



## Florida TaxWatch Center for Educational Performance and Accountability

# Public Education Capital Outlay

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### Executive Summary

Like other Florida public institutions, educational facilities require capital funding. The facilities housing our educational systems not only use money to repair and renovate existing structures, but also to build new facilities as our state grows, and the needs of the taxpayers with it. Funding for schools used to be done almost exclusively at the local level, but over time and with increases in both growth and complexity, state spending for educational facilities entered Florida’s budget.

Florida’s primary source of funding for the capital needs of public schools, community colleges, and universities is the Public Education Capital Outlay (PECO) fund. PECO funds are generated through the revenue from the gross receipts tax, a 2.5 percent tax on the sale of gas and electricity and a 2.52 percent tax on communications services. Of this revenue, roughly 75 percent is used for issuing bonds, rather than used as direct payments. Issuing bonds gives the state cash immediately, allowing for more funding for projects in the near term, but also forcing the state to pay a significant amount of debt service annually – nearly \$1 billion in 2011. Most of the available funds are used to pay for outstanding

interest, rather than on actual projects. PECO bonds currently account for nearly 40 percent of the state's debt.

The PECO funding source, revenue from the utility gross receipts tax, must grow from year to year in order to create funding for new projects as annual debt service is first subtracted from the amount. The state is perpetually paying on projects previously funded while new projects are susceptible to fluctuations in the economy. Because of the recent economic crisis, revenue from the utility gross receipts tax has fallen, reducing the amount of estimated revenue, and, as a result, what has been available for PECO is reduced and severely limits access to capital for new projects. This year, although the PECO estimating conference determined there was no money for new construction, the 2011 Legislature funded \$175 million of new university and college projects, making some statutory changes to provide more capacity. Up until this action, the state had no previous plans for any new construction until at least 2013 and funds for existing projects would have been cut. The amount of PECO funds available for appropriation is determined by the analysis of the Revenue Estimating Conference, and then allocated by the Legislature largely based on the budget requests submitted by the Department of Education based on multiyear plans of the individual school districts, colleges, and universities.

## Introduction

Schools and other educational institutions need two types of funds: operating and capital. Operating funds are used for the every day expenses needed to run the school, like salaries for teachers and electricity. These funds are generated through various taxes and fees, mostly local property taxes and state general revenue, and then allocated appropriately. On the other hand, capital funds are used for the purchase of large assets, like a new school building, investments of public resources that can last for multiple years.

Prior to 1900, school districts throughout the country were entirely dependent on local property taxes for capital funds in order to finance repair and construction projects. Simpler institutions than in present day, schools at this time required relatively less capital. American schools were once not more than one room buildings for only a dozen or students, but they now need a significant amount of technology and often span multiple large buildings to house hundreds, if not thousands, of students. It was not until just after the turn of the century that Alabama, in response to increasing need, became the first state to use state aid to help finance construction in local districts. In 1904, Louisiana turned to a new method to finance school construction: issuing bonds.<sup>1</sup> A bond is a financing instrument in which the issuing party, in this case the state, owes the holder of the bond a debt, to be repaid with interest over a fixed interval of time. The holder is paid a set amount of interest, called a coupon, every six months, and the entirety of the principal at the end of the contract term. A bond therefore operates like a marketable and transferable loan.

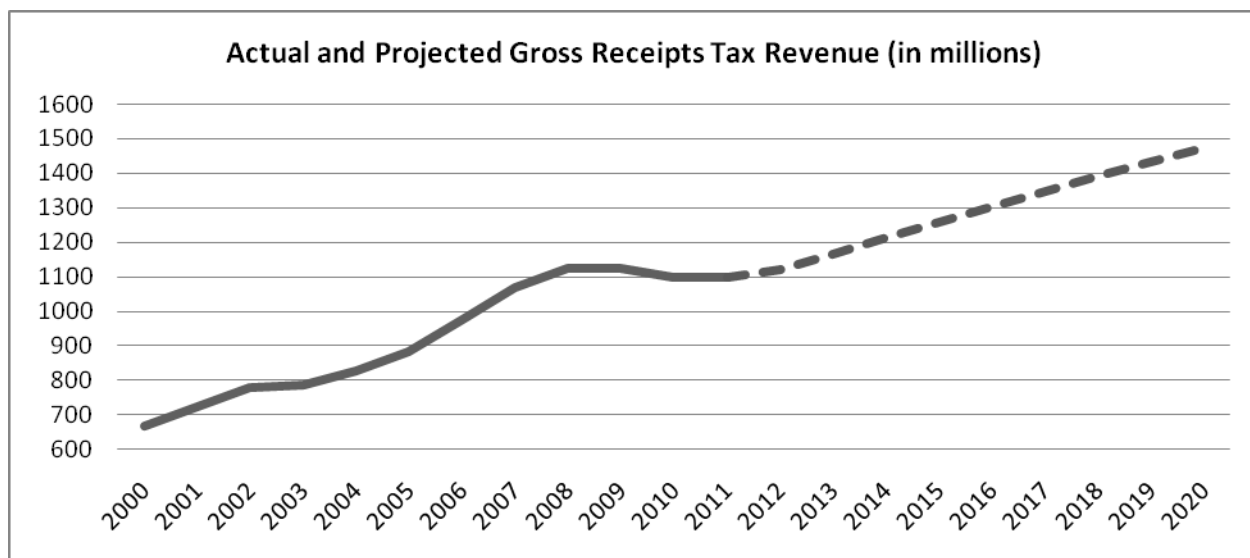
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<sup>1</sup> *Alternative financial simulation models for distributing new sources of Florida public education capital outlay (PECO) revenue.* - Watson, John Allan, Sr., 1993

In Florida, the first continuing form of state support for capital outlays and debt support for school districts was established in 1947. Before this, state aid for such projects had been minimal and inconsistent. This first state program distributed to each school district the fixed sum of \$300 from general revenues per instructional unit, provided the local district also matched that with a \$100 contribution of their own. Only a couple of years later, however, the matching requirement was dropped. In 1953, the law was changed to use the revenue from the licensing fees on motor vehicles, including the bonding of that revenue, but continued to use the \$400 per instructional unit. Funding and bonding using the revenue from the gross receipt taxes for higher education institutions was added to the constitution in 1963. In 1974, the Legislature made primary and secondary public schools eligible for these gross receipt tax revenue funds, creating the structure of the current method for funding these outlays, the Public Education Capital Outlay and Debt Service Trust Fund.<sup>2</sup>

## Where do the funds come from?

PECO funds come from revenue generated by the gross receipts tax, a tax imposed at the rate of 2.5 percent on gross receipts from the sale, delivery, or transportation of natural gas, manufactured gas, or electricity to a retail consumer in Florida based on index prices set by the state and a 2.52 percent on gross receipts of sellers of communication services. Approximately 75 percent of PECO funding comes from issuing bonds using this revenue, as opposed to the revenue itself.<sup>3</sup> PECO bonds are secured primarily by these specific revenues, a second lien on gross tax receipts, and ultimately by an unconditional guarantee by the state known as *full faith and credit*.<sup>4</sup> **In effect, bonding gives the state a little more than \$15 dollars today in exchange for \$1 a year for the next 30 years.**<sup>5</sup>



<sup>2</sup> House Joint Resolutions 2289 and 2984

<sup>3</sup> <http://edr.state.fl.us/content/conferences/peco/pecoflow.pdf>

<sup>4</sup> <http://www.sbafla.com/bond/pdf/programs/education/PECO.pdf>

<sup>5</sup> At 4% cost of debt

Source: Florida Office of Economic and Demographic Research, 2011.

Over time, revenue from the gross receipts tax has proven to be a stable base for PECO funds. Utilities and communication services are more non-cyclical sectors of the economy, so revenue tends to follow a slight upward trend. But, that said, no revenue source is entirely immune from a poor economy, as the past couple of years have shown. Revenue grew quicker than normal in the economic bubble build-up of 2005 to 2008, and then fell more than 2.5 percent over the next couple of years.<sup>6</sup> In response to last year's declining revenues, the Legislature approved an approximately \$20 million dollar revenue shift for FY 2010-11. This change to the communications services and gross receipts tax transferred these monies away from general revenues and into PECO funds, creating about \$234 million more for capital outlays in the budget due to bonding.<sup>7</sup>

Annual debt service is subtracted from the annual amount available for PECO funded projects. Therefore, revenue from the gross receipts tax must grow from year to year in order to create funding for new and continuing projects. Thus, a dip in revenue like we are currently experiencing completely chokes off capital for new projects. Even a gain of just a couple percentage points in the growth rate of revenue generated by the gross receipts tax translates into tens or hundreds of millions of dollars in extra PECO appropriations - or conversely, with a drop in a few percentage points, millions of dollars fewer.

As of the 2010 debt affordability report, an annual report detailing the impact of future debt obligations, PECO bonds account for \$11.2 billion of the state's outstanding debt. Out of \$28.2 billion in total state debt, \$15.8 billion is for the construction of educational facilities, with PECO as the primary issuer, followed by the Lottery. Over the last decade, there has been a net increase of \$4.2 billion in PECO bond issuances. It is projected that over the next decade there will be another \$5.8 billion in PECO issuances.<sup>8</sup> Estimated FY2010-11 PECO bonding for this year alone is approximately \$304.8 million, of which about half has been appropriated to institutions so far.<sup>9</sup>

In March 2011, the Division of Bond Finance reissued \$336.75 million in PECO bonds. The reissue has saved \$39.9 million (gross) and approximately \$33.3 million in net present value, and has brought down the average outstanding debt obligation interest rate to 3.27 percent from 4.87 percent.<sup>10</sup> Florida's PECO bonds are currently rated AAA (Prime) by both Fitch and Standard & Poor's, but have a negative rating outlook. Moody's has rated these bonds as Aa1 (High Grade) with a stable outlook.<sup>11</sup>

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<sup>6</sup> Data from <http://edr.state.fl.us/Content/conferences/grossreceipts/grossreceiptsresults.pdf>

<sup>7</sup> <http://www.floridatathwatch.org/resources/pdf/TURKEYWATCHREPORT2010.pdf>

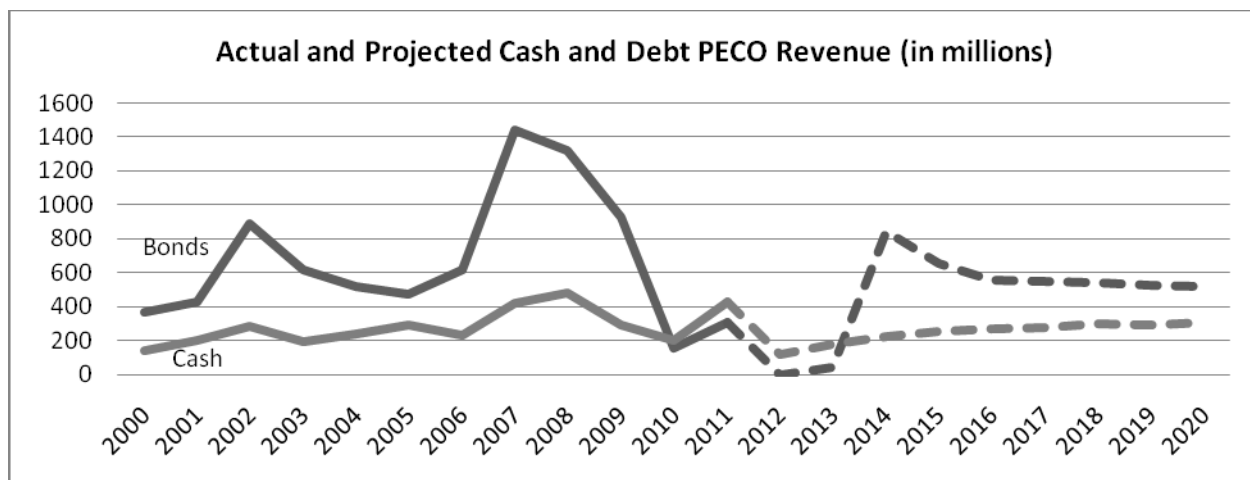
<sup>8</sup> <http://www.sbafla.com/bond/pdf/publications/DAR2010.pdf>

<sup>9</sup> <http://edr.state.fl.us/content/conferences/peco/pecoexec.pdf>

<sup>10</sup> 4/5/11 Florida Cabinet Meeting -

<http://www.myflorida.com/myflorida/cabinet/agenda11/0405/audioindex.html>

<sup>11</sup> <http://www.businesswire.com/news/home/20110308006872/en/Fitch-Rates-Floridas-175MM-PECO-Bonds-AAA>



Source: Florida Office of Economic and Demographic Research, 2011.

For at least the next couple years, the PECO revenue stream has been fully leveraged. Looking back, Florida's insistence on issuing close to the maximum amount of PECO bonds possible during periods of high tax revenue growth has effectively tied the state's hands from issuing any new bonds during lower growth periods, regardless of need. Additionally, this means that a sharp enough drop off in revenue from the gross receipts tax, however unlikely, could leave the PECO fund insolvent and reliant on other state revenue to meet their debt obligations. The use of debt, rather than a PAYGO system, for public education creates a cycle of uncertainty in fulfilling the expectations of growth and competitive educational facilities.

**In the FY 2010-11 Legislative Budget Request, the State Board of Education estimated annual debt service of more than \$998 million on just PECO bonds.**<sup>12</sup> The state could save a tremendous amount of money on interest if it used only available current revenues to fund school construction on a "pay as you go" basis, instead of issuing debt. However, because the state must service the debt it issued previously, there is not enough PECO revenue to fully fund new capital projects each year. Therefore, the state must issue more debt.

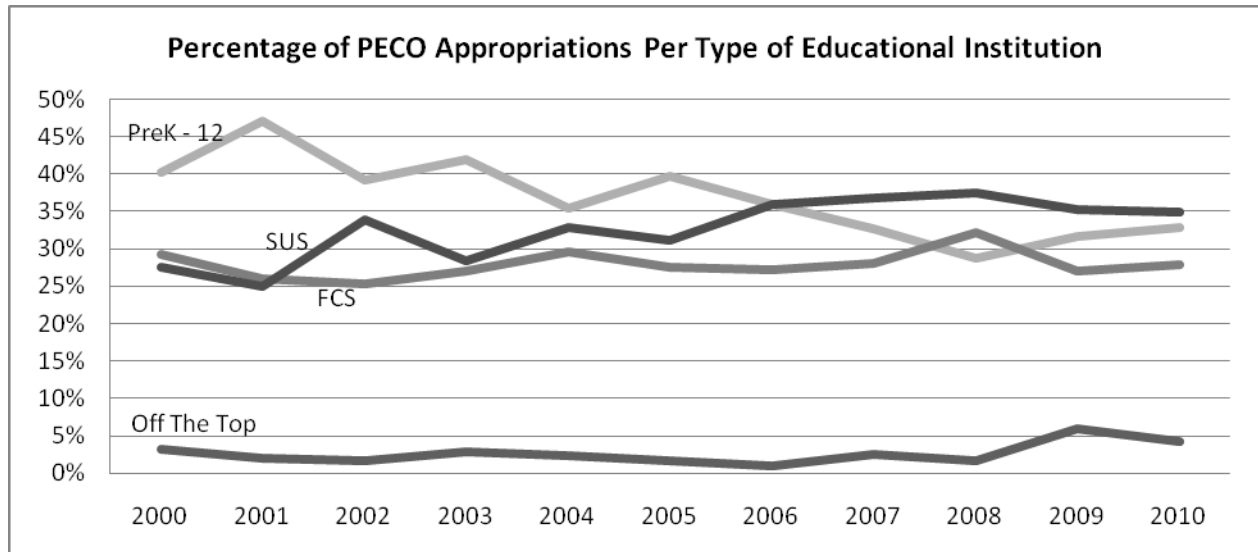
## How are the funds allocated?

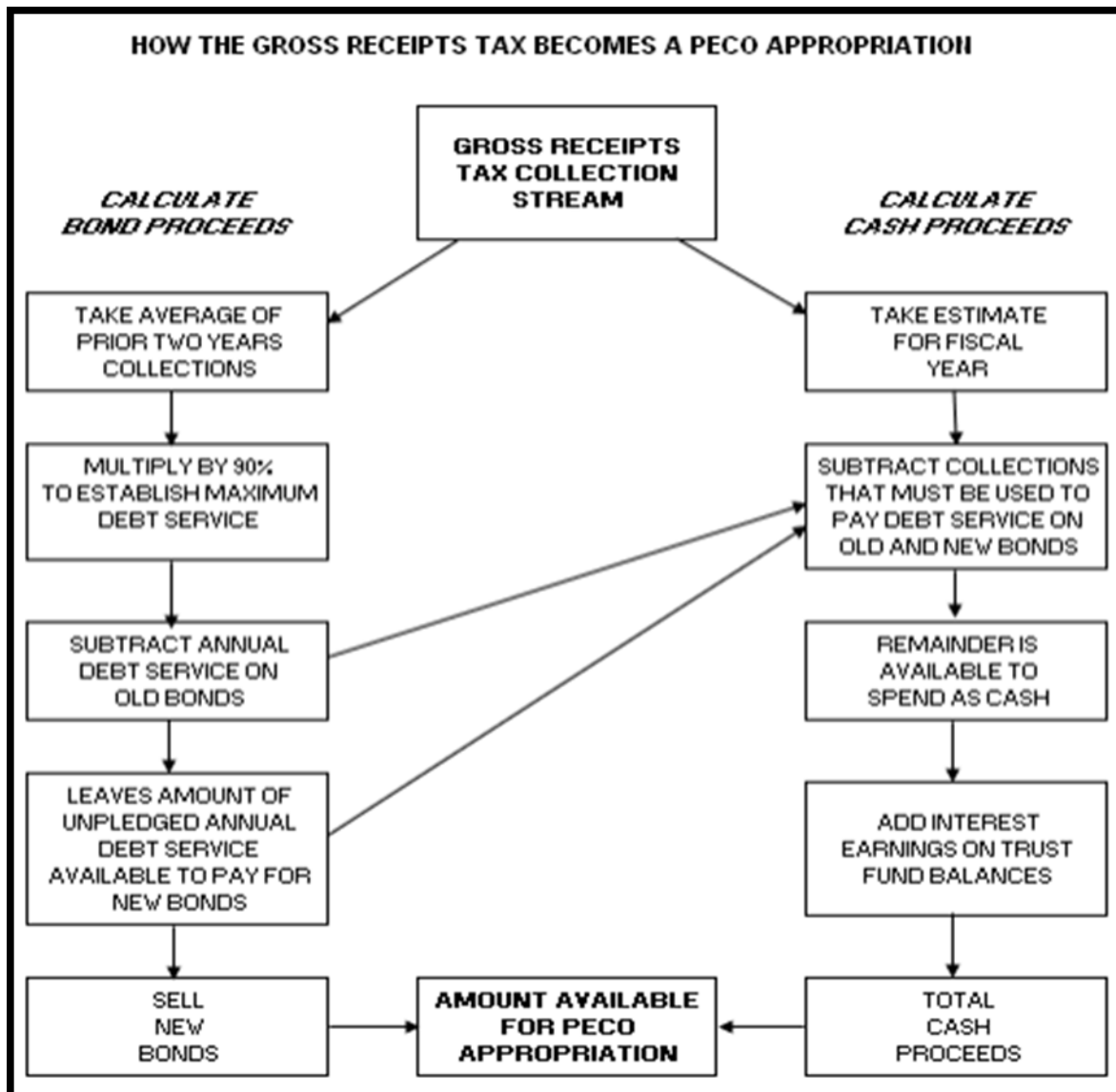
Public Education Capital Outlay funds are allocated between PreK-12 schools, the Florida College System (community colleges), the State University System, and special off-the-top appropriations. The amount available for appropriation is set based on the analysis of the Revenue Estimating Conference (REC), which had determined there was no money available for bonding this year. The current PECO budget, as submitted in March 2011 by the Board of Governors calls for no new projects in both the FY2011-12 and FY2012-13 school years and funds to maintain existing buildings are reduced by a minimum of 50 to 80 percent.<sup>13</sup> However, the 2011 Legislature funded \$175 million of new university and college projects by

<sup>12</sup> [http://www.fldoe.org/board/meetings/2009\\_09\\_15/2010-11FixedCapitalOutlayLegislativeBudgetRequest.pdf](http://www.fldoe.org/board/meetings/2009_09_15/2010-11FixedCapitalOutlayLegislativeBudgetRequest.pdf)

<sup>13</sup> <http://fltrib.com/money-problems-dominate-board-governors-meeting>

making some statutory changes. First it directed the State Board of Education - determining the amount of bonds that can be serviced by gross receipts tax - to disregard the effects of a pending \$26 million refund, which the REC had figured into its forecast. This provided additional PECO funds for bonding. The Legislature also expanded the Class Size Reduction bond program – funded with lottery revenues – to include other educational institutions. This allowed \$36 million in college and university projects to be added to the budget. These bonds will be secured by lottery revenues, not gross receipts taxes.





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ce Florida Office of Economic and Demographic Research, 2011,  
<http://edr.state.fl.us/Content/conferences/peco/pecoflow.pdf>.

## Off The Top Appropriations

Since FY 1993-94, a small percentage of PECO funds are required to be spent on repair, maintenance, and construction for the Florida School for the Deaf and the Blind, the Division of Blind Services, and Public Broadcasting for the state.<sup>14</sup> Over the last decade, this has averaged a little bit over two percent of total PECO appropriations.

<sup>14</sup> <http://www.flsenate.gov/laws/statutes/2010/1013.31>

## PreK-12 Appropriations

Each district is required to create a capital outlay plan which is then submitted to the State Board of Education. The individual district plans are then compiled into a Legislative budget request. Over a period of 2005 to 2008, this type of state funding accounted for about 21 percent of total capital outlay for PreK-12 schools.<sup>15</sup> Several counties in Florida also use a one-cent local option sales tax to fund capital outlays for education.

After PECO funds are allocated to remodeling, repair, maintenance, and repair of existing PreK-12 facilities, funds are then given to programs that are required by Florida statutes, including the funding for developmental research schools. This funding provides the equivalent revenue of a two mill property rate (0.2 percent) for schools that operate as independent districts and are on the cutting edge of educational development, like P.K. Yonge in Gainesville. Additional funding is available for districts that cannot afford their top priority program<sup>16</sup> and for vocational educational facilities.<sup>17</sup>

However, PECO funds can only be used for buildings primarily used for education. Statutorily, the funds cannot be used for any competition type facilities (such as football fields, tennis courts, or bleachers) outside of what is necessary for students to fulfill physical education curriculum. An exception to this can be made for multi-school football stadiums. Similar rules exist for performing arts facilities.

## Florida College System & State University System Appropriations

For the State University System (SUS), allocations for capital outlays are decided based on three-year and five-year plans. The three-year plan takes funding into consideration, whereas the five-year plan is simply an assessment of everything the university believes it needs over the next five years without regard to funding.<sup>18</sup> Due to the difference in scope, the plans rarely look similar. Once all of the state universities have submitted their plans to the Board of Governors, the requests are combined into statewide three and five-year plans. These plans are then presented to and reviewed by the Council of Presidents, who then makes recommendations to the Board of Governors. The final three-year plan is then submitted as the SUS legislative budget request.

Allocations for the Florida College System are handled similarly to the SUS, in that individual plans from each college are combined by the FCS into a single budget request for the Legislature.

## Other Similar Educational Funding

Additional funding is available for PreK-12 schools and the Florida College System through the Capital Outlay & Debt Service (CO&DS) Fund. The CO&DS Fund is financed by motor vehicle and license tag revenue, and provided as either net bond proceeds or as direct cash payments, similar to PECO. The

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<sup>15</sup> [http://www.ncef.org/pubs/state\\_capital\\_spending\\_on\\_school\\_facilities.pdf](http://www.ncef.org/pubs/state_capital_spending_on_school_facilities.pdf)

<sup>16</sup> Special Facilities Construction Account, only available once every three years

<sup>17</sup> <http://www.fldoe.org/board/meetings/budgetWorkshop/CommissionerBudgetWorksheets.pdf>

<sup>18</sup> [http://www.facilities.fsu.edu/FDC/Major\\_Funding.php](http://www.facilities.fsu.edu/FDC/Major_Funding.php)



funds are allocated according to the number of instructional units and the growth in instructional units in school districts and community colleges.<sup>19</sup>

<b>Total CO&amp;DS Allocations</b>				
	<b>FY06-07</b>	<b>FY07-08</b>	<b>FY08-09</b>	<b>FY09-10</b>
PreK-12 Bonds	\$0	\$40,970,000	\$10,735,000	\$0
PreK-12 Cash	\$17,289,039	\$20,718,253	\$19,049,917	\$17,395,418
PreK-12 Total	\$17,289,039	\$61,688,253	\$29,784,917	\$17,395,418
FCS Bonds	\$0	\$1,475,000	\$2,765,000	\$0
FCS Cash	\$3,651,080	\$6,182,722	\$5,470,569	\$6,901,218
FCS Total	\$3,651,080	\$7,657,722	\$8,235,569	\$6,901,218
<b>Total CO&amp;DS</b>	<b>\$20,940,119</b>	<b>\$69,345,975</b>	<b>\$38,020,486</b>	<b>\$24,296,636</b>

Source: Florida Office of Economic and Demographic Research, 2011.

For institutions in the State University System, supplementary capital improvement funding is available through the Capital Improvement Fee (CIF). A fee is assessed to each student at the time of registration, which is then pledged against bonds by the state. When funding becomes available every several years, the Board of Governors notifies the university, who then forms a plan for the funds and submits it back to the Board of Governors, and then processed similarly to PECO funds, subject to Board approval. The fee currently stands at \$2.44 per student per credit hour.<sup>20</sup>

Similar capital outlay funding is available for charter schools, should they meet certain eligibility requirements, but these funds are not a part of PECO and are not financed through gross receipt taxes. In FY2010-11, 302 charter schools were funded with approximately \$56 million for capital outlays from general revenue.<sup>21</sup>

## How does Florida's method of funding educational facilities compare to other states?

Compared to other states, Florida is fairly close to the median regarding the amount of state funding local districts receive for capital outlays.<sup>22</sup> Three states, and the District of Columbia, pay for 100 percent of outlays and in 11 states, districts receive no state funding.

<sup>19</sup>

[http://www.myfloridahouse.gov/FileStores/Web/HouseContent/Approved/Web%20Site/education\\_fact\\_sheets/2011/documents/2010-11%20Capital%20Outlay%20and%20Debt%20Service%20for%20Public%20Schools%20and%20the%20Florida%20College%20System.3.pdf](http://www.myfloridahouse.gov/FileStores/Web/HouseContent/Approved/Web%20Site/education_fact_sheets/2011/documents/2010-11%20Capital%20Outlay%20and%20Debt%20Service%20for%20Public%20Schools%20and%20the%20Florida%20College%20System.3.pdf)

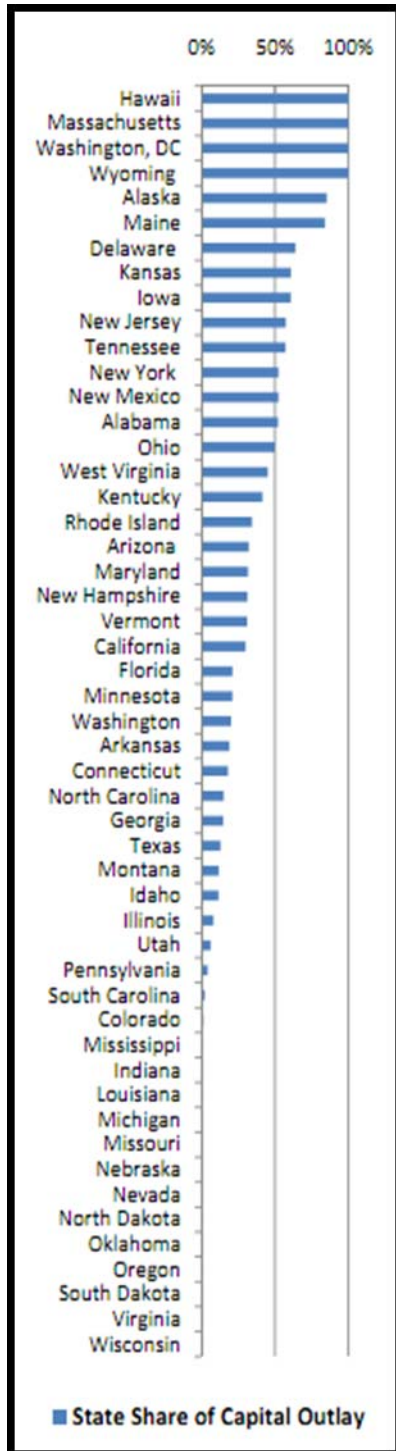
<sup>20</sup>

<http://www.myfloridahouse.gov/Sections/Documents/loaddoc.aspx?FileName=pcb01.HEAS.DOCX&DocumentType=Analysis&CommitteeId=2600&Session=2011>

<sup>21</sup>

[http://www.myfloridahouse.gov/FileStores/Web/HouseContent/Approved/Web%20Site/education\\_fact\\_sheets/2011/documents/2010-11%20Charter%20School%20Capital%20Outlay%20Funding.3.pdf](http://www.myfloridahouse.gov/FileStores/Web/HouseContent/Approved/Web%20Site/education_fact_sheets/2011/documents/2010-11%20Charter%20School%20Capital%20Outlay%20Funding.3.pdf)

<sup>22</sup> [http://www.ncef.org/pubs/state\\_capital\\_spending\\_on\\_school\\_facilities.pdf](http://www.ncef.org/pubs/state_capital_spending_on_school_facilities.pdf)



Georgia, in addition to local property taxes, funds capital outlays through a locally imposed optional sales tax. The Special Purpose Local Option Sales Tax (SPLOST) was created in a 1996 constitutional amendment. If placed on the ballot by the local board of education and approved by voter referendum, a 1% additional sales tax is put in place for five years, and is not subject to any exemptions. The use of these funds is treated similarly to PECO funds, in that the revenue can be immediately spent on capital outlays, bonded, or used to retire existing capital outlay debt.<sup>23</sup>

In California, about 40 percent of the costs of capital outlays are funded through state general obligation bonds. The remaining 60 percent is funded through a mixture of local bonds, fees on new developments, and Mello-Roos taxes.<sup>24</sup> Mello-Roos taxes are a special, additional property tax to obtain funding for community projects. These taxes were created in order to skirt the constitutional cap on the rate of growth of property taxes. The state has an office of Public School Construction that administers a \$35 billion school facility construction program.<sup>25</sup>

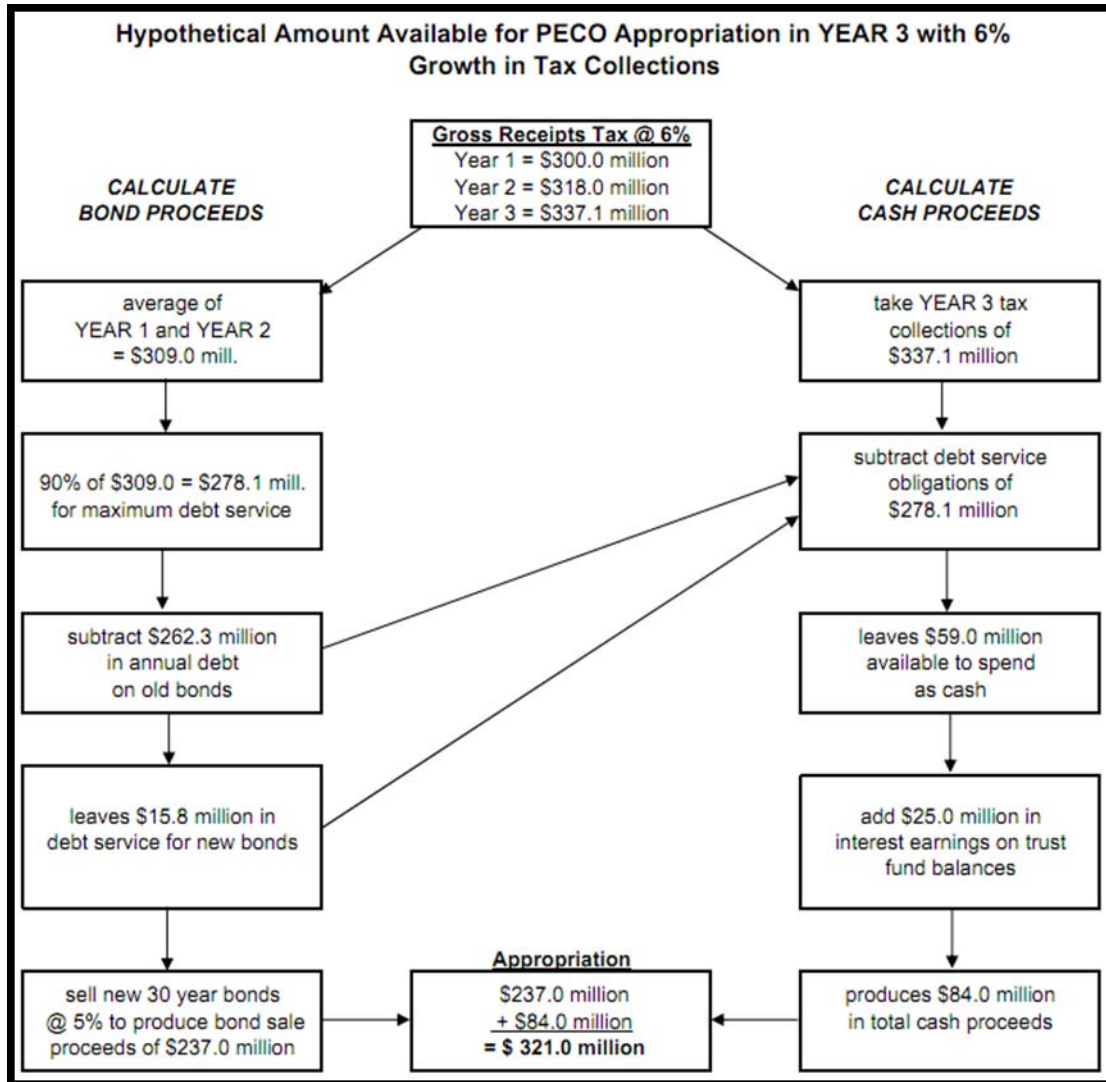
## Conclusion

Florida's system of funding the capital outlays of educational facilities is complex and subject to fluctuation not necessarily dictated by need. PECO funded projects in higher education have historically been a source of "turkeys," construction projects that have been placed in the budget by legislators, often bypassing the established Board of Governors or State College planning processes. Often, these projects can be added during conference negotiations, further bypassing the Legislature's own budgeting process. Considering the reliance the state has on education to support and grow a competitive workforce, how the state sustains and increases investment in capital projects for its educational systems is worthy of review and thoughtful deliberation.

<sup>23</sup> [http://www.doe.k12.ga.us/fbo\\_facilities.aspx?PageReq=FBOFacilitiesSPLOST](http://www.doe.k12.ga.us/fbo_facilities.aspx?PageReq=FBOFacilitiesSPLOST)

<sup>24</sup> [http://www.lao.ca.gov/2001/school\\_facilities/050101\\_school\\_facilities.html](http://www.lao.ca.gov/2001/school_facilities/050101_school_facilities.html)

<sup>25</sup> <http://www.dgs.ca.gov/Default.aspx?alias=www.dgs.ca.gov/opsc>



Source: Florida Office of Economic and Demographic Research, 2011,  
<http://edr.state.fl.us/Content/conferences/peco/pecohists.pdf>.