributions would result in a proration of local effort, which he did not think was clear. He thought that if you prorated the formula and it turned out voluntary local contributions were not prorated, then the disparity test would be examined.

[9:31:15 AM](#)

Senator Micciche asked if it was fair to say that if a district contributed 75 percent or less of the cap, the local contribution would not be affected; while contributing 75 percent or more of the cap would mean a district was affected. He cautioned that the document only included cash contributions; and did not include in-kind contributions, which were also included under the cap. He mentioned the \$11 million in building maintenance, insurance, custodial services, utilities, and audits that Kenai Peninsula Borough contributed to the school district.

MICHAEL PARTLOW, FISCAL ANALYST FOR EDUCATION, LEGISLATIVE FINANCE DIVISION, agreed that the calculations on the document did not include in-kind contributions. He thought it was worth mentioning that the calculations on the sheet were done at a time when the contribution for school district was not finally set. Later in the slide deck there was more up to date material.

Senator Micciche thought it was important to note that many local communities contributed in-kind, and it might be possible that the in-kind contribution would hit the cap.

Mr. Teal showed the document "Document 3: FY19 Local Effort" (copy on file). He thought that the material on the slides had already been covered.

[9:35:14 AM](#)

AT EASE

[9:35:36 AM](#)

RECONVENED

Co-Chair Stedman thought the slide was representing the FY 19 budget if the \$20 million proposed in the supplemental budget was taken out.

9:36:20 AM

AT EASE

9:36:35 AM

RECONVENED

Mr. Teal noted that there were two slides that looked much the same: one with the \$20 million, and one without. He noted that the amount of voluntary local contributions was determined in part by the amount of basic need, which included money that was distributed in the same way as the formula even though it was outside the formula.

Co-Chair von Imhof thought there was good reason to focus on Document 3. She stated that districts aside from Anchorage, Denali, Juneau, and Skagway were shown as funding under the cap (especially as shown without the \$20 million in page 2). She noted that she had constituents advocating for increased education funding and a BSA increase. She pondered the local and state options if a district was looking for more money. She saw there was room under the funding cap under the "no \$20 million" option on page 2 of the document. She emphasized that the matter was a policy issue. She acknowledged there could be unknown challenges within school districts. She pondered the choices that would have to be considered in a school district if a BSA was reduced (whether through statute or un-allocation).

Senator Bishop emphasized Co-Chair von Imhof's point and did not believe that some rural communities could make up the funding difference because of lack of a tax base.

9:40:23 AM

Senator Micciche did not disagree that districts needed to weigh options if there was a funding reduction. He reiterated that the committee needed to consider a list of school funding including in-kind contributions. He discussed the portion of funding below the cap and considered a 25 percent reduction in the BSA payment; and thought mathematically it did not work out.

Co-Chair Stedman asked for DEED to provide another document with an additional column with in-kind expenses.

Mr. Teal thought that members had made good points. He pointed out that while some communities had headroom under the cap, the remainder of the governor's budget needed to be considered. One part of the governors' proposal was to eliminate school debt reimbursement. If the reimbursement was eliminated, school districts would have difficulty keeping funding stable without even increasing the funding below the cap.

Co-Chair Stedman asked Mr. Teal to adjust the document to include in-kind contributions and debt reimbursement information.

Senator Wielechowski noted that the slide was for FY 19. He pointed out that Anchorage was taxing at the cap, and if the \$20 million was not funded it would be short \$1.3 million and be faced with a shortfall. He asked if he was understanding the matter correctly.

Mr. Teal answered in the affirmative.

Co-Chair Stedman asked if Senator Wielechowski had been referring to the \$20 million in FY 19.

Senator Wielechowski answered "yes."

Mr. Teal pointed out that if the \$20 million was not distributed, a school district would be essentially in a hole for its share.

Co-Chair Stedman thought the law of the land was for the money to be dispersed, unless the law was changed.

Mr. Teal agreed.

[9:43:50 AM](#)

Senator Wielechowski noted that it was the middle of March and the \$20 million had not been disbursed. He said there appeared to be an Alaska Supreme Court case directly on point that indicated the governor had to disburse the funds. He asked when the latest that Mr. Teal had seen the state dispersed funds for education.

Mr. Teal stated that the law of the land (referred to by Senator Wielechowski) was a court case that said the governor could not withhold money that had been appropriated by the legislature. He continued that in theory, the funds should have been distributed to school districts beginning July 1, 2018. He thought the department withheld the funds assuming there would be a "true up" at the end of the fiscal year when there was a second student count. He thought the Office of Management and Budget (OMB) director had stated that the school districts should not have expected or spent the funds. He recalled that several school districts had testified to having expected the money that was appropriated and, in many cases, having spent the funds. He expanded that to not receive the funds would cause many schools to spend reserves if they had them.

Mr. Teal continued to address Senator Wielechowski's question. He stated that some schools did not have reserves and could be in a position of over-spending or of reducing spending during the last couple months of the year. He stated that theoretically the governor had to distribute the funds during the current fiscal year. He did not know what the legislature could do to urge the governor to send out the funds as early as possible. He suggested that there could be intent added to the appropriations bill, or the legislature could talk to the governor. He thought if the legislature did not intend to repeal the \$20 million as the governor had requested, it may want to request that he distribute the funds as soon as possible.

Co-Chair Stedman thought that unless the legislature took affirmative action in an appropriation bill, the law would stand and the governor had until the end of June to disburse the funds.

Mr. Teal agreed.

[9:46:58 AM](#)

Senator Wilson asked for an updated list of school districts' fund balances.

Co-Chair Stedman stated that the committee could ask for help with the information. He thought there had been comments made that there were significant reserves in some districts. He thought each district would be different.

Mr. Teal thought he could get the requested information from DEED. He thought the committee might want to have the department come to committee and discuss reserves, in-kind contributions, and school debt; and at the same time, it could discuss why voluntary local contributions would be prorated when legal opinions pointed in the other direction.

Co-Chair Stedman stated that the committee had invited the department and could encourage attendance in committee to help with budget scenarios. He commented that the education budget, along with the Department of Health and Social Services, was one of the biggest challenges in the budget. He lamented about the possibility of making decisions with less information than could be had.

[9:49:18 AM](#)

Mr. Teal reviewed the document "Document 4: Disparity Test" (copy on file):

<https://education.alaska.gov/schoolfinance/foundationfunding>

The disparity test is an annual submittal from the State of Alaska to the U.S. Department of Education, Impact Aid Program, under the Elementary and Secondary Education Act (ESEA) of 1965 as amended by Every Student Succeeds Act (ESSA) of 2015, section 7009 State Consideration of Payments in Providing State Aid.

In General...

- A state may reduce state aid payments, as applicable by law, when a district receives federal Impact Aid revenues.
- A state must apply for recertification annually, not later than 120 days prior to the next fiscal year (end of February).
- In order to qualify for this provision the state must demonstrate an equalized funding formula:
 1. the highest per revenue district versus the lowest per revenue district;
 2. not more than a 25% disparity between districts revenue per Adjusted Average Daily Membership (AADM); and,

3. disregard the revenue per AADM above the 95th percentile and below the 5th percentile per AADM.

Fiscal Year	Disparity percentage
2012	19.31%
2013	19.37%
2014	21.40%
2015	22.58%
2016	22.40%
2017	22.32%

Mr. Teal noted that the slide brought up a complication in the formula. The formula was such that state aid equaled basic need, which was the BSA times the student count multiplied by a number of factors. He continued that state aid was basic need minus required local contributions, minus 90 percent of federal deductible impact aid. He told the committee to disregard required local contributions, which would not change in any way due to the funding controversy.

Mr. Teal continued his comments on Document 4. He explained that the formula clearly said the state could reduce its state aid by the amount of federal impact aid that was deductible. The state must show that it had an equalized formula, which was demonstrated by a disparity test. The test ranked school districts in the order in the amount of aid per AADM (adjusted student count). Without voluntary local contributions, all districts would get nearly identical amounts. It was only voluntary local contributions (which varied from district to district) that gave differences in funding at the local district level.

Mr. Teal continued to address Document 4. He discussed the parameters of the disparity test. He questioned that voluntary local contributions were pro-rated, there was no additional risk of failing the disparity test because local contributions would be limited. If the legal opinions were correct and voluntary local contributions were not prorated along with the formula, the state was almost certain to fail the disparity test. He shared that the state would lose federal aid (of about \$82 million) if the test failed.

[9:53:17 AM](#)

Mr. Teal showed the document "Document 7: LFD Impact Aid Percent of State Aid" (copy on file). He stated that the

federal deductible aid meant that the state formula could not deduct the amount of federal money received by local districts. He pointed out the third column from the right, "Eligible Federal Impact AID." If the state failed the disparity test, Anchorage would get to keep the \$7.7 million, and the state would have to pay Anchorage \$7 million because the federal impact aid was not deductible if the disparity test was failed. In total, the state could have to pay \$82 million more than it currently paid. Potentially, prorating the formula reduced cost by \$300 million, but also increased costs by \$82 million and did so in an unfair way.

Mr. Teal pointed out that Anchorage, while it received a lot of money, had impact aid as 2 percent of the budget. He pointed out \$11 million in Bering Strait, which was 36 percent of its budget. He explained that some districts received a disproportionate amount of federal impact aid, which was calculated by the amount of exempt property was in the district. The communities with substantial federal deductible aid would benefit a great deal by the scenario. He noted that by in large the communities were rural.

Mr. Teal reiterated that if the state failed the disparity test, it was for a minimum of three years, and it would cost the state \$82 million to \$85 million each year the test was failed. The cost was one of the dangers of prorating the formula. If the law was interpreted so districts must prorate voluntary local contributions, there was no additional risk. Legal opinions suggested that it was not the case and a district simply may be able to increase its voluntary local contributions, causing the entire state to fail the disparity test.

[9:57:30 AM](#)

Mr. Teal did not know whether the department could enforce a voluntary local contribution amount by approving or failing to approve a school district's budget. He closed by saying there were other ways to reduce school funding. He thought if reducing funding was a goal, prorating may be the least desirable option because of the potential impact on the federal deductible aid.

Co-Chair Stedman asked Mr. Teal to elaborate on other options for reducing school funding.

Mr. Teal discussed reduction of school debt reimbursement, which had a disproportionate impact on rural districts because only urban districts had school debt reimbursement. The mill rate could be increased, which would increase required local contributions, but again it would impact urban areas. He thought the fairest option would be reducing the retirement aid paid on behalf of districts. He reminded that the state payed everything over 12.56 percent in the Teachers Retirement System (TRS), and the actual contribution exceeded 30 percent. He did not suggest the legislature should do so, but if the goal was to cut \$100 million from education spending, reducing the state TRS contribution would be much fairer than prorating. He thought there could be other options.

Co-Chair Stedman commented on the complexity of Public Employees' Retirement System (PERS) and TRS issues.

[10:00:15 AM](#)

Senator Micciche asked if school bond debt reimbursement counted as a local contribution under the cap, or if it was disregarded.

Mr. Teal stated that the two issues were unrelated. School bond debt reimbursement affected local contributions only in the sense that if the state didn't reimburse districts for school debt reimbursement, the local government had less money available and then may have to reduce contributions to school districts.

Co-Chair Stedman mentioned defaults by bond-owners, which could create complexities.

Co-Chair Stedman reiterated that the Senate Finance Subcommittee on DEED was being led by Senator Hoffman, who was working on the K-12 and University budgets. Co-Chair von Imhof had been working on some other options for consideration by the committee. He thought the next two weeks would solidify the subcommittee. The committee would be hearing presentations the following week on some options being considered.

[10:02:35 AM](#)

Co-Chair von Imhof summarized the conversation and thought there were several questions being generated by members.

She thought the purpose of the committee was to bring up questions to ponder. She referenced Mr. Teal's remarks about a legal opinion that was unclear. She wanted the committee to avoid unintended consequences of its decisions. The following week the committee would consider a presentation by Mr. Mark Foster, a board member of the Anchorage School District who had also served as the chief financial officer. Mr. Foster had been doing research on education looking at state and national data and would be presenting his findings.

Co-Chair von Imhof continued that the committee was considering research supporting small class sizes, supporting effective teachers, encouraging home and community support, and early and intermediate literacy. She discussed three bills being considered by the committee: SB 79 pertaining to virtual education, SB 74 pertaining to broadband, and SB 30 pertaining to a middle school model. She emphasized the committee's aspiration to avoid unintended fiscal consequences while supporting education to increase student achievement across the state.

[10:05:58 AM](#)

Senator Hoffman thought that it was fortunate that the legislature had passed education funding legislation the previous year. He noted that the opportunity to address the \$10 million in additional funding in 2019 was signed into law. The appropriation for education in 2020 had also been signed into law. The \$30 million increase for 2020 had also been signed into law. He commented that the control (for the most part) of the appropriations was in the hands of the legislature and the involvement of the administration had been bypassed by the signing of the three bills by former Governor Bill Walker. He expressed concern about the difficulty of budgeting for 2021 and considered that whatever the legislature passed would be subject to a veto pen. He thought a veto override was almost impossible as it required 45 of 60 members to agree.

[10:08:07 AM](#)

Co-Chair Stedman thought Co-Chair von Imhof and Senator Hoffman had made good comments. He stated that the legislature would be considering the effects (not only in education) of a step-down approach. He pondered if it was better to take large budget reductions in one year, or

phase it in over three or four years when trying to have revenues match expenditures. He thought if the legislature did not deal with the \$30 million, there might be a steeper decline in funds the following year.

Co-Chair Stedman discussed increasing student performance while reducing spending. He considered if reductions could be tied to achievement goals or net benefit.

Senator Bishop recounted that he had made a concerted effort to bring back career and technical education (CTE) when he served as commissioner of the Department of Labor and Workforce Development. He had worked with DEED, the University, and school districts. He discussed working to improve graduation rates. He was concerned that CTE might have to be cut.

[10:11:21 AM](#)
AT EASE

[10:11:30 AM](#)
RECONVENED

Co-Chair Stedman remarked on how many members of the Senate were in the meeting.

Co-Chair Stedman discussed the agenda for the following day.

ADJOURNMENT
[10:13:49 AM](#)

The meeting was adjourned at 10:13 a.m.