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Opinion No. 07-90

K-12 Capital Outlay Grant Program

QUESTIONS

1. In light of the Court's previous rulings in the *Small Schools* lawsuits, would the distribution of excess lottery proceeds on a non-equalized basis be unconstitutional?

2. Under the terms of the constitutional provisions relative to the use of lottery proceeds, could an LEA use the amounts distributed under the proposed statutory provisions to pay for debt amortization of debt previously issued for educational capital outlay purposes?

OPINIONS

1. The Supreme Court's opinions in the *Small Schools* cases do not categorically require that every dollar spent by the state on K-12 education be distributed among local education agencies (LEAs) on an "equalized" basis. Whether the Court would deem the proposed grant program unconstitutional because it provides for the distribution of grant proceeds on a basis that does not account for differences among the LEAs' fiscal capacities is uncertain. A number of factors might influence the analysis, including, but not limited to, the overall size of the grant program in relation to the total amount of funding for debt service and other capital needs made available to LEAs on an equalized basis under the Basic Education Program (BEP), the types of capital projects for which grant monies will be spent by LEAs, the long-term effect of the program upon the equitable distribution of capital assets (buildings and equipment) among LEAs across the state, and the effect any maldistribution of such assets caused by the program's funding structure would have upon the state's ability to carry out its constitutional duty to provide substantially equal educational opportunity to all students. This office lacks the factual information necessary to predict the outcome.

2. No, a local education agency could not use the capital outlay grant funds to pay debt service on existing bonds.

ANALYSIS

The General Assembly is currently considering proposed statutory changes that would establish a K-12 capital outlay grant program for LEAs. Funds for the grant program would come from excess lottery funds. Each LEA's grant amount would be based upon its average daily membership in relation to the state total average daily membership. The LEA could use the grant funds to supplement, *not supplant*, non-lottery educational resources for capital outlay projects for K-12 education facilities. If not awarded to an LEA before fiscal year end, the funds do not revert to the lottery education fund or the general fund but are carried forward in the LEA's account. Individual district grants not awarded in the first year of the program would be credited and accumulated for the benefit of that district, and the LEA could apply for a grant of those funds in a subsequent year. To take advantage of the grant program, an LEA would have to match each dollar of state grant funds with one dollar of local funds. The grant funds would not be part of, or distributed under, the BEP, the state's funding method for K-12 education. Finally, the proposed statutory language is clear on the use of the funds. The bill states as follows:

> Moneys in the lottery capital outlay account shall be used exclusively for capital outlay projects for K-12 educational facilities consistent with Article XI, § 5 of the Constitution of Tennessee. . . . Such moneys *shall supplement, not supplant*, non-lottery educational resources for capital outlay projects for K-12 educational facilities.

(Emphasis supplied).

The grant funds would be available to every LEA statewide, and the amount of each grant would be measured by the same standard for all LEAs — the LEA's average daily membership (ADM). Further, the matching requirement would be the same for each LEA — dollar for dollar. What the proposed grant program does not do is make an adjustment for an LEA's relative capacity to raise local revenues to meet the required match. By comparison, the BEP also requires "both state and local funding, but with the proportionate local share determined by each county's relative ability to pay or its 'fiscal capacity.'" *See Tenn. Small School Sys. v. McWherter*, 91 S.W.3d 232, 235-36 (Tenn. 2002). Fiscal capacity would not be a factor under the proposed grant program.

1. Constitutionality of Proposed Grant Program

The Tennessee Supreme Court has examined state K-12 funding in three cases. In the first of those cases, the Court held that the state was required by the Tennessee Constitution to maintain and support a system of public schools that affords substantially equal educational opportunities to all students and found the state's school funding scheme unconstitutional because it denied equal education opportunities to all students. *Tenn. Small School Sys. v. McWherter*, 851 S.W.2d 139 (Tenn. 1993) (*Small Schools I*). In the second appeal, the Court conditionally upheld a new funding plan allocating funds to school systems according to a formula based on the cost of forty-three components necessary for a basic education, known as the Basic Education Program. The state achieved equalization in the BEP by requiring both state and local funding, but "with the

proportionate local share determined by each county's relative ability to pay, or its 'fiscal capacity.'" *Tenn. Small School Sys. v. McWherter*, 91 S.W.3d at 235-36 (*Small Schools III*). The Court also concluded, however, that omitting a requirement for equalizing teachers' salaries was a significant defect in the BEP and that this flaw put the entire plan at risk functionally and legally. The Court instructed the state to equalize teachers' salaries according to the BEP formula. *Tenn. Small School Sys. v. McWherter*, 894 S.W.2d 734, 738 (Tenn. 1995) (*Small Schools II*).

The case came back to the Court when the small school systems challenged the state's method of equalizing teacher pay. The Court agreed with the small school systems. It ruled that the state's method of equalizing teacher pay was constitutionally defective because it contained no mechanism for cost determination or annual cost review of teachers' salaries, unlike the BEP approved in *Small Schools II*. *Tenn. Small School Sys. v. McWherter,* 91 S.W.3d at 241 (*Small Schools III*). The Court, in essence, directed the state to scrap the teacher pay equity plan then in effect and to equalize teacher pay through the BEP itself, thus assuring that teacher pay would be equalized "according to the BEP formula." *Id*. at 243.

In none of the *Small Schools* cases did the Supreme Court face the particular question posed by this request. In fact, the only similar grant programs we have identified are the lottery-funded "after school programs" competitive grants, Tenn. Code Ann. §§ 49-6-701, *et seq.*, and the voluntary pre-K program grants at Tenn. Code Ann. §§ 49-6-101, *et seq.* The "after school" program grants are funded fully by the state and thus have no local matching requirement. *See* Tenn. Code Ann. § 49-6-702. In the pre-K program, the LEA must provide a matching amount of funds "based on the applicable state and local BEP classroom component ratio in effect for the LEA in which the program is located." Tenn. Code Ann. § 49-6-107(c). In addition to local dollars, the LEA may meet this particular matching requirement with other sources of funds, such as other grants, federal funds, and private funds and in-kind matches (*e.g.,* non-LEA owned physical facilities).

Thus we have three different funding structures:

a. Solely state-funded grants, in which fiscal capacity would not be an issue (after school programs);

b. State and locally funded grants with the match dollars requirement based upon the same state/local ratio as found in the BEP, *i.e*., the program structure takes fiscal capacity into account (voluntary pre-K programs); and

c. State and locally funded grants with a one to one matching requirement not based upon fiscal capacity (proposed capital outlay grant program).

The Supreme Court's opinions in the *Small Schools* cases do not categorically require that every dollar spent by the state on K-12 education be distributed among the LEAs on an "equalized" basis. Whether the Court would deem the proposed grant program unconstitutional because it provides for the distribution of grant proceeds on a basis that does not account for differences among the LEAs' fiscal capacities is uncertain. A number of factors might influence the analysis, including, but not limited to, the overall size of the grant program in relation to the total amount of funding for debt service and other capital needs made available to LEAs on an equalized basis under the BEP,

the types of capital projects for which grant monies will be spent by LEAs, the long-term effect of the program upon the equitable distribution of capital assets (buildings and equipment) among LEAs across the state, and the effect any maldistribution of such assets caused by the program's funding structure upon the state's ability to carry out its constitutional duty to provide a substantially equal educational opportunity to all students. This office lacks the factual information necessary to predict the outcome.

2. Use of Grant Funds for Pre-Existing Debt

The second question is whether an LEA could use the proposed grant funds to pay for debt amortization of debt previously issued for educational capital outlay purposes. Tenn. Const. Art. XI, § 5, to which the bill refers, forbids the use of lottery funds in a fashion that supplants "non-lottery educational resources for capital outlay projects." "Non-lottery educational resources" could be state resources as well as local.

Debt service on previously issued bonds would be a recurring, annual budget expense for the local government. The local government would have already committed to the repayment of the debt, *i.e.*, the local government's existing budget would include an amount to meet this obligation, either with local funds or capital outlay funds distributed under the BEP, or both. To use the new capital outlay grant funds to pay off an established debt, to which a local government has already committed its resources, would result in the replacement of existing "non-lottery educational resources" already committed to capital outlay projects which could then be used for other purposes. This action would seem to fall within the scope of the constitutionally prohibited act of supplanting, [1] using surplus lottery funds to do the job of local funds. On the other hand, an LEA could use the grant funds on new capital outlay projects without violating the prohibition against supplanting.

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[1]"Supplant" — to take the place of; supersede. *The American Heritage Dictionary* (2nd Coll. ed. 1985).

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