

# Short-Form Summary



## FUNDING ALTERNATIVES TO BUILD STATE- OF-THE-ART LEARNING ENVIRONMENTS FOR HAWAI`I'S KEIKI

SUBMITTED BY:

THE HAWAI`I INSTITUTE FOR PUBLIC AFFAIRS

UNDERWRITTEN BY:

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*Hawaii Institute for Public Affairs*  
*Funding Alternatives for State-of-the-Art Learning Environments*  
*Short-Form Summary*

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## SHORT-FORM SUMMARY

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### KEY POINTS

The short-form summary is designed to combine a high-level presentation of the full report with enough detail to support some of the findings and to encourage a review of the entire report. For a brief synopsis, the following 11 points reflect some of the primary take-aways and major thoughts contained in the report.

1. The stakeholders in this process who matter the most are the ultimate customers using the school facilities and receiving the education service – **Hawaii’s children**.
2. **Underfunded school buildings have negative consequences** on educational achievement, student health, and teacher morale and effectiveness, creating risks and adding costs.
3. Recently, capital funding per pupil in **Hawaii has ranked at the bottom nationally**; the **national average was nearly four times higher** than Hawaii’s per-student amount.
4. Hawaii’s school system is effectively the **ninth largest school district in the nation** and, unlike other parts of the country, is **administered by the State rather than by local government**.
5. **DOE’s CIP budget is approved by the State Legislature**, and is funded with State general fund revenues and/or general obligation bond funds. Recent efforts are underway to impose a DOE development impact fee in certain areas of the State.
6. In most states, capital funds for schools are generated at **both the state and local levels**.
7. A variety of **typical and innovative dedicated and general fund revenue sources** are used throughout the country to fund public school facilities.
8. **Schools represent just one of the critical components** that comprise the entire infrastructure package needed to serve existing communities and new development. There will be **stiff competition for every dollar** that may be generated by alternative funding sources, not just for infrastructure but for **other pressing issues facing Hawaii such as affordable/workforce housing**.
9. An array of potential funding tools are available to fund schools and other infrastructure, including the following:

#### **Municipal Bonds**

- a. General Obligation Bonds
- b. Revenue Bonds
- c. Land-Secured Bonds

**Other Public Financing Sources**

- d. Tax Increment Districts
- e. Development Impact Fees
- f. Federal Programs

**Private and Other Funding Sources**

- g. Grants/Donations
- h. Land Dedication/Public Land Equity Program
- i. Traditional Public-Private Partnership
- j. Alternative Public-Private Partnership (Joint Development)
- k. Public-Public Partnership (Joint Use)
- l. Other Cost Reduction Strategies
- m. Traditional Revenue Generation Strategies (e.g., RPT, GET, TAT)
- n. State Lottery

- 10. **Financing policies and selection criteria** must be developed to determine the best funding tools and ideas for school facilities in Hawaii and to ensure that a sustainable, system-wide plan for school facilities funding is in place that offers as much long-term fiscal stability and predictability as possible.
- 11. The **next step in this process could be a detailed financing plan**, which would be guided by DOE, HIPA, and a host of stakeholders that comprise the key public sector and private sector participants involved in public school facility construction and modernization. That plan to develop a long-term funding strategy would involve determining a process to engage all stakeholders, identifying roles for key financing participants, refining financing policies and selection criteria, running high-level funding analyses and projections, and selecting financing tools to implement.

**REPORT OBJECTIVES**

Although its K-12 students generally score above the national average in academic performance, per-pupil spending in Hawaii on school facilities and related infrastructure has in the past ranked the State at the very bottom nationally. In 2013, the State Legislature passed Act 155 to develop a pilot program to improve educational facilities. This Act requires the Department of Education (DOE) to identify three school-related sites that could generate revenue through a public-private partnership (P3) or other mechanisms to create a source of funding for the construction of new schools and enhancement of existing schools into state-of-the-art learning environments. The three pilot projects may entail the provision of a new or renovated school, generation of upfront funding or an annual stream of revenue to fund new or renovated schools, a hybrid process that combines both of these approaches, or other alternative approaches.

A state-of-the-art learning environment is a space that can accommodate innovative education practices like differentiated instruction, cooperative and project-based learning, and multiple pathways. These new strategies call for designs that include significant updates, like

flexible and adaptable floor plan layouts, advanced technology, improved daylight, and other considerations.



The Hawaii Institute for Public Affairs (HIPA) is Hawaii's first non-governmental public policy institute. HIPA conducts policy research on key issues facing Hawaii, has completed over 20 policy initiatives and reports, and has raised over \$10 million to support public policy initiatives. HIPA's primary goals are to provide a neutral forum for key stakeholders to resolve complex policy issues, and to support collaborative and value-based leadership programs.

HIPA initiated its State-of-the-Art Learning Environments Project approximately two years prior to the passage of Act 155, initially to work with DOE to foster innovative and workable solutions to improve school facilities, and later to assist DOE with implementation of the Act, which was to some extent an outgrowth of the work HIPA and DOE had already been doing together. Through a process intended to involve significant community engagement, development of a systemic approach, and identification of creative financing sources, HIPA hopes to support the DOE mandate to install, modernize, and manage vibrant learning environments for Hawaii's school-age children.

This report is a starting point to initiate a dialogue among public-sector and private-sector stakeholders regarding funding ideas that may be implemented in whole or in part, separately or in combination, to increase the availability of funding tools and funding amounts for the capital needs of public schools. It is a survey of alternative funding mechanisms rather than an in-depth analysis of how those mechanisms might be used and applied to public schools in Hawaii. It may also be the basis for a more detailed plan to be refined and adopted by DOE, a plan that draws a blueprint for a strategic, sustainable capital funding approach for public schools.

Underfunded school buildings have negative consequences on educational achievements and student health, creating risk and cost for states. Underfunded school buildings will, over time, undermine teacher performance and student achievement, cause or accentuate health problems among children, and have a shortened useful building life. Student morale and effort

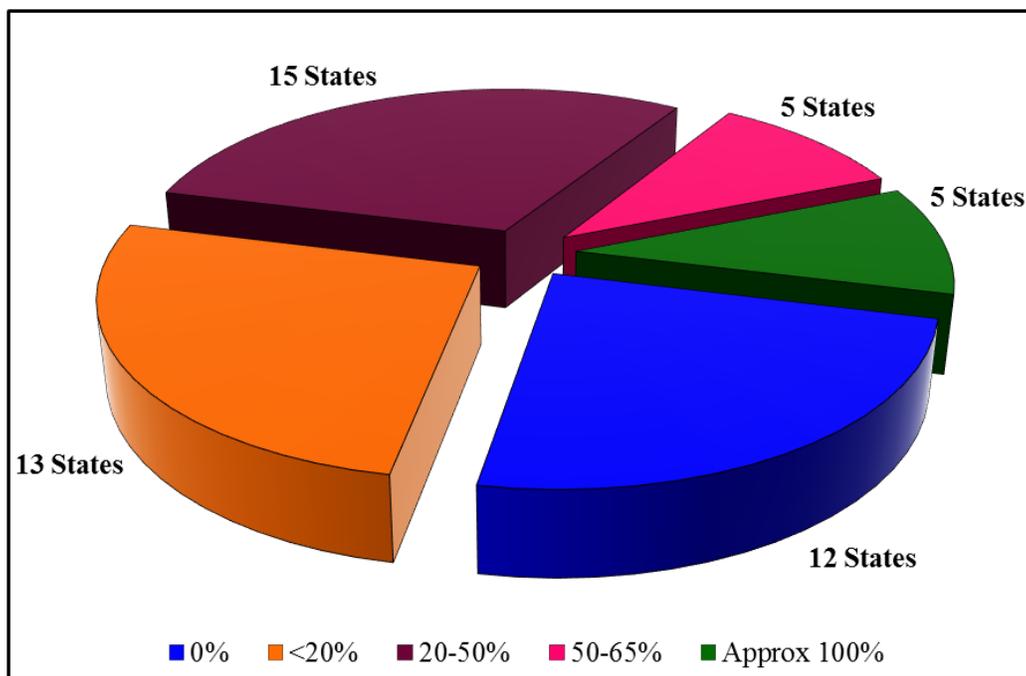
are weakened by crowded and uncomfortable conditions in schools. In particular, inadequate lighting and climate control, chronic noise, poor indoor air quality, and too little physical space all work against student concentration. The same factors that affect students also negatively affect teacher morale and effectiveness, and reduce teacher retention. As these poor conditions cause or exacerbate health problems in children and adults, they lead to increased student and teacher absenteeism, which is linked to lower student achievement. Additionally, building systems and components that are not regularly cleaned and maintained end up having a shorter useful life and need to be replaced sooner than expected, a reality that creates added expenditures down the road on school district budgets.

## NATIONAL AND STATE BACKGROUND

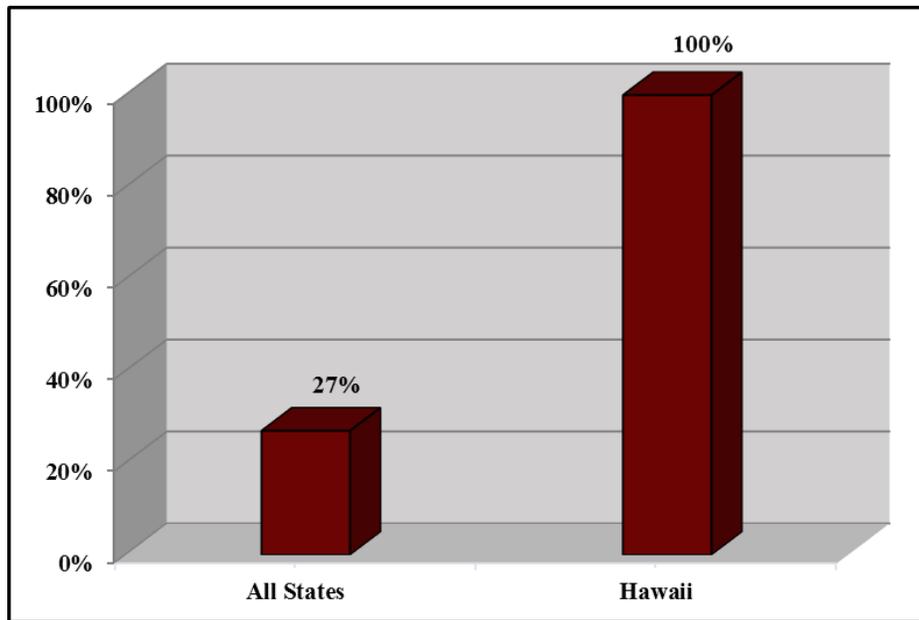
### National Context

In most states, both operating funds and capital funds are generated at the state level as well as the local level, and at the local level predominantly by school districts. The extent to which capital funding is shared between a state and its school districts varies considerably from state to state. Based on a study prepared in 2010 by the 21<sup>st</sup> Century School Fund, which covered four years of spending between 2005 and 2008, total state contributions for all 50 states amounted to approximately 27% of the total capital funding for public schools. However, the State contributed 100% of the public school capital funding in Hawaii during the time period for which data was collected. Figures 1 and 2 below depict some of the details of that study.

**FIGURE 1**  
**CAPITAL FUNDING FOR PUBLIC SCHOOLS**  
**STATE CONTRIBUTIONS AS % OF TOTAL**



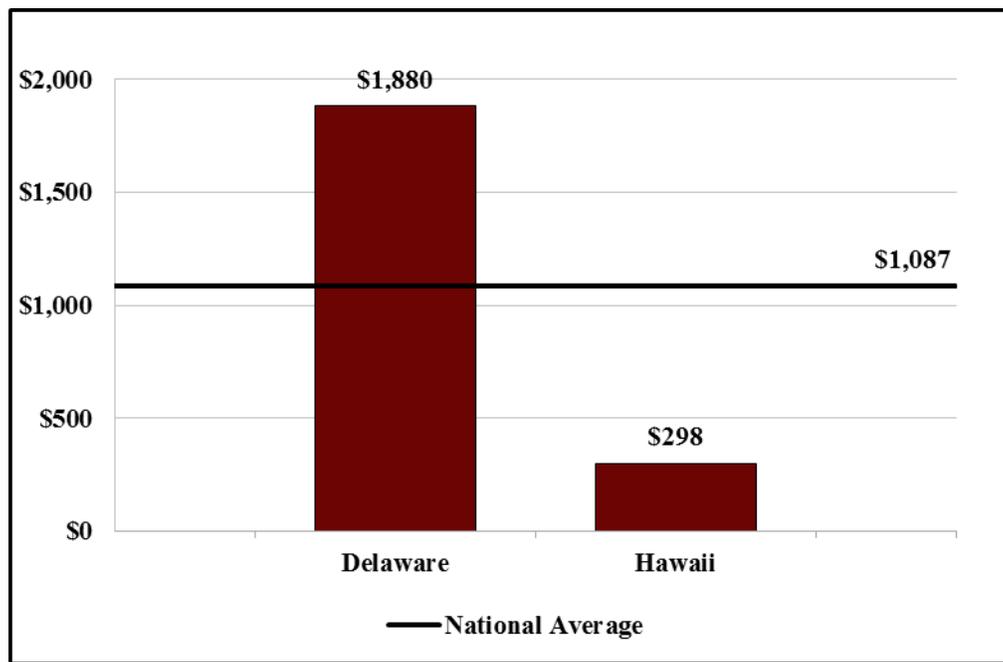
**FIGURE 2**  
**STATE SHARE OF CAPITAL FUNDING FOR PUBLIC SCHOOLS**  
**AVERAGE FOR ALL STATES VS HAWAII**



Fiscally independent school districts can levy their own taxes to support school building and renovation projects. To raise capital funds, fiscally independent school districts often identify a particular need for a school building project, estimate the cost, and go to voters in a bond referendum to request an increase in taxes to repay the principal and interest on the bonds that will be issued to raise funds for the building project. Of course, other funding sources are also tapped at the local level, especially for new school construction projects. Almost 90% of the approximately 14,000 public school districts nationwide are fiscally independent. However, in both fiscally independent and dependent school districts, debt limits are closely regulated by the states.

Total public school capital funding per student also varies significantly from state to state. Wyoming ranked first among the 50 states, spending \$2,066 per student on capital outlays; however, Wyoming enjoys a unique funding source (as does Alaska) that almost all other states do not (see below for more information about the funding sources used in certain states). Second behind Wyoming was Delaware, which spent \$1,880 per student. At the other extreme, Hawaii ranked last among the 50 states with per-student capital spending of \$298. Average capital spending across all 50 states was \$1,087 per student. At the high end, Delaware provided over six times the amount provided by Hawaii on a per-student basis, and the national per-student average was nearly four times the per-student amount provided by Hawaii, as illustrated in Figure 3 below. New information, which may shine a better light on Hawaii, is expected to be available soon to update the original study conducted in 2010.

**FIGURE 3**  
**PUBLIC SCHOOL CAPITAL FUNDING PER STUDENT**



States with the highest student populations (greater than approximately two million) achieved a high average per-student capital outlay ranking of 15 (out of 50, for 50 states), while states with the lowest student populations (less than approximately 200,000) attained a low average per-student capital outlay ranking of 36 (Alaska and Wyoming are excluded from the average calculations due to their unique funding sources). For a variety of reasons, it may be more challenging for low population states than high population states to fund public school construction, which may mean that Hawaii, as a low population state, will need to work especially hard to find ways to increase its public school capital funding.

States that contributed all or nearly all of the public school capital funding obtained a low average per-student capital outlay ranking of 44, and states that contributed nothing toward public school capital funding also reached a low average per-student capital outlay ranking of 35 (again, Alaska and Wyoming are excluded from the average calculations due to their unique funding sources). Although unscientific, this conclusion appears to indicate that in circumstances where state and local agencies work together to share in the capital funding for public schools, greater funding is available on a per-student basis. This may also suggest that establishing a wide range of funding options, those that both states and local agencies utilize, is likely to produce more money to fund public school construction.

#### **Examples of Capital Funding Sources in Other States**

California is one of the few states that rely almost solely on statewide general obligation school construction bonds for the state's share to fund capital needs in school facilities. Local school district GO bonds represent the majority of funding for California school capital needs,

while developer impact fees, CFD land-secured financing (see below for a description of CFDs), and other sources (such as the sale or lease of land and/or buildings) are also utilized.

In Alaska, approximately 90% of the state's general fund budget is supported by oil revenues, and Alaska is one of only two states in the country with neither an income tax nor a sales tax. Although oil revenues are not a dedicated revenue source for public school funding, K-12 education has consistently been one of the largest line items in the state's budget.

States primarily use general fund revenue to support debt service on school construction bonds. However, some states dedicate specific revenue sources for public school capital needs. Over the last couple of decades, Wyoming has directed billions of dollars in bonus revenue from the sale of federal coal leases to support school construction. These coal lease revenues represent the vast majority of funding to address existing and new school facility needs. Examples of dedicated school facility revenue sources in other states include: a 1% state sales tax in Massachusetts and Iowa; a local option sales tax in Georgia, where counties can vote to dedicate a portion of the sales tax to repay local school bonds; a statewide property tax in South Carolina; oil and gas lease revenues in New Mexico; tobacco settlement funds in Ohio; a public-private partnership law in Virginia that allows procurement of school construction through partnerships in real estate developments; tax increment financing in Chicago and other cities throughout the nation; and, although not a state, transfer/conveyance tax revenue on commercial property transactions in the District of Columbia.

### **State Context**

Unlike many other parts of the country, the State, rather than local government, administers and funds the public school system in Hawaii. The single, statewide school system managed by DOE is effectively the ninth largest school district in the country and consists of approximately 255 schools, 50 libraries, and other related sites. There are approximately 2,880 facilities, including 3,872 buildings that comprise 44.6 million square feet with an estimated replacement value of \$5 billion. The average building is 65 years old, so DOE continually faces an extensive amount of deferred maintenance. It also faces an increasing demand for new schools and related facilities to accommodate new growth areas around the State. Both of these pressures are creating the need for state-of-the-art learning environments.





It is important to always include schools in any conversation about critical infrastructure, as it is required to support development across the State and is integral to building vibrant communities. On the flip side, it is also important to remember that schools are but one piece, albeit an expensive one, of the entire infrastructure puzzle. As new funding ideas are contemplated for public school facilities, all stakeholders must keep the perspective that there are other critical infrastructure funding needs in Hawaii, and that there will be stiff competition for every dollar that may be produced by alternative funding sources.

With a price tag measured in billions, it will take some creative and aggressive funding to manage all of the infrastructure required just to address existing repairs and upgrades throughout the State. Moreover, tens of thousands of new dwelling units – not just market-rate units but workforce/affordable housing units as well – together with millions of square feet of commercial and industrial space are anticipated to be developed around the State over the next few decades. Layering the infrastructure needs associated with new development on top of the existing requirements will push much of that incremental infrastructure burden onto the private sector and require still more innovative funding to handle it.

Finally, a lack of housing that is affordable to working families throughout the State has become an increasingly pressing issue. Boosting the stock of affordable, or workforce, housing will be much more challenging, if not nearly impossible, without also boosting the types of funding tools and the amount of funding for schools and other public facilities.

## **CURRENT SCHOOL FUNDING APPROACH**

As noted previously, Hawaii is the only state in the union structured as a single, statewide school district. Likewise, the system of financing public education is different from any other state in that no property tax funds or local sources of tax revenue are levied for the support of education. Instead, property taxes are collected separately in each county and used solely to fund

county government services. Counties in Hawaii function in many respects like combined counties/cities, providing all types of municipal services to its constituents. Although Hawaii operates as one single school district, schools are grouped into 15 “Complex Areas,” which are funded and staffed to provide services directly to these specific areas.

There are two DOE budgets, one for operating costs and one for capital improvement projects (CIP). School services, school programs, testing, and administration are funded through the Operating Budget. School facility development and major improvements are funded through the CIP Budget, which includes renovations, repairs and major maintenance to existing facilities, landscape improvements, new construction, land acquisition, and utility modifications. DOE’s Operating Budget and CIP Budget must be approved by the Legislature. There is no provision in the statutes to allow DOE to borrow money through issuance of bonds or warrants. Also, the elected Board of Education has no independent authority to raise funds for either operations or capital improvements, other than school impact fees through recently enacted Act 245.

The CIP Budget, which is tapped mostly for renovation, reconfiguration, and even replacement projects, is funded and managed entirely by the State as part of a comprehensive program to centrally administer state lands and facilities. With respect to new schools, oftentimes residential builders are providing land and either constructing a turnkey school or paying for a portion of the school.

DOE’s CIP Budget request was \$406 million for Fiscal Year 2015-16 and \$420 million for Fiscal Year 2016-17; the Legislature approved \$288 million and \$78 million for Fiscal Years 2015-16 and 2016-17, respectively. This total of \$366 million over two fiscal years appears to be generally consistent with DOE CIP Budget levels in recent years. However, DOE requested a \$456 million supplemental CIP Budget for Fiscal Year 2016-17, which could bring the total two-year fiscal budget for capital spending to \$822 million.

Note that these budget requests are miniscule compared to the total modernization requirements across the country. The 21<sup>st</sup> Century School Fund, in its 2013 *State of Our Schools* study, reports that \$542 billion is necessary nationwide over the next decade to upgrade pre-kindergarten through 12<sup>th</sup> grade facilities. Upgrades would improve air quality, acoustics, thermal comfort, daylight, technology, and other factors that affect student stress levels and general well-being.

## **POTENTIAL FUNDING TOOLS**

The State and counties have access to a variety of funding tools, some of which they use regularly and some of which they use infrequently or not at all; still others are only concepts at this time and additional legislation must occur to create and/or improve them. While there are some variations between mechanisms, most funding techniques are authorized by law to pay for any backbone infrastructure or public facilities that the State or a county may own and operate. This includes not only the costs to construct the public improvements, but also the costs associated with right-of-way/public lands, design and engineering, inspection and project management, and financing district formation and administration costs. Provided below is a

description of funding mechanisms the State and counties may employ, together with landowners and developers, to pay for public school capital facilities, as well as for needed improvements to all types of existing infrastructure and for new infrastructure required to support development around the State.

There may be legal, even constitutional, issues in Hawaii associated with some of the ideas presented below, and of course there may be political, operational, economic, and other issues that need to be addressed as well. The primary objective of this process, of which this report is merely a first step, is to expand the universe of funding alternatives and, ultimately, to unlock more money for public school capital needs in Hawaii, in some ways simulating how an independent school district works collaboratively with its state.

The challenges of funding school infrastructure call for continued innovation and creativity, and an ability to combine tools into comprehensive strategies. Some of these tools have rarely been applied to school infrastructure and might require modification to apply in public school contexts. The concepts and ideas in this report are intended to help DOE and various stakeholders learn about the tools, encourage consideration of emerging approaches, and, where appropriate, even create modified versions of the tools.

### **Municipal Bonds**

**General Obligation Bonds:** General Obligation (GO) bonds are governed by the State Constitution and Hawaii Revised Statutes (HRS) Chapter 47. The security for these bonds is the full faith and credit of the State or a county, and the principal and interest payments on the bonds are a first charge on the general fund of the State or county. GO bonds that finance revenue-generating facilities are considered reimbursable GO bonds to the extent that the revenues are actually used to reimburse the general fund for debt service payments it has made. Reimbursable GO bonds may also fund facilities that do not generate revenue; instead, these bonds are reimbursed by revenues created with another funding source, such as special taxes from a CFD (see below). Reimbursable GO bonds are generally excluded from State or county debt limitations. Certain county staff have in the past noted that reimbursable GO bonds appear to be a viable, even desirable, funding tool under appropriate circumstances. Those circumstances may be instances where the public facility being financed provides some kind of regional or environmental benefit, or assists a county in meeting specific public policy goals related to workforce housing, economic development, or other similar objectives; in addition, a mechanism to generate revenue to pay debt service on the bonds must be in place, or an ability to put it in place must exist.

**Revenue Bonds:** Revenue, or enterprise, bonds are governed by the State Constitution and HRS Chapter 49. The security for revenue bonds is the State or a county general fund, an enterprise fund (e.g., a fund collecting bi-monthly consumer water charges), or some dedicated revenue stream of the State/county or an enterprise. They are issued to fund revenue-generating activities (e.g., public facilities or systems), and the issuer is obligated to charge and collect enough revenues to make the endeavor self-sufficient. Certificates of Participation (COPs) and lease revenue bonds are other forms of revenue bonds that provide long-term financing for public improvements via a lease or installment sales structure. COPs can be an efficient and

straightforward method of securing tax-exempt financing for public facilities by taking advantage of an available stream of revenue, such as a long-term ground lease.

***Land-Secured Bonds:*** Improvement Districts and Community Facilities Districts are the primary land-secured financing tools. Improvement District (ID) financing is governed by HRS Section 46-80 and implemented by various county codes as follows: Revised Ordinances of the City and County of Honolulu (ROH) Chapter 36; Hawaii County Code (HCC) Chapter 12; Maui County Code (MCC) Title 14, Article 3, Chapter 14.36-14.60; and Kauai County Code (KCC) Title X, Chapter 10. The security for these bonds is an assessment levied on property inside the specified boundaries of an ID, which is typically repaid in annual installments. Annual installments/assessments are generally added to the property tax bill and collected at the same time as property taxes. Business Improvement Districts (BIDs) are another form of land-secured financing; the County of Hawaii, for example, has language that governs BIDs at HCC Chapter 35. A BID is very similar to an ID, except that the primary purpose of a BID is typically to fund annual operating costs (e.g., security, landscaping, marketing, trash removal, graffiti abatement) associated with the needs of local businesses, rather than to fund infrastructure.

Community Facilities District (CFD) financing is governed by HRS Section 46-80.1 and implemented by the following county codes: ROH Chapter 34; HCC Chapter 32; and KCC Chapter 25. The County of Maui has not adopted an implementing ordinance for CFDs. The security for these bonds is an annual special tax levied on property inside the designated boundaries of a CFD. Annual special taxes are typically added to the property tax bill and collected at the same time as property taxes. It appears that school facilities may be financed directly through a CFD established by a county (note that “county” as used in this report means a county in Hawaii or the City and County of Honolulu), or together with the State through a Joint Community Facilities Agreement or Joint Powers Agreement between a county and the State.

These two financing techniques – an ID and CFD – share obvious similarities, but also have key differences. Examples of additional similarities are that interest on land-secured bonds is tax-exempt in almost all cases, these districts are usually formed over project areas where development has not yet occurred, and there is no commitment from a county to pay the assessments or special taxes in the rare event of default (i.e., these are non-recourse bonds that also do not count against a county’s capacity to issue GO bonds). The most important difference is that an ID assessment must be based on a finding of direct and special benefit, or nexus, while the CFD special tax may be based on special or general benefit or any other reasonable factor. Also, a CFD can distinguish the levy of a special tax between developed and undeveloped property, may fund both local and regional public facilities, may fund improvements that are outside its boundaries, and may exempt land owned by public agencies from the special tax levy. Finally, combining CFDs with reimbursable GO bonds can be a powerful technique to accelerate funding for needed infrastructure or to fill funding gaps that may occur with disharmonious development schedules that could leave pieces, or voids, of unconstructed infrastructure.

The trend in California and in other states with a financing tool similar to a CFD is to move toward CFDs and away from IDs due to the many favorable aspects of CFDs. Also, it may not be possible to utilize an ID to fund school infrastructure due to the requirement to make a special benefit finding. The Kukui’ula CFD in Kauai was formed in 2008 and approximately

\$12 million of CFD bonds were sold in mid 2012 to pay for non-school infrastructure. That financing was well-received by the land-secured bond market, achieving a strong (i.e., relatively low) interest rate and setting a solid precedent in Hawaii for these types of bonds.

### **Other Public Financing Sources**

**Tax Increment Districts:** TIDs are governed by HRS Section 46-101 to 46-113 (the Tax Increment Financing Act) and HCC Chapter 33 (Hawaii County); the other three counties have not adopted an implementing ordinance for TIDs. The source of this revenue stream is an increase in property tax revenue, or tax increment. The increment results not from an increase in property tax rates, but from an increase in taxable property value primarily due to redevelopment or new development. A specific geographic boundary must be drawn for a TID. Since no new taxes or other annual burdens are being proposed with a TID, protest or election proceedings are not required like they are for an ID or CFD; instead, TIDs are adopted by ordinance of the County Council.

TIDs have not been implemented yet in Hawaii County or elsewhere in the State. The current law in the County of Hawaii, having been instituted approximately two decades ago, contains certain provisions that severely limit the applicability of this financing tool. To make it more useful, HCC Chapter 33 would need to be amended to eliminate two specific requirements from the law.

It is important to note that any amount of property tax diverted to a TID and away from the county general fund represents money not available to cover the cost of services typically paid with general fund revenue, as least while the TID is in effect. Although a TID does not create a new stream of revenue, like a CFD, it can be an effective tool for areas where otherwise there would be no, or less, development and the accompanying upside potential for property tax revenue. Also, all of the tax increment does not have to be directed to the TID; a specified percentage can be allocated to a TID, with the remainder continuing to flow to the county general fund. Since the tax increment is not current property tax revenue, but future property tax revenue that does not yet exist, this tool is simply implementing a different way to use some or all of the future revenue for a temporary, or interim, period of time specified when the TID is established. All future tax increment reverts back to the county once the TID expires. Tax increment financing can be a strategic public sector investment in critical infrastructure that does not take a bite out of existing county property tax revenue.

There is another potential impediment to using a TID to its fullest extent, but this obstacle is outside the control of the counties. While the Tax Increment Financing Act authorizes the issuance of tax increment bonds that may be secured in whole or in part by tax increment, it is uncertain whether the State constitution allows for the issuance of bonds solely with a pledge of tax increment. Therefore, a constitutional amendment confirming a county's ability to issue tax increment bonds may be needed to correct this issue. Constitutional amendments do not happen often, and there are strict procedures and timeframes regarding how and when they will be considered. Alternatively, an opinion from the Attorney General (AG) confirming that tax increment bonds can be issued could also provide the needed assurance to effectively use this financing tool.

Although this impediment may preclude the issuance of bonds secured by tax increment, counties can still use TIDs right now. Rather than bond against the stream of tax increment, schools and/or other infrastructure could be funded on a pay-as-you-go basis by applying annual tax increment revenue to pay directly for improvements. To bond against tax increment revenue, tax increment generated through a TID would have to be used to pay debt service on other bonds. It may be possible to form a CFD and establish maximum special tax rates sufficient to pay debt service on CFD bonds, but use tax increment revenue to pay all or a portion of the debt service on those bonds and, in so doing, reduce or eliminate the special tax that actually gets levied. Alternatively, or concurrently, some or all of the tax increment could allow for more CFD bonds to be issued. These CFD bonds would not count against a county's capacity to issue GO bonds. This approach would be somewhat less efficient than simply issuing bonds secured by tax increment, but it may be a way to utilize TIDs and indirectly bond against tax increment if the State constitution cannot be amended or an opinion from the AG cannot be rendered.

There are also other benefits to using TID and CFD financing together. CFD financing can provide a source of funding for infrastructure sooner than traditional tax increment financing. Combining tax increment financing with CFDs has been done successfully in California, and may prove to be an attractive form of public-private financing partnerships where both the public agency and private landowner/developer contribute funding (the public agency through a TID and the private landowner/developer through a CFD). Tax increment could be another tool in a county's financing toolbox, and it would facilitate the process of mixing and matching and timing funding options with school and other infrastructure requirements.

***Development Impact Fees:*** Impact fees are governed by HRS Section 46-141 to 46-148, and implementing ordinances have been adopted in two counties: ROH Chapter 33A (for Ewa); and MCC Title 14, Article 4, Chapter 14.62-14.78. Hawaii and Kauai Counties have not adopted development impact fee programs. Also, HRS Chapter 302A Section 1601-1612 (Act 245) allows DOE to collect school impact fees within defined impact fee districts. The source of this revenue stream is fees on new development generally collected at the time a building permit is issued, but fees may be collected when final subdivision approval occurs or at other times (e.g., when a certificate of occupancy is issued). Impact fees are a pay-as-you-go mechanism because the fee revenue to fund infrastructure trickles in as development occurs, so it is not useful to finance large components of infrastructure that are needed upfront or early in the development cycle. Also, existing infrastructure deficiencies cannot be funded with impact fees; the State or a county would need to identify another source to fund any current public facility inadequacies.

***Federal Programs:*** The vast majority of the burden to provide funding for school facilities rests with states and local governments. The U.S. Department of Education plays a small role in addressing school facility needs, but there are some dedicated funding programs at the federal level. For example, Equipment Assistance Grants for School Food Authorities, provided through the Department of Agriculture, offer funding for school kitchen improvements. The Department of Agriculture also offers the Rural Community Facilities Program to help rural communities improve their facilities, which may include schools. The Department of Energy provides grants through its Energy Efficiency and Conservation Block Program, which are earmarked for energy efficiency and conservation school facility projects. The Department of

Defense also has a small school funding program through its DoD Impact Aid for Military Connected School Districts.

Federal funding programs often involve unpredictable amounts of money and are often hyper competitive to obtain. However, this is typically a “free” funding source, so every attempt to secure any federal dollars should be made. The State, and counties (as applicable), should aggressively and diligently endeavor to maximize the use of federal sources to fund school infrastructure. However, it is recognized that these funding sources may eventually be lost on a temporary, or even permanent, basis. Extra care must be taken in basing funding decisions on the future availability of federal money since these sources are outside the State’s control.

### **Private and Other Funding Sources**

**Grants/Donations:** Local, national, and global non-profit organizations and private charities offer a variety of grants with a charitable purpose. They can also make program-related investments, at below-market interest rates, to support their philanthropic mission and leverage their donations. These entities have an array of unique funding sources available to them, including: corporate and foundation gifts; events, sponsors, and memberships; education and tours; royalties and advertising; endowments; and donation campaigns. They can also access grants and loans generally unavailable to public agencies, as well as provide technical assistance or advocacy and advisory services. Every reasonable effort should be made by the State, and counties (as applicable), to secure various grants and donations since they represent a form of “free” money. However, the amount of such funding is generally small and the timing cannot be predicted or relied upon, so it should not be included as a funding source (unless it has already been obtained) for the infrastructure identified in any serious, implementation-oriented school or other facilities funding plan.

**Land Dedication/Public Land Equity Program:** Under its police powers, government may regulate land in the interest of public health, safety, or welfare. Instead of purchasing land, governments have used their regulatory police powers to require the dedication of land as a condition of permit approval. So as not to encourage private landowners to challenge dedication requirements as a “taking” (an exercise of the government’s eminent domain power without just compensation), a cooperative approach is recommended that includes all stakeholders that may be involved in the dedication of lands for public schools. One of the best ways to establish a public land equity program (PLEP) is to develop a plan that sets forth the network of desired public school lands and equitably distributes the land requirements as proportionately as possible to participating private landowners. Credits to landowners for public school land allocations that are disproportionately high, and fee/payment requirements for public school land allocations that are disproportionately low, would be factored into the PLEP.

**Traditional Public-Private Partnership:** In a traditional public-private partnership (P3) arrangement, a contract is structured so that the risks and rewards of the infrastructure project are shared based on the skills, assets, and strengths of the public- and private-sector participants. Typically, the private entity provides the capital to finance a public project, such as a parking facility, toll road, hospital, or airport, then collects some portion of the revenue generated by the

project. In addition to financing, any combination of project design, construction, and operation/maintenance can be assumed by the private participant.

***Alternative Public-Private Partnership (Joint Development):*** Rather than simply focusing on the installation of public improvements in a traditional P3 approach, an alternative P3 approach involves development of a real estate project together with the construction of public improvements. This joint development approach typically entails a private developer working with a public agency to complete a residential and/or commercial development project together with infrastructure on land owned by the public agency, which would be ground leased on a long-term basis. As the Hawaii Authority for Rapid Transportation (HART) high-speed rail project unfolds, it will create numerous development opportunities along the rail line in the form of Transit-Oriented Developments (TODs) and other more traditional development projects. These new development areas are likely to shift where student populations are concentrated on Oahu. The rail line may offer many opportunities to bundle state-of-the-art, urban infill, vertically-oriented school projects with new development projects.

***Public-Public Partnership (Joint Use):*** One way to reduce capital costs, which is essentially the same as finding more money for infrastructure, is to look for synergies between school and other infrastructure projects. By grouping infrastructure projects together, communities might be able to create viable efficiencies. This paradigm could involve joint use of schools with parks, drainage facilities, and community centers. It could also involve joint use with parking facilities, which could entail paid parking in commercial areas or simply shared parking with residential areas.

Current state standards for school development require 12.5 acres for an elementary school, 16.5 acres for a middle school, and 49 acres for a high school. Land costs and possibly other construction costs may be reduced if the land requirements are also reduced. Vertically-oriented schools integrated into larger buildings may eliminate school-related land costs altogether. Implementing smaller school footprints, where possible, would also tend to be consistent with the basic tenets of TOD, fostering compact, efficient development. Combining reduced land requirement standards with joint use infrastructure projects could produce meaningful cost reductions.

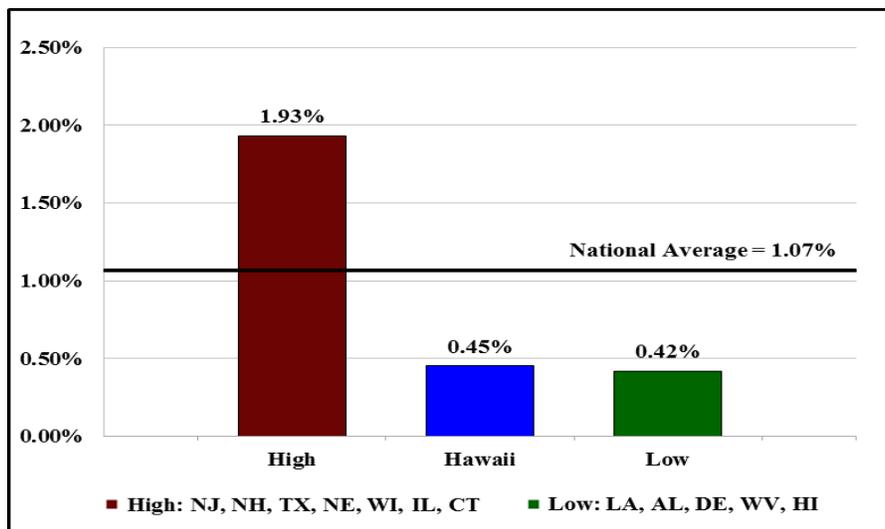
***Other Cost Reduction Strategies:*** There are many possible ways to reduce both school capital costs and operating costs. Operating cost reductions may allow not only for a more efficient, productive school operation, but also free up revenue to be directed to other vital uses or to debt service on bonds that could fund school capital projects. For example, utility expenses for each school facility are centralized at the DOE office, so there may not be accountability at the local/school level in this regard. Establishing standards and incentives for local school effort and accountability may help reduce operating costs. A related example links directly to the State's ambitious goal to be 100% reliant on renewable energy sources by 2045. This particular approach involves development of multiple, sustainable, non-incineration, closed-loop, waste-to-energy systems in various school networks throughout the State. It would expand on the anaerobic digester system used on Oahu at select wastewater treatment plants, and move from a waste-to-energy approach as implemented at the H-POWER plant in the Campbell Industrial Park to a non-incineration approach.

The concept could involve anaerobic digesters, fuel cells, and thermal gasification reformers (non-incineration) to process all manner of waste from any source by virtually 100% and to produce ultra-clean combined heating/cooling and power for school and other facilities, as well as synthetic gas, pure hydrogen, or clean diesel and jet fuels. This type of process generates some of the most promising alternative fuels for energy production and transportation, is scalable to meet increasing demands, minimizes waste that would otherwise end up in a landfill, reduces fossil fuel consumption, and eliminates greenhouse gas and other adverse emissions. By integrating this type of energy system into the school construction or renovation process, DOE could meet multiple environmental and sustainability goals, leverage financing sources, reduce overall construction costs, improve energy supply reliability, reduce building O&M costs, and even revitalize communities and promote economic development.

**Traditional Revenue Generation Strategies:** Assuming that State and county general funds will be strained or unavailable, the tax revenue proposals below are not intended to redirect existing tax revenue to public school capital funding from other non-school budget/department areas. Instead, the following funding ideas involve an increase to the existing tax rates. Tax increase proposals could be permanent, or they could include sunset provisions with specified expiration or renewal dates. These tax increases could be implemented in combination across multiple tax categories, which may lower the tax increases for each individual tax category and spread the incremental tax burden over different segments of the resident, business, and tourist population. The notion here is that any tax increase would be earmarked, or dedicated, specifically for public school construction and modernization.

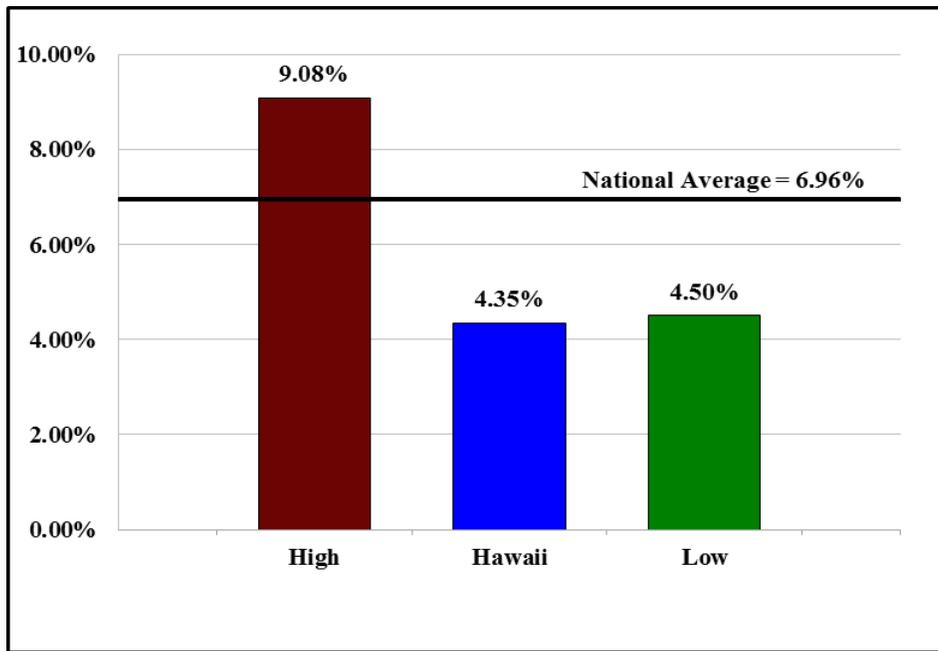
- **Property Tax (RPT):** A relatively modest increase in property tax rates could produce significant incremental property tax revenues earmarked for public school funding, which would constitute a county, or local, contribution to public school capital funding. Alternatively, a separate statewide property tax could be instituted. It appears that Hawaii’s property tax rates are below the national average by a factor of two to three times. Figure 6 below presents this information.

**FIGURE 6  
PROPERTY TAX RATE COMPARISONS**



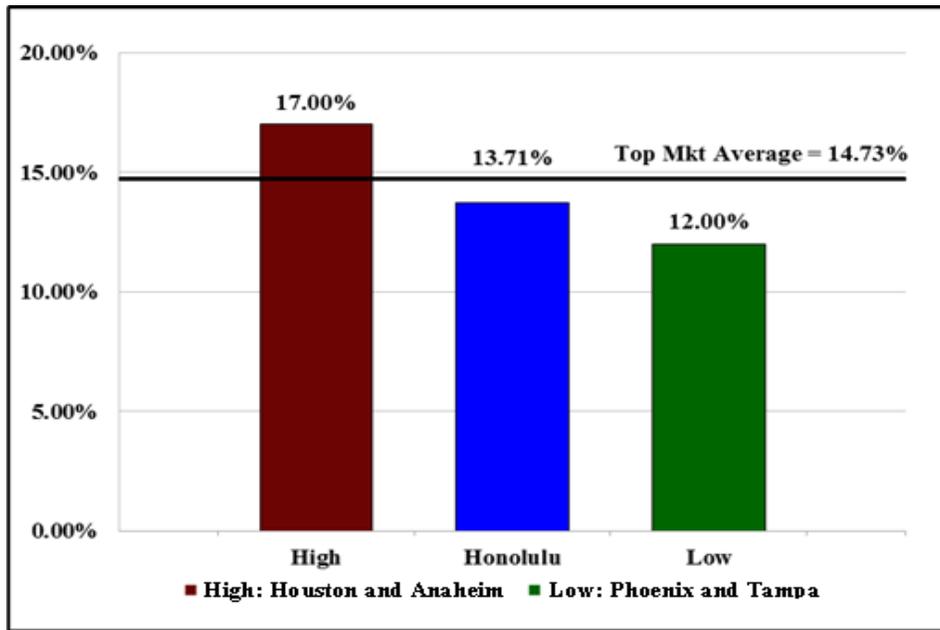
- Sales Tax (General Excise Tax - GET):** GET surcharges have been discussed in the past in Hawaii, and the City and County of Honolulu implemented a 0.5% surcharge to help fund the HART high-speed rail project. Data suggest that the sales tax rate in Hawaii is significantly below the average total sales tax rate across the country (see Figure 7 below). However, note that the sales tax, or general excise tax, in Hawaii is probably the broadest sales tax in the country because it is applied not just to retail transactions but to service and business-to-business transactions as well. Nonetheless, the end user, or retail customer, in Hawaii experiences a very low sales tax pinch compared to retail customers in most other states.

**FIGURE 7  
END USER SALES TAX RATE COMPARISONS**



- Transient Accommodations Tax (TAT):** Total tax rates on lodging include all lodging taxes, as well as sales taxes levied on room charges, collected at the state and municipality level. Many states and municipalities, including Hawaii, levy both a bed tax and a sales tax on lodging stays. A recent study reviewed the top 25 lodging markets in the country, and Honolulu’s total tax rate on lodging ranked 19<sup>th</sup> among those top 25 markets. These results are shown in Figure 8 below.

**FIGURE 8  
COMPARISON OF TOTAL TAX RATES ON LODGING**



*State Lottery:* Only a handful of states have not adopted state-run lotteries, and Hawaii is one of them. There may still be reluctance to gambling of any kind in Hawaii, but with so many other states implementing lotteries, a lottery in Hawaii would not appear to either attract the “gaming element” that Hawaii would like to avoid or to somehow disrupt the tourism industry upon which Hawaii’s economy so heavily depends. State lotteries have become a significant source of revenue for many states. Lottery money can be used for many purposes, but most states use all or a portion of it for K-12 public school funding.

## **FINANCING POLICIES AND SELECTION CRITERIA**

Financing policies and selection criteria are intended to provide informal guidance to assemble the best funding tools and ideas for school facilities in Hawaii and to ensure that a sustainable, system-wide plan for school facilities funding is in place that offers as much long-term fiscal stability and predictability as possible. The policies and criteria presented in this report are preliminary in nature, and are expected to be refined by stakeholders as discussions and analyses concerning school facilities funding proceed.

With respect to the potential set of funding tools in the school facilities funding toolbox, a community’s context, needs, and resources may determine which strategy or combination of strategies is most appropriate for funding public schools. Examples of principles and/or characteristics to contemplate regarding an individual funding source or strategy, or a group of funding tools being considered as a whole, include the following:

1. How much funding can the tool generate?
2. How difficult or complex is it to implement the tool initially, and then administer it annually?
3. Will the funding source garner support from voters or other impacted constituents?
4. Can affordable, or workforce, housing merit special treatment, minimizing infrastructure burdens on affordable housing and/or facilitating construction of affordable housing?
5. Should there be a direct, or at least a logical indirect, connection (i.e., nexus) between the implementation of the funding tool and the need for increased public school funding?
6. Does the toolbox establish a comprehensive, long-term vision, yet is flexible enough to respond to changing market cycles, funding opportunities, and other conditions?
7. Is a broad funding base being established, one that will both generate the most funding possible and create the most stable combined revenue stream?

## **NEXT STEPS**

This report could serve as a prelude to a more detailed study regarding the funding of public school facilities in Hawaii, and state-of-the-art learning environments in particular. A School Facilities Financing Plan (SFFP) could quantify and analyze: public school facility requirements and costs; the timing/phasing of those facilities; anticipated amounts, locations, and absorption of new development; and how to best fund improvements to existing school facilities as well as construction of new facilities. The SFFP would be a blueprint to guide the funding of public school facilities that currently support existing communities and will support new growth. The purpose of the SFFP boils down to a single set of fundamental questions: who pays, how, and when? Of course, it is much more complex than that, and the key issues that frame that complexity might include concepts such as concurrency, fairness, coordination, prudence, strategy, and feasibility.

Several scenarios could be evaluated as part of the SFFP. One scenario could involve a super high-level review of the entire system-wide, statewide school facility needs. In addition, three to five specific school sites or school system asset areas could be selected and analyzed as part of the SFFP. Site-specific analyses would result in a slightly more detailed assessment and allow for a better understanding of how each type of site may be able to meet its school infrastructure obligations.

The SFFP would be guided by DOE, HIPA, and a host of stakeholders that comprise the key public sector and private sector participants involved in public school facility construction and modernization. In essence, to develop the long-term funding strategy, a process to engage all stakeholders needs to be determined, roles for key financing participants need to be identified, financing policies and selection criteria need to be refined, high-level funding analyses and projections need to be run, and financing tools need to be selected and then implemented.